



**Preparation of Model Requests for Proposals (RFPs), Toolkit and Guidance Notes for preparation of RFPs for e-Governance Projects**

**ADDITIONAL REFERENCE FOR GOOD  
PRACTICES  
FOR  
MODEL RFP TEMPLATES FOR PUBLIC PRIVATE PARTNERSHIPS**



December 2011

*This document is advisory in nature and aim to sensitize the bid management teams on good practices and harmonize/standardize the RFP clauses and terms & conditions.*

*All the deliverables of the assignment “Preparation of Model Requests for Proposals (RFPs), Toolkit and Guidance Notes for preparation of RFPs for E–Governance Projects” are based on existing Central Government Guidelines, feedback from stakeholders and prevalent international practices. However it is possible that the State Government / Nodal Agencies may have their own specific procurement Guidelines which may or may not be consistent with the clauses of the RFP, Guidance notes or Contract Agreement.*

*It may be noted that these documents do not substitute or overrule any approvals currently required by the concerned Department/State Government Nodal Agency for finalization of the RFP. Accordingly it is advised that all necessary approvals are taken from appropriate authorities, as done before publishing of these model documents.*

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*It may be noted that the (Draft) Public Procurement Bill (2011) has been published by the Government of India for consultations and this may be revised on the basis of the suggestions received. The Bill contains broad principles and will be supplemented by rules. It is expected that the final version of this Bill (and rules) will cover some of the contents of this documents. Users of this document are advised to refer and ensure compliance to the Act, as and when it is brought into force.*

## Glossary

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1.	ADB	Asian Development Bank
2.	BOO	Build Own Operate
3.	BOOT	Build Own Operate Transfer
4.	BOT	Build Operate Transfer
5.	CVC	Central Vigilance Commission
6.	DFID	Department for International Development
7.	DIT	Department of Information Technology, Government of India
8.	EOI	Expression of Interest
9.	GFR	General Financial Rules
10.	GoI	Government of India
11.	ICT	Information and Communication Technology
12.	LROT	Lease Renovate Operate and Transfer
13.	MMP	Mission Mode Project
14.	NeGP	National e-Governance Plan
15.	NICSI	National Informatics Centre Services Inc.
16.	O&M	Operations and Maintenance
17.	OP	Outright purchase
18.	OPE	Out-of-pocket expenses
19.	PPP	Public Private Partnerships
20.	RFE	Request for Empanelment
21.	RFP	Request for Proposal
22.	SOW	Scope of Work
23.	T&M	Time and Material

## Key Reference Documents

1. Standardization of Public Funded Initiatives (PFI) Contracts (Version 4), HM Treasury, © Crown Copyright 2007, which allows to be “reproduced free of charge in any format or medium providing that it is reproduced accurately and not used in a misleading context”
2. Public-Private Partnerships in e-Government: Knowledge Map An Infodev Publication Prepared By: The Institute for Public-Private Partnerships, June 2009
3. The Guide to Guidance: How to Prepare, Procure and Deliver PPP Projects, European PPP Expertise Centre (EPEC)
4. Public-Private Partnership Handbook, Asian Development Bank (ADB)
5. PPP In India, Ministry of Finance, Government of India - <http://www.pppinindia.com/>
6. Toolkit for PPP in Roads and Highways, Public-Private Infrastructure Advisory Facility (PPIAF)
7. Risk Allocation – CRISIL

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## 1. INTRODUCTION

### 1.1. Key considerations

Contract design & monitoring procedures are key components of a successful PPP project. Contracting agencies and regulatory bodies must be vigilant in proactively designing a “near leak-proof contract” and thereafter monitoring the technical and financial requirements of all PPP projects to ensure appropriate performance and mitigate stakeholder complaints. A Government agency considering PPP models for e-government projects should bear in mind the following:

1. Contract design is the most important part of contract compliance. A poorly designed contract will be difficult to enforce, leaving the government, consumers, and the private partner open to unnecessary risk. Clearly established guidelines for PPP arrangements are a critical component to the legal framework.
2. Contracts must contain the necessary contract monitoring clauses. Specifically, the contract should clearly articulate: how the technical performance of the private partner will be evaluated (SLAs); procedures for collecting, managing, and reporting data for internal and external use.
3. Contracts should clearly specify who is responsible for monitoring. A good e-government PPP contract identifies the individual, department, or agency with oversight responsibilities so that the private partner knows who to talk to about when any issues or challenges in project implementation arise. Many governments choose to set up a contract-monitoring unit (CMU) for large-scale PPP projects.
4. Contracts must include dispute resolution procedures. Dispute resolution procedures define the context under which contracts can be renegotiated, under which the government or private sector can default on the agreement, such as “force majeure”, and what third party body will arbitrate, in the event that disputes cannot be resolved between the private partner and the government contracting agency.

### 1.2. Assumptions

1.2.1. The following assumptions apply to the guidance, unless otherwise indicated:

- the party contracting with the public sector is a company registered under The Companies Act’ 1956 or (a special purpose company) with Sub- Contractors providing the actual performance on its behalf;
- the project involves a development, followed by an operational phase during which the full Service is provided; and
- the project is wholly financed by PPP Vendor

1.2.2. These assumptions are relevant because: (a) that is how the majority of PPP transactions continue to be structured and (b) such a contractual structure is inherently complicated and thus large parts of the guidance will be particularly helpful to users.

1.2.3. Use of these assumptions does not mean however that one financial structure is inherently preferable to another. The suitability of various structures, including trade-offs between cost,

complexity and risk, should naturally form part of the public sector's overall appraisal of bidders' proposals. Accordingly, no conclusion may be drawn in advance of such appraisal as to which form of financial structure is most appropriate, including whether a special purpose company will be required.

### 1.3. Terminology

In this guidance, the public sector party buying the Service is referred to as the "Nodal Agency" and its counterpart as the "PPP Vendor" or "Contractor", with the overall scheme referred to as the "Project". The agreement entered into between the Nodal Agency" and the "PPP Vendor" is referred to as the "Contract".

### 1.4. Interpretation

1.4.1. Set out below is required wording for the following general definitions which are used at various stages in the guidance:

**"Affiliate"**

means in relation to any person, any holding company or subsidiary of that person or any subsidiary of such holding company and "holding company" and "subsidiary"

**"Assets"**

means all assets and rights to enable the Authority or a successor contractor to own, operate and maintain the Project in accordance with this Contract, including:

- (a) any land or buildings;
- (b) any equipment;
- (c) any books and records (including operating and maintenance manuals, health and safety manuals and other know-how);
- (d) any spare parts, tools and other assets (together with any warranties in respect of assets being transferred);
- (e) any revenues and any other contractual rights; and
- (f) any intellectual property rights, but excluding any assets and rights in respect of which the Authority is full legal and beneficial owner;

**"Associated Company"**

means in respect of a relevant company, a company which is a subsidiary, a Holding Company or a company that is a subsidiary of the ultimate Holding Company of that relevant company,

**"Base Case"**

means the financial model agreed between the parties prior to the date of this Contract (as updated from time to time in accordance with the terms of this Contract) for the purpose of, amongst other things, calculating the Unitary Charge;

**"Termination Amount"**

means,:

(a) all amounts outstanding at the Termination Date, including interest and Default Interest accrued as at that date from the PPP Vendor; and

(b) all amounts including costs of early termination and other breakage costs payable by the PPP vendor (including prepayment in respect of permitted Borrowing, subject to the Contractor mitigating all such costs to the extent reasonably possible; less, to the extent it is a positive amount, the aggregate of:

(i) all credit balances on any bank accounts held by or on behalf of the Contractor on the Termination Date;

(ii) any amounts claimable on or after the Termination Date in respect of Contingent Funding Liabilities;

(iii) all amounts, including costs of early termination; and

(iv) all other amounts received by the PPP vendor on or after the Termination Date and before the date on which any compensation is payable by the Authority to the Contractor as a result of enforcing any other rights they may have;

**"Business Day"**

means a day (other than a Saturday or Sunday) on which banks are open for domestic business;

**"Capital Expenditure"**

means any expenditure which falls to be treated as capital expenditure in accordance accounting principles in the India from time to time;

**"Consents"**

means all permissions, consents, approvals, certificates, permits, licenses and authorisations of a Relevant Authority required for the performance of any of the PPP Vendor's obligations under this Contract;

**"Planned Service Commencement Date"**

means [fixed date by [on] which Service Commencement is planned to occur] or such other date as the parties may agree;

**"Project"**

means [ ];

**"Project Documents"**

means the agreements entered into by the Contractor for the performance of the obligations under this Contract which are listed in [ ] copies of which have been initialed by the parties for the purposes of identification;

**“Sub-Contractors”**

means each of the counterparties of the PPP Vendor to the Project Documents or any person engaged by the PPP Vendor from time to time as may be permitted by this Contract to procure the provision of the Services (or any of them). References to subcontractors means sub-contractors (of any tier) of the Contractor;

**“Sub-Contracts”**

means the contracts entered into between the Contractor and the Sub-Contractors;

**“Tax”**

means any kind of tax, duty, levy or other charge (other than VAT) whether or not similar to any in force at the date of the Contract and whether imposed by a local, governmental or other Relevant Authority;

**“Termination Date”**

means any date of early termination of this Contract in accordance with Section 19 (Early Termination);

**“Unitary Charge”**

means the payment calculated in accordance with [Section 7 (Price and Payment Mechanism)];

**“VAT”**

means any value added taxes.

## 2. DURATION OF CONTRACT

### 2.1. Introduction

2.1.1. The Contract must specify its duration. It will usually also specify a Service Commencement Date to distinguish the time (if any) from the signing of the Contract and before the Service Period from the Service Period itself. The choice of duration should be considered in the light of the issues set out in Section 2.2 (Factors to Consider).

### 2.2. Factors To Consider

2.2.1. The Nodal Agency will wish to specify a duration which is expected to result in the best value for money solution for the Project. Factors to be taken into account when deciding on the duration of the Contract will include:

- the Service requirements of the Nodal Agency (see Section 7 (Price and Payment Mechanism)) and the Nodal Agency's ability to forecast quality and quantity outputs in the longer term;
- the expected life of the assets underpinning the Service and any possible residual value (see Sections 2.2.2 and 18 (Treatment of Assets on Expiry of Service Period)) and the need for and timing of major refurbishment or asset refreshment programmes during the Contract (see Section 11 (Maintenance));
- the importance of continuity in the delivery of the Service, including the degree of transition difficulties and inefficiencies that might be caused by changing Contractors;
- the importance of maintaining performance incentives over time;
- the viability of re-competing the Contract regularly, including private sector capacity and bidders' likely willingness to bid against the incumbent;
- the ability of the PPP Vendor accurately to forecast its base cost; and
- the possibility of an option to extend the term of the Contract by entering into a further contract period with the initial PPP Vendor (this can equally be structured as a no cost early termination option – see Sections 18.2.5 and 18.6 (Valuation of Terminal Payments on Expiry where Residual Value Risk has been transferred)) even if there is no alternative use.

2.2.2. Some assets (e.g Servers, Desktops etc.) may have an alternative use which means that they can generate revenue for the PPP Vendor after the Contract expires (see Section 18 (Treatment of Assets on Expiry of Service Period)). If this is the case, the PPP Vendor should not expect to recover the full cost of financing its investment over the life of the Contract, as it will be able to recover the balance by putting the assets to such alternative use after the Contract expires (e.g. selling them). The price the PPP Vendor charges to the Nodal Agency can therefore be lower and the Contract duration shorter than would be the case if the PPP Vendor needed to recover all of its costs over the life of the Contract (see Section 18.2 (Assets where the Nodal Agency retains Residual Value on Expiry)). However for it may be noted that given the short lifespan of the IT projects, the value of such assets may not be significant. However the same needs to be established.

2.2.3. Given the rapid pace of both technological change in IT and Nodal Agency functions, the Nodal Agency should ensure that the Contract is sufficiently flexible to allow changes to the Service over time (see Section 13 (Change in Service)). If, however, the Nodal Agency is concerned that changes will be so radical that the Service in its present form may become redundant it may wish to retain some flexibility by having shorter Contract periods, consistent with an affordable financing plan.

2.2.4. The impact of certain events on the duration of a Contract is dealt with in the Sections on Compensation Events (see Section 5.2 (Compensation Events)), Relief Events (see Section 5.3 (Relief Events)) and Force Majeure (see Section 19.3 (Termination on Force Majeure)). A delay in the Service Commencement Date should not lead to an extension of the Contract (see Section 5 (Supervening Events)).

### **ILLUSTRATIVE DRAFTING**

#### **Duration of Contract**

- a) This Contract and the rights and obligations of the parties to this Contract shall take effect on the [date of this Contract][Effective Date].
- b) The Service Period will commence on the Service Commencement Date and terminate on the earlier of:
  - i. the Expiry Date; and
  - ii. the Termination Date.

## 3. SERVICE COMMENCEMENT

### 3.1. Introduction

3.1.1. After the Contract is signed and in force, there is usually a solution development or development period during which the PPP Vendor carries out its solution development or development obligations and puts in place the operational procedures which it believes will meet the Service requirement.

3.1.2. During this period, the Nodal Agency naturally wants to know if the PPP Vendor is going to deliver the Service on time and in a way which meets all the Nodal Agency's contracted requirements. The PPP Vendor will not wish to be unnecessarily hampered by the Nodal Agency, but it will also want to be reassured that what it is developing will meet the Nodal Agency's requirements.

3.1.3. The key issue here is the extent to which the Nodal Agency should be involved during this period and what rights, if any, the Nodal Agency should have to approve or monitor the PPP Vendor's progress prior to and on Service Commencement.

3.1.4. There must be a clear limit to the extent of Nodal Agency participation as involvement to a greater extent than is appropriate may lead to the Nodal Agency taking back both a risk it is paying the PPP Vendor to accept and a management role it is paying the PPP Vendor to deliver. It will not be appropriate for the Nodal Agency to adopt the type of overseeing role it might traditionally expect to have when procuring stand-alone solution development or development services.

### 3.2. Nodal Agency's Role – General

3.2.1. The design, solution development, integration, installation, testing, commissioning, operation, maintenance and ultimate performance of any asset procured or developed for the purposes of meeting the requirements of the output specification are all the PPP Vendor's responsibility and the Nodal Agency should not (save in exceptional circumstances) take any responsibility for this risk.

3.2.2. Correspondingly, the PPP Vendor should be afforded the freedom to manage its activities without interference from the Nodal Agency. It is the PPP Vendor's risk whether the design and development it has carried out and the operational procedures it has put in place are capable of satisfying the Nodal Agency's service requirements. The Nodal Agency should not, save in exceptional circumstances (for example, those giving rise to Nodal Agency step-in (see Section 26 (Nodal Agency Step-In)), agree to any role before or following Service Commencement which involves the Nodal Agency taking back any part of the PPP Vendor's risk. In this context, the issues referred to in Section 3.3.2 are important.

3.2.3. The Nodal Agency's role prior to signature of the Contract includes:

- defining the output requirements and any constraints within which the output requirements must be achieved;
- reviewing the PPP Vendor's proposals for achieving the outputs in terms of approach, methods, resources, timetable, management and organisation (including design, maintenance and operational procedures and method statements); and
- negotiating and agreeing with the PPP Vendor all contractual terms, including the procedure for either party proposing and implementing a change in Service (see Section 13 (Change in Service)), the consequences of a failure to meet the Service Commencement Date (see Section 4 (Protections Against Late Service Commencement)), and the procedure for accepting the Service Commencement (see Section 3.6 (Acceptance and Service Commencement)).

In accordance with the principle outlined in Section 3.2.1, the Nodal Agency should not confirm to the PPP Vendor that the PPP Vendor's proposals will meet the Service requirement. In practice, however, the Nodal Agency should be confident before signing the Contract that the PPP Vendor's proposals (including method statements) will be capable of delivering the Service once fully developed and implemented. The Nodal Agency should also ensure that the PPP Vendor's basic design proposal is incorporated into the Contract (see Section 3.4 (Submission of Designs and Information to the Nodal Agency)).

3.2.4. The Nodal Agency's role after signature of the Contract and prior to Service Commencement will normally include:

- reviewing and commenting upon the PPP Vendor's solution designs, maintenance and operational procedures and method statements as they are developed (see Section 3.4 (Submission of Designs and Information to the Nodal Agency));
- viewing and observing tests of any equipment being developed;
- administering the agreed process for either the PPP Vendor or itself to propose and implement changes to the output requirements, constraints on inputs or the PPP Vendor's proposals (see Sections 3.5 (Quality Management Systems) and 13 (Change in Service));
- following the agreed procedure by which the PPP Vendor demonstrates to the Nodal Agency that Service Commencement can be accepted (see Section 3.6 (Acceptance and Service Commencement));
- following the agreed procedure in relation to a failure to meet the Service Commencement Date and agreeing with the PPP Vendor the measures to be taken and the financial consequences (see Sections 4 (Protections Against Late Service Commencement) and 5 (Supervening Events)); and
- auditing the PPP Vendor's activities in accordance with an acceptable Quality Management Systems regime (see Section 3.5 (Quality Management Systems)).

3.2.5. The Nodal Agency should require enough management information to be reassured that the delivery timetable is on track and any overriding safety issues are being satisfactorily addressed. This will involve having access to the site.



3.2.6. The principle outlined in Section 3.2.1 must be upheld to ensure the appropriate risk transfer during the pre-Service Commencement period. The Nodal Agency should not, for example, retain any rights to approve or accept interim stages such as practical completion of solution development or detailed design prior to acceptance of Service Commencement, as this may dilute any risk transfer (unless, of course, the Nodal Agency takes the risk of commissioning as the NHS does for clinical services in relation to the technical interface in hospital projects). This is different to the point made in Section 3.6.4 in relation to accepting Service Commencement before all solution development requirements are completed. In the case of certain defence projects involving very specialised or necessarily subjective requirements there may be a case for the Nodal Agency to accept some aspects of the design by agreeing a methodology for meeting such requirements in the Contract (see Section 3.6.2). This should only be contemplated where transfer of all aspects of the design risk would clearly not offer the best value for money.

### 3.3. Critical Dates

3.3.1. In many projects the effects of late Service Commencement can be handled through the payment mechanism (see Section 7 (Price and Payment Mechanism)). In some cases, however, there will be a critical date beyond which the adverse consequences of non-provision of the Service are greatly magnified (see Section 4 (Protections Against Late Service Commencement)). Where failure to provide the Service by a critical date would be unacceptable, the Nodal Agency must develop a contingency plan (and this could be implemented at the PPP Vendor's expense).

3.3.2. As a last resort, the Nodal Agency would usually expect to have the ability to terminate the Contract so that it can use another PPP Vendor (see Section 19 (Early Termination)). In Section 19.2.2.1 (Events Leading to Termination), paragraphs (j) and (k) of the definition of PPP Vendor Default give the Nodal Agency the right to terminate during the solution development or development period. Section 19.2 (Termination on PPP Vendor Default) makes it clear that termination for failure to achieve a milestone during that period is not recommended.

### 3.4. Submission of Designs & Information to Nodal Agency

3.4.1. The key aspects of the PPP Vendor's tender should be incorporated into the Contract schedules so as to ensure that the PPP Vendor is bound to deliver the Project in accordance with its tender submission. However, the incorporation of the PPP Vendor's tender submission in the Contract should not be interpreted as representing any form of approval by the Nodal Agency that the plan will satisfy the requirements of the output specification<sup>1</sup>.

3.4.2. The basic design proposal must be set out in the Contract and will be developed further by the PPP Vendor after signature<sup>2</sup>. The procedure for developing the design must also be specified in

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<sup>1</sup> This can be achieved by setting out in the Contract that the output specification takes priority over the technical solution being provided by the PPP Vendor. Under no circumstances should the output specification be amended to reflect the PPP Vendor's solution

<sup>2</sup> Depending on the nature of the Contract, the Nodal Agency may also wish to include (amongst other things) the PPP Vendor's operational procedures, key asset proposals or manpower and spares policies in the Contract

the Contract so that changes beyond the permitted parameters of further design development can be distinguished from permitted design developments. The Contract should also specify the extent (if at all) to which other minor changes<sup>3</sup> may be made without triggering the change in Service mechanism (see Section 13 (Change in Service)).

3.4.3. Although the PPP Vendor is responsible for the design development, the Nodal Agency knows its own service requirement and the means by which it has been delivered in the past and this should not be lost to the development process<sup>4</sup>. Consultation with the Nodal Agency and subsequent adoption of any comment made by the Nodal Agency must, however, remain firmly at the PPP Vendor's risk. The PPP Vendor should accept that it is not in the Nodal Agency's interests to watch without comment as a design is developed and implemented which it knows will not be able to deliver the Service. The procedure for submitting and commenting on design issues should be capable of giving all parties the reassurance they need.

3.4.4. The Contract should therefore set out a mechanism for:

- the PPP Vendor to submit designs and information to the Nodal Agency and its representatives. Such designs should be in a package and format and submitted to a timetable to be agreed between the parties;
- the PPP Vendor to submit minor design changes which do not have any impact on cost or the Service and which the Nodal Agency can accept without the change in Service mechanism having to be implemented (see Section 13 (Change in Service));
- the Nodal Agency to comment (if it wishes) on such submissions within an agreed time period<sup>5</sup> (see Section 5.2 (Compensation Events)); and
- the discussion of and, if appropriate, adoption by the PPP Vendor of any comments by the Nodal Agency.

## 3.5. Quality Management Systems

3.5.1. One central source of comfort for the Nodal Agency that assets and services are being provided in accordance with good industry practice should be the PPP Vendor's quality management system (such as ISO 9000 or an equivalent standard).

3.5.2. The Nodal Agency should retain the right to audit the PPP Vendor's quality management system which should include the right to examine or inspect works or activities on or off-site to establish the adequacy and accuracy of the system documentation. The Contract should provide for the PPP Vendor and Sub-Contractors to provide such assistance and access as the Nodal Agency requires and include provisions setting out the obligations upon the PPP Vendor and Sub-Contractors to respond to any recommendations which result from an audit. No other rights or

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<sup>3</sup> Such changes will include, for example, changes which have no financial impact or which do not affect the pre-agreed risk allocation

<sup>4</sup> It may be acceptable for an Nodal Agency to accept a limited degree of design responsibility insofar as it relates solely to the ability of the Nodal Agency to carry out its functions

<sup>5</sup> Irrespective of the Nodal Agency's comments (if any) on the minor design changes submitted by the PPP Vendor which do not have any impact on cost, level of fit-out, quality of the scheme or the Service, the PPP Vendor may choose to adopt such changes, albeit at its own risk, to ensure that it satisfies the Nodal Agency's service requirement.

remedies (e.g. rights to terminate for default) should arise from such an audit since deficiencies in the quality management system will manifest themselves through poor performance (see Section 9.5 (Consequences of Poor Performance)). The audit is essentially a due diligence tool available to the Nodal Agency.

### 3.6. Acceptance and Service Commencement

3.6.1. Before Service Commencement and at points in the Contract where the Service changes significantly (for example on the introduction of a new asset or new operational procedures), the PPP Vendor should be under an obligation to demonstrate that the arrangements put in place will meet the output specification in the Contract. The method of demonstration by the PPP Vendor will be dependent on each situation but may take the form of:

- a completion inspection of any asset built or developed with demonstration of principal facilities and services;
- completion of acceptance trials for new services; and
- other performance tests or inspections.

3.6.2. The Contract should set out in detail:

- the form of the tests, inspections or demonstrations (“Tests”) to be carried out by the PPP Vendor;
- the timetable for the Tests – it may be appropriate to undertake partial Tests over a period rather than a single Test;
- the consequences of a failure to pass a Test;
- the notice of the Tests to be given by the PPP Vendor to the Nodal Agency – this is particularly important if the Nodal Agency has to roster staff and resources to participate. If it is essential for the Nodal Agency to attend the Tests, the Contract should specify a time period for the Nodal Agency to respond to the notice and, to the extent that the Nodal Agency does not respond in time, a Compensation Event will have occurred (see Section 5.2 (Compensation Events)) although the Nodal Agency can still attend once it has responded; the responsibility for the cost and organisation of resources for the Tests. Again this is particularly important if the Nodal Agency’s staff and resources are to be involved (also the responsibility for costs if Tests have to be repeated should be considered);
- the access for the Nodal Agency to witness the Tests (if the Nodal Agency does not control the site);
- the documentation required by the Nodal Agency as evidence of the results of the Tests;
- who is responsible for assessing satisfaction of the Tests – this should, in most cases, be done by joint assessment by the Nodal Agency and the PPP Vendor or by an independent third party, although there will be cases where both parties accept that the Nodal Agency is the best judge (e.g. with defence equipment projects the best judge of whether the equipment behaves like it should are its users). The Nodal Agency should in no circumstances rely on any technical or other adviser appointed solely on behalf of the PPP Vendor, but may accept an adviser that has been jointly appointed and owes duties to all sets of interested parties; and the timing and procedure for acceptance of Service

Commencement if the results of the Tests are satisfactory. Acceptance may be confirmed by the third party tester or by the Nodal Agency, in which case again the Compensation Event consequence of being late should be borne in mind if the Service cannot commence before any such confirmation is issued.

3.6.3. At the time of acceptance of the Service, there must be no “approval” of the means of delivery of the Service, as this may involve the Nodal Agency in taking back part of the PPP Vendor’s risk. Rather, acceptance should be based as far as possible on satisfaction by the PPP Vendor of objective Service Commencement based tests.

3.6.4. As stated in Section 3.2.5, the Nodal Agency should not generally accept stages of work (e.g. by signing off milestones) prior to the Service Commencement Date and delivery of the full Service as this dilutes risk transfer<sup>6</sup>. In certain projects, however, it may be appropriate for the Nodal Agency to commence payment before a complete service is available. The principal examples of these are as follows:

- where certain priority module impacting citizen services are rolled out first
- where the PPP Vendor start collecting “Unitary Charges” from the citizen on behalf of the Nodal Agency
- where certain costs of the Nodal Agency are reduced due to the implementation of the project

In these projects there may be aspects of the project for which the Nodal Agency retains a part of the risk deliberately, as it will ultimately retain responsibility for a part of the overall Service; and in certain other projects in which Service Commencement is phased, then an appropriate phasing in the introduction of payments (again with built-in incentives) may be appropriate.

3.6.5. In projects where Service Commencement is phased, there are two clear alternatives available to the Nodal Agency:

- to stipulate that full Service Commencement will only be accepted when all phases in the scheme reach the required output specification level, which would incentivise the PPP Vendor to bring them all up to the output specification standard as quickly as possible. This would mean, however, that the Nodal Agency would receive the full output specification level of service for some phases without paying for it; or
- to accept full Service Commencement as each phase reaches the output specification standard, so that payments reflect the service received. A slight variant to this that may be adopted in very large grouped schemes, where it would be administratively cumbersome to have phase by phase Service Commencement, would be to accept Service Commencement in batches as full service availability is confirmed. If this approach is adopted, some of the incentive effect of the first alternative above can still be achieved if payment is not increased pro rata as phases reach the output specification, so that there is in effect an amount retained or abated until the last phase reaches Service Commencement.

3.6.6. **3.6.6** The overall time period until the planned completion and service commencement of the last phase is likely to have a significant impact on the relative value for money of these two

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<sup>6</sup> Neither should the Nodal Agency seek to impose any milestones during the solution development phase.

alternatives - the longer the period, the more reluctant the PPP Vendor is likely to be to accept the delayed payment involved in the first alternative above.

### 3.7. Existing Services

3.7.1. The approval/acceptance procedure raises other issues if the PPP Vendor is taking over existing services as well as undertaking additional services. The Nodal Agency should structure the payment mechanism and any termination compensation so as to incentivise the PPP Vendor to commence delivery of the new service on time, so that it cannot simply choose to provide the existing service only. This is the case even where provision of the existing service is more important to the Nodal Agency from an operational perspective than provision of the new service.

3.7.2. The first question to address is, when does the PPP Vendor take over full or partial responsibility for service delivery? Nodal Agency should recognise that any movement of staff that may arise out of the Contract are likely to take effect from the time at which the PPP Vendor takes over provision of the relevant service. There are therefore three options open to the Nodal Agency:

- responsibility for all sites in the Contract is taken over by the PPP Vendor following financial close, commonly after a brief mobilisation period. This provides a clean start and minimises ambiguity about responsibilities between the Nodal Agency and the PPP Vendor, and is therefore the recommended approach.;
- phase the handover so that the PPP Vendor takes over responsibility for the sites when it has planned to start works on them to bring them up to the full output specification standard. This would leave the Nodal Agency responsible for some sites between financial close and the programmed start date of the PPP Vendor's work on site. For a large grouped scheme this may well create some greater complexity in the management arrangements throughout the transitional phase from financial close to the point at which all of the sites have reached full Service Commencement, but is recommended where the first approach above does not provide value for money; and
- only hand the sites over to the PPP Vendor once they have been brought up to the full output specification standard. This would cause an additional complexity as the pre-contract arrangements, involving in-house provision or a separate PPP Vendor, would continue in relation to facilities management (if relevant), whilst the PPP Vendor was carrying out works to bring the sites up to the output specification standard. Scope for disputes over responsibility for problems that arise suggest that this would not be an attractive option, and it is therefore not recommended.

In some cases, the existing condition of Hardware and site infrastructure may be such that there is a risk (however remote) of criminal prosecution, for example under security breaches. The output specification will generally require the IT Infrastructure solution to be in a condition that complies with all applicable law. In some schemes prospective shareholders of a PPP Vendor will be understandably nervous about taking on such a risk for the period before Service Commencement. In such circumstances, Nodal Agency should consider retaining legal responsibility for the IT Infrastructure solution until planned Service Commencement, and so any Existing Services provided by the PPP Vendor may be in the form of a maintenance and/or FM contract.

3.7.3. In relation to the first two options, a specification will be needed for the service level that is expected for the period while the PPP Vendor is responsible for each site, but has not yet reached full Service Commencement. The specification should include requirements in relation to individual FM services that the PPP Vendor will be required to provide (if relevant), and a reactive and responsive maintenance and repair service that at least keeps the sites open to the standard they are when the Contract starts. It is important for all parties that there is a common understanding of the Service required during this period. This will assist in minimising dispute if under performance occurs. There are generally two options available to the Nodal Agency:

- use the output specification that will apply from Service Commencement for the transitional period as well, albeit with a relaxed payment and performance regime (including default termination thresholds). However, this may lead to regular performance failures due to the pre-existing condition of the Facility and cause disputes between the parties; or
- tailor a bespoke specification for the transitional period which sets out the Nodal Agency's requirements and is realistic in terms of delivery. In relation to some individual service requirements however, the Contract output specification may be relevant and sufficient for the transitional period (e.g. response and rectification periods, or if it is reasonable to expect individual "soft" FM services to be provided to the output specification standard from the award of the Contract). However, where the output specification for the Service Period cannot be met by the PPP Vendor during the transitional period, bespoke outputs will need to be tailored.

3.7.4. There are two approaches that the Nodal Agency can take in relation to payment for delivery of services during the transitional period and the Nodal Agency should assess which of these approaches to adopt depending on the value for money they provide:

- Nodal Agencies can have transaction based payments before full Service Commencement on their current expenditure, pre-contract, and then applied a performance regime so that, in accordance with the principles of the full payment mechanism, there would be no payment if, for example, a Facility was unavailable and could not be used, and deductions from the payments if there was poor performance, for example a failure to meet response or rectification periods that did not lead to non-availability. Payment for those parts of the services being delivered will not diminish the significance of full Service Commencement provided the Unitary Charge is structured to incentivise the PPP Vendor to achieve this standard; or
- an alternative to the approach described above would be for the Nodal Agency to make payments for the capital infrastructure created. However in this case, no transaction payments should be made. This would maximise the incentive on the PPP Vendor to bring the facilities up to the Service Commencement level as quickly as possible and the risk would be equitably shared between the two parties.

As the two approaches will lead to different funding requirements and cash flows for the PPP Vendor, it may well have a significant impact on price.

### 3.8. Range of Services to be provided

3.8.1. Nodal Agency should consider carefully, at an early stage in their procurement planning, the range of services which need to be provided through the Contract. In particular they should consider whether or not it offers value for money to include soft services as part of the range of services to be provided. Where hard services only are procured, adjustments will need to be made to the Contract and in particular (a) any benchmarking/market testing provisions are unlikely to be applicable, though some sort of value testing for the Contract could still apply (see Section 15 (Price Variations)), (b) the Sub-Contracting provisions (see Section 16 (Sub- Contracting, Employees and Documentary Changes) and Section 9.3 (Replacement of Sub- Contractors)) may need consideration, and (c) Nodal Agency will need to give particular attention to any interface issues which might arise with the providers of other services.

### 3.9. Capital Contributions

3.9.1. In the ordinary course of events, no public sector capital contributions should be made to the Project, and no Unitary Charge should be payable, until the Works have been completed and accepted. In certain exceptional circumstances however an Nodal Agency may want to make a capital contribution of its own to the Project. Nodal Agency should always discuss any such proposal at an early stage with relevant Government department for taking the permission. Any capital contributions, if approved, should be kept to a modest size. PPP is concerned with payments for Services rather than public sector capital financing. A large contribution may upset the risk transfer balance and incentives of the Project (especially where the Project gets into difficulty). Any contributions should be scheduled to, or towards, the end of the Solution development period and linked to acceptance of the Service or other important milestones. In any event it is important that any Nodal Agency payments are not paid towards advisers' fees or working capital or other similar costs.

3.9.2. If there is a solution development delay or cost over-run, Nodal Agency capital contributions should be withheld. Nodal Agency should also ensure that levels of subcontract security (bonds, liquidated damages, etc.) remain at the same levels regardless of any public-sector capital contribution (i.e. if there is a 10% Nodal Agency contribution, sub-contract security levels should still be gauged against 100% costs and not just against the 90% private sector contribution). No amendment of the core drafting listed in Section 1.4.1 should be made.

### 3.10. Early Works Agreements

3.10.1. In the ordinary course of events, for a well planned procurement exercise no agreements should be needed for the commencement of early works ahead of the parties signing the Contract. Such agreements would generally be considered bad practice for a number of reasons:

- there may be questions as to whether any such early works agreement had been procured in accordance with relevant procurement law and regulation;

- in the ordinary course, no payments would be made to the PPP Vendor or any Solution development Sub-Contractor prior to completion of the relevant facilities and commencement of the Services (see further Section 3.9 (Capital Contributions));
- in the ordinary course, Nodal Agency should not be under any obligation to make any payments prior to Financial Close;
- negotiations on early works agreements tend to be a distraction for the negotiating teams on the main Contract and obstruct the completion process for the main Contract;
- project integration issues can arise;
- early works agreements can undermine the bargaining position of the Nodal Agency and adversely affect the balance of risk on the procurement; and □ to date, early works agreements tend not to have been factored into the original procurement programme and are often a sign that a procurement is in difficulty.

3.10.2. For all these reasons early works agreements are generally to be avoided. However, for certain projects where particular issues apply (such as offices who wish to avoid facility handovers occurring during financial close), basic enabling works may be needed prior to Contract signature, and for such projects the following rules should apply:

- the enabling works should be planned well in advance and as part of the overall procurement strategy (and alternatives to it should always be appraised);
- consideration should be given as to whether it is appropriate for the bidder to do such works or whether the Nodal Agency should independently commission a third party to do them;
- the works proposal should offer demonstrable savings to the project timetable and be value for money in its own right;<sup>11</sup>
- the relevant Private Finance Unit should be consulted and approve the proposal;
- the works should only comprise essential early works which the Nodal Agency would wish to have done in any event.;
- the works should be of a general nature, and not specifically related to the specific project solution proposed by the bidder, such that they will be of value to the Nodal Agency whether or not the Contract is signed;
- the works completed should not impair the risk allocation in respect of work subsequently done under the Contract; and
- the scale/cost of such works should not be significant and the Nodal Agency should ensure it has funding for them.



## **4. PROTECTIONS AGAINST LATE SERVICE COMMENCEMENT**

### **4.1. Introduction**

4.1.1. The Contract must ensure that the Nodal Agency is protected against late Service Commencement by the PPP Vendor in a way which gives the Nodal Agency value for money, taking into account the type of loss the Nodal Agency may suffer and the need for (and cost of) any contingency plans that are put in place (see Section 3.3.1). This Section deals with the level, types and combinations of protections appropriate in relation to a particular project.

4.1.2. In considering the issue of late Service Commencement, the Nodal Agency should acknowledge that the PPP Vendor is likely to be at least as concerned as the Nodal Agency to commence Service delivery on time due to significant financial pressures. The PPP Vendor's financing will often be structured with limited contingency to deal with a delay in Service Commencement, and the PPP Vendor risks suffering a cash flow drain investment return obligations are not being met by payments of the Unitary Charge by the Nodal Agency. For every day the PPP Vendor is late in commencing Service delivery, not only does it lose revenue, but its revenue earning period is also reduced. The longer the solution development period is, relative to the Service Period, the greater the concern for the PPP Vendor.

4.1.3. If the Nodal Agency will not suffer any significant loss as a result of late Service Commencement, then it is unlikely to need specific protections. In exceptional cases, however, the Nodal Agency may need protections from the PPP Vendor (in addition to the non-payment of the Unitary Charge) such as liquidated damages, performance bonds and/or parent company guarantees. These types of protections are, however, likely to increase the price and affect the project timetable, so the Nodal Agency must consider carefully their effect on value for money (see Sections 4.2 (Liquidated Damages), 4.3 (Performance Guarantee) and 4.4 (Parent Company Guarantees)).

4.1.4. The Nodal Agency should also protect itself against prolonged uncertainties arising from late Service Commencement by having a cut-off date after which it may terminate the Contract if the PPP Vendor has not commenced Service delivery by such a date (see Section 4.5 (Long-stop Date)) . As stated in Section 3.3.2 and elsewhere throughout this guidance, termination should be a last resort.

4.1.5. The Nodal Agency should also consider the issue of early Service Commencement and whether the Nodal Agency should accept and reward early delivery (see Section 4.6 (Bonus Payments for Early Service Commencement)).

### **4.2. Liquidated Damages**

4.2.1. Liquidated damages for delayed Service Commencement are an ascertained payment representing a genuine pre-estimate of the losses or damages the Nodal Agency will suffer if the PPP Vendor fails to fulfil its obligation to commence Service delivery on time. If the Nodal Agency

will not suffer any losses in excess of the payment of the Unitary Charge (taking into account the cost of procuring the Service itself), liquidated damages are not appropriate or recoverable. If the Nodal Agency will suffer such losses, liquidated damages may be appropriate but only where they offer the Nodal Agency value for money, taking into account the effect of any other protections being required by the Nodal Agency or the PPP Vendor.

4.2.2. To protect against late Service Commencement, PPP Vendors will usually require the Sub-Contractors to cover risk for any period of delay through liquidated damages paid to the PPP Vendor. The Sub-Contractor will price this requirement into the price it charges the PPP Vendor (for example, by increasing its solution development costs to ensure completion will be achieved on time) and may also require a longer build period to allow itself more contingency time. This cost is then likely to be passed on to the Nodal Agency through the Unitary Charge and the Project timetable is likely to be longer. If the Nodal Agency requires liquidated damages to be paid by the PPP Vendor to itself, this is likely to further increase the Unitary Charge and the build period. Liquidated damages payable to the Nodal Agency may therefore prove bad value for money unless circumstances such as those outlined in Section 4.2.3 exist.

4.2.3. Liquidated damages may prove value for money in situations where the costs the Nodal Agency incurs as a result of the delay are so great as to justify the increased expense (e.g. a higher Unitary Charge) to which such liquidated damages give rise. This could be the case where there are critical dates (see Section 3.3 (Critical Dates)) and the Nodal Agency's contingency plan to cope with such dates has a significant quantifiable expense associated with it. Liquidated damages may also be justified where:

- the Nodal Agency has contributed a valuable asset to the Project which could otherwise have been used by the Nodal Agency during the period prior to Service Commencement, so an "opportunity cost" is incurred; or
- there are no prior claims on liquidated damages paid by a Sub-Contractor and liquidated damages give value for money.

4.2.4. If liquidated damages are considered worthwhile and value for money, the Nodal Agency should specify the level of liquidated damages, and any cap<sup>7</sup>, early on in the bidding process (i.e. in the Pre-Bid Discussions) to enable the bidders to price the risk of incurring liquidated damages<sup>8</sup>. Bidders could also be invited to submit alternative bids without liquidated damages and/or using higher or lower caps. The Nodal Agency's technical or financial adviser should advise on an appropriate level.

4.2.5. The Nodal Agency should note that any assessment of the appropriate rate of liquidated damages must be a genuine pre-estimate of the losses the Nodal Agency is likely to incur as a result of the delay in Service Commencement. If this is not the case, the rate may be judged to be a penalty and the liquidated damages provision will not be legally enforceable against the PPP Vendor.

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<sup>7</sup> A cap will be a key issue for PPP Vendor

<sup>8</sup> It will assist the evaluation of any bids submitted if the cost of providing liquidated damages could be identified separately within such bids

4.2.6. If the PPP Vendor is not going to be able to deliver the Service on time, but is able to find some form of alternative which is acceptable to the Nodal Agency and which can commence on the Planned Service Commencement Date (or will reduce the delay in Service Commencement), the Nodal Agency may agree that this alternative service may be provided for a certain period for a reduced Unitary Charge. Any liquidated damages liability will be deferred for the period in question and the PPP Vendor's revenue stream will commence. The Unitary Charge will be reduced appropriately to reflect the fact that the Service is not being provided as contracted. This is not an issue which needs to (or necessarily can) be agreed prior to signature of the Contract, so it may need to be negotiated at the time.

### **4.3. Performance Guarantee**

4.3.1. In the IT / e-Governance industry, performance bonds are generally given by Vendors as a form of guarantee of completion and satisfactory performance of the services (the amount guaranteed is usually a percentage of the value of the contract). They can be called by the recipient when, for example, the Planned Service Commencement Date is missed or due to the poor quality of services provided. Accordingly, the PPP Vendor may well require a performance bond from the Sub-contractor. The Sub-Contractor will pass through the cost and timing effects of providing such a bond to its customer (i.e. the PPP Vendor), who will in turn pass them on to the Nodal Agency.

### **4.4. Parent Company Guarantees**

4.4.1. In traditional procurement, the Nodal Agency may expect to obtain parent company guarantees from the parent companies to the PPP Vendor and/or the Sub-Contractors (in particular, the Sub-Contractor) to support the obligation to deliver the Service on time. This is not, however, normally appropriate in PPP Contracts and should not be a pre-condition to acceptance of a bidder's bid.

4.4.2. Rather, the necessary comfort and protection for the Nodal Agency can be provided through the Project Documents, the use of collateral warranties and or direct agreements between the Sub-Contractors and the Nodal Agency. Further discussion of this issue takes place in Section 21 (Indemnities, Guarantees and Contractual Claims).

### **4.5. Long-Stop Date**

4.5.1. Service Commencement should not generally be allowed to be delayed indefinitely due to PPP Vendor default. The Nodal Agency may impose a long-stop date after which the Contract may be terminated by the Nodal Agency if the Service has not yet been commenced (see Section 19.2.2 (Events Leading to Termination)).

4.5.2. The long-stop date is often fixed by reference to the Planned Service Commencement Date. The date chosen should be reasonable, taking into account the nature of the Project and the length of time the PPP Vendor should reasonably be allowed to remedy the situation. The Planned Service

Commencement Date and, therefore, the long-stop date should be extended to the extent of any delay caused by any Compensation Event, Relief Event or Force Majeure Event (see Sections 5 (Supervening Events) and 19.3 (Termination on Force Majeure)).

#### **4.6. Bonus Payments For Early Service Commencement**

4.6.1. It is sometimes proposed that “bonus payments” should be paid for early Service Commencement, particularly where the Nodal Agency has required protections of the types described above against late Service Commencement. The term “bonus payment” can be misleading, however, so it is important to understand what is envisaged and how it ties in with the implications of early Service Commencement.

4.6.2. The key point for the Nodal Agency is that it should not be under an obligation to accept early Service Commencement (unless it has agreed to be). It should only accept early Service Commencement and payment of any relevant bonus if it offers value for money. Early Service Commencement may clearly prove good value for money if there is a critical demand for the Service or if it would benefit the Nodal Agency financially. This might be the case, for example, if the early start date meant the Project generated additional third party revenue, or the PPP Vendor made savings, in which the Nodal Agency shared. Any benefit to the Nodal Agency should be assessed on a case by case basis.

4.6.3. There may be budgetary problems for some Nodal Agencies in accepting and paying for early Service Commencement. These should generally be surmountable, however, if sufficient warning is given by the PPP Vendor of early commencement, particularly as the Nodal Agency would in many cases be sharing in extra revenue or savings.

4.6.4. If the Nodal Agency decides to accept early Service Commencement, the PPP Vendor’s revenue stream will commence earlier than originally planned. The Nodal Agency will have the choice between bringing the Expiry Date of the Contract forward to retain the length of the original Service Period or retaining the original Expiry Date, thereby extending the original Service Period. This is where the “bonus payment” concept is relevant since:

- if the Nodal Agency retains the original Expiry Date, the PPP Vendor will receive a “bonus” amount of revenue through the Unitary Charge payable in respect of the extra Service Period;
- if the Nodal Agency brings the Expiry Date forward, the Nodal Agency may either simply pay the Unitary Charge for the same length of Service Period (i.e. essentially what it would have paid originally), which involves a “bonus” element (as payment is being received earlier) or it may pay the PPP Vendor a “bonus payment” equivalent to the additional amount the PPP Vendor would have received if the original Expiry Date had instead been retained. The difference between this approach and the alternative outlined in the first bullet point is that this bonus would not be subject to deductions as a result of unavailability or poor performance. It would also be likely to be paid as a lump sum;

- the Nodal Agency may alternatively simply opt to make a “bonus payment” which is unrelated to the length of the Service Period or any additional amounts of revenue which the PPP Vendor may expect to receive due to its early Service Commencement. Such a bonus would typically be an agreed fixed amount.

## 5. SUPERVENING EVENTS

### 5.1. Introduction

5.1.1. The PPP Vendor undertakes to ensure Service Commencement usually by a particular fixed date<sup>9</sup> and to continue to provide the Service for the duration of the Contract. There may, however, be circumstances in which the PPP Vendor should fairly be relieved from liability for failure to commence or provide the Service. A balance must be struck between encouraging the PPP Vendor to manage the risk and protecting the Nodal Agency from non-performance.

5.1.2. Supervening events for which some relief is appropriate should be divided into three categories:

- Compensation Events – i.e. events which are clearly at the Nodal Agency's risk and in respect of which the PPP Vendor should be compensated (see Section 5.2 (Compensation Events));
- Relief Events – i.e. events which are best managed by the PPP Vendor (although not necessarily in its control) and for which the PPP Vendor bears the financial risk, but in respect of which no rights of termination should arise (see Section 5.3 (Delays Due to a Relief Events)); and
- Force Majeure Events – a limited set of events which arise through no fault of either party, which are best managed by the PPP Vendor (although not in its control) and in respect of which rights of termination can arise (see Section 5.4 (Force Majeure Events)).

5.1.3. The distinction between Compensation Events and Relief Events is sometimes expressed as being the difference between the PPP Vendor being given 'time and money' and 'time' only.

5.1.4. Certain events may be dealt with differently in specific projects, depending on the nature of the Project, the likelihood of the event occurring and the value for money obtainable if the PPP Vendor prices the risk of such event occurring into its price. Given the effect on the Nodal Agency of adding risks to Compensation Events, this should only be done after careful consideration in specific cases. For example, in a project in which Government use means that delays during the development phase are a high risk, the Nodal Agency may accept that the event leading to such increased risk should be a Compensation Event. In a project where such risks do not exist, the parties may agree that a Relief Event is the way to deal with that risk. An alternative way of dealing with the risk of discovery of new requirements (functional or Non-functional) during the solution development period, which lies somewhere between the Compensation Event and Relief Event approach, is for the PPP Vendor to bear a pre-determined initial level of loss (both financial and in terms of delays to the solution development timetable), as defined in the Contract, with further losses above that prescribed level being shared by the parties in accordance with an agreed formula<sup>10</sup>.

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<sup>9</sup> The typical structure will require the PPP Vendor to ensure Service Commencement either by a scheduled date for completion of solution development (i.e. the Planned Service Commencement Date) or at any time from the date of the Contract or the Effective Date (depending upon the presence of conditions precedent) but by a pre-agreed long-stop date (see Section 4.5 (Long-Stop Date)).

<sup>10</sup> A different approach is justified here because of:  
(a) the potential impact of such risk being greater than is the case with other possible Relief Events; and

5.1.5. Similarly, the risk of planning delays may require different treatment in different projects. For example, the Nodal Agency may accept some planning delay risk in order to obtain value for money if it wants the Contract to be signed before full detailed planning consent is. As far as the discovery of adverse ground conditions and historic events is concerned, this should not usually be at the Nodal Agency's risk as the PPP Vendor should have carried out appropriate surveys in relation to such matters prior to signing the Contract and can often assess and accept such risks more economically than the Nodal Agency. The situation may be different in specific circumstances such as where the PPP Vendor has been prevented from carrying out appropriate surveys or it is not reasonable or good value for money for surveys to be undertaken (e.g. because of the number of sites involved in the project). For instance, normal practice for a creating a CSC scheme / VAT Computerization would be for the Nodal Agency to organize surveys/provide data itself and ensure that the bidders (who would ultimately bear the risk) could rely on them.

## 5.2. Compensation Events

### 5.2.1. Purpose and Scope

5.2.1.1. Compensation Events are designed to cater for events which arise before the Service Commencement Date which are at the Nodal Agency's risk and which result in a delay to Service Commencement and/or increased costs to the PPP Vendor, although the concept can be extended to the Service Period (see Section 5.2.1.4). Such events are more appropriately dealt with by compensation methods than by being an Nodal Agency Default (see Section 19.1.2.1 (PPP Vendor's Right to Terminate for Nodal Agency Default)) as termination should in all circumstances be a last resort (although if an event renders the parties' contractual relationship untenable the Nodal Agency may choose to exercise its voluntary termination rights). In fact, even a delay is not strictly necessary for the occurrence of a Compensation Event (see Clause 5.2(a)) as cost increases can arise without any timetable changes.

5.2.1.2. Events which can arise before the Service Commencement Date and which are at the Nodal Agency's risk (i.e. for which compensation should be paid to the PPP Vendor) are:

- Nodal Agency breach of an obligation (which includes a breach occasioned by third parties for whom the Nodal Agency is responsible, such as department officials who are to provide inputs / approvals);
- Nodal Agency changes (see Section 13 (Change in Service)); and
- discriminatory or specific changes in law (see Section 14.6 (Discriminatory, Specific and General Changes in Law)).

The Nodal Agency should bear the effects of Nodal Agency changes and Qualifying Changes in Law in accordance with the principles set out in Sections 13 (Change in Service) and 14 (Change in Law)

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(b) the public benefit that is derived from the discovery of new requirements (functional or non-functional).

respectively. The only significant difference in relation to how the approaches are dealt with during the Service Period is referred to in Section 5.2.3 (Calculation of Compensation).

As mentioned in Section 5.1.4, it may, after careful consideration in certain projects (or sectors), be appropriate to add other specific events. As Nodal Agency changes and Qualifying Changes in Law are dealt with in Sections 13 and 14 respectively, the required definition of Compensation Event is as follows:

**“Compensation Event”** means a breach<sup>11</sup> by the Nodal Agency of any of its obligations under this Contract<sup>12</sup>.

5.2.1.3. It is of course possible that Nodal Agency changes and changes in law will occur during the Service Period. The Nodal Agency should bear the risk of these events in accordance with the principles set out in Section 13 (Change in Service) and Section 14 (Change in Law).

5.2.1.4. The Nodal Agency may be faced with a request by the PPP Vendor to give compensation for Nodal Agency breaches which occur during the Service Period. This will not always be appropriate and the Nodal Agency should consider carefully the nature of its obligations during the Service Period<sup>13</sup>. If its sole obligation is to make payment, then there is no need to give compensation as non-payment in the Service Period is addressed through the provisions dealing with interest on late payment (see Section 7.2.3 and Clause 27.6 (Interest on Late Payments)) and, in extreme cases, through termination for Nodal Agency Default (see Section 19.1 (Termination on Nodal Agency Default)).

5.2.1.5. If, however, the Nodal Agency has significant ongoing obligations and breach of such obligations would seriously adversely affect the PPP Vendor's ability to perform (e.g. if the Nodal Agency failed to carry out procedures for certifying operating matters) or materially affect the cost of performance, then it may be appropriate to give compensation if such breach occurs. This can most easily be addressed by extending the scope of the Compensation Event concept.

## 5.2.2. Consequences

5.2.2.1. A practical consequence of a Compensation Event occurring is that the Planned Service Commencement Date may have to be postponed, usually by the length of any delay caused (and any long-stop date will be similarly put back). This means that the start date of the PPP Vendor's revenue stream is also delayed and/or additional costs<sup>14</sup> are incurred (see Section 5.2.2.6). As a

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<sup>11</sup> This is a breach that will not normally lead to an Nodal Agency Default (which can lead to termination - see Section 21.1 (Termination on Nodal Agency Default)), but which will nevertheless cause delay and put the PPP Vendor to material expense, including, for example, a failure to allow the PPP Vendor appropriate access to an Nodal Agency provided site.

<sup>12</sup> To the extent that the Nodal Agency is contracting on behalf of others, then these should be included. Other persons responsible to the Nodal Agency can, by failing to act, also trigger Compensation Events.

<sup>13</sup> If it is appropriate for the Nodal Agency to give the PPP Vendor compensation for Nodal Agency breaches arising during the Service Period, the Contract will need to incorporate an appropriate compensation mechanism.

<sup>14</sup> A Compensation Event may not affect the PPP Vendor's ability to achieve the Planned Service Commencement Date but increase the PPP Vendor's costs.



result, the PPP Vendor may incur finance charges and additional costs which could involve the PPP Vendor in significant expense<sup>15</sup>.

5.2.2.2. The PPP Vendor should be compensated for any delay to Service Commencement resulting directly from a Compensation Event. The original Expiry Date should be retained and the PPP Vendor compensated for its loss. This does not mean that payment of the Unitary Charge is made for a month in which no Service has been provided although the monetary value of the compensation may be derived from the Unitary Charge subtracting the costs.

5.2.2.3. If the Contract contains liquidated damages provisions (see Section 4 (Protections Against Late Service Commencement)), then the PPP Vendor's liability for liquidated damages will also be relieved for the period of delay caused by the Compensation Event. The PPP Vendor should, of course, also be relieved of any other liability for the Nodal Agency's losses in respect of the Compensation Event. This should be taken into account in determining the consequences for the Nodal Agency of a Compensation Event.

5.2.2.4. The main advantages of this approach are first, simplicity and second, it will be preferable to PPP Vendors. This approach also means that the Nodal Agency has an incentive to manage its rights and obligations in the solution development period in a way that does not result in delay. The detail of how this approach should work in practice can be seen by reference to Section 5.2.3 (Calculation of Compensation).

5.2.2.5. The PPP Vendor should be obliged to use reasonable endeavours to mitigate its losses and costs (for example, by rescheduling its works timetable or by redeploying staff). Such mitigation may result in there being no delay in the Planned Service Commencement Date (although extra costs may result from steps taken to mitigate).

### **5.2.3. Calculation of Compensation**

5.2.3.1. The Unitary Charge may need to be adjusted if the Compensation Event concerned involves an additional cost or a time delay which has cost or loss of revenue implications. The Contract must contain an appropriate method for dealing with any changes that arise as a result of a Compensation Event. Section 5.2.3.3 below sets out the required drafting. The treatment of issues here is equally applicable to costs arising as a result of an Nodal Agency change in Service (see Section 13.2 (A Typology of Changes)) and a Qualifying Change in Law (see Section 14.8 (General Change in Law as a Shared Risk)).

5.2.3.2. One common way of dealing with such events is to rely on the financial model to deal with the issue and for both parties to use this to calculate how and when compensation should be paid. Typically this would require the Nodal Agency to agree that the investments and the returns

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<sup>15</sup> If "bonus payments" are to be made for early Service Commencement (see Section 4.6 (Bonus Payments for Early Service Commencement)) the parties will need to consider what, if any, further compensation should be paid to the PPP Vendor where early Service Commencement has been prevented by the occurrence of a Compensation Event.

remain unchanged. Whilst there is no objection in principle to the parties referring to a financial model (provided both parties fully understand all of its various aspects), there are three principal problems that can arise in using a financial model to calculate compensation payable for Compensation Events (and for that matter the effects of a Nodal Agency change in Service (see Section 13.2 (A Typology of Changes)) and Qualifying Changes in Law (see Section 14.8 (General Change in Law as a Shared Risk):

- the financial model may obscure the process being followed in reaching the answer, unless there is clarity on all sides on how the relevant formulae used in the model work. For example, if something has happened which was not originally modelled for and audited, there could be conflict arising on how to model it, which could impact on the calculation concerned;
- if the Nodal Agency has access to a financial model in sufficient detail and to all of the internal costs, returns and other assumptions (to the level of detail required), then more information than is relevant simply to value the consequences of the event may have to be provided by the PPP Vendor, which may not be acceptable to it (and, in addition, certain of the assumptions may need to be updated); and
- the result of preserving the investment return ratios can be achieved in a number of different ways (these are referred to in Section 5.2.3.4).

The guidance requires that as simple an approach as possible is followed as the only concern of this Section is to ensure fair compensation for a limited number of events which can be calculated in a straightforward manner. If the Unitary Charge is to change, then financial advice is likely to be needed.

5.2.3.3. The approach taken in the drafting to the various events that may lead to a change in the Unitary Charge is as follows:

- if the event concerned requires Capital Expenditure (whether before or during the Service Period), then in most cases, it will be more practicable to deal with this by a lump sum reimbursement (subject of course to the possibility of staged payments)<sup>16</sup> (see Clause 5.2(c)(ii)); and
- if the event concerned requires a change in operating costs, then an alteration in the Unitary Charge is the appropriate means of payment (see Clause 5.2(c)(iii)).

Although the issue is dealt with in this way in the drafting, it is important to stress that for Nodal Agency breach it is also perfectly acceptable for the Nodal Agency simply to reimburse the PPP Vendor on the basis of costs incurred (for example, as a result of any delay in giving an approval).

5.2.3.4. The approach referred to in the drafting and Section 5.2.3.3 ensures that a minimum of additional financing costs are incurred. Other reasons, including affordability constraints may, however, mean that a Nodal Agency wishes to reserve the right to ask the PPP Vendor to use

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<sup>16</sup> Significant Nodal Agency changes are likely to be acceptable to the PPP Vendor only if compensation is paid by the Nodal Agency, so as to match the timing of the agreed costs of the change.

reasonable endeavours to finance the event where Capital Expenditure is required. If this is done then careful scrutiny of the value for money implications should be undertaken.

5.2.3.5. Where the compensation involves an increased obligation to incur Capital Expenditure, other possibilities<sup>17</sup> to that referred to in the drafting and Section 5.2.3.3 include:

- a lump sum payment from the Nodal Agency paid immediately on Service Commencement, the amount payable to exceed the amount of the relevant increase in Capital Expenditure by any incremental increase in financing than originally anticipated and the agreed costs incurred in arranging any such financing;
- an adjustment to the Unitary Charge to take account of the PPP Vendor's additional investment for the event concerned. This adjustment would reflect the actual terms and conditions of the funding, which would have been agreed between the parties at the outset, and be applied on the basis that the PPP Vendor is no worse and no better off, from the perspective of risk and return, than they would have been had the increase in Capital Expenditure not arisen. As stated above, in practice this generally means that an increase is made to the Unitary Charge (over the term of amortisation of the additional dedicated funding) to restore the investment and returns to their values had the additional funding not been required. This calculation can only be made by using the financial model (as to which see Section 5.2.3.2 above). The Nodal Agency should not seek a grace period on paying higher Unitary Charge even if this would satisfy the investment and equity return for the PPP vendor (as this could cause inappropriate distortion to the cash flow profile); or
- particularly if the Nodal Agency cannot afford to pay compensation in the form of a lump sum but wishes to avoid having to use a financial model, it may offer to pay a supplementary Unitary Charge over a period of its choosing as an annuity equivalent of the Capital Expenditure. If this approach is adopted, the discussion can be reduced to a single issue, namely the annuity rate to be applied. In this case, the Nodal Agency need not be concerned with how and at what cost the PPP Vendor has arranged additional dedicated funding, if any<sup>18</sup>.

5.2.3.6. If the event concerned involves a Capital Expenditure reduction (e.g. cancellation of citizen service thereby impacting the capital and operational expenses), this would involve:

- a reduction in Unitary Charge. The size of reduction will depend upon not only savings in Capital Expenditure but also consequent savings in finance and operating costs. The decision on whether or not to cancel any excess committed finance prior to project completion (if this is possible with the financing structure concerned) will be taken with the PPP Vendor.
- there are two alternative approaches to determining the appropriate reduction in Unitary Charge: either to use the financial model (see Section 5.2.3.2 above); or to determine the annuity equivalent reduction. With an annuity equivalent reduction the term of the annuity should be the term of the Contract, unless the parties otherwise agree.

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<sup>17</sup> Particularly to avoid the time and expense of engaging advisers for what may be minor compensation sums (if this approach is used), it is recommended that the parties agree and record in the Contract the incremental impact on Unitary Charge of minor capital expenditure and operational expenditure changes

<sup>18</sup> If the original Unitary Charge over the chosen annuity payment period is profiled, then the supplementary Unitary Charge should similarly be profiled. Annuities being based upon nominal discount rates would be excluded from any indexation provisions of the Unitary Charge.

5.2.3.7. If the compensation arises only because of a change in operating costs then appropriate changes in the Unitary Charge should be by negotiation and may be possible without reference to the financial model, even where the impact on operating costs is periodic or irregular over time. The change in Unitary Charge should be made at the time of the Compensation Event to reflect forecast operating costs changes, as to amount and timing. The use of lump sum compensation payments or annuity equivalents are also inappropriate for changes in operating costs. As many of the above issues have complicated financial consequences, financial advisers should be consulted as to the most appropriate approach for a particular project.

5.2.3.8. In any event, (even if this approach is taken in relation to Nodal Agency changes and Qualifying Changes in Law) it is not appropriate in any circumstances for breach by the Nodal Agency of its obligations to give rise to an obligation on the PPP Vendor to finance any Capital Expenditure consequences.<sup>17</sup>

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

The following draft may be considered while finalizing the contract (please refer to the contract template provided along with this document):

#### **5.2.4. Delays in Service Commencement Due to a Compensation Event**

- a) If, on or before the Service Commencement Date<sup>19</sup>, as a direct result of the occurrence of a Compensation Event<sup>20</sup>:
  - i. the PPP Vendor is unable to achieve Service Commencement on or before the Planned Service Commencement Date, or, following the Planned Service Commencement Date, the Long Stop Date;
  - ii. the PPP Vendor is unable to comply with its obligations under this Contract; and/or
  - iii. the PPP Vendor incurs costs or loses revenue<sup>21</sup>,

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

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<sup>19</sup> This provision may also be applied during work of a solution development nature (such as on an insurance reinstatement following total or partial destruction of an asset) (see Section 5.2.1.4). The concept can also be extended in respect of an Nodal Agency obligation to be performed during the Service Period, particularly if there are non payment obligations on the Nodal Agency (again see Section 5.2.1.4). Subject to the reinstatement point, however, the principal obligations in the Service Period will be payment related and can often be dealt with through provisions dealing with interest on late payment (see Clause 30.6 (Interest on Late Payments))

<sup>20</sup> In the event of a delay to the Planned Service Commencement Date the solution development costs will most likely increase, due to a longer financing period. The PPP Vendor is under a duty to mitigate its other costs associated with any delay (for example, by delaying recruitment, if this can be done

<sup>21</sup> This loss means not only out of pocket costs but also a claim for loss of profits (including a lost completion bonus) caused directly by the Compensation Event.

- b) Subject to sub clause (d) below, to obtain relief and/or claim compensation the PPP Vendor must:
- i. (as soon as practicable, and in any event within [21] days after it became aware that the Compensation Event has caused or is likely to cause delay, breach of an obligation under this Contract and/or the PPP Vendor to incur costs or lose revenue, give to the Nodal Agency a notice of its claim for an extension of time for Service Commencement, payment of compensation and/or relief from its obligations under the Contract;
  - ii. within [14] days of receipt by the Nodal Agency of the notice referred to in paragraph (b)(i) above, give full details<sup>22</sup> of the Compensation Event and the extension of time and/or any Estimated Change in Project Costs and/or loss of revenue claimed;<sup>23</sup> and
  - iii. demonstrate to the reasonable satisfaction of the Nodal Agency that:
    - A. the Compensation Event was the direct cause of the Estimated Change in Project Costs and/or loss of revenue and/or any delay in the achievement of the Planned Service Commencement Date and/or breach of the PPP Vendor's obligations under this Contract, or, following the Planned Service Commencement date, delay in achieving Service Commencement before the Long Stop Date; and
    - B. the Estimated Change in Project Costs and/or loss of revenue, time lost, and/or relief from the obligations under the Contract claimed, could not reasonably be expected to be mitigated or recovered by the PPP Vendor acting in accordance with good industry practice.
- c) In the event that the PPP Vendor has complied with its obligations under paragraph (b) above, then:
- i. in the case of a delay, the Planned Service Commencement Date or, following the Planned Service Commencement Date, the Long Stop Date, shall be postponed by such time as shall be reasonable for such a Compensation Event, taking into account the likely effect of delay;<sup>24</sup>
  - ii. in the case of an additional cost being incurred or revenue being lost by the PPP Vendor:
    - A. on or before the Service Commencement Date; or
    - B. as a result of Capital Expenditure being incurred by the PPP Vendor at any time the Nodal Agency shall compensate the PPP Vendor for the actual Estimated Change in Project Costs as adjusted to reflect the actual costs reasonably incurred and, without double counting, for revenue actually lost (to the extent it

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<sup>22</sup> The Nodal Agency and the PPP Vendor may wish to specify in the Contract precisely what details are required

<sup>23</sup> This figure will not calculate the compensation payable, but it gives an indication of the seriousness of the breach and so what should be taken by way of mitigation

<sup>24</sup> Since the Long Stop Date is linked to the Planned Service Commencement Date, where (prior to the Planned Service Commencement Date), the Planned Service Commencement Date is put back, the Long Stop Date will automatically be put back too. If the PPP Vendor is required to pay the Nodal Agency liquidated damages for failure to achieve Service Commencement by the Planned Service Commencement Date, the Nodal Agency and its advisers should consider how the PPP Vendor's obligation to pay will be relieved if a Compensation Event occurs after the Planned Service but prior to actual Service Commencement.

could not reasonably have been mitigated), within [30] days of receipt of a written demand by the PPP Vendor supported by all relevant information<sup>25</sup>;

- iii. in the case of a payment of compensation for the Estimated Change in Project Costs and/or without double counting, loss of revenue that does not result in Capital Expenditure being incurred by the PPP Vendor referred to in paragraph (B) above but which reflects a change in the costs being incurred by the PPP Vendor after the Service Commencement Date, the Nodal Agency shall compensate the PPP Vendor in accordance with paragraph (f) below by an adjustment to the Unitary Charge; and /or
  - iv. the Nodal Agency shall give the PPP Vendor such relief from its obligations under the Contract, as is reasonable for such a Compensation Event.
- d) In the event that information is provided after the dates referred to in paragraph (b) above, then the PPP Vendor shall not be entitled to any extension of time, compensation, or relief from its obligations under the Contract in respect of the period for which the information is delayed.
- e) If the parties cannot agree the extent of any compensation, delay incurred, relief from the PPP Vendor's obligations under the Contract, or the Nodal Agency disagrees that a Compensation Event has occurred (or as to its consequences), or that the PPP Vendor is entitled to any relief under this Clause, the parties shall resolve the matter in accordance with Clause 25 (Dispute Resolution).
- f) Any payment of compensation referred to in paragraph (c) (iii) above shall be calculated in accordance with [Section 5.2.3 (Calculation of Compensation) above]<sup>26</sup>.

## 5.3. Relief Events

### 5.3.1. Purpose

5.3.1.1. Relief Events are events which prevent performance by the PPP Vendor of its obligations at any time, in respect of which the PPP Vendor bears the financial risk in terms of increased costs and reduced revenue but for which it is given relief from termination for failure to provide the full Service. The events listed in Section 5.3.2 (Scope of Relief Events) may be outside the PPP Vendor's control, but that is not the appropriate measure of whether an event should appear on the list, as many events beyond a person's control at the time they occur could in fact have been prevented by proper precautions (e.g. fire). In fact, the list of events has been arrived at because the risk of the events concerned occurring is better borne by the PPP Vendor as it is in a better position than the Nodal Agency to mitigate and manage the consequences. In some cases this will be with insurance, in others with a combination of insurance and proper planning and in others still, by risk management and planning (i.e. the events can be worked around for the period they exist).

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<sup>25</sup> This payment can be in the form of a monthly payment as expenditure is incurred (or staged payments against milestones) and invoiced if the delay is for a significant period of time. In the event that the Nodal Agency wishes the PPP Vendor to increase its financing to pay for the consequences of a Compensation Event (other than an Nodal Agency breach), then Section 5.2.3 (Calculation of Compensation) should be reflected.

<sup>26</sup> Authorities should not enter into arrangements whereby after the relevant effects of the Compensation Event has been calculated there is a reconciliation if the costs are greater or lesser than those agreed or estimated

5.3.1.2. It is clear in most cases that termination should not follow a Relief Event. This is because any replacement PPP Vendor would be similarly affected and so the Nodal Agency's position would not be improved by termination. Relief Events do not, however, require the same treatment as Force Majeure Events (see Section 5.4 (Force Majeure Events)) as their consequences are not likely to be as severe and will usually only last for a finite period.

5.3.1.3. In the past it has been argued that a right to terminate should exist for the prolonged occurrence of a Relief Event. Other than in certain defence projects<sup>27</sup>, this is not appropriate for two reasons. First there is a risk of there being no proper incentive on the PPP Vendor to manage the risk (depending on any compensation payable on termination) and secondly the occurrence of such an event is likely either to be short-lived and/or lead to an alternative sourcing of the supply concerned by the PPP Vendor (e.g. any shortage of fuel). In any event, the appropriate measure for a termination payment in such circumstances (i.e. PPP Vendor Default – see Section 19.2.5 (Compensation on Termination for PPP Vendor Default)) would be unlikely to be agreed by PPP Vendor.

### 5.3.2. Scope of Relief Events

#### **ILLUSTRATIVE DRAFTING**

##### **“Relief Event”**

means<sup>28</sup>:

- a) the unintentional introduction of a virus in the software application / database of the IT project
- b) fire, explosion, lightning, storm, tempest, flood, bursting or overflowing of water tanks, apparatus or pipes, ionising radiation (to the extent it does not constitute a Force Majeure Event)<sup>29</sup>, earthquakes, riot and civil commotion;
- c) failure by any statutory undertaker, utility company, local authority or other like body to carry out works or provide services;
- d) any accidental loss or damage [to the solution development];
- e) any failure or shortage of power, fuel or transport;
- f) any blockade or embargo which does not constitute a Force Majeure Event, and
- g) any:
  - (i) official or unofficial strike;
  - (ii) lockout;
  - (iii) go-slow; or

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<sup>27</sup> In the interests of certainty in particular defence projects, for example where the Service is needed by the MOD for military or operational reasons, a right to terminate may be allowed for both parties in the event of prolonged occurrence of a Relief Event. See MOD Standard Form Contract

<sup>28</sup> This list can be further customized provided that the commercial risk of the occurrence of such events clearly still lies with the PPP Vendor. Nodal Agency should be aware that the issues relating to termination rectification should restrict the list to events (other than those set out above) over which the PPP Vendor has no control. There will also be circumstances in which the un-insurability of particular risks may require relief treatment in order to prevent either party from terminating the Contract (see Section 25.9 (Risks that become Uninsurable)).

<sup>29</sup> Force Majeure Events are defined in Section 5.4

(iv) other dispute, generally affecting the industry or a significant sector of it, unless any of the events listed in paragraphs (a) to (f) inclusive arises (directly or indirectly) as a result of any wilful default or wilful act of the Contractor<sup>30</sup> or any of its sub-contractors.

5.3.2.1. The Contract will have similar provisions during both the solution development/development phase and the Service Period. In addition, as mentioned in Section 5.1.5, the above list of events may be extended to include other similar events if the circumstances warrant. Force majeure delays should be excluded (see Section 5.4 (Force Majeure Events)) as they are treated separately. In addition, in circumstances where the Contract imposes a long-stop date for Service Commencement (see Section 4.5 (Long-Stop Date)) the scope of Relief Events may be extended to cover further events (e.g. unforeseen ground conditions) given that the financial risks associated with such events will remain with the PPP Vendor, though in ordinary circumstances allowance will already have been made for such contingency when setting the Long-Stop Date.

Wilful acts and defaults of the PPP Vendor are excepted from the definition of Relief Events. Failure to rectify the default within the agreed period may lead to termination.

### **5.3.3. Consequences**

5.3.3.1. The financial effects of delays caused by Relief Events are borne by the PPP Vendor, so no compensation should be paid by the Nodal Agency on the occurrence of such delays. If a Relief Event occurs prior to Service Commencement any long-stop termination date will be put back by a period equal to the relevant delay. In most cases the only relief given will be relief from termination (i.e. Relief Events are separate and distinct from Compensation Events and Force Majeure Events).

5.3.3.2. There should be no extension to the Contract owing to a Relief Event. The Nodal Agency should not regard an extension of the Contract as a concession without significant cost. This is because if an extension is given, then although the PPP Vendor does not receive the Unitary Charge during a Relief Event (save to the extent the Service is delivered), the PPP Vendor's revenue period would be kept whole. If this occurs, then there is a reduced incentive on the PPP Vendor to manage the effects of the Relief Event and restore the Service as soon as possible. In addition, the Nodal Agency's exposure to any risks it bears under the Contract is extended indefinitely as the Expiry Date may be continually extended. By extending the Contract, therefore, the Nodal Agency can be taking a large element of the risk of the occurrence of Relief Events (as the economic effects of an extension can be substantial).

5.3.3.3. The parties should consider, on a project specific basis, whether or not the PPP Vendor should be relieved of any liability for liquidated damages, although availability and performance deductions should continue to be made where necessary in respect of the period of delay caused by the Relief Event (see Sections 4 (Protections Against Late Service Commencement) and 7 (Price and Payment Mechanism)). Liquidated damages prior to Service Commencement (to the extent they exist) are designed to compensate the Nodal Agency for specific losses due to late Service delivery so

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<sup>30</sup> See also Section 21.2.4.3 in relation to Relief Events occurring during rectification periods for PPP Vendor Default



that if the PPP Vendor fails to commence provision of the Service due to a Relief Event, the Nodal Agency will still suffer this loss. Depending on the nature of the Project, however, the Nodal Agency may feel that it will obtain better value for money if it allows any liability of the PPP Vendor for liquidated damages to be postponed by the period of the delay.

5.3.3.4. When a Relief Event has occurred and the Nodal Agency has been informed, the parties should consult to discuss relevant issues, such as the likely duration of the Relief Event and the action to be taken to mitigate its effects.

5.3.3.5. The Nodal Agency should not normally expect to exercise any step-in rights it has during a Relief Event (see Sections 26 (Nodal Agency Step-In)). If the PPP Vendor is not using reasonable endeavours to rectify matters and mitigate the consequences, it will not obtain the relief afforded by Relief Events and will be at risk of termination for default (see Clause 5.3(b) (Delays due to a Relief Event)). This should provide a sufficient spur for the PPP Vendor to perform (depending, in part, on the approach taken to relief from other obligations under the Contract).

## **ILLUSTRATIVE DRAFTING**

### **Consequences of a Relief Event**

- a) If and to the extent that a Relief Event:
  - (i) is the direct cause of a delay in Service Commencement; and/ or
  - (ii) adversely affects the ability of the PPP Vendor to perform any of [its obligations under this Contract], then the PPP Vendor is entitled to apply for relief from any rights of the Nodal Agency arising under Clause 21.2 (Termination on PPP Vendor Default) [and its obligations<sup>31</sup> under this Contract].
- b) To obtain relief, the PPP Vendor must<sup>32</sup>:
  - (i) as soon as practicable, and in any event within [14] days after it became aware that the Relief Event has caused or is likely to cause delay and/or adversely affect the ability of the PPP Vendor to perform its other obligations give to the Nodal Agency a notice of its claim for relief from its obligations under the Contract, including full details of the nature of the Relief Event, the date of occurrence and its likely duration;
  - (ii) within [7] days of receipt by the Nodal Agency of the notice referred to in paragraph (b)(i) above, give full details of the relief claimed; and
  - (iii) demonstrate to the reasonable satisfaction of the Nodal Agency that:
    - A. the PPP Vendor and its sub-contractors could not have avoided such occurrence or consequences by steps which they might reasonably be expected to have taken, without incurring material expenditure;
    - B. the Relief Event directly caused the delay to the Planned Service Commencement Date or, following the Planned Service Commencement Date, delay in achieving

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<sup>31</sup> In most contracts Relief Events should give only relief from the risk of termination for failure to complete or failure to perform (see Section 5.3.3.1). In cases in which liquidated damages are payable to the Nodal Agency there will be an issue of the extent to which relief can be given from claims for damages or liquidated damages (see Sections 5.3.3.3 and 24 (Indemnities, Guarantees and Contractual Claims)). The performance regime should still apply and this should be made clear, to the extent there is potential for relief from liquidated and other damages

<sup>32</sup> The approach here is to set out a quick procedure so that relief can be given or refused on a sensible timescale without additional delays.

- Service Commencement by the Long Stop Date or [the need for relief from other obligations under the Contract],
- C. the time lost and/or relief from the obligations under the Contract claimed could not reasonably be expected to be mitigated or recovered by the PPP Vendor acting in accordance with good industry practice, without incurring material expenditure; and
  - D. the PPP Vendor is using reasonable endeavours to perform its obligations under the Contract.
- c) In the event that the PPP Vendor has complied with its obligations under paragraph (b) above, then:
- (i) the Planned Service Commencement Date or, following the Planned Service Commencement Date, the Long Stop Date shall be postponed by such time as shall be reasonable for such a Relief Event, taking into account the likely effect of delay; and/or
  - (ii) the Nodal Agency shall not be entitled to exercise its rights to terminate the Contract under Clause 21.2 (Termination on PPP Vendor Default) [and, subject to paragraph (d) below, shall give such other relief as has been requested by the PPP Vendor].<sup>33</sup>
- d) [Nothing in paragraph (c) above shall affect any entitlement to make deductions<sup>34</sup>42 or any deductions made as a result of [Section 9 (Payment Mechanism Management and monitoring)] during the period in which the Relief Event is subsisting].
- e) in the event that information required by paragraph (b) above is provided after the dates referred to in that paragraph, then the PPP Vendor shall not be entitled to any relief during the period for which the information is delayed.
- f) The PPP Vendor shall notify the Nodal Agency if at any time it receives or becomes aware of any further information relating to the Relief Event, giving details of that information to the extent that such information is new or renders information previously submitted materially inaccurate or misleading.
- g) If the parties cannot agree the extent of the relief required, or the Nodal Agency disagrees that a Relief Event has occurred or that the PPP Vendor is entitled to any extension of the Planned Service Commencement Date or the Long Stop Date [and/or relief from other obligations under this Contract], the parties shall resolve the matter in accordance with Clause 25 (Dispute Resolution).

## 5.4. Force Majeure Events

### 5.4.1. Scope of Force Majeure

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<sup>33</sup> This wording is only appropriate where additional relief beyond relief from termination (for instance for liquidated damages) are offered.

<sup>34</sup> If the termination levels under the Contract for non-performance are connected to the deductions made under the Contract or the award of performance points, the Contract should ensure that deductions or points arising due to non-performance caused by Relief Events are not taken into account in the termination provisions of the Contract. This is best dealt with in the performance regime

5.4.1.1. The purpose of force majeure provisions is to give the Affected Party relief from liability and, if the event continues for a certain period, to give the parties an opportunity to terminate the Contract. The definition of Force Majeure Events (see Section 5.4.1.2) should only include events which, unlike Relief Events, are likely to have a catastrophic effect on either party's (although usually the PPP Vendor's) ability to fulfil its obligations under the Contract. In practice, such events are highly unlikely to occur. As neither party is likely to be in a better position than the other to manage either the occurrence or the effects of force majeure, and the events may continue for a long period of time, such events are given a different treatment from Relief Events and the financial consequences shared.

5.4.1.2. The following is the required definition of Force Majeure Events:

**“Force Majeure Event”<sup>35</sup>**

means the occurrence after the date of Contract of:

- (a) war, civil war, armed conflict or terrorism; or
- (b) nuclear, chemical or biological contamination unless the source or the cause of the contamination is the result of the actions of or breach by the PPP Vendor or its subcontractors; or (c) pressure waves caused by devices travelling at supersonic speeds, which directly causes either party (the “Affected Party”) to be unable to comply with all or a material part of its obligations under this Contract.
- (c) could not have been prevented by the non-performing Party's reasonable precautions or commercially accepted processes, or could not reasonably be circumvented by the non-performing Party through the use of substitute services, alternate sources, work-around plans, the implementation of appropriate security measures or the disaster recovery procedures required of Vendor.

5.4.1.3. Relief for Force Majeure Events applies only to the extent that the PPP Vendor or the Nodal Agency is unable to comply with all or a material part of its obligations under the Contract and the parties cannot agree within a limited period (say 6 months) how to resume the Project.

5.4.1.4. The Nodal Agency should not be obliged to pay the PPP Vendor any amount simply to service the PPP Vendors' investment break-even obligations in whole or in part, but the parties should recognise that the PPP Vendor may wish to include certain tolerances into its Contract to allow for this. If termination occurs, the Nodal Agency will in any event compensate the PPP Vendor for outstanding investment return gap. If termination does not occur, then the parties will be discussing continuation of the Contract against a back drop of such a compensation payment.

## **5.4.2. Consequences of Force Majeure**

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<sup>35</sup> This definition should not be expanded without a very careful consideration of the specific issues on the Project concerned, as the effect can be to dilute or undermine agreed areas of risk transfer. It is recognised, however, that there are some obvious sector specific changes that may be needed (for example, certain projects might exclude some of paragraph (a) if it is intended to operate during times of war). The definition may also be narrowed to cope with the fact that paragraph (b) may be inapplicable to Disaster management projects which may be designed to deal with a certain degree of natural disasters.

5.4.2.1. On the occurrence of a Force Majeure Event, the parties should consult to attempt to find a way to continue the Project, such as agreeing how it can be reinstated if destroyed (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 the service requirement, amending the payment mechanism or even extending the term of the Contract. The required drafting for dealing with the effects of Force Majeure Events is set out in Section 19.3 (Termination on Force Majeure).

### **5.4.3. Relief Events, Force Majeure Events and Insurance**

**5.4.3.1** Contractors may take out advance loss of profit or business interruption insurance against certain of the Relief Events (see Section 22 (Insurance)) to provide a replacement revenue stream on the revenue of the Project for the duration of the event and/or the duration of a rebuild. Such insurances will often be subject to an excess for a number of days and so the occurrence of any such event may still involve the PPP Vendor in substantial cost. Such insurance may not be available in respect of all types of Relief Event and, generally, will only pay out where there is physical damage to the Project.

**5.4.3.2** The issue of allocating the risk of Relief Events and Force Majeure Events should be treated separately from the issue of whether or not insurance is available. The primary factor in allocating risk is who is best placed to manage the risk and its consequences and, in the case of Relief Events, this is the PPP Vendor. Whether it can insure against such risk is a matter for the PPP Vendor as it is essentially the PPP Vendor's decision to manage the risk (to the extent the insurances are not required) in a satisfactory manner. Nodal Agency should therefore not accept the argument that uninsurable events should inevitably fall within the definition of force majeure or an equivalent. This would significantly extend the definition of Force Majeure Events (see Sections 22 (Insurance) and 21.3 (Termination on Force Majeure)). Force Majeure is specifically given a different treatment in this guidance as the occurrence of the events listed in Section 19.3.2.2 are judged to be risks which the PPP Vendor is not necessarily best placed to manage, and so should be shared by the Nodal Agency.

## 6. WARRANTIES

### 6.1. Introduction

6.1.1. Bidders base their bids on information provided by the Nodal Agency in the tender documents and the Nodal Agency should make it clear whether or not such information has been verified.

6.1.2. The Contract should determine who should bear the risk if information on which a PPP Vendor relies in its bid subsequently proves to be incorrect. This includes determining who should bear the risk of latent defects appearing in assets transferred from the Nodal Agency to the PPP Vendor.

### 6.2. Due Diligence

6.2.1. A common approach in the past has been for the Nodal Agency to assume automatically that it should hand over full responsibility to the PPP Vendor for verifying information. This involves the PPP Vendor (and other bidders) in due diligence expense in ascertaining what is being bid against and what contingencies to include. PPP Vendors have accepted this risk in Projects in which the due diligence is small in relation to the rest of the Project, particularly where the Project involves only the provision of a new service.

6.2.2. PPP Vendors may be reluctant, however, to bear this risk where the Project involves a great deal of costly due diligence (relative to the size of the Project) or where the Nodal Agency is the sole source of information which cannot otherwise be verified. This is usually the case where the Nodal Agency is handing over a service (and possibly employees) which has been provided in-house for an extended period and/or a range of assets in uncertain condition.

6.2.3. If the PPP Vendor bears the risk of information being inaccurate, then its bid price may increase to reflect the level of risk assumed. The Nodal Agency should consider whether it can obtain better value for money (taking into account the overall risk allocation) if it is able to bear some of this risk itself or transfer some of this risk to a third party. If the risk is sufficiently large it will affect the ability of some or all bidders to submit bids.

### 6.3. Nodal Agency Warranties

6.3.1. The Nodal Agency should be very careful in warranting any information it provides. Warranties, to the extent given, should not extend beyond information on which the PPP Vendor must rely for its bid. Accordingly, the Nodal Agency should seek to minimise the extent of any warranties, unless:

- the Nodal Agency is the sole source of such information or such information cannot be verified by the PPP Vendor at reasonable cost;

- the Nodal Agency is confident in the accuracy of such information or is able to confirm its accuracy without significant expense (e.g. through surveys, in-house checks or inspections); and
- the Nodal Agency will obtain better value for money as a result (taking into account the overall risk allocation).

6.3.2. If the criteria listed in Section 6.3.1 are satisfied and the Nodal Agency gives certain warranties, this will help reduce the PPP Vendor's costs. The Contract could then either contain a price variation mechanism to be employed if the information turns out to be inaccurate (rather than giving rise to a right to terminate) or give rise to a damages claim.

6.3.3. Required drafting for warranty exclusion for Contracts in which warranties are not given by the Nodal Agency is as follows:

### **ILLUSTRATIVE DRAFTING**

#### **Exclusion from Warranty**

- a) The PPP Vendor shall be deemed to have:
  - (i) satisfied itself as to the assets to which it will acquire rights and the nature and extent of the risks assumed by it under this Contract; and
  - (ii) gathered all information necessary to perform its obligations under this Contract and other obligations assumed, including information as to the nature, location and condition (including geography, climate, law & order, terrorism, population density, periodicity etc.);
  - (iii) [other relevant information]
- b) The PPP Vendor shall not in any way be relieved from any obligation under this Contract nor shall it be entitled to claim against the Nodal Agency on grounds that any information, whether obtained from the Nodal Agency or otherwise (including information made available by the Nodal Agency) is incorrect or insufficient and shall make its own enquiries as to the accuracy and adequacy of that information.

## **6.4. Benefit of Surveys and Reports**

6.4.1. There are other means by which the Nodal Agency can help reduce the PPP Vendor's due diligence costs. It may, to the extent possible, disclose the contents of or assign the benefit of any reports or surveys it commissions from third party consultants direct to the PPP Vendor (or the bidders) or share the benefit of such reports or surveys with them having reached an agreement on cost sharing. If the Nodal Agency wants to follow this route, it must ensure that when it appoints the relevant consultant that it agrees to take on the work on the basis of such assignment or sharing of the benefit. In addition, if this approach is to be of value to the PPP Vendor, the relevant report must be up-to-date and address the issues of particular concern to the PPP Vendor.

6.4.2. A practical option for bidders to consider is to share the cost of carrying out expensive aspects of due diligence by jointly appointing a consultant.

## 6.5. Latent Defects Risk

6.5.1. The issue of who should bear latent defects risk in assets transferred to the PPP Vendor by the Nodal Agency should be addressed on a project specific basis as it depends on the type of assets involved.

6.5.2. In transferring latent defects risk from the Nodal Agency to the PPP Vendor in respect of existing space provided to PPP vendor, particular issues will arise where:

- the relevant space is large and;
- there is any significant doubt as to the structural stability; or
- the Project involves minor additions/site preparation in the existing space

## 7. PRICE AND PAYMENT MECHANISM

### 7.1. Introduction

7.1.1. The payment mechanism lies at the heart of the Contract. It puts into financial effect the allocation of risk and responsibility between the Nodal Agency and the PPP Vendor. It determines the payments which the Nodal Agency makes to the PPP Vendor and establishes the incentives for the PPP Vendor to deliver the Service required in a manner that gives value for money.

7.1.2. Many PPP payment mechanisms involve two key determinants of payment – availability of the Service and performance of Service. This Section is an introduction to the wide range of concepts which can be used in payment mechanisms. These two concepts are discussed in more detail in Sections 8 (Availability Requirements) and 9 (Performance Requirements).

7.1.3. When procuring services through PPP contracts, Nodal Agency should assess not only their current requirements but also their requirements into the future. In many projects, demand or usage will be a key risk over the life of the Contract, regardless of whether or not this risk is passed to the PPP Vendor through the payment mechanism. In drawing up a functional and non-functional requirement for the Services required, Nodal Agency should be confident that there will be long-term demand for the Service.

7.1.4. The design and calibration of the payment mechanism requires input from the Nodal Agency and its advisers, including financial, legal and technical advisers. The payment mechanism should be tailored to the individual project. Where more detailed guidance has been issued by a specific department, such as enrollments under UIDAI, this should be followed.

### 7.2. Features of the Payment Mechanism

7.2.1. The key features of a payment mechanism are:

- no payments should be made until the Service is available;
- there should be a single Unitary Charge for the Service which is not made up of separate independent elements relating to availability or performance;
- the level of payment should be linked to the level of Service. For a payment mechanism based on availability with an overlay of performance deductions, this will mean linking payment to both the availability and the quality of the Service;
- the Unitary Charge should never be paid in advance of the period to which it relates;
- the payment mechanism should adjust for sub-standard performance, and deductions should reflect the severity of failure. Thus no Service should lead to no payment, but proportionality is important and therefore a minor failure should cause a minor deduction (except in the case of persistent failure where ratchet mechanisms may increase the level of deduction);
- the mechanism should not only incentivize the PPP Vendor to remedy service failures but should also take into account the importance of that failing Service to the Nodal Agency;



- a balance should be struck amongst the variables in the payment mechanism, such as the initial “weighting” of deductions for failures, response / rectification periods, and the “ratcheting up” of deductions for repeated failures over time;
- the performance and payment regime should not be made up of sub-elements which relate to delivery of inputs (e.g. completion of stages of solution development, cost of Hardware or man-month costs) but should be based on outputs (e.g. the availability of services or standard of Services); and
- the payment mechanism should never contain a fixed element which the PPP Vendor always receives irrespective of performance (e.g. which covers the PPP Vendor’s investments break-even period obligations).

7.2.2. It is not generally appropriate to “sculpt” the Unitary Charge (i.e. through an uneven or irregular payment profile) other than for relevant general price changes or to ensure consistency with any ramp-up in services in an initial period or project phasing. The reason for this is that sculpting the Unitary Charge is contrary to the principle of paying for Services rather than inputs; moreover it is orientated towards affordability rather than value for money concerns and can undermine the effectiveness of the risk transfer to the private sector. “Ramp-up” can happen, for example, where a project involves a mixture of new solution development and refurbishment of existing facilities, with the latter becoming available before completion of solution development.

7.2.3. The Nodal Agency should pay for Services on time and payment should not be unreasonably withheld. The Nodal Agency should agree payment of interest if payment is late. The Nodal Agency should also take steps to ensure that the PPP Vendor complies with best practice in this area. In accordance with Government policy the PPP Vendor should pay its Sub-Contractors ordinarily within 30 days, unless a different period is specified in the relevant Sub-Contract.

7.2.4. The choice of payment mechanism should be a positive decision by Nodal Agency, informed by advice from their advisers. The Nodal Agency should also involve relevant stakeholders (e.g. endusers) as appropriate.

7.2.5. The payment mechanism must be properly applied in practice. There may be occasions where Nodal Agency be wary of imposing deductions for fear of threatening their relationship with the PPP Vendor, or because they are concerned that deductions will damage the ability of Sub-Contractors to rectify problems. Nodal Agency should regard the payment mechanism as an important part of their Contract and should enforce it.

7.2.6. The Nodal Agency’s requirements and payment mechanism are designed to deliver the required Services identified in the business case and accordingly out-performance (i.e. performance to a higher standard) by the PPP Vendor should not ordinarily warrant further payment. However, for some projects (for example, where the performance by the PPP Vendor can affect the financial

position of the Nodal Agency, such as tax collection (VAT, Municipal etc.). Nodal Agency may consider that there is value for money in including scope for additional payments.

In such cases Nodal Agency may wish to cap payments for out-performance (e.g. at the level of previous deductions or by awarding ‘bonus points’ which can only serve to offset ‘negative’ points for poor performance). Such payments will, however, only offer value for money if they are valued by bidders in their pricing for the Project.

### 7.3. Structuring the Payment Mechanism

7.3.1. Nodal Agency should consider the following principles in structuring their regime:

- where the mechanism measures both availability and Service performance, the distinction between points to be included as part of the definition of availability and those to be part of a performance measurement system is important.
- the mechanism might involve (a) direct cash deductions for failure, whether in terms of unavailability, poor performance, or other terms appropriate to the mechanism for a specific project, or (b) a two-stage system whereby failure leads firstly to points which in turn lead to cash implications (e.g. once a certain number of points are reached). If the definition of availability omits key requirements – these being instead covered by the performance measurement system – the latter could include both immediate payment deductions and a system of performance points;
- the payment for a given period, e.g. a month, might be structured as (a) starting from zero, with payment increased in response to availability and performance, or (b) increasing for availability but subject to deductions for poor performance, or (c) a base case figure for the Unitary Charge for that period which is subject to deductions for both unavailability and poor performance;
- a number of performance regimes amongst early projects have been over-elaborate and, as a result, ineffective, and some have not been designed with enough consideration of the practicability of day-to-day procedures. As a rule, simple is best. The payment mechanism should seek to “measure less but measure well”;
- unnecessary complexity can also arise where the movement from specification of inputs to specification of outputs has not been endorsed by the Nodal Agency. The mechanism should concentrate on measuring “outputs” not measuring “inputs”; and
- Nodal Agencies should first build their model from the bottom up, ensuring that for any particular area, or service failure, there is an appropriate potential deduction. The model should then be reviewed from the top down, considering the cumulative effect of all types of deduction. If it is “over-weighted” in terms of the scale of likely deductions, it will encourage excessive risk pricing and cash reserving by bidders. If it is “under-weighted”, bidders will not be sufficiently incentivized to rectify Service failures.

7.3.2. The key objectives are value for money and effective incentivisation; the Contract should contain sufficient incentives for the PPP Vendor to rectify any default.

7.3.3. A variety of payment mechanism structures have been used across various sectors and project types. Models A to C below illustrate alternative features of a payment mechanism. They are not intended to be prescriptive:

- Model A – the Unitary Charge is built up from the number of available places or units, so only places or units that are available are paid for. The definition of available places or units incorporates the provision of ongoing services that are core to the requirements of the Nodal Agency to carry out its functions. On top of this, a performance regime is imposed to address levels of performance that do not impact on the availability of places and/or Services that are outside the definition of the core Service. Sub-standard performance leads initially to “performance points” accruing and, only indirectly, to deductions from the Unitary Charge once a certain level of points has accrued. A ratchet increases the deduction for repeated performance failings.
- Model B – the Unitary Charge (before any deductions) is based on a full provision of the overall requirement and the payment mechanism determines deductions both for unavailability and sub-standard performance, i.e. both are represented in the calculations as deductions from the 100% level. Availability is defined in terms of being usable and accessible and different deductions are made depending on which area is unavailable. There is a system of weightings whereby each section of accommodation is divided into units and given a weighting depending on its importance; for each failure to provide an available unit there is initially a payment deduction equal to the Unitary Charge multiplied by the relevant weighting. The deduction can be based on an escalating tariff so that subsequent days of unavailability of the same space may lead to progressively higher deductions.
- Model C – the Unitary Charge is based both on availability and usage, for example in the context of a online returns filing with payment per returned filed. There is a minimum take-or-pay level (i.e. if usage by the Nodal Agency is below that level it must nonetheless pay for usage at that level) in order to assist with the financeability of the Project and to strike a balance between flexibility and the cost implications of greater risk transfer. There is still a requirement for availability to be defined, as the Nodal Agency will not pay above its actual usage if the units of Service are not available. There can in addition be scope for payment deductions for poor performance of Services.

## 7.4. Usage-Based Systems

7.4.1. An alternative to availability-based payment is for the level of the Unitary Charge to be determined by usage (also referred to as ‘volume’ or ‘demand’), or to combine these approaches within a single payment mechanism. The Income Tax Project relied on usage payments. Normally, where usage is relevant the Unitary Charge is only partly dependent on usage. Payments linked to usage can bring advantages when the PPP Vendor’s performance can influence the level of usage, since customers can “vote with their feet” on the availability and quality of the Service; in this way payment will be linked to performance through this automatic feedback.

7.4.2. It is important to differentiate between regimes where the Unitary Charge itself (payable by the Nodal Agency) is adjustable by reference to usage, and regimes where the Unitary Charge is

based on availability and performance principles, but the PPP Vendor separately takes the risk on the amount of “third party revenue” which can be generated from the facilities (and in respect of which the Nodal Agency may seek some gain share). This relevance of this system is low in the e-Governance areas. However the possibilities of the same cannot be discounted (for e.g. advertising at the back of the Smart card issued by a Government department)

**7.4.3** Third party revenue should be assessed as part of the value for money evaluation of the proposed structure as a whole; if it provides a benefit to the PPP Vendor this should in principle reduce the required return from other activities. The Unitary Charge may be reduced as a result of PPP Vendor access to third party revenue, with a revenue-sharing arrangement for revenue above the amount assumed in the Unitary Charge reduction. The value for money benefit of allowing third party revenue to fall to the PPP Vendor will depend on the PPP Vendor’s ability to forecast and influence it (and Nodal Agencies should be wary of over-optimistic assumptions on these points). In 7.4.3. many projects the scope for recognizing significant third party revenue in the financial model, and thus reducing the Unitary Charge, is limited as the demand is difficult to predict; in these cases upside sharing is particularly important.

7.4.4. In some projects (for example online returns filing for tax) a measure of usage risk may be transferred such that profitability is only affected at the margins. Where there is a mixture of availability and volume-based principles, some “take-or-pay” minimum volume amounts may be used. Nodal Agency must ensure that these structures do not mutate into structures which simply ring-fence the PPP Vendor’s investment as it is contrary to basic PPP risk transfer principles. Where take-or-pay arrangements exist, the mechanics of availability are likely still to be required, since the Nodal Agency should not pay for the minimum level of usage where the facilities are unavailable. Take-or-pay principles should not protect payment streams where Services are unavailable because of Relief Events, Force Majeure events or PPP Vendor failures.

7.4.5. In some circumstances performance regimes which are dependent on levels of usage may not in fact transfer true usage risk to the PPP Vendor. This is the case where the increase in payments corresponding with an additional unit being used is equal to the marginal cost to the PPP Vendor of providing the unit. For example, where an extra transaction of service will cost a PPP Vendor an extra INR 10 to process, increasing the payment by INR 10 per tonne will not affect the PPP Vendor’s profitability.

7.4.6. The factors which determine whether it is value for money to transfer usage risk tend to be project-specific. Genuine transfer of all usage risk to the PPP Vendor, making its profit (i.e. revenue less costs) dependent on usage, is rarely appropriate and should only be considered in cases where the PPP Vendor can forecast and influence future usage. Usage risk transfer may be appropriate where the PPP Vendor is satisfied with predictions of the level of demand for the Service, or where reductions in Nodal Agency usage can be offset by third party revenue. A part of usage risk can be transferred in some cases, but many Projects cannot transfer any usage risk, even where services are being provided. Transferring usage risk in inappropriate cases is likely to result in poor value for money. The PPP Vendors (& their Risk team) tend to have strong concerns over the transfer of usage risk, and “take-or-pay” where investment protection ratios may be required.

***Evaluation and other implications of transferring usage Risk***

7.4.7. Where the Unitary Charge is sensitive to usage or there is third party revenue, bid evaluation (i.e. in terms of the potential costs of alternative proposals) is made more complex. Moreover it may be difficult to predict the likely level of termination payments which would result should the Project in due course be terminated. From the perspective of flexibility for the Nodal Agency, this is particularly relevant to Nodal Agency voluntary termination (where PPP Vendors look for some compensation for their lost opportunity to make returns from future revenues). Areas of the Contract which may require special attention where volume-based payments are significant are Compensation Events, Qualifying Change in Law, Nodal Agency Step-in, Nodal Agency change in Service, Force Majeure, and the various different termination scenarios. The basis for compensation may vary according to the type of event leading up to loss and whether the compensation has any sensitivity to future revenue expectations<sup>36</sup>. For example, following Qualifying Change of Law and in other no-fault scenarios the appropriate measure should be the lower of base case (i.e. the original forecasts) and actual usage levels, and Nodal Agency may also wish to seek to apply this principle to compensation on termination for PPP Vendor Default and/or Nodal Agency voluntary termination.

7.4.8. The volume of usage (demand) risk is, where the risk is material, the key determinant of the accounting treatment of the underlying asset. Nodal Agency should consider, as part of their Business Case prior to commencing procurement, the likely materiality of demand risk, and the allocation of it. Where they have a high level of certainty in the need for the asset, and the volume of usage in relation to it (for example, the number of returns to be filed) is predictable, Nodal Agency may often demonstrate that the risk in relation to demand is immaterial. As transfer of usage risk is rarely appropriate, as described above, Nodal Agencies should generally retain this risk but, it will commonly be immaterial for the reasons described. Where this is not the case, and the Nodal Agency is planning to retain material demand risk, Nodal Agencies should consult their Private Finance Unit prior to commencing procurement to ensure that the accounting implications are appreciated.

## **7.5. Calibration**

7.5.1. The economic characteristics and detailed design of the payment mechanism are central to the achievement of value for money. There are a large number of points of detail involved in assigning numbers to the various parts of the payment mechanism. This process is referred to as “calibration”. The remainder of this section assumes an availability-based payment mechanism but the principles have wider application.

7.5.2. Nodal Agency and their advisers should consider how to approach this issue during the procurement process, and how much input to seek from PPP Vendors and at what point. An over-rigid approach during negotiations will reduce the scope for innovation by the bidders and so reduce

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<sup>36</sup> See Section 21 (Early Termination). In the case of third party revenue and the termination of the Project, the facility may continue to be operated by the Nodal Agency and this may mean that the Nodal Agency's exposure to higher-than-expected costs of termination is offset by higher-than-expected future revenue.

the potential for best value for money to be achieved.<sup>37</sup> However, it is normally appropriate to include a significant level of detail relatively early in the process so that the maximum benefit is taken for development while under competitive tension. Under the Competitive Dialogue procedure there is no scope for making significant alterations to the payment mechanism after completion of the dialogue (though fine tuning is still permitted). Where final calibration is still to be completed at the time of appointment of the winning bidder, the winning bidder's letter should include an obligation to recalibrate with the final details. It is essential that the process is not undermined by last-minute re-calibration following last minute due diligence.

7.5.3. The Nodal Agency should understand how the various responsibilities relating to the drafting and calibration of the output specification and payment mechanism are allocated amongst its advisers, and ensure that all issues have a clear allocation of responsibility.

7.5.4. There are many variables in a payment mechanism, including the following:

- the definitions of availability and performance standards (i.e. how demanding the requirements are);
- response and rectification periods (i.e. how quickly problems have to be addressed);
- the scope (in practical terms and under the contract) for the PPP Vendor to provide (temporary) alternative services/locations instead of having deductions applied, giving them greater flexibility to avoid deductions, or for allowing 'unavailable' facilities to continue to be used;
- levels/weightings of deductions for unavailability or poor performance;
- ratchet mechanisms for repeated or widespread failures; and
- caps on performance deductions<sup>38</sup>

7.5.5. The degree of risk transfer depends on all of these parts; heavy deductions for poor service might not imply a harsh mechanism if the Service requirements are not overly demanding, there are long periods in which the PPP Vendor can respond, the PPP Vendor can provide alternative solution / rectification with lower deductions applying. On the other hand a scheme with small cash deductions might provide strong incentives to perform and significant risk transfer if the definitions give tightly-defined high standards and the time requirements are short or ratchet up.

### ***Calibration methodology***

7.5.6. Nodal Agency should consider the following calibration issues:

- the level of deductions should be considered in the light of the importance of the Services to the Nodal Agency (i.e. large deductions for the unavailability of important parts of the Service). The incentives on the PPP Vendor are also important (i.e. large deductions for types of failure which could be expensive to remedy and therefore require a strong incentive);

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<sup>37</sup> In establishing a suitable system, the Nodal Agency should be aware of the effects a particular system has on the solution offered by a bidder. For example, a bid solution that is capital intensive up-front with reduced life-cycle costs may have one optimum approach and one with lower initial costs but higher life cycle costs another, because the financial structure of the PPP Vendor will be different. It is crucial for the Nodal Agency to understand what system will best achieve the result it seeks.

<sup>38</sup> This is not a complete list of every potential feature of a payment mechanism and other features may be appropriate to particular projects

- the Nodal Agency should determine what level of performance is required, and this should then serve as the benchmark at which 100% or close to 100% payment is achieved; and
- there are a range of approaches available to an Nodal Agency to improve its understanding of how a proposed system might work. These approaches range from consideration of a limited number of specific potential scenarios to the solution development of complex models. A calibration model can be used to suggest what levels of deduction might result from a given specification and payment mechanism, give an insight into the economic incentives they give rise to, and also help an Nodal Agency understand the level of contingency which a PPP Vendor might incorporate in its price.

7.5.7. **7.5.7** Where the Nodal Agency is seeking to simulate how the mechanism is likely to work, it might seek information from other successful projects, and also consider the use of historical data from existing services run by itself.

### ***Standards***

7.5.8. The payment mechanism should give clear economic incentives to the PPP Vendor to perform to the required standards. Availability and performance standards should be defined to meet the requirements of the Nodal Agency, but should also be set at a realistic and achievable level to avoid unnecessary risk pricing by the PPP Vendor and Sub-Contractors.

7.5.9. Given that a key element of the expression of the Nodal Agency's requirements in a PPP Contract is the output SLAs, significant parts of the output SLAs frequently feature in, or are linked to, the payment mechanism. The Contract will be easier to manage, and to change in the event of Contract variations, if these relationships are clearly laid out, and the role of any output specification requirements which do not feature in the payment mechanism should be challenged (or they should be brought into the payment mechanism). The use of specification requirements in the payment mechanism must be clear. Units should be provided where appropriate – for example, a requirement for maintenance to be performed, together with a deduction of INR [ ] for a security breach, requires a clear linkage in terms of how many poorly maintained security, over what period, attract a single deduction of INR [ ].

### ***Time periods for repair/rectification***

7.5.10. Time periods for repair and/or rectification are not applicable to all types of failure (for example, they do not apply to staff being recruited without required qualifications). Where a period is applicable, such as for the bug resolution, the Nodal Agency should ensure that repair periods are challenging but realistic, without entailing costs to a level which does not represent value for money. An Nodal Agency might consider what resources may be available on-site and thus at short notice, and what types of problems might most cost-effectively require outside resources and thus perhaps warrant longer periods for repair. For significant problems, "rectification plans", to be agreed on a case by case basis and to include agreed rectification periods, may be used.

7.5.11. For some failures a concept of “temporary repair” can be appropriate, and some payment mechanisms make a distinction between a response period, being the time within which a temporary solution should be found (would depend on the service), and a rectification period, being the time within which the problem should be properly remedied. Immediately at the start of operations, an Nodal Agency may allow slightly longer periods for stabilization the regime.

#### ***“Unavailable but used”***

7.5.12. The use of a definition of “unavailable but used” (see Section 8.8), dealing with the situation where the Nodal Agency wishes to continue using a facility which is technically “unavailable”, can be appropriate. In some projects it may be common for elements of the scope of work to be unavailable but used so this can be a significant part of the regime.

#### ***Weightings***

7.5.13. In many payment mechanisms the maximum notional deduction for unavailability exceeds 100% of the Unitary Charge. The maximum financial deduction is however capped at 100% of the Nodal Agency’s payment (e.g. the total Unitary Charge for a given month), so the PPP Vendor may receive zero payment before the facility becomes entirely unavailable (or when it is entirely unavailable but only for part of the period e.g. month), but should not be obliged to make payments to the Nodal Agency when notional deductions are higher than the Unitary Charge payment<sup>39</sup>. High weightings clearly strengthen the incentive on the PPP Vendor to perform but also increase the risk on the PPP Vendor and may encourage higher pricing.

If the weighting is too heavy, negative incentives may arise. For example, if the PPP Vendor is receiving zero payment for only one-quarter of service provision there is little incentive to increase to one-half service provision if payment will remain zero at that level.

7.5.14. There is little point in using weightings so low that it is cheaper overall to the PPP Vendor to under-perform. Deductions in respect of poor performance of services need not significantly exceed the estimated cost of those services, so long as the many elements of performance are appropriately weighted. Nodal Agencies should consider the overall weighting in the light of the detail of the output specification, the other variables of the mechanism and the facility/facilities in question.

7.5.15. A benchmark for standard accommodation projects is that the overall weighting of unavailability deductions should be in the range 150-200% (assuming a standard approach to the overall solution development of the payment mechanism). For projects such as Hardware intensive projects it is more difficult to generalise. Factors suggesting a lower level, even below 150%, include a project having a range of separate project outputs which are not interdependent<sup>40</sup>. Factors

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<sup>39</sup> Some payment mechanisms have allowed Authorities to “carry forward” any deductions greater than 100% to apply in the following period. This is unlikely to be value for money and is not recommended. The scope for retrospective deductions (where the Nodal Agency later discovers a performance failure has existed undetected for a period) should be subject to a cap, as the PPP Vendor may not have been aware of the failure and therefore not have taken steps to remedy it.

<sup>40</sup> Thus a lack of inter-connectedness, from the perspective of the overall solution, suggests a lower impact on the Nodal Agency of a single element being unavailable. Note that this is not the only driver of weighting – the deductions must still suffice to incentivize the PPP Vendor. At the same time, if the



suggesting a higher level within that range, or above 200%, are complexity and interdependence of outputs, for example a large IT outsourcing project where a number of applications have interdependencies, each requires the other in order for the project to deliver the desired outcome.

7.5.16. The payment mechanism should not however be designed simply on the basis of broad economic assumptions such as these. These weighting recommendations are designed as a sense check for the regime. Performance regimes should be constructed initially from the bottom-up with weightings for the different output components designed to incentivize good performance. The aggregate figure should then be given a top-down sense check to ensure that the overall economics of the Project offer value for money.

7.5.17. Potential Contractors and Sub-Contractors will model the behaviour of the payment mechanism in order to examine the risks they will face, and base their pricing on the results (noting that for Sub-Contractors the deductions for unavailability may be regarded as of less day-to-day significance than deductions relating to the performance measurement system). Similarly, the riskiness of the Contract will affect the level of interest of the bidders. An onerous output specification and payment mechanism may lead to higher pricing or put off credible bidders. Some early regimes were over-rigorous and overcomplicated when they were constructed, and were not then fully enforced. An over-rigorous Contract combined with weak enforcement offers poor value for money. Nodal Agency should strive to produce fair regimes and diligently enforce them. Section 8.4 (Payment for Availability and Weighting of Critical Areas) provides further comment on this area of the calibration.

### ***Ratchet mechanisms***

7.5.18. Many payment mechanisms include “ratchets” whereby a long delay in fixing a problem, or its repeated recurrence, or its widespread occurrence in a number of areas across a project, leads to higher deductions. Ratchets help ensure that systematic problems are properly dealt with. See further Section 9.5 (Consequences of Poor Performance). The use of ratchets should be considered carefully: a low initial deduction together with a ratchet may simply encourage a reactive rather than pro-active approach to performance management, but on the other hand, without ratchets the incentives may not be effective (for example it may turn out that without a ratchet the deduction is not heavy enough to give an economic incentive to good performance). Ratchets are likely to be useful in most payment mechanisms<sup>41</sup>.

### ***Performance deduction caps***

7.5.19. In some sectors it is common for there to be a cap on the amount of deductions which can be made in respect of poor performance. The Sub-Contractor’s maximum exposure in any year may be limited to receiving zero payment from the PPP Vendor (i.e. they may lose all their income but

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elements are independent from the perspective of the service provider, there can be a “portfolio effect” meaning that a higher weighting might be tolerable by the PPP Vendor.

<sup>41</sup> The ratchet should be triggered by repeated performance failures even if they had different causes.

they do not reimburse the PPP Vendor for deductions which exceed their fee but are due to their failings as a Sub-Contractor). The risk of additional availability deductions then stays with the PPP Vendor. It is important for the Nodal Agency always to preserve the principle of no-service no-fee and in an availability-based payment mechanism there should be no payment if the facility is unavailable. The capping of deductions for poor performance of Services may be acceptable if the Nodal Agency considers that there is little further benefit from further performance deductions which cannot be either passed down or absorbed by the PPP Vendor on a value for money basis.

However, any cap should not be used simply to insulate bidders from risk. In any event, if a Sub-contractor is losing a significant portion of its fee for poor performance it is likely to be in default of its own Sub-Contract and the PPP Vendor has a clear motive to replace it before it puts the availability of the facilities and hence the full Unitary Charge at risk. Nodal Agency should ensure that the PPP Vendor is incentivized to manage Sub-Contractors effectively, and should not concede a cap on deductions without advice from their advisers. Any performance deduction cap must always be justified on value for money grounds.

## **7.6. Financial Risks of the PPP Vendor**

7.6.1. A payment mechanism should not ring-fence or guarantee the PPP Vendor's finance charges.

7.6.2. The PPP Vendors will test deductions against their financial model runs in order to assess their risk in the investment.

## **7.7. Flexibility**

7.7.1. Nodal Agencies should consider how far their payment mechanisms are able to accommodate change in requirements, whether in terms of additional capital works or changes to Services. This is partly a matter of payment mechanism design, but Nodal Agency should also consider including in the payment mechanism a process for annual review of weightings, rectification times, etc. Such a review may only provide for changes to be made where both parties agree, but the Contract can nevertheless set out a framework for discussions. Such a review might be appropriate at the end of any stabilizations period.

7.7.2. For those payment mechanisms where the payment varies with usage or volume (see Section 7.4 (Usage-based Systems)), the payment mechanism allows (subject to any minimum take-or-pay level or the limitations of design capacity) for the payment to be adjusted in response to changes in throughput. This typically means that as changes occur, the payment mechanism needs to be re-calibrated. The weighting of the original facilities as a proportion of the total post-variation Unitary Charge will need to be amended in order to preserve the incentive effect of the original calibration. Particularly where the changes are small to medium-value, the transaction costs of re-calibration can be quite high relative to the cost of the changes.

7.7.3. A relatively straightforward way of dealing with this issue is to design the payment mechanism in such a manner that it can automatically be extended to cover changes up to a limit, with only a periodic review (say once a year, perhaps part of the general annual review suggested above) required of the overall calibration.

7.7.4. Further flexibility can be gained if Nodal Agency agree with the PPP Vendor that below certain volume and value thresholds, change orders will be regarded as normal churn in the Project and will not have to go through detailed due diligence. Instead the PPP Vendor can simply certify, in quarterly/annual reports to all stakeholders, what changes have been put through the Contract with automatic extensions of the payment mechanism. Annual reviews can be carried out as above to check that the calibration is still in balance. This will save technical and legal due diligence fees as well as management time.

## 7.8. Other Remedies for Poor Performance

7.8.1. The payment mechanism provides a mechanism through which the Nodal Agency can calibrate the financial consequences of Service failures. The Nodal Agency should not seek compensation in damages in addition to levying its deductions for Service failures. Please note that this does not limit the Nodal Agency from pursuing other rights expressly given to it in the Contract (such as, for instance, termination rights, step-in rights or specific indemnity rights, or rights to require the replacement of a sub-Contractor if certain levels of poor performance are reached) and does not limit any claim for specific performance or injunctive relief.

### **ILLUSTRATIVE DRAFTING**

#### **Payment Mechanism: No double remedy**

(a) Subject to:

- (i) any other express right of the Nodal Agency pursuant to this Contract, and
- (ii) the Nodal Agency's right to claim, on or after termination of this Contract, the amount of its reasonable costs, losses, damages and expenses suffered or incurred by it as a result of rectifying or mitigating the effects of any breach of this Contract by the PPP Vendor, save to the extent that the same has already been recovered by the Nodal Agency pursuant to this Contract or has been taken into account to calculate any compensation payable by the Nodal Agency pursuant to Clauses 21.3.2 (Compensation on Termination for Force Majeure), 21.2 (Compensation on Termination for PPP Vendor Default), 21.1.3 (Compensation on Termination for Nodal Agency Default), 21.4.4 (Compensation Termination for Corrupt Gifts and Fraud), 21.5.2 (Compensation on Voluntary Termination), the sole remedy of the Nodal Agency in respect of a failure to provide the Services in accordance with this Contract shall be the operation of Schedule [ ] (Payment Mechanism).

(b) Nothing in this Clause 7.8 (Payment Mechanism: No Double Remedy) shall prevent or restrict the right of the Nodal Agency to seek injunctive relief or a decree of specific performance or other discretionary remedies of the court.

7.8.2. PPP Vendor Default is discussed in Section 19.2 (Termination on PPP Vendor Default). The Nodal Agency must ensure that adequate termination rights exist, for example, in terms of the levels of unavailability or Service failure which constitute a termination event, or in terms of alternative definitions where the payment mechanism is not availability-based.

7.8.3. The calibration of payment mechanisms is discussed in Section 7.5. The thresholds for PPP Vendor Default and potential precursors thereto should be determined as part of the overall calibration process. Such precursors typically include:

- warning notices to the PPP Vendor;
- increased monitoring of performance, normally at the PPP Vendor's expense;
- a requirement for the PPP Vendor to produce a remedial plan;
- replacement of the sub-PPP Vendor; and
- PPP Vendor Default (noting that termination remains at the Nodal Agency's discretion).

7.8.4. There is no need to use all of these steps or to be limited to them. Nodal Agency should choose a route to potential termination which will provide a meaningful framework for discussions about how to address the poor performance. These steps can be linked to a given level of payment deduction, for example, a deduction greater than x% of the Unitary Charge in some/each of y successive months or a series of short and longer-term thresholds, or to a system of "termination points" which might be linked to the other elements of the payment mechanism or might run in parallel.<sup>42</sup>

7.8.5. Nodal Agency should primarily consider what constitutes an unacceptable level of performance to themselves when setting the PPP Vendor Default threshold and related thresholds. As a secondary matter, they may also consider the impact which the threshold level of deductions has on the financial position of the PPP Vendor (and even where thresholds are not expressed in simple financial terms it should be possible to consider the relationship between the levels of performance leading to PPP Vendor Default and the level of deductions likely to accompany that performance)<sup>43</sup>.

7.8.6. A different approach might be required for non-availability-based payment mechanisms; a low level of usage and hence of payment does not necessarily mean that the PPP Vendor is failing, although it may do.

7.8.7. Sub-Contracts will typically have termination arrangements which are linked to the wider arrangements for PPP Vendor Default (see Sections 9.3 (Replacement of Sub-Contractors) and 9.4

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<sup>42</sup> So, for example, deductions in a single month of greater than 25% or deductions in each of three successive months of greater than 20% each could earn the PPP Vendor a 'termination point' the accumulation of which leads to PPP Vendor Default. In terms of actual drafting, projects can involve a range of different triggers, and some projects have different thresholds for deductions relating to unavailability and deductions relating to poor performance of services.

<sup>43</sup> If a PPP Vendor is suffering deductions which are sufficient to entirely erode profit margins and allowances for contingency throughout the supply chain, including the risk premium element of the investment return, its position may prove unsustainable. The level at which all contingency and profit margin is eroded might be in the region of a 15-20% deduction from the Unitary Charge over a period of several months, however this can vary in accordance with the overall structure of the payment mechanism.

(Monitoring of Sub-Contractors). When calibrating its remedies, the Nodal Agency should also bear in mind that the PPP Vendor will similarly be calibrating their own remedies. The Nodal Agency should understand how these relate to the Nodal Agency's position and ensure that the overall structure appropriately incentivizes the bidders to exercise their remedies in advance of the Nodal Agency exercising its remedies.

## 7.9. Qualitative Factors and User Satisfaction

7.9.1. The specification even of relatively straightforward requirements such as those relating to capacity utilization can be difficult and subject to dispute after Contract signature; the appropriate level of contractual detail reflects considerations of practicability and clarity, and Nodal Agency should consider these issues carefully for all elements of the payment mechanism. Objective and well-defined performance criteria should always be used as far as practicable, but other methods of measuring performance may be considered and may offer complementary requirements within the overall mechanism.

7.9.2. In some projects there may be qualitative aspects of performance which it may be difficult to measure objectively but which are nevertheless important to the users of the Service, such as the helpfulness of Citizen Contact Centre. More generally, the quality of service in a complex setting such as front window cannot easily be wholly reduced to a practical set of availability and performance criteria.

7.9.3. The most straightforward mechanism to measure this is a regular customer satisfaction survey with deductions for a low or falling score. It is commonly argued that it is difficult to base financial compensation on customer satisfaction surveys because they are based on individuals' perceptions rather than hard measurable facts and so the results may be variable; moreover they may be vulnerable to manipulation. However, surveys are a useful way of monitoring performance, and have been used successfully in a number of outsourcing projects albeit that the maximum deduction is generally a relatively small element of the overall Unitary Charge. Based on the surveys, the requirements for the PPP Vendor to carry out a performance audit and prepare a remedial plan in the event of low user satisfaction. The main advantage of such a system is that the feedback obtained can be very useful as an incentive to good Service provision.

7.9.4. In this context, the focus should be to secure continuous improvement in the way they exercise their statutory functions. This would commonly involve the making of periodic user satisfaction surveys to compare the quality of service under the Contract against the quality of comparable services elsewhere.

7.9.5. A variety of mechanisms have been used successfully in the past to reflect the importance of qualitative factors in the payment mechanism. All projects should as a minimum include the following points:

- provision for regular user satisfaction surveys (at least annual albeit that they may be conducted on a rolling basis), to be paid for by the PPP Vendor. These would usually be carried out by the PPP Vendor, or an independent third party (under contract to the PPP

Vendor)<sup>44</sup>. In the former case, the Nodal Agency should have the option to commission its own survey from an independent third party in the event of its dissatisfaction with the PPP Vendor's own survey, such option to be exercised at the expense of the Nodal Agency and such survey to take precedence over the PPP Vendor's survey unless the Nodal Agency agrees otherwise. The intention is that even if the results of the survey have no direct financial impact, this information is useful management information for both the Nodal Agency and PPP Vendor. Failure to carry out the survey should itself trigger a penalty under the payment mechanism

- a requirement for production of a remediation plan, by the PPP Vendor at their expense, in the event of low satisfaction. This plan should set out the PPP Vendor's view of why satisfaction is measured as low in the survey, their planned actions to improve it insofar as it (in their view) relates to their performance, and their proposals for assessing the effectiveness of these actions (for example, inclusion of related questions in the next survey). "Low" satisfaction should be defined in the Contract where possible, but it is acceptable to set it for an initial period and provide for review after, say, five years of operations. The production of a plan clearly requires some management time and therefore it is a form of indirect financial cost for the PPP Vendor, but it is intended primarily as a device to ensure that issues with user satisfaction are taken seriously by the PPP Vendor; and
- the findings of user satisfaction surveys should be regarded as legitimate evidence, insofar as they relate to the relevant service provider, in the evaluation of incumbent Service providers for market testing of soft facilities management services.

7.9.6. As regards sanctions for poor user satisfaction, Nodal Agency should consider the following potential approaches:

- immediate direct financial deduction (for example, a set amount per percentage point short of a pre-agreed base-line, which might remain constant or be adjusted to reflect obligations for continuous improvement). The design of such deductions should be subject to value for money evaluation and are likely to be fairly modest;
- the award of performance points, to be treated in a similar way to points for other types of performance failure where such a system is used;
- the remediation plan discussed above could be connected to deductions should its adoption have no effect on user satisfaction;
- low satisfaction could require the PPP Vendor to carry out a performance audit (at the PPP Vendor's expense) in relation to the mechanism more widely. In effect, this represents using poor satisfaction ratings as a tool to ensure rigorous application of the "standard" elements of the payment mechanism, and it is an indirect approach to giving financial effect to poor user satisfaction; and/or
- linking deductions to complaints or to calls to a help-desk.

7.9.7. Nodal Agency should consider whether to deduct from the Unitary Charge for poor satisfaction or reward for out-performance, or both. Payments linked to user satisfaction might be

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<sup>44</sup> These options both assume that the respondents will be the actual users. Another suggestion is to use "mystery shoppers". A mystery shopper is a qualified independent individual used to test aspects of the Service; this reduces subjectivity as they will apply the same standards throughout.

an area where reward for out-performance does have merit (see Section 7.2.6) in which case the incentive could work both ways.

7.9.8. As with other elements of the payment mechanism, Nodal Agency should agree the detail of the measurement process and the financial implications before the appointment of the winning bidder (for example, they should agree the design and content of any questionnaire, required scores, sample size/identification process, and the details of who is going to carry out the survey, how and when).

7.9.9. The best approach to choice of user groups for satisfaction surveys will depend on the particular project. There are a range of different “users” in most projects, from the Secretary of the department, to Section officers, to Field Officers to operational staff (e.g. data entry operators) and wider stakeholders (e.g. citizens). Either party may be more comfortable with surveying some groups than others, depending on their relationships with the parties involved.

7.9.10. It may in some cases be value for money to measure outcomes from the Service as a whole, which reflect the performance of public-sector staff and PPP Vendor staff together, e.g. applications for health or educational assistance . This moves away from a focus on the PPP Vendor’s activities but is more objective, albeit that it may be more appropriate for payments for out-performance than deductions.

7.9.11. Nodal Agency can calibrate user satisfaction requirements against pre-PPP performance where possible, or results from similar projects (e.g. those run by the same project sponsors or Nodal Agency).

## 8. AVAILABILITY REQUIREMENTS

### 8.1. Introduction

8.1.1. The substance of a PPP deal should be the procurement of a Service. The payment mechanism is therefore often structured around the availability or unavailability of the Service, with unavailability resulting in a reduced payment by the Nodal Agency or, in certain circumstances, no payment. This Section applies to projects where the payment mechanism or an element thereof has been structured in this way. This Section should be read in conjunction with Section 7 (Price and Payment Mechanism).

8.1.2. Among the most obvious examples of projects in which payment depends on availability are those that involve the internet based Service (such as a online payments, online applications, online status updates etc.).

### 8.2. Definition of Availability

8.2.1. Contracts with availability-based payments must define what is meant by “available” (or, alternatively, what is meant by “unavailable”). The definition will typically specify certain conditions which must be met if the Service is to be treated as available. As payment depends on the definition being met, the PPP Vendor is very concerned that the definition is objective, measurable, reasonable and does not contain criteria which are unachievable or immaterial in the context of the Service as a whole.

8.2.2. The definition of availability should therefore concentrate on the core functions of the Service and consist of objective, measurable criteria, so that it is clear to both parties whether or not those criteria have been satisfied. For example, an “application uptime” is a core requirements for any e-Governance project and for the Nodal Agency to carry out its functions. For such projects, the existence of a “application uptime” to be an acceptable minimum standard may be appropriate to include in the definition of availability. Provided minimum standards are met, failure in performance in such circumstances would not, however, make the whole Service unavailable.

8.2.3. In general terms, unavailability should be measured in as simple a way as possible. Accordingly, complex definitions that require excessive monitoring costs should be avoided, although definitions may have to be very specific. The precise measure will depend on the nature of the individual project, the particular times when the Service should be provided and the rectification periods allowed (see Section 8.7 (Rectification of Unavailability)). Possible examples of periods triggering unavailability include:

- for critical services, less than one hour;
- the remainder of a 12 or 24 hour period, i.e. measured in days or half days; or
- the remainder of normal working hours (say 8am to 6pm). Unavailability outside normal working hours will usually not affect payment (unless for a specific function).



### **8.3. Examples of Unavailability**

8.3.1. Unavailability will occur if the relevant key objective criteria determining availability are not satisfied. These, for example, may include:

- network downtime
- application downtime
- Front window downtime
- Helpdesk downtime
- failure to comply with any other specified factors (i.e. those which are likely to jeopardise continuing operations).

### **8.4. Payment for availability and Weighting of Critical Areas**

8.4.1. Payment for availability of the Service will vary according to each project and the scope defined for the project.

8.4.2. Where the Service is divided into areas, the financial consequences of unavailability of an area should depend on its level of criticality, as some areas will be critical to the provision of the Service whilst others will be less so.

8.4.3. The Contract must therefore specify which areas are most important (i.e. core to the Service) and allocate them a higher weighting (i.e. make a greater deduction from the Unitary Charge if they are unavailable). For example, for e-Governance project in Commercial Taxes, the critical availability are Application uptime, website uptime, helpdesk uptime, network uptime, data entry and front window uptime : the most important area includes Application uptime (for usage by Public Sector staff) and website uptime (for tax payers); the area of medium importance includes network uptime and helpdesk, and the least important areas may be front window & data entry services.

8.4.4. The effect of weighting can also be achieved through or in conjunction with other means, for example, by allowing shorter rectification periods for key areas before the PPP Vendor suffers deductions.

8.4.5. The calibration of the payment mechanism and weightings of deductions is discussed further in Section 7.5.

### **8.5. When does availability commence?**

8.5.1. The Contract must specify what happens if the PPP Vendor is able to provide the Service earlier than the Planned Service Commencement Date. The Nodal Agency should not be obliged to make any payment of the Unitary Charge before the Planned Service Commencement Date unless it has agreed in the Contract to accept earlier Service Commencement (see Section 4.6 (Bonus Payments for Early Service Commencement)). If early commencement is practical and agreed, then

the Contract should also provide for adequate notice to be given to the Nodal Agency of a possible early Service Commencement Date so that the Nodal Agency can make all necessary preparations for earlier Service Commencement.

## 8.6. When does unavailability commence?

8.6.1. The Contract must specify precisely when unavailability starts so that any permitted rectification period can be measured by both parties. Both parties should therefore be notified as soon as practicable when unavailability is discovered. Possible triggers which should be considered are:

- when the PPP Vendor (e.g. the “Help Desk” provided by the PPP Vendor) receives a notice of unavailability from the Nodal Agency. This may take the form of a simple telephone call, an e-mail that is activated when opened by the Help Desk<sup>45</sup> or a paper based pro-forma sent to the Help Desk. The key issue is that there must be formal recognition and recording of receipt of the notice so that the time taken for rectification can be measured; and
- when monitoring indicates that the availability criteria are not being met. The PPP Vendor will need to verify the reported unavailability if it has not carried out the relevant monitoring.

8.6.2. If the Nodal Agency detects the unavailability but is unable to notify the PPP Vendor because, for example, there is a failure in access to the Help Desk<sup>46</sup> then unavailability commences from the time when the failure is detected. If, however, the Nodal Agency fails to notify until later because of other duties, then unavailability and any applicable rectification period should not commence until the PPP Vendor has been notified.

## 8.7. Rectification of Unavailability

8.7.1. The Contract should usually provide for a rectification period within which the PPP Vendor has the opportunity to rectify the problem without triggering the start of a period of unavailability. How long the rectification period should be (e.g. one hour or twelve hours) will depend on the criticality of the area or function and the nature of the Project<sup>47</sup>. In the event that the PPP Vendor is able to rectify / supply the Service by other means (e.g. delayed data entry) and where the Contract recognises this option, availability payments should continue in full (although deductions to reflect standards of performance of the Service may be made and the effects of any disruption should be dealt with).

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<sup>45</sup> To the extent such an e-mail is not opened within a certain time frame this will be dealt with through performance points and/or deductions

<sup>46</sup> Failure to provide a Help Desk Facility may give rise to deductions being made and performance points being awarded under the performance regime.

<sup>47</sup> The Nodal Agency should consider carefully any requirement for rectification periods, taking into account tolerances already built into the Service levels and considering separately those events which lead to immediate unavailability and those which do not, but which provide an opportunity for rectification prior to failing to meet the availability criteria. When assessing whether or not to grant rectification periods to the PPP Vendor, the Nodal Agency should ensure that the PPP Vendor will continue to be incentivised to carry out maintenance during the planned maintenance periods and not as and when the Service becomes unavailable.

8.7.2. If the PPP Vendor rectifies the failure(s) within the relevant rectification period, the Service should be deemed to have been available throughout that period (i.e. from the commencement of unavailability determined in accordance with Section 8.6) and no availability deductions should be made.

8.7.3. If the PPP Vendor fails to rectify the failure(s) within the relevant rectification period, the Service should be deemed to have been unavailable throughout that period and availability deductions should be made. Any performance points accrued during that period in respect of the relevant failure should be discounted to the extent the availability deduction represents the full agreed financial consequence of that failure to avoid double counting for the same failure.

8.7.4. As well as any rectification period(s), the payment mechanism will need to make clear what deduction an instance of unavailability for a given length of time will give rise to. Longer periods of unavailability may give rise to higher deductions than shorter ones.

## **8.8. Service Unavailable but used**

8.8.1. The Contract should specify what happens if the Nodal Agency continues to use the Service despite the defects which would otherwise render that part of the Service unavailable (for e.g. poor response time of the application). If part or all of the Service is unavailable but used then this may lead to either only a proportion of the availability fee being paid, based on what part of the Service is available, or appropriate deductions or performance points accruing in respect of the relevant failure. In either case, the PPP Vendor should not receive a full Unitary Charge (with no availability or performance deductions) as it has not provided the Service at the required standard. The deduction should reflect the degradation in Service. However the Nodal agency & PPP vendor should ensure that there are measurement systems in place which can measure and report such sub-standard quality of services. In case this cannot be measured, it is better to look out for some alternate mechanism of measurement or measure some other service parameter which covers this quality of service.

8.8.2. However, the Nodal Agency must ensure that where it is able to use any alternative service (e.g. provided by the PPP Vendor or a third party), this is reflected in the deductions made. In addition, the PPP Vendor should not be penalized if the Nodal Agency obstructs the PPP Vendor from remedying the defect. Both the PPP Vendor and the Nodal Agency should agree reasonable access times for remedial work to occur.

8.8.3. Unavailability should be excused if it is caused by Nodal Agency step-in and the PPP Vendor is not itself in default (see Section 26 (Nodal Agency Step-In)). The effects of a Compensation Event on availability are set out in Section 5.2 (Compensation Events).

8.8.4. As availability is a factor in determining payment, the dispute resolution procedure should contain a mechanism to ensure a quick solution to any disagreements (see Section 25 (Dispute Resolution)).

## **8.9. Restoration of Availability**

8.9.1. The Contract must include a mechanism for assessing when availability has been restored. This can be done by technology (for e.g. Enterprise management Systems). Alternatively, the monitoring personnel on the Nodal Agency's project management team may simply submit a pro-forma confirmation to the Help Desk. There should be an agreed procedure for both parties to be notified, particularly so that the Nodal Agency can where necessary confirm such availability.

## **8.10. Planned Maintenance**

8.10.1. Maintenance is required in order to allow the PPP Vendor to keep any facility at the appropriate standard in order to meet the output specification throughout the life of the Contract (see Section 11 (Maintenance)). The programme for planned preventative maintenance should be agreed in advance in the Contract between the parties so that the extent to which units or areas will be affected by the PPP Vendor undertaking such maintenance is clear.

8.10.2. There should be no deduction for unavailability or performance deductions during periods when agreed preventative maintenance is taking place as planned. The PPP Vendor will have to balance whether maintenance occurring at times other than those agreed will result in an improvement or worsening in its financial position (e.g. by postponing or accelerating maintenance).

8.10.3. Arrangements and contractual requirements in relation to planned preventative maintenance must be considered by the Nodal Agency and its advisers, including arrangements around the timing of work. What is reasonable will depend on the nature of the activities undertaken by the PPP Vendor. For example, the maintenance of an application can be planned around weekends or holiday periods.

## 9. PERFORMANCE REQUIREMENTS

### 9.1. Introduction

9.1.1. The level of Unitary Charge paid can be conditional upon the quality of the performance of services (see Section 7 (Price and Payment Mechanism)). Performance regimes normally work in conjunction with availability regimes (see Section 8 (Availability Requirements)).

- 9.1.2. Where this approach is used within the payment mechanism the Contract should set out:
- the level of performance required;
  - the means by which the Nodal Agency is able to monitor the PPP Vendor's performance against such required level; and
  - the consequences for the PPP Vendor of a failure to meet the required level.

### 9.2. Setting the Performance Level

9.2.1. In order to encourage innovation and optimise risk transfer, the Contract should specify the required performance level through output requirements (i.e. the Service standard required), rather than through prescriptive inputs (i.e. how the Service will be delivered). In some cases there may be no appropriate comparators or benchmarks available. In such circumstances a suitable performance regime (baseline) will need to be carefully worked out by the Nodal Agency and the bidders during the competitive stages of the procurement (or during the stabilization phase of the project). The performance regime will form a key element of the risk-transfer mechanism. The Nodal Agency should pay due attention to the principles set out in Section 7.5 (Calibration).

9.2.2. In setting the performance level, the Nodal Agency should focus primarily on the level of Service it requires and not, for example, on what it is familiar with. If, however, the Nodal Agency or a third party is already providing the same type of Service or part of the Service, this may provide a benchmark against which the Nodal Agency may compare the quality and price of the PPP Vendor's bid.

9.2.3. Benchmarking against a comparator group of other providers of the same or similar Services may be useful where the Service to be delivered has not been measured before in the manner required by the performance monitoring regime in the Contract. An untested performance measurement system may by itself result in performance deductions being too high or too low, so a mechanism for setting the level by comparing similar services should avoid this problem.

9.2.4. As with availability, PPP Vendor will be concerned that the performance level required is reasonable and objectively measurable. They will seek to establish that the Unitary Charge will not, save in circumstances which they have satisfied themselves are unlikely to occur, drop below a level that makes the project risky. In considering what a reasonable level is, the Nodal Agency should decide what the optimum 100% performance standard would be and whether it is achievable and essential (taking into account the nature of the Service), to set the required standard in the Contract

at this level. For example, in some cases such as railway ticket bookings, the optimum 100% standard will always be required and should always be achievable.

9.2.5. In other cases, however, the Nodal Agency may recognise that the optimum 100% standard is not, in practice, always essential (or necessarily always achievable). In such cases, the Nodal Agency may retain the optimum 100% level, but allow a certain leeway before the PPP Vendor suffers for performing below such 100% level. For example, it may be acceptable for the PPP Vendor to incur a certain number of performance points in any specified period before suffering financially where the Service provided is adequate without being excellent and the under-performance does not materially affect the operation in that area (see Section 9.5 (Consequences of Poor Performance)).

### 9.3. Replacement of Sub-Contractors

9.3.1. Some Contracts allow flexibility in the performance regime where a replacement of Sub-Contractor is allowed.

9.3.2. The PPP Vendor should bear the risk of poor performance of its Sub-Contractors. The Nodal Agency should not be disadvantaged by any change in Sub-Contractors so the performance regime should not be interrupted. The Nodal Agency should, however, recognise that it should allow the PPP Vendor the right to replace its Sub-Contractors in order to improve performance and avoid termination. To enable it to do so, the PPP Vendor will normally set a stricter termination threshold (or trigger termination earlier in point of time) in its Sub-Contracts than that which applies in the Contract.

9.3.3. However, where there are one or two Sub-Contractors, the PPP Vendor may find it impossible to find a replacement Sub-Contractor where the performance points accrued at Contract level are such that a further very minor default under the Sub-Contract could trigger termination of the Contract. In these circumstances, the Nodal Agency should consider whether it should:

- give relief from termination of the Contract on replacement of that Sub-Contractor for a limited period of time (e.g. two months) during which failures attributable to poor performance of the relevant Services provided by the replacement Sub-Contractor will not result in termination of the Contract. Financial deductions under the Contract should continue to be made for such failures to incentivize proper performance of that contract and to the extent that the performance regime includes any “ratchet” mechanisms for continued poor performance, these should not be relaxed; and/or
- cancel any performance points or warning notices, in so far as they count towards any termination threshold only, accrued by the PPP Vendor under the Contract in relation to the relevant Services provided by the replaced Sub-PPP Vendor on the appointment of the replacement Sub-PPP Vendor.

9.3.4. The PPP Vendor’s ability to benefit from the performance relief regime should be limited to twice in the life of the Contract.

9.3.5. As mentioned above, the Nodal Agency should not be disadvantaged by the replacement of any Sub-Contractor. Accordingly, the Nodal Agency should consider allowing itself the opportunity to approve the identify of any replacement Sub-Contractor if a request is made by the PPP Vendor for temporary relief under the performance regime following the replacement of a Sub-PPP Vendor.

9.3.6. For Projects where there are a number of Sub-Contractors the Nodal Agency should not give this relief as failures attributable to a single Sub-Contractor in these circumstances are less likely to cause accrued penalty points under the Contract to approach termination thresholds.

## **9.4. Monitoring of Sub-Contractors**

9.4.1. An Nodal Agency may feel it needs to use the Contract to allow it to intervene at Sub-Contractor level to protect its interest if a Sub-Contractor is underperforming (e.g. the Nodal Agency may want the right to direct or require the replacement of the Sub-Contractor). This approach should only be allowed as a final resort, since ordinarily it should be for the PPP Vendor to manage its Sub-Contractors and intervention by the Nodal Agency will affect the degree of risk transfer achieved (see Section 16 (Sub-Contracting, Employees and Documentary Changes)). The Nodal Agency should instead rely on the payment mechanism and its termination rights to address sub-standard performance.

9.4.2. Deductions under the payment mechanism and, ultimately, the risk of the Nodal Agency terminating the Contract for under-performance, should be a sufficient incentive on the PPP Vendor to manage its Sub-Contractors' performance. The PPP Vendor will typically ensure it has the right under the Project Documents to replace its Sub-Contractors before the Nodal Agency's right to terminate arises under the Contract. Concerns regarding Sub-Contractors' performance may be further addressed in the Contract by requiring a temporary increase of monitoring at the PPP Vendor's expense in specified circumstances as well as requiring the PPP Vendor to provide an acceptable plan outlining how any defects in the Service will be put right. Both of these measures impose costs on the PPP Vendor and are only acceptable if there has been a persistent and verifiable period of under-performance (see Section 7.8 (Other Remedies for Poor Performance) regarding termination arrangements and calibration).

## **9.5. Consequences of Poor Performance**

9.5.1. The Contract must set out clearly the consequences of any failure by the PPP Vendor to perform to the standard required by the output specification.

9.5.2. The simplest approach is to categorise the various types of performance shortcomings and use a simple grid of monetary deductions. An alternative two-stage approach is for the PPP Vendor to incur a specified number of performance points for each failure, with the number of points incurred varying according to the seriousness of the failure and for there to be then a mechanism for translating points to monetary deductions. The Contract would in this case include a schedule setting out in detail the level of points imposed for each failure to meet a specified performance output.

The Contract may be structured so deductions only start once a certain threshold level of points is exceeded.

9.5.3. There should be a clear link between the seriousness of the failure, the number of points accrued where applicable, and the financial impact on the PPP Vendor. Similarly, the same type of failure may also incur different deductions depending upon the nature of the area in which it arises.

9.5.4. If performance deteriorates below a particular level then a range of other non-financial mechanisms can be implemented to encourage the PPP Vendor to improve performance. These range from formal warnings to eventual termination for breach of the Contract (see Section 7.8 (Other Remedies for Poor Performance) and Section 19.2.2.1 (Events Leading to Termination)).

### ***Ratchet mechanisms***

9.5.5. It may be appropriate to have a ratchet mechanism to encourage the PPP Vendor to improve performance if it is consistently poor in relation to a particular part of the Service or a particular failure is not rectified. This can be particularly useful where the financial cost of performance points which accrue is insufficient to provide an appropriate incentive on the PPP Vendor to rectify the fault. Too complicated a regime can, however, be difficult to manage and including onerous measures in the pricing mechanism can lead to poor value for money. A key advantage of a ratchet mechanism is that poor performance that continues for a significant period of time will be more difficult to ignore, encouraging early action by the PPP Vendor. It is recommended that ratchets be used in most payment mechanisms.

9.5.6. A simple ratchet mechanism will work by increasing the number of penalty points awarded for a particular failure in the Service which recurs too often within a specified period. For example, if  $x$  points are awarded for a failure to achieve a particular output then  $(x+3)$  points may be awarded for each failure over and above a specified maximum number of failures within a predefined period<sup>48</sup>. It is of vital importance to tailor the ratchet mechanism to a particular project in a way that produces best value for money. Ratchets might also apply to failures which occur in a high proportion of areas within a large project, i.e. for repeated failures geographically rather than repeated failures over time.

9.5.7. There is an argument that performance points should not be capable of being “earned back” retrospectively by the PPP Vendor performing above the standard required: the required performance level should be set at what is considered reasonable and achievable, so if the PPP Vendor is capable of performing at a consistently higher level then either the level is too low (i.e. the payment mechanism has been poorly calibrated) or the PPP Vendor is simply performing very well and delivering a standard of service at a higher level than the Nodal Agency expected or required. However, for some projects it may be considered that the higher level of performance is of additional benefit to the Nodal Agency, in which case it may be appropriate for the PPP Vendor to receive additional consideration over and above the usual Unitary Charge and “earn back” the points. See also Section 7.2.6.

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<sup>48</sup> Alternatively, the number of points may increase for each failure over and above *de minimis* level.



9.5.8. The performance points regime should as far as possible cover every aspect of the Service. Where an all-encompassing performance regime is not feasible or does not sufficiently address persistent failures, the Nodal Agency should consider what recourse it has against the PPP Vendor for sub-standard performance which is not covered under the performance regime (see Section 19.2.3 (Termination for Persistent Breach by the PPP Vendor)).

## 10. PAYMENT MECHANISM MANAGEMENT AND MONITORING

### 10.1. Contract Management

10.1.1. Robust contract management arrangements must be in place in respect of all areas of the Contract and payment mechanism. In many contracts the performance measurement system will be the most complex element of the payment mechanism, and the detail in the following Sections relates most directly to that element.

10.1.2. The following issues must be considered:

- the requirement for the monitoring system to be set out in the Contract so that all parties are clear where their responsibilities lie (see Section 10.2 (Monitoring Against the Payment Mechanism));
- when monitoring/transition arrangements should start (see Section 10.3 (Commencement of Monitoring));
- what to do where Sub-Contractors have been replaced (see Section 9.3 (Replacement of Sub-Contractors));
- who performs the monitoring function (see Section 10.4 (Who does the Monitoring?)). In many cases it will be appropriate for the PPP Vendor to self-monitor, with Nodal Agency audit procedures and Nodal Agency rights to investigate complaints;
- who pays for monitoring against the payment mechanism (see Section 10.5 (Who pays for the Monitoring?)). The PPP Vendor should normally pay for monitoring, and the pre-bid discussions should make this clear;
- what information must be communicated, to whom, when and in what format (see Section 10.6 (Reporting the Results of Monitoring)). Lack of adherence to information requirements needed to enable the payment mechanism to be applied should itself be subject to incentives on the PPP Vendor;
- the relationship with other contracts or activities of the Nodal Agency, or dependencies of the Nodal Agency on the successful performance of the PPP Contract. This area is generally referred to as “interface risk”, but also includes the initial transition/handover of the Project; and
- the relationship between the requirements of the Contract and the Nodal Agency’s actual procedures in relation to such matters as invoicing and acceptance of completed works.

10.1.3. Nodal Agency should develop & document best practice, to help ensure that the desired performance level is achieved. These points include the following<sup>49</sup>:

- Nodal Agency should develop a “manual” or “user guide” to support effective monitoring. This manual should provide a plain English/<Local Language> explanation of the payment mechanism, together with references to the Contract as appropriate, to facilitate effective

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<sup>49</sup> The Nodal Agency should refer to the “Capacity Building Guidelines” issued by DIT, Gol

management by individuals who may not have been involved with the original negotiation. It may be helpful to include worked examples in this;

- the manual should provide references to relevant guidance and contact details;
- for complex payment mechanisms or complex elements of payment mechanisms, the manual should explain the desired incentive effects;
- successful Contract management has resource requirements for the Nodal Agency, which should be considered at the Project planning stage and during procurement. There must be adequate resourcing of suitably-qualified staff during the Project's operational phase. The individuals or groups who will be involved in Contract management should be brought into the procurement process prior to Financial Close;
- training should be provided on the payment mechanism to relevant staff, on both the Nodal Agency and private-sector side, and also involving users as appropriate. This is particularly important where the knowledge retained by relevant staff may be limited, for example, where the procurement has involved external advisers for project management or where the lead managers for the Nodal Agency have not been involved in the development of the Contract;
- Nodal Agency should consider holding a "dry run" of the payment mechanism and monitoring system prior to Financial Close, by testing scenarios to see how the payment mechanism and monitoring staff would deal with these. Similarly, Nodal Agency might also perform a "shadow" or "trial" run of the payment mechanism after Contract signature but prior to Service Commencement, in order to ensure its effective application once the Project is in operation and to ensure that the relevant staff have been trained adequately in its application;
- review mechanisms for the calibration of the payment mechanism can be appropriate (see Section 7.7.1 (Flexibility));
- the payment mechanism should not be constructed as a technical document drafted only by technical, financial and legal advisers. It must be user-friendly. An over complex mechanism risks being ignored in practice. Where it is necessary to have a complex structure, consideration should be given to what in practice might be the distinction between features applied on a day-to-day basis and those which are designed to ward off specific potential performance problems; and
- where the Contract will be managed for the Nodal Agency by an individual or group which is relatively remote from the actual Project, careful consideration should be given to initiatives to ensure that contract management arrangements are robust and that the Service is responsive to the requirements of users. Nodal Agency and Contractors should put in place training sessions to assist third parties in understanding their monitoring role and should issue user guides so that the processes and the communications between the Nodal Agency/PPP Vendor/third party are clearly set out.

## 10.2. Monitoring against the Payment Mechanism

10.2.1. There must be a mechanism under the Contract which enables the Nodal Agency to monitor the PPP Vendor's performance against the payment mechanism so that the payment mechanism can

operate effectively. The Nodal Agency should also be able to identify other performance problems so that any other remedies for poor performance can be pursued if necessary.

10.2.2. The monitoring requirement should be set out in the main bid documents<sup>50</sup> and a full methodology included in the bid. The methodology will normally include a substantial element of monitoring by the PPP Vendor, subject to periodic Nodal Agency audits. Additional Nodal Agency monitoring will also take place on an exceptional basis.

10.2.3. The reports relied upon for monitoring performance will be key to the management of the Contract and the payment mechanism, and should be specifically tailored to meet these requirements. Monitoring reports should be set out in detail in the Contract sufficient to minimize the scope for future disagreement.

10.2.4. Monitoring involves the collection and evaluation of data that should be objective, relevant, quantifiable and agreed with the PPP Vendor. There should be a clear connection between the data collected, unavailability and the financial penalties for poor performance.

### **10.3. Commencement of Monitoring**

10.3.1. Whilst availability should only be recognized from the time that the Service is actually available, further consideration may be appropriate as regards whether the Contract should specify the performance regime to apply in full from the Service Commencement Date. In some projects, it is recognized that issues are inevitable in the stabilization period, and the PPP Vendor can be afforded a degree of flexibility. In other projects, it is essential that the PPP Vendor ensures there are no settling in problems, and the Nodal Agency requires the full performance regime from day one, even if the implementation happens in phases.

10.3.2. One approach which gives flexibility in the stabilization period is to allow the PPP Vendor to accrue a higher number of performance points during that period before financial penalties are triggered than is allowed during the remainder of the Contract. Some Contracts (e.g. where the Service involves a relocation from existing facilities into new facilities) have alternatively made successful use of a regime where the Contractors are allowed a 3 to 6 month stabilization period. During this time, monitoring takes place, but any financial deductions imposed on the PPP Vendor for poor performance are set at a lower level than is the case once operations are fully established (but, in such cases, this does not affect the Nodal Agency's rights to terminate for PPP Vendor Default). A third approach is to award performance points at the normal Contractual rate so that the Nodal Agency only pays for the Services which it receives but to apply a more lenient mechanism in counting the points which trigger the right to terminate for PPP Vendor Default.

### **10.4. Who does the monitoring?**

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<sup>50</sup> Including an indication of who should bear the costs associated with performance monitoring (see Section 10.5 (Who pays for the Monitoring?)

10.4.1. A key issue is who will do the monitoring – the Nodal Agency, the PPP Vendor, a partnership between the two or a third party.

10.4.2. Monitoring should occur at three levels:

- a systematic monitoring by the PPP Vendor through a quality management system measuring availability and performance (see Section 3.5 (Quality Management Systems));
- a review of the quality management system of the PPP Vendor by the Nodal Agency with certain planned and random spot checks (with an ability to increase monitoring on repeated failure or poor performance) (see Section 9.5 (Consequences of Poor Performance)); and
- the ability for users to report failures (e.g. citizen complaints, number of calls to call centre ).

A failure to agree such a system can cause difficulties, particularly if disputes arise on the issue of whether a payment is due.

10.4.3. Monitoring requires the use of information that can only be gathered with co-operation from the PPP Vendor. Mechanisms must be in place to ensure the PPP Vendor provides data accurately<sup>51</sup>. The right approach depends on the particular Project but will always call for cooperation between the parties as benefits will accrue to the PPP Vendor as well as the Nodal Agency. Where a PPP Vendor is providing the information, the Nodal Agency should obtain a right of audit to verify the information.

10.4.4. The Nodal Agency must ensure that sufficient resources and people with the right level of experience are available to manage and monitor the Contract. Some projects arrange for joint training and development of Nodal Agency and PPP Vendor staff to encourage partnership.

## 10.5. Who pays for the monitoring?

10.5.1. Monitoring arrangements impose obligations on the PPP Vendor and may cause the PPP Vendor natural concern about any exposure to onerous obligations. It is therefore sensible for each party to bear its own costs of monitoring and this should reassure the PPP Vendor that the Nodal Agency will not act with too heavy a hand and avoid any possible conflict of interest. The Nodal Agency's cost of additional monitoring or audit required due to the poor performance of the PPP Vendor however should be paid for by the PPP Vendor.

10.5.2. The Nodal Agency should ensure that the monitoring arrangements are proportional to the consequences of Service failure. This will ensure that where it is possible to have a less onerous system it will be in all parties' interests to do so. Equally, where the consequences of failure are severe, for example, system uptime, then a rigorous monitoring system (preferably through automated systems) should be specified.

## 10.6. Reporting the results of Monitoring

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<sup>51</sup> Failure to provide data should give rise to deductions and/or the award of performance points under the performance regime

10.6.1. The Contract will need to specify the way in which information regarding shortfalls in availability or performance are reported. Wherever possible, monitoring should allow co-ordination of report production in a way that avoids duplication of effort and all parties should consider carefully what is needed. The key issues which have to be considered are:

- what reports are required by whom? How frequently? Are different reports required by different people in the organization, e.g. Department Secretary, contract manager, etc?
- what is the content of the various reports (it is not enough for the Contract simply to state that a “report” be produced)?
- is there to be a standard monitoring form or an electronic format to present results?
- how soon after a monitoring period is the report to be received?  
how often are meetings required between the Nodal Agency and the PPP Vendor? who is required to attend from the PPP Vendor?

## 11. MAINTENANCE

### 11.1. Introduction

11.1.1. The PPP Vendor will base its costings on a forecast capital expenditure to maintain the IT Assets at the specified output standards. The PPP Vendor will also consider the means of funding this expenditure throughout the life of the Project and refreshing the technology, as and when required to meet the requirements. The risk associated with assessing what will need replacing, when and how much this will cost, is one that the PPP Vendor should take and therefore the Nodal Agency should not attempt to be prescriptive in this respect.

11.1.2. The Nodal Agency will find it easier to achieve this risk transfer if it starts by expressing its service requirements as an output specification. Bidders should be allowed to develop their own proposals which may, for example, incorporate alternative programmes of maintenance where IT assets with a longer life are used or used differently. An Nodal Agency should not attempt to impose its own system of asset replacement on bidders.

11.1.3. The parties should, however, establish a planned preventative maintenance programme so that both parties know when parts of the Service are permitted to be “unavailable” without any payment deductions being made (see Section 8.10 (Planned Maintenance)). The Contract should also contain a mechanism by which either party can propose reasonable alterations to the planned programme (i.e. alterations which will not adversely affect the delivery of the Service).

### **ILLUSTRATIVE DRAFTING**

#### **Maintenance<sup>52</sup>**

The PPP Vendor shall ensure on a continuing basis that at all times its maintenance and operating procedures are sufficient to ensure that:

- (a) the Service is continuously available<sup>53</sup>;
- (b) it can maintain the design intention of the assets<sup>54</sup> to achieve their full working life;<sup>55</sup> and
- (c) [the Assets are handed back to the Nodal Agency on the Expiry Date in a condition complying with the requirements of this Clause.]<sup>56</sup>

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<sup>52</sup> It may also be appropriate to include a further provision within this Clause requiring the Contractor to keep the physical assets in good structural and decorative order (subject to fair wear and tear).

<sup>53</sup> This provision should cross refer to the relevant output specification

<sup>54</sup> These are the physical assets referred to in the definition of “Assets”. In certain Contracts this may not be required and in others, such as IT contracts, equivalent provision may be needed in relation to any maintenance of IPR

<sup>55</sup> This will often be for the life of the Contract. To the extent a significantly longer period is required then this should be made clear as soon as possible in the competitive process (and certainly not after the bid documentation has been issued). If relevant, reference could be made to the output specification

<sup>56</sup> Paragraph (c) will only apply to the extent that the Nodal Agency has at least an option to acquire the Assets and the PPP Vendor does not bear the residual value risk (see Section 20 (Treatment of Assets on Expiry of Service Period)).

## 11.2. Sinking Fund

11.2.1. The Unitary Charge will usually be made on a broadly level basis in accordance with the principles of value for money, whereas the need for capital replacement will only occur at intervals. The Unitary Charge will accordingly include amounts to cover the PPP Vendor's anticipated future expenditure on maintenance, and technology refresh costs.

11.2.2. The PPP Vendor will therefore usually build up a sinking fund over some years, in anticipation of significant capital expenditure in future periods. It will usually be required to do so where the maintenance & technology refresh risk is left with the PPP Vendor and not passed to Sub-Contractors. The sums involved could be considerable.

11.2.3. Maintenance should be left firmly at the PPP Vendor's risk and the Nodal Agency should not attempt to prescribe the quantum, location or availability of a sinking fund<sup>57</sup>. The Nodal Agency should not require rights over any sinking fund established by the PPP Vendor and should instead ensure that the maintenance requirement is adequately protected through payment and termination provisions<sup>58</sup>. The Nodal Agency will wish to ensure that the PPP Vendor is as equally incentivised to maintain the Assets in the later years of the Contract as it is to the early years. The Nodal Agency should have the ability to conduct a final survey towards the end of the Contract and withhold payment of the Unitary Charge if the Assets are not restored to the required maintenance standard.

11.2.4. To protect themselves in the event of Default, the PPP Vendor will have a charge over the sinking fund as security. The PPP Vendor should look to its own resources first to repay its investment, and so any compensation payable to the PPP Vendor by the Nodal Agency on a termination should be reduced by all cash held by the PPP Vendor, including amounts in sinking funds (see Section 20 (Calculation and Payment of Early Termination Payments)). The Nodal Agency should not need any additional rights over the sinking fund.

## 11.3. Expiry of the Contract

11.3.1. As the Expiry Date approaches, the Nodal Agency's interest in the maintenance of any Asset will become most acute where ownership and use of the physical assets will (or may) rest with the Nodal Agency from expiry. The PPP Vendor's proper management of the maintenance requirements of such physical assets will be facilitated by the Nodal Agency informing the PPP Vendor of its handover requirements as early as possible prior to the Expiry Date.

## 11.4. Transfer of Assets at end of Contract

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<sup>57</sup> The PPP Vendor may, however, be required to provide the Nodal Agency with details of the balance of the sinking fund in accordance with Clause 26.2 (PPP Vendor's Records and Provision of Information)

<sup>58</sup> If, however, the size of the Project (including associated maintenance obligations) is comparatively large in relation to the financial resources of a PPP Vendor, the Nodal Agency may want to consider requiring a sinking fund over which it has secured rights.



11.4.1. In projects where the assets are unlikely to revert to the Nodal Agency on termination, and the PPP Vendor is taking a risk on their residual value, then it is in the interests of the PPP Vendor properly to maintain any assets. Accordingly, the Nodal Agency may be less concerned to put in place protections in respect of asset condition on expiry of the Contract (unless it retains an option to purchase).

11.4.2. In contrast, if the assets are likely to revert to the Nodal Agency on termination at no cost or a fixed price, then the Nodal Agency will have to ensure that the price it is paying for the Service during the term of the Contract (and on which its value for money assessment has been made) includes coverage for appropriate maintenance obligations. Generally, the transfer or reversion to the Nodal Agency at the end of the Contract will be at zero cost. In these circumstances, the Contract should provide for sums to be retained in the final years (or alternatively bonding to be provided by the PPP Vendor) if handback surveys reveal that significant maintenance is likely to be required to ensure that the relevant assets meet the handover requirements at the end of the term of the Contract.

## 11.5. Technical Assessments

**11.5.1.** Particularly where the Nodal Agency will take back the Assets at the end of the Contract, maintenance obligations need to be monitored (other than through the performance monitoring system – see Section 10 (Payment Mechanism Management and Monitoring)) and a mechanism needs to be agreed whereby this can be done in as non-intrusive a manner as possible.

### **ILLUSTRATIVE DRAFTING**

#### **Technical Assessments**

(a) If the Nodal Agency reasonably believes that the PPP Vendor is in breach of its obligations under Clause 11.1 (Maintenance) then it may carry out (or procure) a Technical Assessment of the Assets to assess whether the Assets have been and are being maintained by the PPP Vendor in accordance with its obligations under Clause 11.1 (Maintenance). This right may not be exercised more often than once every [two] years.

(b) The Nodal Agency shall notify the PPP Vendor in writing a minimum of [14] days in advance of the date on which it wishes to carry out the Technical Assessment. The Nodal Agency shall consider in good faith any reasonable request by the PPP Vendor for the Technical Assessment to be carried out on a different date if such request is made at least [7] days prior to the notified date and the PPP Vendor (acting reasonably) is able to demonstrate that carrying out the Technical Assessment on the notified date would materially prejudice the PPP Vendor's ability to provide the Service.

(c) When carrying out any Technical Assessment, the Nodal Agency shall use reasonable endeavours to minimise any disruption caused to the provision of the Service by the PPP Vendor. The cost of the Technical Assessment shall, except where paragraph (d) below applies, be borne by the Nodal

Agency. The PPP Vendor shall give the Nodal Agency (free of charge) any reasonable assistance required by the Nodal Agency during the carrying out of any Technical Assessment.

(d) If the Technical Assessment shows that the PPP Vendor has not complied or is not complying with its obligations under Clause 11.1 (Maintenance), the Nodal Agency shall:

- (i) notify the PPP Vendor of the standard that the condition of the Assets should be in to comply with its obligations under Clause 11.1 (Maintenance);
- (ii) specify a reasonable period within which the PPP Vendor must carry out any necessary rectification and/or maintenance work; and
- (iii) be entitled to be reimbursed by the PPP Vendor for the cost of the Technical Assessment.

(e) The PPP Vendor shall carry out such rectification and/or maintenance work within the period specified and any costs it incurs in carrying out such rectification and/or maintenance work shall be at its own expense. immaterial failures.

## 12. PAYMENTS AND SET-OFF

### 12.1. Introduction

12.1.1. The Nodal Agency should ensure that the Contract contains an express right for the Nodal Agency to deduct liquidated amounts owed to it by the PPP Vendor under the Contract from any payments it is obliged to make to the PPP Vendor (whether during the Service Period or on termination). This applies to liquidated damages and all other debts or liabilities owed to the Nodal Agency (including amounts owed in respect of failure by the PPP Vendor to comply with its maintenance obligations at the end of the Contract).

12.1.2. The right to set-off being described here does not apply to deductions for non-availability or sub-standard performance of the Service (see Section 7 (Price and Payment Mechanism)) as these are contractual deductions which apply automatically if the relevant circumstances arise (e.g. if the availability or performance criteria are not met). Disputes relating to these are dealt with under Section 25 (Dispute Resolution).

### 12.2. Scope of Nodal Agency's Right to Set Off

12.2.1. One of the best practice in procurement has been for the Nodal Agency to have the right to set-off amounts owed to it by the PPP Vendor against amounts due to the PPP Vendor under any contract between the PPP Vendor and the Nodal Agency.

12.2.2. If the PPP Vendor does have other contracts with the Nodal Agency, the bidders would be highly unlikely to agree to a wide set-off clause which enabled amounts relating to other contracts (whether PPP or non-PPP contracts) to be set off against amounts due under the Contract. Generally, the bidders will only agree to the Nodal Agency having the right to set-off any ascertained amount owed to it by the PPP Vendor under the Contract and Project Documents (subject to any agreed restrictions) against amounts the Nodal Agency owes to the PPP Vendor under such documents. The Nodal Agency should not usually seek to extend such right as many of the value for money benefits of PPP projects come from isolating the rights and obligations of the Project from more general rights and obligations.

12.2.3. Over-payments, liquidated damages and amounts claimed under indemnities are the only liquidated claims that are likely to give rise to a set-off. Provided that any relevant criteria are fulfilled, as specified in the Contract (e.g. the Planned Service Commencement Date is missed due to the PPP Vendor's fault or the Nodal Agency suffers a loss due to a breach covered by an indemnity), then the applicable amounts should be calculated by the Nodal Agency and set-off against the next payment. The determination of any dispute as to whether such criteria were fulfilled or about the level of any indemnity amount set-off will also determine whether or not any amounts should be repaid. Interest should be paid on any amounts which it is determined should be repaid with effect from the due date.

12.2.4. To the extent an amount owed is disputed, the Nodal Agency should pay the undisputed amount, but be entitled to retain the disputed amount until the dispute is resolved (see Clause 25 (Dispute Resolution)).

### 12.3. Timing of Set-Off

12.3.1. During the Service Period, any amount to be set-off should generally be applied against the next payment of the Unitary Charge (or other payments) due after the amount owed by the PPP Vendor has fallen due and payable (unless the PPP Vendor has already paid the Nodal Agency the relevant amount).

#### **ILLUSTRATIVE DRAFTING:**

##### **Set-off**

- (a) The PPP Vendor shall not be entitled to retain or set off any amount due to the Nodal Agency by it, but the Nodal Agency may retain or set off any amount owed to it by the PPP Vendor under this Contract which has fallen due and payable<sup>59</sup> against any amount due to the PPP Vendor under this Contract<sup>60</sup>.
- (b) If the payment or deduction of any amount referred to in paragraph (a) above is disputed<sup>61</sup> then any undisputed element of that amount shall be paid and the disputed element shall be dealt with in accordance with Clause 25 (Dispute Resolution).

### 12.4. VAT on Payments

12.4.1. Standard required provisions for VAT on such payments may be as follows<sup>62</sup>.

#### **12.4 VAT**

- a) All amounts due under this Contract are exclusive of VAT.
- b) If any supply made or referred to in this Contract is or becomes chargeable to VAT then the person receiving the supply (the “Recipient”) shall in addition pay the person making the supply (the “Supplier”) the amount of that VAT against receipt by the Recipient from the Supplier of a proper VAT invoice in respect of that supply<sup>63</sup>.

12.4.2. If amounts due under the Contract are calculated by reference to costs incurred by any person and VAT has been incurred on the costs, then VAT should not be included in the calculation of those costs if the person concerned can reclaim the VAT.

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<sup>59</sup> This must be by definition an ascertained amount

<sup>60</sup> The right to set-off here is subject to the restriction in Clause 22.4 (Set-off on Termination)

<sup>61</sup> This would apply, for example, to performance or availability deductions

<sup>62</sup> For changes in law relating to VAT that qualify for compensation see Section 14.10.2 (Changes in VAT Scope).

<sup>63</sup> In relation to transactions that are “VATable” at the election of the Supplier (e.g. grants of land interests) then other considerations will be relevant. Typically, the Recipient should be entitled to agree the election before it is made

**ILLUSTRATIVE DRAFTING:**

Where under this Contract any amount is calculated by reference to any sum which has or may be incurred by any person, the amount shall include any VAT in respect of that amount only to the extent that such VAT is not recoverable as input tax by that person (or a member of the same VAT group), whether by set-off or repayment.

12.4.3. A provision as follows is also required for the above to work: The PPP Vendor shall provide the Nodal Agency with any information reasonably requested by the Nodal Agency in relation to the amount of VAT chargeable in accordance with the Contract and payable by the Nodal Agency to the PPP Vendor.

## 13. CHANGE IN SERVICE

### 13.1. Introduction

13.1.1. The Service requirements set out in the Contract should take into account the Nodal Agency's long-term (and not just its current) requirements, anticipating any changes in Service that can reasonably be foreseen. Accordingly, an appropriate amount of flexibility should be designed into the initial bid solution to cope with *anticipated* changes, and a well-developed change mechanism put in place in the Contract to cope with the residual *unanticipated* changes to the Service over the length of the Contract period.

13.1.2. Changes in Service can take various forms in PPP projects (see below), but may broadly be categorised into at least three distinct types as follows:

- Changes in use or functionality, for example:
  - conversion of VAT application into a GST application (as and when it comes under force)
  - integration of CCTNS application with UIDAI or NATGRID; and/or
  - adding a feature to send sms for status updates
- Changes in capacity or throughput, for example:
  - More electronic returns filed in a VAT application, than forecasted;
  - Capturing of scanned document along with the registration form
  - Increase in data archival period;
- Changes in service specifications or performance standards, for example;
  - changes in solution development standards;
  - enhancement in the SLAs;
  - introduction of new standards in solution development

13.1.3. Nodal Agency should consider carefully whether anticipated changes in its Service requirements are capable of being specified, designed and priced as part of the initial bid solution, ideally at a stage where there is some competitive pressure in the procurement. This will ensure that the desired flexibility is priced efficiently, and will enable the change to be processed and implemented effectively at the appropriate time, imposing minimum disruption on the Project.

13.1.4. In some projects, changes to requirements may be quite foreseeable (e.g. new type of citizen services would get added). In such circumstances, the Nodal Agency should consider the feasibility of requiring the PPP Vendor to commit to pricing pre-specified changes as part of the Contract. Similarly, it is feasible in some cases to include within the Contract a formulaic method of adjusting the Unitary Charge for increases or decreases in capacity. In the VAT Computerization project for instance, the unit rates for processing a return could be planned for any change in the capacity to handle returns. The justification being that beyond a certain limit the changes in the unitary charges may not be linear and may undergo a step change.

13.1.5. However, many changes, even if anticipated, may not be amenable to specification, design and pricing during the initial procurement – for instance, an Nodal Agency may anticipate a phased

expansion of capacity to accommodate expected increases in demand, but may not be in a position during the procurement to specify the scale of expansion required. In such circumstances, Nodal Agency should carefully assess if additional flexibility can be created within the Contract to deal appropriately with changes in Service that can be anticipated but not specified upfront with any degree of precision. The following elements of the Contract could be reviewed for greater long-term flexibility:

- well-developed change mechanisms;
- shorter Contract lengths;
- early termination rights (including the ability to terminate parts of a Contract and/or Nodal Agency Break Points); and
- phased project development through long-term partnering frameworks.

13.1.6. In general, greater flexibility in PPP Contracts will usually come at a higher price. Well designed Contracts therefore need to strike a balance between price, long-term flexibility and certainty of whole-life costs, and so consideration of all these issues should form an important part of procurement design and evaluation.

13.1.7. PPP Contracts in IT tend to be long-term contracts, commonly ranging around 10 years. Over such long periods, it is inevitable that changes will occur that cannot be anticipated at the start. Provided long-term requirements have been well thought through and adequate flexibility built into the design of the Contract (as discussed above), the frequency and impact of unanticipated changes should be limited and manageable.

13.1.8. All PPP Contracts can and should deal effectively with a limited volume of unanticipated change, and this is best achieved through well-developed change mechanisms written into the Contract. Good change mechanisms should seek to achieve at least the following four outcomes:

- **Clear** process, with clearly defined roles, responsibilities and timescales;
- **Quick** and **efficient** procedures (appropriate to the scale and complexity of the change required), with transaction time and cost kept to a minimum;
- **Transparent** pricing; and
- **Value for money**.

## 13.2. Typology of Changes

13.2.1. Changes in PPP Contracts can be classified in different ways, and it is recommended that Nodal Agency collect data on changes to projects to build up a pattern of changes that are occurring.

13.2.2. The typology below should help Nodal Agency in drafting change mechanisms that are best suited for the pattern and types of changes.

13.2.3. Changes in Service can be classified:

### By Origin

- Nodal Agency change

- PPP Vendor change
- Changes in law

#### **By Timing**

- Solution development
- Early operations
- Steady state operations

#### **By Value**

- Small
- Medium
- Large

#### **By Impact**

- Financial only
- Facility only
- Services only
- Facility and Services

#### **By Type**

- Change in use or functionality
- Change in capacity or throughput
- Change in service specifications or performance standards.

13.2.4. *Changes by origin:* As discussed above, the Nodal Agency may wish to make anticipated or unanticipated changes to its Service requirements. In many cases, such changes tend to be driven either by underlying changes in the Nodal Agency's initiative / policy or changes in legislation<sup>64</sup>. Similarly, the PPP Vendor may wish to propose changes to either the Service requirement itself (e.g. to improve efficiency), or to the way in which it delivers the Service. Although the output specification should generally be flexible enough to allow the PPP Vendor to make changes to its method of delivering the Service (e.g. by introducing new technology) without formally consulting the Nodal Agency, there may be circumstances where aspects of the method of delivery impact on the Service requirement and are therefore critically important to the Nodal Agency. In such circumstances, the Nodal Agency will wish to be formally consulted prior to the implementation of the changes. This can usually be done most efficiently by including in the Contract a suitable form of review procedure (providing a quicker, simpler way of dealing with these matters than a full-fledged change mechanism)<sup>65</sup>. Such review procedures deal typically, for instance, with design development and changes to solution development proposals, the solution development programme, Service Delivery proposals, programmed maintenance and third party use arrangements.

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<sup>64</sup> Changes in Law are discussed in Section 14

<sup>65</sup> In most PPP contracts, there is a clear and deliberate distinction made between the change mechanism (which is used to make changes to the Nodal Agency's Service requirements) and a review procedure through which the Nodal Agency is given the right to comment on (and in some cases – if it wishes – to raise objections to) the manner in which the PPP Vendor delivers the Nodal Agency's Service requirements. Apart from its limited rights under the review procedure, the Nodal Agency should not otherwise constrain the PPP Vendor's ability to make changes to its Service delivery methodology so long as the Service requirements are met



13.2.5. The rights of the parties will vary depending on the origin of the change. For instance, the Nodal Agency should generally have an unfettered right to request changes in the operational period, but a more restricted ability to do so during the solution development period. The PPP Vendor should generally be given only limited rights to object to or refuse to undertake the changes, such as if the change would imperil the economics of the Project or otherwise make it impossible for the PPP Vendor to meet its obligations under the Contract. In contrast, the PPP Vendor should generally be given the right to propose changes to the Service requirements but the Nodal Agency should have an absolute right to approve or reject such proposals. However, if the change is required to comply with a Qualifying Change in Law, then both parties will be obliged to agree and implement it.

13.2.6. *Changes by timing:* Changes during the solution development phase should, where possible, be kept to a minimum and unless a long period of time is scheduled to elapse before the Service Commencement Date (e.g. three years or more) the Nodal Agency should not ordinarily seek to change its solution development requirements prior to Service Commencement. In exceptional circumstances the PPP Vendor may be able to incorporate such a change during the solution development period (if it is requested early enough in the solution development programme) more cheaply than after the Service has commenced, and the Contract (in such exceptional circumstances) should then incorporate provisions to reflect this possibility. However, in general Nodal Agency should seek to ensure that no significant changes of scope occur during the solution development period, as this can seriously imperil the ability of the PPP Vendor to deliver the project to time and budget.

13.2.7. *Changes by value:* Some of the unanticipated changes in the solution provided in the PPP projects may be small. Small and medium value changes need to be specified, agreed and implemented relatively quickly and cost effectively to avoid users perceiving the Contract as “inflexible”, causing in turn a negative impact on user satisfaction.

13.2.8. In contrast, large-value changes typically reflect major changes in strategy or policy that could not have been anticipated when the Contract was signed. As such, they tend to occur less frequently and generally warrant the time and cost of proper due diligence (from the Nodal Agency, the PPP Vendor). The Nodal Agency should consider what rights the PPP Vendor should have to refuse to implement large-value changes (particularly if they impact on the risk profile of the Project), and how to secure transparent, value-for-money pricing from the PPP Vendor. Large value changes could give rise to procurement issues if they were not properly covered under the terms of the original Scope of work<sup>66</sup>.

13.2.9. The definition of small, medium or large-value changes should be relative to the size of the Project. For instance, a INR 1000 crores ESIC project may define “small” as less than INR 5,000, “medium” as INR. 5,000 to INR 100,000 and “large” as values higher than INR. 100,000; a INR 25 crore PPP project may well have different thresholds.

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<sup>66</sup> Nodal Agency should seek professional procurement advice when drafting their original Scope of work to ensure that, as far as possible, procurement issues do not obstruct the processing of changes

13.2.10. *Changes by impact:* A proposed change may involve solution development and/or changes to the facilities management “(FM)” services. It is generally easier to accommodate changes which are solely related to the FM service provision but do not involve additional solution development works. For the latter, a variety of commercial issues surface in relation to how the change should be implemented – for instance, the choice of the solution development company could be significant if there are interfaces between the new solution development and the existing solutions which will need to be managed by the PPP Vendor.

*Changes by type:* The commercial issues related to different types of change normally arise from their differential value or impact. For instance, changes in use or functionality typically tend not to be large-value, and may not even involve any change to Facility or Services. On the other hand, changes in capacity would almost certainly involve both new solution development and more Services, and would tend to be large in value. Changes in Service specifications or performance standards probably fall somewhere in between and can be much more variable – they may have a purely financial effect (e.g. a change in the risk sharing on energy efficiency), or they may involve both Facility and Services.

13.2.11. *Other Changes:* Occasionally other changes are needed to the arrangements between the parties, which are neither changes to the Services or to the Works or to the PPP Vendor’s proposals. These would not fit in to the review procedure or the change mechanisms, but would involve a change to the Contract, negotiated between the parties and effected through a Deed of Amendment. It is vital to the integrity of the arrangements between the parties that all such amendments, together with all other various change orders which might be implemented, are clearly recorded and that the Contract, as an ongoing document, remains complete, coherent and up to date.

### 13.3. Change Protocols

13.3.1. Nodal Agency must include in their Contract a well-developed Change Protocol that deals effectively and appropriately with the different kinds of changes discussed above. Such Change Protocols must be developed during the procurement process, and be agreed and incorporated into the Contract at Financial Close. At the same time, Nodal Agency must ensure (as part of the evaluation process prior to the selection of the winning bidder) that the PPP Vendor will be properly resourced to provide an appropriate change management service to the Nodal Agency that complies with the Change Protocol during the operational period, reflecting its responsibilities and obligations as a responsive partner.

13.3.2. Change Protocols should cover, at a minimum, the following elements of the change management process for all types of changes:

- Notification and Specification;
- PPP Vendor’s Estimate;
- Nodal Agency Approval;
- Change Implementation;
- Funding and Payment;

- Due Diligence; and
- Documentation and Monitoring.

At each stage, the Change Protocol should clearly define the roles and responsibilities of each party and the timescales within which they are expected to perform, whilst recognising the different requirements (in terms of process and timing) of different types of changes.

**13.3.3. Notification and Specification:** It is important that Nodal Agency inform the PPP Vendor early on of their intention to request changes (and vice versa). The Change Protocol should set out a clear format and timing for early notification, following which the parties should collaborate in good faith to develop an appropriately detailed specification for the change request. The specification should wherever possible be a restatement of the original output specification, and where not, an alternative output specification. However, it may be that (particularly with small to medium-value changes) an input specification may be more appropriate where the Facility or Services required are very specific. Nodal Agency should agree with the PPP Vendor a catalogue of pre-specified small Works and Services that can simply be ordered (at pre-priced rates). The rates in this catalogue can then be reviewed and refreshed each year of the Contract by indexing them to an appropriate inflation index like the CPI or WPI. The final specification should be signed off by the Nodal Agency and submitted to the PPP Vendor as a formal Change Request (unless it relates to a PPP Vendor change), together with any other information the PPP Vendor may reasonably require in order to develop a design solution and estimate for the change.

**13.3.4. PPP Vendor's Estimate:** Following the receipt of the Change Request from the Nodal Agency, the PPP Vendor should generally be given a reasonable period of time (depending on the scale and complexity of the change requested) to notify the Nodal Agency if it wishes to refuse to implement the change<sup>67</sup>. It would be reasonable for the PPP Vendor to have the right to refuse on the following grounds.

- if it requires the Service to be performed in a way that infringes any law or is inconsistent with good industry practice;
- if it would cause any consent to be revoked (or a new consent required to implement the relevant change in Service to be unobtainable);
- if it would materially and adversely affect the PPP Vendor's ability to deliver the Service;
- if it would materially and adversely affect the health and safety of any person;
- if it would require the PPP Vendor to implement the change in Service in an unreasonable period of time;
- if it would (if implemented) materially and adversely change the nature of the Project (including its risk profile); and/or
- the Nodal Agency does not have the legal power or capacity to require the implementation of such a Change.

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<sup>67</sup> Although the expectation must be that any issues the PPP Vendor has with respect to the change are resolved in the collaborative process of developing the specification. Furthermore, small value changes should not generally have any material impact on the Project and so it should be the presumption that the PPP Vendor will have no objection to carrying them out.

If the PPP Vendor agrees to proceed with the change (or, in the case of a PPP Vendor change, once the final specification is agreed), the Change Protocol should set out the timescales by when the PPP Vendor will respond with a design solution (if required) and an estimate of the costs of the change, together with any other information the Nodal Agency reasonably requires to approve the change (“the PPP Vendor’s Estimate”). The PPP Vendor’s Estimate should generally include the opinion of the PPP Vendor on (as appropriate)<sup>68</sup>.

- a detailed timetable for implementation;
- whether relief from compliance with obligations is required, including the obligations of the PPP Vendor to achieve the Planned Service Commencement Date and meet the performance regime during the implementation of the change in Service;
- any impact on the provision of the Service;
- any amendment required to the Contract and/or any Project Document;
- any Estimated Change in Project Costs, taking into account any Capital Expenditure that is required or no longer required;
- any gain or loss of revenue;
- any regulatory approvals which are required; and
- the proposed method of certification of any solution development or operational aspects of the Service required by the change in Service if not covered by the procedures specified in Section 3 (Service Commencement).

Timescales for the submission of the PPP Vendor’s Estimate should distinguish between the scale and complexity of different change requests. The Change Protocol should set out a definite (and short) timescale for responding to requests for small value changes to the service, whereas timescales for medium to large value changes can be agreed flexibly between both parties in each case depending on the type and complexity of the change.

**13.3.5. Nodal Agency Approval:** Upon receipt of the PPP Vendor’s Estimate, the Nodal Agency should similarly have a reasonable period of time in which to consider the response, and then indicate its approval or otherwise to the PPP Vendor. The Nodal Agency’s rights of approval should be related to the origin of the change as discussed above: it should have absolute rights to approve or reject the PPP Vendor’s Estimate if the change is an Nodal Agency or PPP Vendor change. The Nodal Agency should not be able to reject a change in Service which is required in order to conform to a Qualifying Change in Law. The costs of introducing a change in Service resulting from a Qualifying Change in Law (including any resulting variation in the Unitary Charge) should be shared in accordance with Section 14 (Change in Law) and to the extent not dealt with should be borne by the PPP Vendor. It is recommended that for large-value changes, Nodal Agency should follow a 2-stage approval process with the PPP Vendor providing an initial budget price at Stage 1 (based on which the Nodal Agency can confirm it can afford to pay for the change), followed by detailed design work and a fixed price at Stage 2. This will prevent significant abortive costs from being incurred by

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<sup>68</sup> The timetable should identify the different phases of the development period, such as technical, pricing, planning, legal, etc. and indicate which of the deliverables will be issued in which phase, and the points at which the PPP Vendor will require the Nodal Agency to issue any further confirmations to proceed.

the PPP Vendor in the earlier (less certain) stages, and also give the Nodal Agency more confidence and certainty of affordability.

For small-value changes, Nodal Agency should consider delegating approval rights to local representatives so that such changes can be agreed quickly and without too much process or bureaucracy.

**13.3.6. Change Implementation:** Once the Nodal Agency has signalled its approval of the PPP Vendor's Estimate, the PPP Vendor should proceed to implement the change in Service in accordance with the agreed timetable. A standard timescale can be set out in the Change Protocol for small-value changes (such as those listed in an agreed catalogue of small Works and Services), or agreed on a case by case basis for larger or more complex changes.

**13.3.7. Funding and Payment:** Nodal Agency will generally be liable for the cost of changes associated with Nodal Agency changes, and should ensure they have budgeted accordingly. For PPP Vendor changes, the Nodal Agency should be under no obligation to pay unless a payment from the Nodal Agency is specifically agreed as part of the discussions with the PPP Vendor.

Where the Nodal Agency is responsible for bearing or sharing the cost of the change in Service, it should generally be assumed that:

- the payment for any capital works will be made on the achievement of milestones or on completion through lump sum capital payments; and
- the payment for any change to Services shall be made through an adjustment to the Unitary Charge.

### **13.3.8. Due Diligence**

**13.3.8.1. PPP Vendor's Due Diligence:** It is reasonable for the PPP Vendor to wish to conduct due diligence on changes which can alter the risk profile of the Contract, in order to protect their investment. Accordingly, Change Protocols should set out a framework for due diligence which, whilst protecting the position of the PPP Vendor, allows routine small value changes to be processed at minimal transaction costs. Some ways in which this might be achieved are suggested below.

**13.3.8.2. Legal and technical due diligence:** Legal due diligence will generally be necessary whenever there is either a change to the terms of the Contract, or a separate Deed of Amendment (see Section 13.3.8.9) is required to give effect to the change. Similarly, where changes in Service pose any additional Solution design or solution development risks, or may have a material impact on the operating and life-cycle costs of providing the original Service, technical due diligence will be necessary and desirable.

The Change Protocol should list circumstances where a change in Service can be agreed between the Nodal Agency and the PPP Vendor without the need for legal and/or technical due diligence. This could include for example:

- where the change in Service is called off from a pre-priced catalogue of small and routine Services (like make changes in the masters, change of user rights); and/or

- where the change in Service can be implemented without any material impact on the ability of the PPP Vendor to deliver the existing Service.

13.3.8.3. *Financial due diligence:* Financial due diligence will typically concentrate on adjustments to the financial model and calibration of the payment mechanism.

13.3.8.4. Adjustments may need to be made to the financial model to give effect to a change in Service, so that the Unitary Charge is adjusted to take into account the change in Project Costs wish to conduct due diligence over the financial model to ensure that cover ratios remain acceptable.

13.3.8.5. To improve the efficiency and speed of the process, Nodal Agency should agree with the PPP Vendor that the financial model should generally only be adjusted and reviewed periodically (say once or twice a year), so that all the changes that have occurred during that year can be ‘bundled’ together into a single cumulative adjustment as necessary. This will avoid the expensive and cumbersome exercise of carrying out financial due diligence on the financial model every time a change occurs, and greatly reduce the transaction costs of undertaking changes. An exception to this rule can be on the occurrence of large-value changes, where it is quite likely that the financial model will need to be adjusted on a case by case basis.

13.3.8.6. Similarly, payment mechanisms are usually calibrated at Financial Close based on the economics of the Project at that time. As changes in Service accumulate, the payment mechanism may well need to be re-calibrated to ensure that it remains a fair and effective method of incentivizing the PPP Vendor. To keep due diligence costs at an efficient level however, it is strongly recommended that Nodal Agency agree with the PPP Vendor as part of the Change Protocol that reviews of the Payment Mechanism should only be triggered after changes up to a certain aggregate value have occurred in a year. Below this threshold, the parties should only need to agree a periodic review of the payment mechanism (such as every year or every two years) to ensure that the calibration stays in line with its desired objectives.

13.3.8.7. *Insurance due diligence:* Changes in Service, particularly where they involve a change to the insured assets, may also require authorisation from the insurers<sup>69</sup>. Underwriters rely on the concept of utmost good faith, and will normally expect to be notified immediately of any material change in the scope of the Project. Materiality will to a large extent depend on the size and nature of the scope change. The insurance arrangements can be structured to give the PPP Vendor a degree of flexibility in processing changes without any additional insurance due diligence. For instance:

- A capital additions Clause in the material damage insurance will cover the PPP Vendor for ‘modest’ changes in the scope of the Project leading to a change in the capital value of the insured assets. Typically the amount is capped at a relatively low level (e.g. c. INR. 100,000). The insurer will still need to be advised of the material change, though this can be when the insurance is renewed, rather than at the time of the scope change.
- A contract works extension could be included in the insurance package which will cover the PPP Vendor for works undertaken during the operational period. The above provisions are fairly.

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<sup>69</sup> It may be noted that the insurance clause is applicable only if the ownership of the assets is with the PPP vendor

**13.3.9. Documentation and Monitoring:** All changes in Service should be implemented in accordance with the Change Protocol, with the PPP Vendor acting as the prime counter-party responsible for implementation. The alternative to this is for the Nodal Agency to contract directly with another agency to implement the change, but this is not recommended as, over time, it can lead to serious interface risks and confusions as to responsibilities. It could also have significant value for money implications if it displaces the basic risk allocation embedded in the Contract.

There is a separate issue as to the *terms* under which the Nodal Agency should contract for changes in Service. Small value changes should generally be capable of being covered under the existing terms of the Contract and the Change Protocol where the implementation process is typically straightforward and solution development or operation risks are not substantial. However, for those changes in Service where the implementation is complex or the risks are substantial, it is quite likely that the parties will need to agree a bespoke set of terms and conditions under which the PPP Vendor will deliver the change particularly in relation to matters such as:

- payment terms;
- site issues;
- statutory permissions;
- warranties from solution development or services sub-contractors;
- protections against failure to complete (liquidated damages, deductions, termination rights);
- Relief and Compensation Events (including the interface with the existing Project);
- limits of liability; and/or
- indemnities and insurance issues.

This makes it likely that for complex changes, a separate Deed of Amendment that accurately encapsulates the particular terms agreed in relation to such changes will usually be appropriate. It is important for both parties to accurately document and monitor all changes, and ensure that they are captured in a change log which tracks any new assets or services agreed as part of the Change Protocol, and references the terms (e.g. Deed(s) of Amendment) under which the changes have been carried out.

## **13.4. Transparency of Pricing and Value for Money**

**13.4.1.** The Change Protocol should place a general requirement on the PPP Vendor to process and implement changes using a transparent open-book approach to pricing, with an obligation to secure value for money for the Nodal Agency.

**13.4.2.** Two key questions arise in relation to the issue of transparency and value for money:

- which items should reasonably be included and which excluded when costing a variation, and
- for the pricing of items which *are* included, how might the Nodal Agency assess whether or not it is getting value for money?

### **13.4.3. Costing Issues**

13.4.3.1. *Time and materials costs:* Clearly, the costing of a variation must include the basic resource costs of implementing the change (i.e. in terms of the labour and materials expended on design, solution development, facilities management, and/or maintenance). This can also include professional fees (e.g. where design work or solution development is involved), and an element of contingency to deal with any performance risk being accepted by the Sub-Contractor.

13.4.3.2. *Sub-Contractor margins:* In addition to the basic resource costs, many Sub-Contractors charge a “margin” that provides a contribution to overheads and profits at the Sub-Contractor level. While this is fairly standard practice in the industry, the levels can vary. In the context of variations, Sub-Contractor margin levels could be set in two ways:

- the levels could be fixed in the Change Protocol with reference to the levels set in the original Sub-Contracts; and/or
- independent technical advice could provide a market benchmark for margin levels at the time of the change.

For small-value changes, the catalogue pricing should include both the time and materials cost, as well as any Sub-Contractor margins.

13.4.3.3. *PPP Vendor mark-ups:* There are three potential areas in respect of which the PPP Vendor may seek to charge a separate fee or margin over and above the elements discussed above:

- processing time and cost (e.g. paperwork, liaison, meetings, external advice etc);
- accepting performance risk on the implementation of the change (i.e. “wrapping” the performance of the Sub-Contractors carrying out the change in terms of the time, cost and quality of delivery); and
- accepting any interface risks between the implementation of the change and the provision of the existing Service.

13.4.3.4. In some cases (particularly during the solution development period), the PPP Vendor acts largely as a passive intermediary, whilst the work to process and implement changes occurs at the Subcontractor level. In such cases, there is very little case for any additional processing charges being paid to the PPP Vendor.

In most other cases (certainly during the operational period), the PPP Vendor should be resourced to process changes themselves and add value in providing a change management function for the Nodal Agency. The proper resourcing of Contractors to provide an effective change management Service should be a part of the specification set at Financial Close. Since change management therefore forms a routine part of the Service provided by the PPP Vendor, there should be no need for the Nodal Agency to pay any additional PPP Vendor fee or margin for processing each variation. However, there may still be instances (e.g. complex changes) where the PPP Vendor is required to put in significant additional resources of its own over and above what was envisaged as part of the standard Service. In such cases, the Change Protocol should:

- enable fair re-imburement of any third party costs (such as consultant fees) incurred by the PPP Vendor to supplement its own resources; and/or



- set out a standard day rate by which any additional PPP Vendor staff time incurred on processing the change (i.e. over and above what is required as part of the Service).

The PPP Vendor should make the case for such additional processing costs on a case-by-case basis and a suitable budget should be established with the Nodal Agency before work is commenced.

13.4.3.5. The Nodal Agency should consider carefully how performance risk is priced by the PPP Vendor. Where the PPP Vendor is required to fund the change (see Section 13.3.7 above), the “charge” for bearing the Sub-contractor performance risk will be reflected in the rates of return charged, and will be reflected in the calculation of the revised Unitary Charge. No separate PPP Vendor mark-up (over and above the appropriately benchmarked cost of capital) should therefore be included within the costing of the change for this reason.

However, where the change is funded by the Nodal Agency, the risk of Sub-contractor failure should be carefully considered. It may be the case (in limited circumstances such as high-value or complex changes) that the risk of Sub-contractor default is material. In such cases an additional mark-up in the costing of the change reflecting the risk and impact of Sub-Contractor default may be reasonable.

13.4.3.6. Finally, the PPP Vendor will need to manage any interface risks between the implementation of the change in Service and the existing Service. How significant these interface risks are and what value should be assigned to them will vary from case to case, and it is impossible to generalize. Indeed, in some cases, it is entirely possible that a change in Service may reduce the overall risk for the PPP Vendor. Nodal Agency will need to seek specialist technical advice for the impact and valuation of such interface risks. In any case these risks, where justified, should be priced separately (as higher solution development, operating or lifecycle costs) rather than being included as a standard PPP Vendor mark-up over the basic costs of the change.

13.4.3.7. In summary, there should not generally be any separate PPP Vendor mark-up priced into the costing of changes. The exceptions to this rule would be:

- where the PPP Vendor is likely to be required to put more significant additional resources into the processing of a change (e.g. in procurement or project management) than contemplated as part of the standard change management service (in which case an additional fee should be calculated based on a pre-set man-month rate); and
- where the PPP Vendor is not required to invest, but is nevertheless asked to take performance risk on the Sub-Contractors implementing the change (in which case a mark-up reflecting the probability and impact of Sub-PPP Vendor failure will usually be reasonable).

13.4.3.8. *Transaction Costs:* Finally, there are the costs of conducting financial, technical, legal and insurance due diligence on variations. All such costs, where reasonably incurred by the PPP Vendor, ought to be reimbursed or compensated by the Nodal Agency provided that budgets are agreed in advance. However, the Change Protocol should require the PPP Vendor to minimize such costs as described in Section 13.3.8 above.

#### **13.4.4. Pricing Issues**

13.4.4.1. There are a number of different pricing techniques which could be systematically introduced into the Change Protocol to increase transparency and certainty in pricing changes (although different techniques will be relevant to different types of changes).

13.4.4.2. *Small-Value Changes:* The recommended approach for transparent pricing of small value changes is that Nodal Agency agree a detailed catalogue of small works and Services (at preset prices that are linked to a suitable inflation index such as CPI or WPI), so that such small value changes can simply be “called off” the catalogue. For small-value changes that cannot be pre-priced in the catalogue, there should be a schedule of rates for any specialist labour required for design, solution development, installation or commissioning purposes, and any cost of materials incurred in implementing the change should be charged at cost to the Nodal Agency on an open-book basis or using industry benchmarks. Wherever possible, the small value change in service should be carried out by a suitably qualified on-site PPP Vendor employee so that specialist labour charges are avoided.

13.4.4.3. Where small-value changes have long-term lifecycle or FM implications, the PPP Vendor should clearly indicate this to the Nodal Agency as part of the specification-setting process, and the pricing for such extensions to the FM and lifecycle Services should be done on an open-book and transparent basis. Wherever practicable, however, PPP Vendor should seek to develop a flexible Service solution so that small-value changes (particularly those drawn from a catalogue of pre-priced works and services) can be accommodated relatively easily.

13.4.4.4. *Medium-Value Changes:* One of the difficult pricing issues in respect of medium-value changes is that they can encompass a very large variety of fairly bespoke works and services, and frequently have long-term lifecycle and FM service implications. As a result, they are neither standard enough to allow a pre-priced approach (as for small-value changes) nor large enough to warrant a full-fledged technical audit, benchmarking or competitive tendering approach (as would apply for large-value changes).

13.4.4.5. As a result, it is likely that the best method of introducing greater transparency into the pricing of medium-value changes is to adopt a framework approach with:

- standard allowances agreed between the Nodal Agency, the PPP Vendor and the Solution development and Services Sub-Contractors at Financial Close for professional fees, overheads, contingencies and profit margins (as described above in Section 13.4.3);
- a schedule of rates for specialist labour services and an agreement to charge the cost of materials based defined on market rates; and
- the pricing for any bespoke risks (e.g. site conditions) agreed on an open-book basis.

13.4.4.6. This framework approach could reflect a form of “after-sales support” provided by the Sub-Contractor, and a method of on-going support from the Services Sub-Contractor(s) during the operational period. Other than for projects with very long solution development periods, it should be possible for the Sub-Contractor to sign up to a support package for implementing medium-value changes that runs for at least 2 years post-Service Commencement. The framework can then be

renewed (depending on use and anticipated activity) every few years from then on by the PPP Vendor, or put out to competition.

13.4.4.7. *Large-Value Changes:* For Large Value changes, it will usually be cost-effective to go through an intensive due diligence process that ensures the Nodal Agency can be confident about the value for money of the price developed by the PPP Vendor. Nodal Agency can choose from any of the following approaches to ensuring value for money in pricing large value changes:

- benchmarking;
- independent technical adviser approach; and/or
- competitive tendering/market testing.

13.4.4.8. *Benchmarking:* A benchmarking approach requires the Nodal Agency to develop its own independent estimate of the cost of the change in Service (perhaps with the assistance of its own technical advisers), so that it can intelligently query the PPP Vendor's Estimate, and judge whether or not it is getting value for money. This benchmarking approach can be quite useful and efficient where the types Services involved are relatively standard and there is sufficient data available in-house to conduct the benchmarking. In the absence of good data however, there is a risk that the approach can collapse into a dispute between the technical advisers on either side, and other alternatives (such as the ones discussed below) should be considered.

13.4.4.9. *Independent Technical Adviser approach:* Under this approach, both parties agree a joint appointment for a suitably qualified independent technical adviser (ITA) (or maybe, NIC) who will advise on the pricing for the change in question. This jointly appointed adviser would be independent in the sense that it is not contracted solely to either party and therefore would not face a conflict of interest.

The terms of reference of the ITA could include:

- assisting the Nodal Agency and the PPP Vendor in developing a high level Reference Price based on a clear specification for the change order as part of the Stage 1 approval, before detailed design or pricing work is done by the PPP Vendor; and
- reviewing and sign off the PPP Vendor's estimates for reasonableness as part of the Stage 2 approval.

The cost of the ITA's services would be borne by the Nodal Agency.

13.4.4.10. *Competitive Tendering approach:* Under this approach, the Nodal Agency can require the PPP Vendor to obtain competitive quotes from at least three suppliers for the provision of the Services associated with the change. The PPP Vendor should generally be responsible for:

- deciding how best to package the Works and Service into work packages;
- ensuring a price discovery for Sub-Contract work packages;
- evaluating and selecting the preferred suppliers;
- negotiating and finalising appointments of suppliers; and
- managing the implementation of the change order.

The Nodal Agency should have the following rights in respect of the tendering procedure:

- the right to approve the tendering procedure (including the evaluation criteria) for suppliers to ensure that it is fair and transparent;
- the right to prevent the selection of any person as a prospective bidder if it reasonably believes that such person does not (or could not reasonably be considered to) comply with the evaluation criteria;
- the right to prevent the selection of any person as a bidder on the grounds that the prospective bidder has been blacklisted
- the right to review the list of prospective bidders. The PPP Vendor should provide the Nodal Agency with an explanation of the reasons behind the non-inclusion on the list of prospective bidders of any person identified as suitable by the Nodal Agency, if so requested by the Nodal Agency; and
- the right to dispute the PPP Vendor's decision on the selected bidder.

Where any company associated with the PPP Vendor, its shareholders or its Sub-Contractors intends to bid, the Nodal Agency may require that an independent tender process manager is appointed to manage the tendering process.

#### **13.4.5. Abortive Costs**

In cases where the Nodal Agency decides to withdraw a request for a change in Service (particularly following Stage 1 approval for large-value changes) and the PPP Vendor has incurred significant third party costs, the Nodal Agency should agree to reimburse the PPP Vendor for any such third party costs reasonably incurred and evidenced in developing proposals up to the time the change request was withdrawn provided that budgets for such costs have been agreed in advance.

### **13.5. Incentivisation**

13.5.1.1. An important consideration for Nodal Agency in managing changes to their projects is how to ensure the PPP Vendor is incentivized to perform in accordance with the Change Protocol. The procedures set out in the Change Protocol should generally encourage a collaborative working relationship between the Nodal Agency and the PPP Vendor, but explicit incentivization through the payment and performance mechanism is nevertheless recommended.

13.5.1.2. The Contract should contain some performance indicators for the “change management service” that the PPP Vendor is asked to provide in accordance with the Change Protocol. This should set reasonable targets for the PPP Vendor's performance (particularly in respect of meeting the agreed timescales for processing and implementing changes). Failure to meet these timescales should attract deductions, which should increase with further delay. The Nodal Agency could also consider whether it would offer value for money to reward performance in excess of the targets (i.e. changes processed or implemented earlier than expected) through e.g. bonus payments or reward points that can be used to offset other deductions.

13.5.1.3. Wherever possible, the PPP Vendor and the Nodal Agency should both establish a framework of delegated Nodal Agency to local representatives, so that changes can be agreed and processed quickly with minimum bureaucracy.

13.5.1.4. Experience from the management of earlier PPP contracts shows that tiers of sub-subcontracting by the PPP Vendor can slow-down and, potentially, impair the process of communication between the Nodal Agency and those providing the Services on the ground. Accordingly, the Change Protocol should include an obligation on the PPP Vendor to ensure that regardless of whether it performs all the Services itself, or through Sub-Contracts or through Sub sub-contracts to any level, the speed and responsiveness of those providing the Service to requests and other communications from the Nodal Agency should be in accordance with performance standards set out in the payment and performance mechanism.

## 14. CHANGE IN LAW

### 14.1. Introduction

14.1.1. The PPP Vendor must comply with all applicable legislation. A failure to comply could give rise to termination for PPP Vendor Default (see Section 19.2 (Termination on PPP Vendor Default)). The cost of complying with legislation which is current or foreseen at the time of the Contract should be built into the price the PPP Vendor bids to provide the Service. Nevertheless, the PPP Vendor may not, for example, be capable of including in the price specific costs arising from changes in law which are not foreseeable prior to contract signature. Accordingly, the issues concern who should be responsible for the costs arising from changes in law and how such costs should be funded.

14.1.2. The treatment of changes in law relates very closely to the issues of indexation, benchmarking and market testing (see Section 15 (Price Variations)), particularly in relation to the risk of increases in operating costs. These provisions must be developed in conjunction with each other when negotiating the overall level of change in law risk to be transferred by the Nodal Agency. For example, the more often a Contract provides for benchmarking and market testing to occur (allowing upward revisions of price), then the more likely an apparently tougher change in law provision can be achieved by the Nodal Agency. It is recognised, however, that benchmarking, market testing and indexation provisions are not likely to have a significant bearing on the risk transfer position in relation to increases in capital costs due to a change in law.

### 14.2. PPP Vendor's and Nodal Agency's Concerns

14.2.1. PPP Vendor would be concerned that change of law is a risk which they cannot control and which they regard as being within the control of the Nodal Agency or wider Government. In practice, however, Nodal Agency would have negligible influence over legislation whereas the private sector has traditionally proved adept at managing the effects of changes of law and minimising their impact on their business. Hence it is appropriate for the PPP Vendor to bear or share in the risk.

14.2.2. Under more traditional commercial contracts, the PPP Vendor is usually able to pass on the costs of changes in law to its customers through an increase in price or, in Contracts of relatively short duration, is able to take a view on the prospects of changes in law arising during the term of the Contract. As the prices in PPP Contracts are agreed on a long-term basis and are not flexible in the same way, the PPP Vendor will often not be in a position to price the full cost of prospective changes in law effectively.

14.2.3. A sharing approach is the best way to ensure that the costs of implementing changes in law are minimised. The approach set out in this Section in respect of the sharing of risks relating to changes in law is intended to play to the strengths of both the public and private sectors and ensure that the PPP Vendor is incentivised to manage its costs, even where the Nodal Agency agrees to meet the PPP Vendor's costs resulting from complying with a change in law.

### 14.3. Definition of Change in Law

14.3.1. The Contract should specify that the PPP Vendor is expected to comply with all relevant law and should contain a mechanism for handling the effects of a change in law.

#### **ILLUSTRATIVE DRAFTING:**

##### **“Change in Law”**

means the coming into effect after the date of this Contract of:

- (a) Legislation, other than any Legislation which on the date of this Contract has been published:
  - (i) in a draft Bill as part of a Government Consultation Paper;
  - (ii) is with the Standing Committee
  - (iii) in a draft statutory instrument; or
  - (iv) in a Bill;
- (b) any applicable judgment of a relevant court of law which changes a binding precedent.

##### **“Legislation”**

means any Act of Parliament or subordinate legislation.

### 14.4. Allocation of Risk of Change in Law

14.4.1. In some projects, it is possible to treat changes in law of any type as the PPP Vendor’s risk. For e.g. in case it requires to make minor modification in the software application.

14.4.2. In other cases, a risk sharing approach has developed where the main user of the Project is the Nodal Agency and it is not appropriate for the PPP Vendor to bear all of the change in law risks as the risk cannot be quantified or passed on to third party users. There are a number of different possible approaches to risk sharing that build on the distinctions between discriminatory/specific legislation and general legislation. These all involve a sharing of the risk of changes in law.

### 14.5. Mitigation

14.5.1. Whenever the Nodal Agency bears some of the risk of a change in law, the PPP Vendor should be obliged to keep any cost increases to a minimum.

14.5.2. This duty to mitigate can be measured, in part, by reference to the extent to which price increases in comparable sectors are experienced. It will also require the PPP Vendor to foresee and anticipate the effect of changes in law, particularly in relation to expenditure which it has planned to incur anyway in the ordinary course of the Contract. For example, a PPP Vendor cannot on one day change a database server under its normal maintenance programme and then argue that it immediately has to replace it due to a subsequent change in law which the PPP Vendor should have

anticipated at the time of replacement (and for which the Nodal Agency bears the cost in whole or in part). For that reason, any compensation should reflect any anticipated future saved maintenance costs.

## 14.6. Discriminatory, Specific and General Changes in Law

### **ILLUSTRATIVE DRAFTING:**

#### **“Discriminatory Change in Law”**

means a Change in Law, the terms of which apply expressly to:

- (a) the Project and not to similar projects procured under the PPP;
- (b) the PPP Vendor and not to other persons; and/or
- (c) PPP Contractors and not to other persons.

#### **“Specific Change in Law”**

means any Change in Law which specifically refers to the provision of [services the same as or similar to the Service] or to the holding of shares in companies whose main business is providing [services the same as or similar to the Service].

### **ILLUSTRATIVE DRAFTING:**

#### **“General Change in Law”**

means a Change in Law which is not a Discriminatory Change in Law or a Specific Change in Law.

14.6.1. Where a risk sharing approach is adopted in respect of Change in Law (as referred to in Section 14.4.2), any costs arising from Discriminatory Changes in Law and Specific Changes in Law should be at the Nodal Agency’s risk.

## 14.7. General Change in Law at PPP Vendor’s Risk

14.7.1. Costs arising from changes in non-discriminatory/non-specific legislation (i.e. General Changes in Law) can either be for the account of the PPP Vendor or shared between the PPP Vendor and the Nodal Agency.

14.7.2. General Changes in Law are generally only at the PPP Vendor’s sole risk in specific sectors where the length of the Contract is such that the PPP Vendor is comfortable that the risk of General Changes in Law occurring is low, or where the relationship between the parties and the history of changes in the sector concerned is such that the PPP Vendor is prepared to accept this risk.

14.7.3. Although the PPP Vendor may appear to bear all the risk of General Changes in Law, this approach will often involve some method of mitigating the effect on the PPP Vendor. For example, market testing, benchmarking and/or indexation provisions will in fact lead to the sharing of some of his risk (see Section 15 (Price Variations)) in that additional operating costs may be reflected in



increases to the Unitary Charge following a benchmarking or market testing and/or indexation, although the PPP Vendor will bear such risk for the period up to benchmarking or market testing.

## 14.8. General Change in Law as a Shared Risk

14.8.1. General Change in Law may affect the Project in a variety of ways. For example:

- the change may require alterations to the technical architecture (with an impact both on Capital Expenditure and, potentially, timetable); and
- the change may necessitate a change in the way a Service is delivered (e.g. the number of people required to deliver it may change).

14.8.2. Costs arising from General Changes in Law should generally be for the account of the PPP Vendor, as the PPP Vendor is protected through the combined effects of benchmarking, market testing and indexation<sup>70</sup>.

14.8.3. This alternative approach recognises, however, that it may be more equitable for the Nodal Agency to share costs which are difficult for the PPP Vendor to manage. An exception is therefore made of General Changes in Law which:

- require Capital Expenditure; and
- take effect during the Service Period (i.e. after solution development is completed (but see Section 14.8.8)); and
- were not reasonably foreseeable at Contract signature.

Under this approach the costs of a General Change in Law falling within this exception are shared between the PPP Vendor and the Nodal Agency. If the change was foreseeable during the solution development period although not yet in effect, the PPP Vendor's obligation to mitigate (see Section 14.5 (Mitigation)) would require it to have taken all reasonable action to minimize the eventual cost of implementing such change (e.g. by altering solution development prior to completion). This approach promotes a shared incentive to keep the costs of a change in law to a minimum without exposing the PPP Vendor to excessive risk.

14.8.4. An appropriate approach to sharing the risk of the type of change in law described in Section 14.8.3 is to share such risk on a progressive scale. the Contractor takes 100% of the first Stage of Capital Expenditure, 75% of the next stage, 50% of the next stage and so on (see the table set out in Section 14.8.10). Once a certain amount is reached, the Authority takes 100% of any amounts above that amount. The threshold figures agreed and the number of graduated steps will take into account the size of the Project and the impact of other. The levels of Cumulative Capital Expenditure (see Section 14.8.10) are not indexed (as the totals are cumulative, indexation can lead to unnecessary

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<sup>70</sup> The PPP Vendor should also receive the benefits of any cost savings resulting from General Changes in Law. Benchmarking, market testing and indexation should act to restrict the overall benefits received by the PPP Vendor.

complication). The PPP Vendor's total liability should generally be between 2% to 5% of the initial capital cost of the Project<sup>71</sup>. A cap by reference to time is not recommended.

14.8.5. The advantage of sharing the risk in the way described (as opposed to the PPP Vendor simply being liable for the first stage is that it both incentivises the PPP Vendor to minimise the cost of implementing the change (as opposed to the PPP Vendor simply invoicing the Nodal Agency for whatever it costs) and reduces any concern the PPP Vendor has that the Nodal Agency can take advantage of the situation.

14.8.6. Although it is the responsibility of the PPP Vendor to manage the way in which it will fund any increases in capital costs which occur as a result of a General Change in Law occurring during the Service Period, if it is clear to the Nodal Agency from the winning bidder's Base Case that it has priced the risk at 100 percent, the Nodal Agency may wish to retain the risk on value for money grounds. Experience has shown however, that the competitive bidding process incentivizes bidders to price the risk at less than 100 percent and bidders are typically comfortable that General Changes in Law can be managed either by:

(i) standby finance; (ii) undrawn revolving working capital facilities; or (iii) building up sums over time from free cash flow:

- changes in law are usually consulted well in advance;
- there is normally a grace period for implementation; and
- such changes rarely apply retrospectively.

14.8.7. The Nodal Agency should generally pay such Capital Expenditure in accordance with the principles set out in Section 13.3.7 (Funding and Payment). Any consequent operating cost increases are borne by the PPP Vendor although these costs will be mitigated by the effects of market testing, benchmarking and/or indexation (see Section 15 (Price Variations)). The points made in Section 5.2.3 (Calculation of Compensation) are similarly relevant here.

14.8.8. All other General Changes in Law requiring Capital Expenditure (e.g. those which take effect during a typical solution development period) should, with this approach, be at the risk of the PPP Vendor in terms of time and money.

14.8.9. For projects which have unusually long solution development periods, transferring the risk of General Changes in Law for the entire solution development period (rather than adopting a sharing approach) may in fact be poor value for money and is likely to be difficult to achieve in practice .

14.8.10. Changes arising in operational costs as a result of a General Change in Law should also be borne by the PPP Vendor (subject to Section 15 (Price Variations)). If a General Change of Law requires changes to the Service then either party should be entitled to require a variation to the project specifications to comply with a Change in Law and no breach of contract should arise while this is being done.

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<sup>71</sup> Bidders will price into their bid submissions any General Change in Law risk they are required to take. Both the Nodal Agency and bidders should seek to ensure that cost and adequate risk transfer are balanced as far as possible to achieve the best value for money

## **ILLUSTRATIVE DRAFTING:**

### **“PPP Vendor’s Share”**

means the percentage figure corresponding to that part of the Cumulative Capital Expenditure at the relevant time, shown in the first column of the table set out below.

#### **Cumulative Capital Expenditure<sup>72</sup> PPP Vendor’s Share<sup>18</sup>**

INR. 0 – INR. [a] million (inclusive) 100%

INR. [a] million to INR. [b] million (inclusive) 80%

INR. [b] million to INR. [c] million (inclusive) 60%

INR. [c] million to INR. [d] million (inclusive) 40%

INR. [d] million to INR. [e] million (inclusive) 20%

INR. [e] million to INR. [f] million (inclusive) 10%

INR. [f] million and above 0%

### **“Cumulative Capital Expenditure”**

means the aggregate of:

- all Capital Expenditure that has been incurred as a result of each General Change in Law that has come into effect during the Service Period; and
- the amount of Capital Expenditure that is agreed, or determined to be required, as a result of a General Change in Law under Clause 14.8 (Qualifying Change in Law).

### **“Qualifying Change in Law”<sup>73</sup>**

means:

- a Discriminatory Change in Law;
- a Specific Change in Law; and/or
- [a General Change in Law which comes into effect during the Service Period and which involves Capital Expenditure<sup>74</sup>] which was not foreseeable at the date of this Contract<sup>75</sup>.

## **14.8 Qualifying Change in Law**

(a) If a Qualifying Change in Law occurs or is shortly to occur, then either party may write to the other to express an opinion on its likely effects, giving details of its opinion of:

- (i) any necessary change in Service<sup>76</sup>;
- (ii) whether any changes are required to the terms of this Contract to deal with the Qualifying Change in Law;

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<sup>72</sup> These figures are to be bid as part of the bid submission. In each case they are not to be indexed

<sup>73</sup> It may of course be that there is a particular uncertainty attaching to a particular change in law (even if foreseeable), such as where, for example, its effects can vary by a significant factor. If this is so, then risk sharing can be agreed where the value for money impact is extremely difficult to assess.

<sup>74</sup> This will depend on which option in Section 14.7 (General Change in Law at PPP Vendor’s Risk) is adopted and the extent to which Capital Expenditure is at the risk of the PPP Vendor (i.e. the extent to which such amounts have been included in the bid).

<sup>75</sup> If any greater clarity can apply to this in a particular Project (such as concerns over particular envisaged changes in law) then this should be expanded upon

<sup>76</sup> For example, the contractual, financial, operational and/or solution development implications of the change in Service. Any change in Service should be agreed and implemented in accordance with the Change Protocol described in Section 13 (Change in Service), with the costs of the change being shared as recommended in this Section.

- (iii) whether relief from compliance with obligations is required, including the obligation of the PPP Vendor to achieve the Planned Service Commencement Date and/or meet the [performance regime] during the implementation of any relevant Qualifying Change in Law;
  - (iv) any loss of revenue that will result from the relevant Qualifying Change in Law;
  - (v) any Estimated Change in Project Costs that directly result from the Qualifying Change in Law; and
  - (vi) any Capital Expenditure that is required or no longer required as a result of a Qualifying Change in Law taking effect during the Service Period, in each case giving in full detail the procedure for implementing the change in Service. Responsibility for the costs of implementation (and any resulting variation to the Unitary Charge) shall be dealt with in accordance with paragraphs (b) to (f) below.
- (b) As soon as practicable after receipt of any notice from either party under paragraph (a) above, the parties shall discuss and agree the issues referred to in paragraph (a) above and any ways in which the PPP Vendor can mitigate the effect of the Qualifying Change of Law, including:
  - (i) providing evidence that the PPP Vendor has used reasonable endeavours (including (where practicable) the use of competitive quotes) to oblige its subcontractors to minimize any increase in costs and maximize any reduction in costs;
  - (ii) demonstrating how any Capital Expenditure to be incurred or avoided is being measured in a cost effective manner, including showing that when such expenditure is incurred or would have been incurred, foreseeable Changes in Law at that time have been taken into account by the PPP Vendor;
  - (iii) giving evidence as to how the Qualifying Change in Law has affected prices charged by any similar businesses to the Project; and
  - (iv) demonstrating that any expenditure that has been avoided, which was anticipated to be incurred to replace or maintain assets that have been affected by the Qualifying Change in Law concerned, has been taken into account in the amount which in its opinion has resulted or is required under paragraph (a) (v) and/or (vi) above.
- (c) If the parties agree or it is determined under Clause 25 (Dispute Resolution) that the PPP Vendor is required to incur additional Capital Expenditure due to a Qualifying Change in Law (excluding the PPP Vendor's Share of any Capital Expenditure agreed or determined to be required as a result of a General Change in Law under this paragraph), then the PPP Vendor shall use its reasonable endeavours to obtain funds on terms reasonably satisfactory to it.
- (d) If the PPP Vendor has used reasonable endeavours to obtain funding from external sources (c), but has been unable to do so within [60] days of the date that the agreement or determination in paragraph (c) occurred, then the Nodal Agency shall pay to the PPP Vendor an amount equal to that Capital Expenditure on or before the date falling 30 days after the Capital Expenditure has been incurred.

- (e) Any compensation payable under this Clause by means of an adjustment to or reduction in the Unitary Charge<sup>77</sup> shall be [see Section 5.2.3 (Calculation of Compensation) above].

## 14.9. Changes in Tax Law

14.9.1. Discriminatory and specific changes in tax law should be dealt with in accordance with Section 14.6 (Discriminatory, Specific and General Changes in Law).

14.9.2. Whichever approach is adopted on General Changes in Law, all costs arising from changes in tax law that are general should be for the account of the PPP Vendor, except as stated in Section 14.10 (Changes in VAT) in relation to changes in VAT legislation.

14.9.3. Save as otherwise expressly permitted by this guidance (e.g. gross up on certain termination payments or change in VAT regime), Nodal Agency should not provide tax indemnities to the PPP Vendor, and the Change of Law provisions should not be used as a device to transfer tax risk<sup>78</sup>.

## 14.10. Changes in VAT

### 14.10.1. Changes in the VAT Rate

14.10.1.1. The Contract should be explicit regarding the consequences of a change in the rate of VAT affecting the Service. Where the Service is within the scope of VAT, a change in the rate will affect the Unitary Charge paid by the Nodal Agency. This risk is borne by the Nodal Agency.

14.10.1.2. A change in the rate of VAT may also affect the gross costs borne by the PPP Vendor if input VAT is not reclaimable (i.e. the Service supplied by the PPP Vendor to the Nodal Agency is specifically disallowed or relates to “exempt supplies” as at the date of the Contract). If the rate changes in relation to supplies received by the PPP Vendor, then the PPP Vendor will benefit or not in the same way as if its general corporation tax bill changes. This risk should, therefore, be borne by the PPP Vendor.

14.10.1.3. Changes in the rate of VAT can lead to a cash flow cost or advantage. There is always a difference in timing of VAT payments and their recovery. A PPP Vendor should not increase its Unitary Charge to deal with any such disadvantage.

### 14.10.2. Changes in VAT Scope

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<sup>77</sup> There will only be an adjustment to the Unitary Charge in respect of increased capital costs if the PPP Vendor's Share is less than 100% and the Nodal Agency does not make a lump sum payment to the PPP Vendor. Increased operational costs resulting from any General Change in Law are borne by the PPP Vendor and will not result in an adjustment to or reduction to the Unitary Charge

<sup>78</sup> If a change of tax law does however fall within the Discriminatory Change in Law or Specific Change in Law provisions, the normal protections available to the PPP Vendor would apply. The loss of charitable status which a PPP Vendor could suffer as a result of any General Change of Law would not fall within these categories.

14.10.2.1. During the course of the Contract, changes in the scope of VAT may affect the PPP Vendor's ability to recover its input VAT. The Contract should make it clear that the PPP Vendor bears this risk unless it results from a change in the VAT status of the Service e.g. the Service becomes exempt from VAT. In this exceptional case, the Contract should provide for an adjustment to the Unitary Charge.

**ILLUSTRATIVE DRAFTING:**

**Payment of Irrecoverable VAT**

The Nodal Agency shall pay to the PPP Vendor from time to time as the same is incurred by the PPP Vendor sums equal to any Irrecoverable VAT but only to the extent that it arises as a result of a Change in Law. Any such payment shall be made within 30 days of the delivery by the PPP Vendor to the Nodal Agency of written details of the amount involved accompanied by details as to the grounds for and computation of the amount claimed. For the purposes of this Clause 14.10 "Irrecoverable VAT" means input VAT incurred by the PPP Vendor on any supply which is made to it which is used or to be used exclusively in performing the Services or any of the obligations or provisions under the Contract (together with input VAT incurred as part of its overhead in relation to such activities) to the extent that the PPP Vendor is not entitled to repayment or credit from VAT Authorities in respect of such input VAT.

## 15. PRICE VARIATIONS

### 15.1. Introduction

15.1.1. The Contract will set out the Unitary Charge for the entire Contract term. However, due to the uncertainties of inflation rates and certain operating costs over a long-term contract, it is usually in the interests of both Nodal Agency and PPP Vendor to set out provisions for varying the Unitary Charge in certain specified circumstances. The PPP Vendor should always be encouraged to control its costs, but if there are mechanisms for addressing unforeseeable changes in costs, the PPP Vendor can reduce the contingency in its bid price for such risk. Similarly, although the Nodal Agency should ensure it obtains a competitive price initially by undergoing a “price discovery”, it will take additional comfort if there is some means of ensuring the price it has agreed to pay in future years will not be in excess of future market prices for such Services.

15.1.2. The Contract must achieve the right balance between the provisions for change in law (see Section 14 (Change in Law)), indexation and value testing; these are inherently interrelated, particularly in relation to the allocation of operating-cost risk. PPP Vendors will be more willing to take risk in relation to certain changes in law, or in relation to cost increases above the relevant indexation rate, if they have some protection through the value testing provisions (i.e. they can bear certain risks for the period up to value testing as the extra costs are likely to be covered to an extent following value testing). The Nodal Agency should consider such inter-relationships when preparing its bid documents.

### 15.2. Inflation Indexation

15.2.1. The PPP Vendor will be concerned to protect itself against its costs inflating over the course of the Contract, rendering the Unitary Charge insufficient to meet its operating costs and financing obligations. The payment mechanism should therefore usually include arrangements for indexing the Unitary Charge to this extent. If there is no indexation mechanism, the PPP Vendor is likely to have to build a contingency into its price to cover operating-cost inflation risk and this is unlikely to give the Nodal Agency value for money (as the risk is outside the control of the PPP Vendor and, historically, has been difficult to forecast accurately). It is highly unusual for prices to be fixed (i.e. without indexation) throughout the term of any Contract for periods for which PPP Contracts are typically let. Conversely, it is not usual for the whole Unitary Charge to be indexed, and such “over-indexation” should not be used as a method of artificially reducing the initial Unitary Charge.

15.2.2. The Nodal Agency should focus on the appropriate method of applying indexation to the payment stream at an early stage in Project development. By the time a tender is issued, the Contract should specify the index to be applied and how it applies (i.e. how the proportion of the Unitary Charge to be indexed is to be determined). Nodal Agency should not leave the indexation proportion or choice of indices to the bidders, given the difficulties in comparing one bidder’s price and value for money with that of another bidder where different bidders use different proportions and methods of indexation.

15.2.3. Nodal Agency should bear in mind that the use of benchmarking or market testing gives some protection to Vendors for the Services covered by these arrangements. In most cases value for money can be achieved through indexation of a proportion of the Unitary Charge which matches the proportion of total costs represented by any elements of the PPP Vendor's underlying costs which are not fixed, using a general price index such as WPI or CPI.

15.2.4. On certain projects, the use of a more focussed index may be preferable. In these cases, the Nodal Agency should take care with index selection. Choosing an index that may be short lived, or is not independently produced, is not a sensible approach. It is also not appropriate to have too narrow a focus on a particular industry or sector, where the Contractors or their Affiliates are themselves responsible to a significant extent for inflationary costs (that is, they can actually affect the index by increasing their price).

15.2.5. Whilst choosing an index and weighting that reflect the underlying cost exposure of the PPP Vendor has the effect of reducing its cost risk, amended forms of such indexation formulae can incentivize real cost savings over the life of the Contract<sup>79</sup>.

### 15.3. Value Testing of Operating Costs

#### 15.3.1. Introduction

15.3.1.1. As noted above, it may be beneficial to include within the Contract provisions for periodic value testing of certain Services provided by the PPP Vendor. By "value testing", this guidance generally refers to either market testing or benchmarking, although other forms of value testing may sometimes be appropriate.

15.3.1.2. Market testing means the re-tendering by the PPP Vendor of a relevant Service to ascertain the market price of that Service. This may lead to the replacement of the Sub-PPP Vendor operating such Service by the winning bidder. Any increase or decrease in the cost of such Service following market testing should be reflected by an adjustment in the price charged to the Nodal Agency.

15.3.1.3. Benchmarking is a process by which the PPP Vendor compares either its own costs or the cost of its Sub-Contractors for providing certain Services against the market price of such Services. This may lead to a price adjustment, but not to a change in the sub-Contractor providing the Service.

15.3.1.4. The Services provided by the PPP Vendor that are suitable for value testing are generally limited to soft services. By "soft services", this guidance means Services such as Facility Management services, to the extent they do not involve a significant capital outlay in their performance or affect the value of any capital asset under the Contract. These services are suitable as the prices charged

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<sup>79</sup> One such amended indexation formula of  $x \times (1 + \text{CPI} \pm y)$  could be used by the Nodal Agency in its Pre-Bid Discussions, with bidders required to bid values of  $x$  and  $y$ . Where future cost reductions are reasonably foreseeable and not reflected in the initial Unitary Charge these can be reflected in the value of  $y$ . The bidder can propose a value of  $x$  reflecting the percentage of any elements in its cost structure that are not fixed. The variable  $x$  will therefore be a number between 0 and 1.



by the incumbent sub-Contractor and by various potential sub-contractors for such services from year to year should be comparable. Where an incumbent sub-Contractor has incurred capital costs, its price cannot be expected to compete with the price of a bidder who was not required to incur those capital costs. Services such as building a turnkey solution or lifecycle maintenance of equipment should not generally be market tested or benchmarked. These services are referred to as “hard services”.

15.3.1.5. Providing for periodic value testing of soft services in the Contract may benefit both the Nodal Agency and the PPP Vendor. Testing against the market is an important mechanism for the Nodal Agency to ensure that the soft service costs remain value for money over the life of the Contract and that the PPP Vendor does not become complacent in its pricing or delivery. In addition, if the PPP Vendor was required to enter into a fixed price long-term contract for soft services (with a simple indexation mechanic and the assumption of operational change of law risk) without any form of periodic testing, significant risk reserves may need to be built into its price. This in turn would not offer value for money to the Nodal Agency. It is important that both the Nodal Agency and the PPP Vendor understand the purpose of the value testing process and the results it may yield. In particular, if the PPP Vendor has misjudged its original service delivery bid or is inefficient in its operation, value testing should not be viewed by it as a means of passing Service or delivery risk back to the Nodal Agency.

### **15.3.2. Choice of Value Test - Preference for Market Testing**

15.3.2.1. It is now standard practice in most sectors of the PPP market to include some form of value testing. The recommended approach in Version 3 of this guidance was to adopt benchmarking as the preferred value testing mechanism and to use market testing only to the extent that the parties cannot agree on the outcome of benchmarking. This position has now changed.

15.3.2.2. Market testing allows a more flexible approach to the provision of Services than benchmarking because it ensures that the soft service provision for the Project can be reassessed to match public sector requirements at the time the exercise takes place. Market testing also offers greater opportunity for transparency and competition. Accordingly, and because of a greater maturity in the soft services market, the recommended approach is to provide for market testing of soft services, as this is most likely to yield best value for money.

15.3.2.3. In certain limited circumstances however, it may not be appropriate to provide for market testing. For example:

- the Service may be specialised and only provided by one or two contractors, or it may require specific security clearance. In these cases neither market testing nor benchmarking may be appropriate but some alternative form of value testing such as profit-sharing may be considered,<sup>7</sup> or
- there may be no competitive market for the relevant Service in the area, although Nodal Agency should be expected to actively develop a market for the Service where possible. If no competitive market exists or can be developed and effective market testing would thus be impossible, benchmarking (perhaps against suppliers of a similar service operating in a different geographic region) or an alternative form of value testing may be used.

Nodal Agency should consult their relevant departmental Private Finance Units for guidance where benchmarking is proposed instead of market testing.

15.3.2.4. Whether the Nodal Agency determines market testing or benchmarking to be appropriate, it should consider whether it would be beneficial to include provisions in the Contract for an alternative method of value testing. Where market testing is selected as the primary value testing method, provisions could be included to allow the Nodal Agency to require a benchmarking process following the initial market test procedure if the market test fails, perhaps due to lack of any bidder other than the incumbent.

15.3.2.5. Similarly, where benchmarking is thought to be the most appropriate value test, it will usually be appropriate to include provisions in the Contract to allow the Nodal Agency to require a market test, at its discretion, with or without a prior benchmarking process. Benchmarking on its own is unlikely to produce best value for money results. Nodal Agency should move to market testing following a benchmarking process where adequate benchmark data was not available, a robust benchmark process had not been achieved, or a price adjustment was not agreed. Further, it would be appropriate to move straight to a market test where benchmarking was selected due to a lack of competitive market, and a sufficiently competitive market has developed between Contract signature and the value testing date.

15.3.2.6. Different Services within the same Project may need different treatment (or possibly the same Service could have different treatment at different points in the Project). Nodal Agency need therefore to consider their options carefully both at the outset and at any value testing point.

### **15.3.3. Planning and Management**

15.3.3.1. At the outset of the Project, when developing its business case, the Nodal Agency should consider what Services it needs and whether it is appropriate to include soft services. An Nodal Agency may decide that only those Services intimately connected with the design solution of the Project, such as hard services, should be included in the Project; a number of hospital projects have taken this route. If soft services are to be included in the Contract, the nature of the individual services and their degree of integration in the design solution and with each other needs to be considered.

15.3.3.2. The Nodal Agency should specify in the PRE-BID DISCUSSIONS when the first value testing exercise will take place. Commonly the value testing exercise will occur at five to seven year intervals with a longer interval before the first exercise. The longer initial period (which should be well into the Service Period) should ensure that bidders do not set a deliberately low initial price that they then try to increase through the review. An excessively long initial period may, however, expose the Nodal Agency to an unreasonable price premium for transferring this risk. Where benchmarking is appropriate, the first benchmarking exercise could be limited such that it is capable of resulting in decrease in price only or a capped increase in price.

15.3.3.3. Some early projects have experienced practical difficulties in managing their benchmarking and market testing procedures and some early contracts lack detail on these processes. Contracts in any event are unlikely to provide a comprehensive blue print for such procedures.

15.3.3.4. Benchmarking and market testing are the responsibility of the PPP Vendor, from both a cost and management perspective. Depending on the Project, this may involve an independent tender manager being employed to manage the market testing and/or benchmarking processes. Having some independent management level (coupled with appropriate information barriers) would be essential where the current service provider, or any bidder, or any member of their respective groups, had a shareholding interest in the PPP Vendor or relevant sub-PPP Vendor.

15.3.3.5. This guidance assumes that the person providing the soft services to be benchmarked or market tested is an operating Sub-PPP Vendor who has a direct contractual relationship with the PPP Vendor. If the relevant Services are instead being provided by a sub-PPP Vendor to such an operating Sub-PPP Vendor, and thus there is no direct contract with the PPP Vendor, the same principles apply. However, in these cases the calculation of pricing adjustments to the Unitary Charge following value testing may become more complicated, since the relationships between cost and price charged to the PPP Vendor become more remote.

## 15.4. Market Testing

15.4.1. As outlined in Section 15.3.2, the recommended approach is to provide for market testing of soft services in the Contract, as this is most likely to yield best value for money. The procedure for market testing should be as follows:

- on certain fixed dates, the PPP Vendor re-tenders the relevant Project Document and conducts a competition for potential replacement sub-contractors (and normally the existing sub-Contractor would be allowed to bid). Care must be taken to avoid any conflict of interest issues, for instance where the PPP Vendor may be part of the same corporate group as any bidder;
- if the competition shows that the PPP Vendor can obtain better value for money with a new winning bidder, then the Unitary Charge should be reduced (as described in Section 15.5.4) and the PPP Vendor would obtain a reduction in cost by appointing the winning bidder as a replacement sub-Contractor; and
- if the competition shows that the PPP Vendor's current sub-PPP Vendor is better value for money than any potential replacement, then the sub-PPP Vendor should continue, but with an appropriate change being made to the Unitary Charge to reflect the subcontractor's bid price.

15.4.2. Information will need to be collected by the PPP Vendor and made available to bidders for the market testing to be effective. For example, information relating to the terms and conditions, job title, age, length of service and benefits of the employees of the service provider engaged wholly or mainly in the provision of the market tested services may be required. The Contract should provide

that this information is provided to the Nodal Agency (see Section 23, (Information and Confidentiality)).

15.4.3. The Contract should also make clear that the market testing of each Service is the responsibility of the PPP Vendor who should ensure a smooth transition between sub-contractors.

The Nodal Agency may however wish to actively support the PPP Vendor in encouraging bidders for the relevant Services, perhaps by the appointment of an independent tender manager, in order to ensure there are sufficient bidders willing to compete against an incumbent Service provider to provide an effective competition.

### **ILLUSTRATIVE DRAFTING:**

#### **Market Testing**

- a) At least [40] weeks before each market testing date, the parties shall meet together as often as may be necessary in respect of all market tested services to be market tested on that date:
  - (i) to consider any changes required to the relevant services;
  - (ii) to discuss and seek to agree the appropriate manner of advertising the services required and the means of identifying prospective bidders;
  - (iii) to discuss and seek to agree the tender requirements which must include:
    - A. a statement of the tender validity period;
    - B. details of the tender evaluation criteria;
    - C. the terms and conditions under which the services will be contracted;
    - D. information relating to employees and their conditions of employment;
    - E. the information that bidders are required to provide;
    - F. how many tenders are required for the market testing to be valid; and
    - G. whether or not an independent tender manager needs to be appointed by the PPP Vendor to manage the tender process.

15.4.4. Where a number of Services are being market tested, the question may arise as to whether bidders must tender for all such Services or whether they can select certain Services and tender in respect of those only (for example, some bidders may only want to take over the data entry function, whereas others may want a wider role). One way of dealing with this is as follows:

#### **Grouping of Services**

Unless the PPP Vendor can demonstrate to the Nodal Agency that best value for money is likely to be achieved for the PPP Vendor if market tested services are tendered separately or in particular groupings, or if any market tested service is divided into separate parts, the grouping of any market tested services shall be left to the discretion of bidders on the basis that the tender requirements shall specify that:

- a) bidders may submit tenders for all or any of the market tested services; and

- b) if a bidder submits a tender for a group or groups of market tested services, then it may be required to provide all or any of the services in such group or groups.

15.4.5. The next step in the market testing provisions will be to specify how bidders are selected<sup>80</sup>. A suggested way of doing this is set out below:

#### **Selection of Bidders**

- a) The PPP Vendor shall be responsible for compiling the list of prospective bidders and selecting the bidders from the list of prospective bidders on the basis of their:
  - (i) financial standing; and
  - (ii) technical and managerial experience and ability (taking into account any relevant references).
- b) The Nodal Agency shall have a right to prevent the selection of any person as a prospective bidder if it reasonably believes that such person does not (or could not reasonably be considered to) comply with any of the criteria referred to in Clause 15.4.4 (a)(iii) above.
- c) The Nodal Agency shall, in its absolute discretion, have the right to prevent the selection of any person as a bidder on the grounds that the prospective bidder has been blacklisted by the agency (or DIT(GoI)).
- d) The Nodal Agency shall have a right to review the list of prospective bidders. The PPP Vendor shall provide the Nodal Agency with an explanation of the reasons behind the non-inclusion on the list of prospective bidders of any person identified as suitable by the Nodal Agency, if so requested by the Nodal Agency.
- e) The PPP Vendor shall provide any prospective bidder which is unsuccessful in being selected with an explanation of the reasons behind its non-selection, if so requested by the person in question.

15.4.6. Once the period for submission of tenders has ended, the PPP Vendor must determine the best tender. The following drafting deals with this issue:

#### **ILLUSTRATIVE DRAFTING:**

- (a) The PPP Vendor shall determine which compliant tender in respect of any market tested service represents the best value for money<sup>81</sup>.
- (b) On making this determination, the PPP Vendor shall supply to the Nodal Agency a copy of its tender evaluation, together with sufficient supporting information concerning the tender evaluation

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<sup>80</sup> The Contract will also have to deal with the extent to which any person is disqualified from selection as a bidder merely by virtue of its connection with any other person in the Project. Typically, no such connection should disqualify a bidder provided an independent tender manager is appointed and appropriate information barriers are put in place. See Section 15.3.3.4

<sup>81</sup> If only one compliant tender is submitted in respect of some or all of the market tested services, the Nodal Agency is at risk of being obliged to pay an uncompetitive price for that part or all of the Service. Accordingly, the Contract may provide a right for the Nodal Agency to prevent the PPP Vendor appointing a single bidder and passing those costs onto the Nodal Agency through the Unitary Charge without its approval. The risks of only one such bid being received in practice should be remote and capable of assessment by the PPP Vendor (unless there are project specific reasons to the contrary) which should enable the PPP Vendor to accept the inclusion of a provision of this nature. If the parties wish to specify what would happen in those circumstances, the provision should be amended on a project specific basis.

to enable the Nodal Agency to analyse and understand the basis for the PPP Vendor's determination.

(c) If the Nodal Agency does not agree with the PPP Vendor's determination, the Nodal Agency may, within 15 Business Days of being provided with the tender evaluation, dispute such determination and, if the parties do not resolve such dispute within a further 15 Business Days, the dispute shall be dealt with in accordance with Clause 25 (Dispute Resolution).

15.4.7. On selection, the winning bidder will take over the provision of the Service and the Unitary Charge should be adjusted on the basis agreed in the Contract. As the PPP Vendor is responsible for the market testing, the Nodal Agency should be indemnified against any claims brought against it (for example, from a losing bidder) as a result of any market testing (for example, for a breach of the agreed market testing procedures).

## 15.5. Benchmarking

15.5.1. The following provisions of this Section 15.5 are relevant if a benchmarking process is included in the Contract, either as the sole value test or included along with market test provisions (as outlined in Section 15.4).

15.5.2. To ensure any benchmarking exercise provides a good comparison with the costs of a Sub-PPP Vendor, the PPP Vendor will have to ensure the following issues are addressed:

- that the cost comparison encompasses only the services being benchmarked;
- that the cost comparison includes factors relating to risks inherent in a change of service provider (such as mobilisation costs);
- that PPP Vendor's own costs are not used as a benchmark;
- whether individual services are to be benchmarked separately, in clusters, or all together;
- whether it is possible to rely on the information being provided by those persons contacted for benchmarking information;
- whether it is possible to verify the appropriateness of the benchmarking information as a comparator for the service being benchmarked; and
- whether there is any other reason or factor that would make benchmarking unrealistic or impracticable.

See further Operational Taskforce guidance referenced at Section 15.3.3.3 above.

15.5.3. The procedure for carrying out a benchmarking exercise is as follows:

- on certain fixed dates, the PPP Vendor compares certain of its costs (e.g. what it pays its Sub-Contractors providing soft services) with equivalent prevailing market costs (e.g. what it would have to pay other Sub-Contractors to provide the equivalent service) and, if appropriate, proposes a variation to the Unitary Charge;
- the Nodal Agency and the PPP Vendor should generally begin planning 40 weeks ahead of the benchmark adjustment date in order to allow sufficient time to complete the benchmarking process (and allow a market testing to occur, should this be needed and

provided for in the Contract), though this period could be longer or shorter depending on the scale and nature of the relevant services;

- if the market cost is higher than the PPP Vendor's current costs and the current Sub-Contractor is still obliged to provide the Service at the lower price, there is no need to adjust the Unitary Charge (it may be that the Sub-Contractor concerned is simply more efficient than the rest of the market);
- if the market cost is higher than the PPP Vendor's current costs and the current Sub- PPP Vendor is contractually entitled to review its price, the Unitary Charge may be adjusted (although this will not necessarily be the case - see Section 15.5.4);
- if the market cost is lower than the PPP Vendor's current costs, there should be an adjustment to the Unitary Charge (see Section 15.5.4). It could be that the Sub- Contractor is not as efficient as its competitors. The price decrease should encourage the PPP Vendor to take appropriate steps to reduce its costs (for example by replacing the sub-Contractor, taking into account the costs of such replacement). The Nodal Agency should encourage efficiency, for example by comparing the PPP Vendor's costs to those of the most efficient quartile of the market, rather than the median;
- the Nodal Agency must have the right to inspect the PPP Vendor's and sub-PPP Vendor's cost information to confirm cost details. Full transparency of cost information is needed for benchmarking to function properly (see Clause 26.2 (PPP Vendor's Records and Provision of Information) and
- if the Nodal Agency and the PPP Vendor cannot agree on any price adjustment or the Nodal Agency is not satisfied that there has been a robust benchmark process, then if the Contract so provides the Service concerned should be market tested (see Section 15.4 (Market Testing)).

15.5.4. The outcome of the review should not necessarily be a direct pass-through to the Nodal Agency of the benefit or burden of all the cost change. There should instead be a formulaic adjustment that shares any cost increase or decrease in a way that incentivizes the PPP Vendor to control its costs. The sharing ratios need not be symmetrical on an upwards and downwards price variation, and the Nodal Agency should assess the likely value for money impact of a greater sharing in a price reduction than a price increase when deciding on such an approach.

## 16. SUB-CONTRACTING, EMPLOYEES AND DOCUMENTARY CHANGES

### 16.1. Control over Sub-Contractors

16.1.1. The Nodal Agency often has the perception that it must retain a large degree of control of a subjective nature over Sub-Contractors. This perceived need for control applies both to the performance of the Sub-Contractors and to any procedure for appointing replacement Sub-Contractors. The PPP Vendor's stated view is often that as it originally selected these Sub-Contractors and has taken risk on their performance, it should be entitled to change them at will (for example, if they are not performing) whilst recognizing the legitimate interest of the Nodal Agency in the identity of key sub-contractors (as provided for in Section 16.1.5).

16.1.2. In general, attempts by the Nodal Agency to control Sub-Contractors are to be discouraged as it is in most cases unnecessary and may dilute the level of risk transfer achievable by the Nodal Agency (see also Section 9.4 (Monitoring of Sub-Contractors)). The Nodal Agency should in any event (if control is needed) generally only seek a degree of control in relation to Sub-Contractors and not in relation to sub-contractors of Sub-Contractors, though the ability to engage directly with the service provider on-site may also be needed (see further Section 13.5.3).

16.1.3. In certain limited cases, there may be overriding reasons why the Nodal Agency should have a degree of control over sub-contractors. For example, there may be national security issues (particularly in some projects related to national security), other public interest issues (e.g. regarding who should be allowed to be involved in social sector e-Governance projects), or the Nodal Agency may have a statutory duty that it needs to carry out.

16.1.4. In such cases, the criteria that a replacement sub-contractor must satisfy should be reasonable (for example, they should require that the potential sub-Contractor is not a threat to national security or other relevant aspect of the public interest). Any judgment that the potential sub-contractor does not satisfy the criteria should be based on objective evidence. For example, a judgment that employment of a certain sub-Contractor would represent a threat to national security or the public interest should be made on the basis of concrete information received from a relevant legal, financial or other Nodal Agency demonstrating that the national interests would be detrimentally affected. In the majority of cases, criteria of this nature will not be needed.

16.1.5. In cases in which there is no specific reason to control sub-contractors, the Nodal Agency may still want some control on the basis that it placed reliance on the original sub-contractor's identity and ability to perform in awarding the Contract to the PPP Vendor. In such cases, satisfaction of a limited set of objective criteria should prove an acceptable level of control to the Nodal Agency and the PPP Vendor. Any such criteria should include: technical ability and competence; and financial strength (including any willingness to give guarantees to the PPP Vendor).

16.1.6. If in the circumstances described the Nodal Agency retains some control over replacement Sub-Contractors or sub-contractors of Sub-Contractors, these controls will also apply to any substitute Sub-Contractors or sub-contractors.



## 16.2. Control over Employees

16.2.1. The Nodal Agency should not generally seek to control whom the PPP Vendor (or its subcontractors) employs, except where there are valid reasons to do so (e.g. overriding public policy considerations, national security issues, security clearances or statutory duties).

16.2.2. The Nodal Agency's concerns are likely to be focused on preventing or terminating the employment of persons with a criminal conviction relevant to their employment. This is unlikely to be an issue for the PPP Vendor where the concern relates to a matter which is also of concern to the PPP Vendor (e.g. dishonesty convictions). The PPP Vendor will be equally keen to build in safeguards into its employment procedures to take action against dishonest employees.

16.2.3. Examples where a degree of Nodal Agency control is required include Ministry of Home Affairs/NATGRID projects, where the Nodal Agency retains a need to approve all staff because of statutory duties relating to sensitive security considerations. The Nodal Agency has the right to prevent the employment, or require the removal, of any staff. Similarly, public policy considerations may mean that an Nodal Agency involved in e-Governance in Primary Education projects, for example, does not want employees with convictions of a certain nature (but, again, the Nodal Agency and PPP Vendor are likely to have a common interest on such issues).

16.2.4. In the cases in which the Nodal Agency is justified in retaining a degree of control over the PPP Vendor's employees, the Nodal Agency should agree the relevant restrictions with the PPP Vendor as part of the bidding process. The PPP Vendor's personnel and employment policy will need to reflect the Nodal Agency's requirements and this may have a cost implication. The Contract provisions should be reasonable and allow the Nodal Agency to veto or require the removal of staff, with the PPP Vendor bearing the risk of the consequences of such action. Any judgment that an employee does not satisfy certain relevant criteria should, to the extent within the Nodal Agency's control, be made on the basis of objective evidence. Contractors should note that certain security clearance procedures may be outside the control of the Nodal Agency.

16.2.5. Controls need to be exercised over employees at the end of the Service Period, where the considerations referred to in Section 18.4 (Handover Provisions for Assets which transfer to the Nodal Agency) apply.

## 16.3. Consequences of Control

16.3.1. If the Nodal Agency does retain some control over sub-contractors and/or employees then the Contract should contain a procedure to be followed to confirm whether the Nodal Agency has any objections to a particular party. Any failure by the Nodal Agency to respond within the specified time limit should be dealt with in accordance with Section 5.2 (Compensation Events). Nodal Agency should consider carefully whether their "approval" can be deemed to be given if they fail to respond.

## 16.4. Changes to Project Documents

16.4.1. The PPP Vendor will want to retain flexibility in case its sub-contracting need updating, but the Nodal Agency will want to ensure that this does not prejudice the Project, and that the Project Documents reviewed by it prior to Financial Close, as part of its due diligence, are not simply rewritten. Section 20 ensures that the Nodal Agency's own exposure to liability on termination of the Contract is not increased without the Nodal Agency's consent, despite any changes being made to the Project Documents.

Nodal Agency should not use this as a device to micro-manage delivery of the Service.

#### **ILLUSTRATIVE DRAFTING:**

##### **Delivery of Initial and Changed Project Documents**

- (a) The PPP Vendor has provided to the Nodal Agency copies of the Project Documents.
- (b) Without prejudice to the provisions of Clauses 16.4.2 or 16.4.3, if at any time an amendment is made to any Project Document, or the PPP Vendor enters into a new Project Document (or any agreement which affects the interpretation or application of any Project Document), the PPP Vendor shall deliver to the Nodal Agency a conformed copy of each such amendment or agreement within ten (10) Business Days of the date of its execution or creation (as the case may be), certified as a true copy by an officer of the PPP Vendor.

##### **Changes to Project Documents**

The PPP Vendor shall perform its obligations under, and observe all of the provisions of, the Project Documents and shall not:

- (a) terminate or agree to the termination of all or part of any Project Document;
- (b) make or agree to any material variation of any Project Document;
- (c) in any material respect depart from its obligations, (or waive or allow to lapse any rights it may have in a material respect), or procure that any counterparty to a Project Document in any material respect departs from its obligations (or waives or allows to lapse any rights they may have in a material respect), under any Project Document; or
- (d) enter into (or permit the entry into by any other person of) any agreement replacing all or part of (or otherwise materially and adversely affecting the interpretation of) any Project Document, unless the proposed course of action (and any relevant documentation) has been submitted to the Nodal Agency for review and there has been no objection made by the Nodal Agency within [ ] Business Days of receipt by the Nodal Agency of such submission, or such shorter period as may be agreed by the parties, [and provided, in the circumstances specified in Clause 16.4.2 (a), that the PPP Vendor has complied with the provisions of [Section 16 (Sub-Contracting, Employees and Documentary Changes)]. The Nodal Agency may only make objection on the following reasonable grounds [ ].

## 17. ASSIGNMENT

### 17.1. Introduction

17.1.1. Over the course of a long-term contract, the identity of the Nodal Agency and the PPP Vendor may change to some extent. This should be recognized at the time of negotiating the Contract and an appropriate balance struck which allows some flexibility for change where appropriate but gives the parties sufficient comfort about the identity and/or creditworthiness of their counterparties.

### 17.2. Restrictions on the PPP Vendor

17.2.1. The Contract should not allow the PPP Vendor to assign, novate or transfer its rights under the Contract.

### 17.3. Restrictions on the Nodal Agency

17.3.1. The Contract should generally not allow the Nodal Agency to assign or transfer its rights or obligations under the Contract without the consent of the PPP Vendor.

17.3.2. The main exceptions to the above are where transfer either takes place under statute. Specific exceptions may also have to be provided for in a particular project if a transfer is anticipated or particular sectors (e.g. the Nodal Agency where transfers may be required due to change in Ministry or re-organization of States). Nodal Agency should recognise that bidders will be concerned to ensure that the transfer could not prejudice their security.<sup>1</sup> If this is not the case, appropriate credit enhancement (e.g. in the form of a guarantee) may be required so that the PPP Vendor's position is not prejudiced. Where such a right is required by the Nodal Agency, appropriate drafting for both central and non-central government projects is set out below.

#### **ILLUSTRATIVE DRAFTING:**

#### **17.3(A) Restrictions on Transfer of the Contract by the Nodal Agency in Central Government Projects**

The rights and obligations of the Nodal Agency under this Contract shall not be assigned, novated or otherwise transferred (whether by virtue of any Legislation or any scheme pursuant to any Legislation or otherwise) to any person other than to any public body (being a single entity) [acquiring the whole of the Contract and] having the legal capacity, power and Nodal Agency to become a party to and to perform the obligations of the Nodal Agency under this Contract being public body whose obligations under this Contract are unconditionally and irrevocably guaranteed (in a form reasonably acceptable to the PPP Vendor) by the Nodal Agency having the legal capacity, power to perform the obligations under the guarantee and the obligations of the Nodal Agency under this Contract.

### **17.3(B) Restrictions on Transfer of the Contract by the Nodal Agency in Non-Central Government Projects**

The rights and obligations of the Nodal Agency under this Contract shall not be assigned, novated or otherwise transferred (whether by virtue of any Legislation or any scheme pursuant to any Legislation or otherwise) to any person other than to any public body (being a single entity) [acquiring the whole of the Contract and] having the legal capacity, power and Nodal Agency to become a party to and to perform the obligations of the Nodal Agency under this Contract being any [Agency] which has sufficient financial standing or financial resources to perform the obligations of the Nodal Agency under this [Contract2]; or any other public body whose obligations under this Contract are unconditionally and irrevocably guaranteed (in a form reasonably acceptable to the PPP Vendor) by the Nodal Agency having the legal capacity, power to perform the obligations under the guarantee and the obligations of the Nodal Agency under this Contract.

### **17.4. Restrictions on the PPP Vendors**

17.4.1. The Nodal Agency may be tempted to seek to limit the ability of PPP Vendors to transfer their rights. This is due in part to a perceived need to have the original equity holders involved who understand the deal negotiated, but is primarily a confidentiality and national security/public policy issue. The Nodal Agency may be concerned, for example, about whose hands project information may be in and to whom the Nodal Agency may end up owing money. The Nodal Agency does not want to become embroiled in national security issues.

17.4.2. The Nodal Agency should not attempt to put restrictions on the identity of the new equity holders unless exceptional circumstances apply. The appropriate way to deal with confidentiality issues, for example, is to impose confidentiality obligations in the Contract.

## 18. TREATMENT OF ASSETS ON EXPIRY OF SERVICE PERIOD

### 18.1. Introduction

18.1.1. A distinction can be drawn between:

- Contracts where it represents best value for money for the Nodal Agency to take control of the Assets on Expiry. This includes Assets where the long-term public sector demand is clear or for which there is no practical alternative use (for example information technology systems, due to its nature, is only of value to the public sector client). These are dealt with in Section 18.2 (Assets where the Nodal Agency Retains Residual Value on Expiry); and
- Contracts where residual value of the Assets is best transferred to the PPP Vendor. These are generally generic Assets which have alternative use outside the public sector and for which there is no clear long-term public sector need (for example generic information technology systems). These are discussed in Section 18.5 (Transfer of Residual Value Risk).

18.1.2. By “residual value” this guidance means, in the context of a Contract, the market value of the Assets associated with the Contract at the time it expires. When the Contract is signed, the residual value of the Assets is not known. “Residual Value Risk” refers to the uncertainty as to what the residual value will prove to be. There will usually be some estimate of the approximate residual value to be expected, which may be factored into the overall financing structure of the Contract.

18.1.3. The Contract should deal comprehensively with the treatment of Assets on all types of terminations. Which party retains the Assets on termination, and whether those Assets have any alternative use, will affect the level of termination payment (if any) payable by the Nodal Agency.

### 18.2. Assets where the Nodal Agency retains Residual Value on Expiry

18.2.1. In most PPP projects, the Nodal Agency’s long-term objectives will be best served by requiring either automatic transfer or reversion of the Assets to itself on expiry of the Contract or at a minimum an option to purchase the assets at nominal cost. This may be because:

- legal constraints prevent any practical alternative option, for example, the private sector cannot be start collecting taxes so all hardware and related software must revert to the Nodal Agency;
- contracts which involve Assets, are specifically designed to cater for a particular service. In these sectors, the Assets have a useful economic life if retained by the Nodal Agency but there is no realistic alternative use for the Assets. There may be only limited scope for alternative use on expiry of the Contract and conversion is likely to be costly;
- the Nodal Agency requires long-term use of the Asset for the continued provision of its services;
- bidders are likely to discount the residual value of the Assets; or

- the expiry of the useful economic life of the Asset means it has no value but there is a separate reason for the Asset, such as any freehold of the land, to revert to the Nodal Agency<sup>82</sup>.

18.2.2. The Contract must, however, protect the Nodal Agency's interest by not restricting the options exercisable at or immediately before the end of the Contract. These may include:

- taking possession of any Assets at no cost;
- retendering the provision of the Service, with the outgoing PPP Vendor making any Assets available to the new PPP Vendor at no cost; and
- removing any Assets.

18.2.3. In most cases in which the Nodal Agency retains Assets at no cost, the Nodal Agency should consider the extent to which it should have recourse to the PPP Vendor if the condition of the Assets reveals that the PPP Vendor has not carried out all its contractual (for example, maintenance) obligations. This would not be necessary if such Assets had reached the end of their useful economic life (as may be the case, for example, in equipment based projects). The Nodal Agency should be driven by its operational requirements and value for money rather than by an attempt to create some residual value interest.

#### **ILLUSTRATIVE DRAFTING:**

##### **Treatment of Assets at Expiry Date**

- (a) On or before a date falling no later than [12]4 months prior to the Expiry Date, the Nodal Agency shall notify the PPP Vendor in writing whether it wishes to retender the provision of the Service.
- (b) If the Nodal Agency wishes to retender the provision of the Service then:
  - (i) the PPP Vendor shall do all necessary acts (including entering into any contracts)
  - (ii) to ensure that the successor PPP Vendor obtains all of its rights, title and interest in and to the Assets with effect on and from the Expiry Date; and
  - (iii) the Nodal Agency will bear all costs of any retendering of the Contract on expiry.<sup>5</sup>
- (c) If the Nodal Agency does not wish to retender the Service then the Assets shall transfer to the Nodal Agency on the Expiry Date and the PPP Vendor shall do any necessary acts (including entering into any contracts) to ensure that the Nodal Agency obtains all of its rights, title and interest in the Assets with effect on and from the Expiry Date.

18.2.4. The parties may also wish the Contract to deal with a mandatory second term option with the existing PPP Vendor (see Section 18.6.3) in conjunction with an open competition<sup>83</sup>. If this is the case, then the retendering would have to be on substantially the same terms as the original Contract<sup>84</sup>, so that this can be evaluated against other bids. The Nodal Agency must also consider

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<sup>82</sup> In some cases, the land will have significant residual value in its own right, notwithstanding that the other Assets may not (see Sections 20.1.1 and 20.5 (Transfer of Residual Value Risk)).

<sup>83</sup> Such a competition may be subject to any procurement regulations applicable at the time

<sup>84</sup> That is, the Unitary Charge may be substantially different, particularly if the incumbent or incoming PPP Vendor is not, as part of the competition, purchasing any Assets, but is taking over existing Assets

what the effect will be on the Nodal Agency's option if it wants to retender on different terms. The effect of this may then be to transfer some residual value risk.

### **18.3. Preserving the Condition of the Assets on Expiry**

18.3.1. Some early Contracts used Terminal Payments at the end of the Contract (even where the Nodal Agency retained control of the Assets on Expiry) as a means of incentivising the PPP Vendor to maintain high standards of Service throughout the Service Period. The argument here is that if there is a Terminal Payment related to the value of the Assets at the end of the Contract then the PPP Vendor will ensure high Service standards are maintained to the end. This argument confuses the purpose of payments for Services and payments for Asset transfer, as service standards can still be low, even if the Assets are very well maintained. Terminal Payments are not therefore recommended (except for any residual value transfer arrangement – see Section 18.6).

18.3.2. The payment mechanism should be the main method by which the Contract incentivizes the PPP Vendor to maintain service standards at all stages of the Contract. If there will be a re-competition of the Service, this provides further incentive on the PPP Vendor to continue to meet the Nodal Agency's requirements until the Expiry Date.

18.3.3. One means of incentivizing the PPP Vendor to maintain Service standards where there is no alternative use for the Assets would be to structure the Contract to give the Nodal Agency an option to enter a secondary Contract period with the initial PPP Vendor. This will increase the incentive for the PPP Vendor to maintain standards through to the Expiry Date, in addition to the payment mechanism incentives, without the need for a Terminal Payment. The PPP Vendor is obliged to enter into a second term if the Nodal Agency decides to exercise its option, but such decision will be taken in the context of an open competition with other bidders. One drawback of this is that the prices for such a second term (if it is added to the typical term for a PPP contract) are very difficult to bid in advance. The likelihood is that at best only a mechanism for calculating the price for the second period can be set out and such a mechanism is of questionable value. The Nodal Agency may, of course, instead opt to contract with another PPP Vendor if this offers better value for money. If this happens, the new PPP Vendor will have to bid to take over the use of the Assets.

### **18.4. Handover Provisions for Assets which Transfer to Nodal Agency**

18.4.1. Provisions dealing with the transfer of the Assets will need to be set out in the Contract. These will have to deal with:

- the condition of the Assets, any rectification works, their cost and how they are paid for (see Sections 11 (Maintenance));
- any design life requirement after the Expiry Date;
- inspection prior to handover;
- checking any rectification works have been done;
- provision for any assignment of warranties, contracts and other rights relating to the Project;
- and

- any disputes in connection with the above.

18.4.2. Other relevant issues include how employees should be dealt with, as they may transfer to any successor PPP Vendor or the Nodal Agency or be with the PPP Vendor.

18.4.3. To the extent that employees are being transferred, then the Contract should contain restrictions on the ability of the PPP Vendor to alter either the number of employees or their terms and conditions as the end of the Contract approaches (such as in the last 2 to 3 years of the Contract).

18.4.4. A general further assurance provision is usually included in relation to termination, such as the following: The PPP Vendor shall take all reasonable steps and co-operate fully with the Nodal Agency and any successor PPP Vendor so that any continuation in the Service is achieved with the minimum of disruption and so as to prevent or mitigate any inconvenience or risk to health or safety of the employees of the Nodal Agency and members of public.

## **18.5. Transfer of Residual Value Risk**

18.5.1. Where there is the potential for alternative use, and hence alternative users, of the Service or any Assets, there may be scope for the Contract to include provisions that transfer some residual value risk to the PPP Vendor. It is crucial that this issue is dealt with as part of the competitive bidding process if it is to deliver real value.

18.5.2. There are a number of issues for an Nodal Agency to consider. First, is it likely to require long term use of the Assets? If so, it is unlikely to derive best value from transferring residual value risk. Second, if the Nodal Agency has no clear long-term requirement for the Assets, is it possible for the Nodal Agency to pass on any residual value risk to the PPP Vendor? Third, will transfer of residual value risk provide value for money? Finally, how will transfer of residual value impact on any payment on termination on expiry of the Contract.

18.5.3. It will not be possible in all cases to leave the residual value risk of the Assets with the PPP Vendor, even if there is some potential for alternative use. The difficulty of estimating value and the required length of the initial Contract may make it uneconomic for the PPP Vendor to estimate the residual value of the Asset at anything other than an insignificant amount. In such circumstances, PPP Vendors are unlikely to accept being exposed to significant residual value risk. It will in such circumstances generally not represent value for money for the Nodal Agency to transfer this risk as the PPP Vendor will expect to obtain its return over the life of the Contract.

18.5.4. If transfer of residual value risk will enhance value for money, the Nodal Agency can pay a Unitary Charge which does not enable the PPP Vendor to cover the complete cost of financing its investment through the service payments it receives during the Contract. The PPP Vendor instead has to rely on value being left in the Assets remaining on the Expiry Date to recover all such cost. This leaves some real risk with the PPP Vendor in relation to the residual value at the end of the Contract. Where this is the case it will be possible to have a shorter Contract length (see Section 2



(Duration of Contract)). Nodal Agency should also consider Residual Value Risk when setting any capital expenditure contribution limits or liabilities (for example on a Qualifying Change of Law – see Sections 14.6 to 14.8).

18.5.5. The options exercisable by the Nodal Agency on the Expiry Date in relation to Assets with an alternative use where the PPP Vendor is taking the residual value risk are:

- to take over the Asset, in which case a payment should be made to the PPP Vendor (see Section 18.6 (Valuation of Terminal Payments on Expiry where Residual Value Risk has been Transferred));
- to re-tender the Service, in which case the successful PPP Vendor in the re-tendering exercise should make a payment to the previous PPP Vendor reflecting the value of the Assets (see Section 18.6 (Valuation of Terminal Payments on Expiry where Residual Value Risk has been Transferred)); or
- if the Nodal Agency has no further use for the Assets, to walk away at no further cost, leaving the PPP Vendor to realise their value.

18.5.6. Each of these options affords the PPP Vendor the ability to realise the value of the Assets upon expiry of the Contract, and accordingly the NPV of the total Unitary Charges payable under the Contract should be lower than if the Residual Value Risk had been retained (subject, of course, to there being a "price discovery"/tender).

#### **ILLUSTRATIVE DRAFTING:**

#### **18.5 Assets with an Alternative Use**

- (a) On or before the date falling [six] months before the Expiry Date, the Nodal Agency shall notify the PPP Vendor in writing whether it wishes to:
- (i) purchase the Assets by paying to the PPP Vendor an amount equal to the Terminal Payment;
  - (ii) retender the provision of the Service; or
  - (iii) do neither (i) nor (ii) above.
- (b) If no notice is given under paragraph (a) above, then the Nodal Agency shall be deemed to have exercised its option under paragraph (a)(iii) and the Assets shall remain with the PPP Vendor.
- (c) If the Nodal Agency wishes to exercise its option under paragraph (a)(i) above, then:
- (i) the PPP Vendor and the Nodal Agency shall do all necessary acts (including entering into any contracts) to ensure that on the Expiry Date, the Assets are transferred to the Nodal Agency;
  - (ii) Within [30] days of effective transfer of ownership of the Assets to the Nodal Agency, the Nodal Agency shall pay to the PPP Vendor the Terminal Payment.
- (d) If the Nodal Agency wishes to exercise its option under paragraph (a)(ii) above, then:
- (i) it shall carry out the retendering with the aim of entering into a new contract with a successor PPP Vendor to provide the Service on and from the Expiry Date;

- (ii) a condition of any retendering shall be that the successor PPP Vendor must pay the PPP Vendor the Terminal Payment on transfer of ownership of the Assets to the successor PPP Vendor; and
- (iii) the PPP Vendor and the Nodal Agency shall do all necessary acts (including entering into any Contracts) to ensure that ownership of the Assets is transferred to the successor PPP Vendor with effect on and from the Expiry Date.

18.5.7. The Contract will also need to take account of Assets retained by the PPP Vendor in the various scenarios where the Contract may be terminated prior to its expiry date. See Section 20.3 (Retention of Assets by PPP Vendor on Termination).

## **18.6. Valuation of Terminal Payments where Residual Value Risk has been Transferred**

18.6.1. The two main options for determining amounts payable by the Nodal Agency at the expiry of the Contract in respect of Assets with an alternative use (and which are owned by the PPP Vendor) are:

- the market value of the Assets in their existing use; and
- an amount bid by the PPP Vendor when negotiating the original Contract, indexed through the duration of the Contract.

These amounts are referred to as “Terminal Payments”.

18.6.2. The market value of the Assets is the more valid basis for a payment to be made at the end of the Contract. If, however, there is a possibility of an extraordinary increase in market value during the duration of the Project and the Assets are critical to the Nodal Agency’s needs (i.e. the Service cannot be obtained without them) then a cap on the amount payable may be prudent (for example, to guard against excessively inflated property prices).

18.6.3. The mechanism for arriving at the market value must be specified in the Contract to avoid a dispute over the valuation. The final amount will reflect the condition of the Assets.

18.6.4. The alternative method (bid amount) referred to in Section 18.6.1 is unlikely to be appropriate. The value paid should reflect the actual value of the Assets (for example, their condition) and a fixed sum transfers no risk in this regard.

## 19. EARLY TERMINATION

The intention of the parties to the Contract should be that it will run its full course and terminate on the Expiry Date (see Section 18 (Treatment of Assets on Expiry of Service Period)), but the Contract must deal comprehensively with the consequences of early termination. The Contract should specify precisely what compensation is payable if it is terminated early. The amount of compensation payable will depend on the reason for termination. Early termination can be caused by Nodal Agency Default (see Section 19.1 (Termination on Nodal Agency Default)), PPP Vendor Default (see Section 19.2 (Termination on PPP Vendor Default)), Force Majeure (see Section 19.3 (Termination on Force Majeure)) and Corrupt Gifts (see Section 19.4 (Corrupt Gifts and Fraud)).

### 19.1. Termination On Nodal Agency Default

#### 19.1.1. Introduction

19.1.1.1. The Contract should define the events that give the PPP Vendor the right to terminate and determine the rights of the relevant parties under this scenario.

#### 19.1.2. PPP Vendor's Right to Terminate for Nodal Agency Default

19.1.2.1. The PPP Vendor should be allowed the right to terminate the Contract where the Nodal Agency or Government acts in a way which renders their contractual relationship untenable or completely frustrates the PPP Vendor's ability to deliver the Service. A minor breach will not fall into this category and even a material breach of itself is likely to be insufficient if the Nodal Agency's actions do not have the effect described above.

#### **ILLUSTRATIVE DRAFTING:**

##### **"Nodal Agency Default"**

means one of the following events:

- (a) an expropriation, sequestration or requisition of a material part of the Assets and/or shares of the PPP Vendor by the Nodal Agency or other Relevant Nodal Agency;
- (b) a failure by the Nodal Agency to make payment of any amount of money exceeding INR. [ ] (indexed) that is due and payable by the Nodal Agency under this Contract within 30 days of service of a formal written demand by the PPP Vendor, where that amount fell due and payable [two] (or more) months prior to the date of service of the written demand;
- (c) a breach by the Nodal Agency of its obligations under this Contract which substantially frustrates or renders it impossible for the PPP Vendor to perform its obligations under this Contract for a continuous period of [two] months, or
- (d) a breach by the Nodal Agency of Clause 17 (Restrictions on Transfer of the Contract by the Nodal Agency) occurs.

19.1.2.2. Beyond this, the circumstances in which the PPP Vendor is permitted to terminate for Nodal Agency Default must be considered on a project by project basis. The Nodal Agency needs to

examine the nature of its obligations during the Contract and should only extend the list of Nodal Agency Default events to include breaches of other obligations which will render the contractual relationship untenable or completely frustrate the PPP Vendor's ability to deliver the Service.

19.1.2.3. Termination by the PPP Vendor should be a last resort and it is important to ensure that there are no "hair triggers" which could put the Nodal Agency at risk of termination before it has had an opportunity to remedy its default. There can be no question of reciprocity with the defaults that trigger a PPP Vendor Default as the obligations of the Nodal Agency are principally payment obligations and approval rights, rather than detailed performance or other credit related obligations.

19.1.2.4. The PPP Vendor should bear in mind that a failure by the Nodal Agency to comply with the provisions of the Contract before Service Commencement (for example issuing approvals) and sometimes after that date, can in most cases be adequately dealt with by way of a Compensation Event (see Section 5 (Supervening Events)). In addition, any failure by the Nodal Agency to pay sums when due should give rise to interest on late payment (see Section 7.2.3 and Clause 27.6 (Interest on Late Payments)) and so a reasonable grace period for non-payment should be built into the Contract and so neither of these should trigger termination.

#### **ILLUSTRATIVE DRAFTING:**

##### **Termination on Nodal Agency Default**

- a. If an Nodal Agency Default has occurred and the PPP Vendor wishes to terminate the Contract, it must serve a termination notice on the Authority within [45] days of becoming aware of the Nodal Agency Default.
- b. The termination notice must specify the type of Nodal Agency Default which has occurred entitling the PPP Vendor to terminate.
- c. The Contract will terminate on the day falling [45] days after the date the Nodal Agency receives the termination notice, unless the Nodal Agency rectifies the Nodal Agency Default within [30] days of receipt of the termination notice.

##### **19.1.3. Compensation on Termination for Nodal Agency Default**

19.1.3.1. The objective should be to ensure that the PPP Vendor is fully compensated (i.e. no worse off because of Nodal Agency Default than if the Contract had proceeded as expected).

19.1.3.2. The PPP Vendor should be required to specify its preferred method of calculation of investment return at the time of its bid. It should choose between the level set out in the original base case, the market value at the time of termination and the original base case return from the Termination Date (see Section 19.1.3.6).

19.1.3.3. The PPP Vendor is likely to incur redundancy costs as a result of the termination of the Contract and, to the extent that these will occur, these should be included in the compensation payable by the Nodal Agency. Similarly, the Sub-Contractors may incur losses as a direct result of the early termination of the Contract (e.g. in respect of cancellation of orders for materials and goods). The Contract should specify those heads of loss which the Nodal Agency will pay to the PPP Vendor,

on account of the Sub-Contractors' losses. If the Nodal Agency proposes to offer compensation to cover the Sub-Contractors' future loss of profits, it should limit the period of time for which it will pay for such future loss (e.g. for a one year period from termination) and satisfy itself (through conducting due diligence over Sub-Contracts or otherwise) that the quantum of the loss of profit and other consequential losses and breakage costs are reasonable and appropriate.

19.1.3.4. The Nodal Agency should also decide what happens to the Assets following a compensation Payment. As the Nodal Agency has fully compensated the PPP Vendor, they should usually revert to the Nodal Agency. Where the assets may have a significant residual value and the PPP Vendor retains the assets then different considerations will apply (see, for example, Section 20.3 (Retention of Assets by PPP Vendor on Termination)).

### **ILLUSTRATIVE DRAFTING:**

#### **Compensation on Termination for Nodal Agency Default**

- (a) On termination of the Contract under Clause 21.1.2 (Termination on Nodal Agency Default) the Nodal Agency shall pay the PPP Vendor the “Nodal Agency Default Termination Sum” in accordance with [Section 20 (Calculation and Payment of Early Termination Payments)] on the Termination Date. Subject to paragraphs (c) to (e) below the Nodal Agency Default Termination Sum shall be an amount equal to the aggregate of:
  - (i) the investments/costs incurred by the PPP Vendor
  - (ii) redundancy payments for employees of the PPP Vendor that have been or will be reasonably incurred by the PPP Vendor as a direct result of termination of this Contract and any Sub-Contractor Breakage Costs;
- (b) On payment of the amount referred to in paragraph (a) above, the Nodal Agency shall have the option to require the PPP Vendor to transfer its right, title and interest in and to the Assets to the Nodal Agency or as directed by the Nodal Agency.

#### **“Relevant Assumptions”**

means the assumptions that the sale of the PPP Vendor is on the basis that there is no default by the Nodal Agency, that the sale is on a going concern basis;

#### **"Sub-Contractor Breakage Costs"**

means Losses that have been or will be reasonably and properly incurred by the PPP Vendor as a direct result of the termination of this Contract, but only to the extent that:

- (a) the Losses are incurred in connection with the Project and in respect of the provision of Services or the completion of Works, including:
  - (i) any materials or goods ordered or Sub-Contracts placed that cannot be cancelled without such Losses being incurred;
  - (ii) any expenditure incurred in anticipation of the provision of services or the completion of works in the future;
  - (iii) the cost of demobilisation including the cost of any relocation of equipment used in connection with the Project; and
  - (iv) redundancy payments; and

- (b) the Losses are incurred under arrangements and/or agreements that are consistent with terms that have been entered into in the ordinary course of business and on reasonable commercial terms [and [ ]];15 and
- (c) the PPP Vendor and the relevant Sub-PPP Vendor has each used its reasonable endeavours to mitigate the Losses;

19.1.3.5. This is the same level of compensation as is appropriate on a voluntary termination by the Nodal Agency (see Section 19.5.3 (Compensation for Voluntary Termination)). Choosing different approaches for these two types of termination could lead to the Nodal Agency to be incentivized to default in certain circumstances, which is why this document recommends that the methods used should be the same for both Voluntary Termination and Termination for Nodal Agency Default.

## 19.2. Termination on PPP Vendor Default

### 19.2.1. Introduction

19.2.1.1. The Contract must deal comprehensively with the possibility of early termination due to PPP Vendor default. It must achieve a fair balance between the Nodal Agency's desire to be able to terminate for inadequate service provision, even if caused by relatively minor defaults (a right which Nodal Agency are used to having in conventional service contracts) and the PPP Vendor's interest in restricting termination to the severest of defaults, when all other reasonable alternative options have been exhausted, including a reasonable rectification period procedure. It should be the Nodal Agency's last resort to exercise rights of termination.

### 19.2.2. Events Leading to Termination

19.2.2.1. The Contract should specify the events of PPP Vendor Default which may lead to termination. As far as practicable, these should be objective, clear and provide for reasonable tolerances, bearing in mind the undesirable consequences of a termination.

#### **ILLUSTRATIVE DRAFTING:**

##### **"PPP Vendor Default"**

means one of the following events:

- (a) a breach by the PPP Vendor of any of its obligations under this Contract which materially and adversely affects the performance of the Service;
- (b) a Persistent Breach occurs;
- (c) a court makes an order that the PPP Vendor [or Holding company] be wound up or a resolution for a voluntary winding-up of the PPP Vendor [or Holding company] is passed;
- (d) [a breach of Clause 16 (Sub-Contracting, Employees and Documentary Changes) occurs;]
- (e) [a breach by the PPP Vendor of its obligations in Clause [17] (Assignment) occurs;]
- (f) [a breach of Clause [18] (Change of Ownership) occurs;]
- (g) the abandonment of the Contract by the PPP Vendor;
- (h) a failure to achieve the Service Commencement Date by [date];

- (i) a failure to provide [ ] Available [places/areas] [availability for use] for [x] period;
- (j) the accumulation of [ ] or more [performance points] in any [Quarter/Year];
- (k) a breach by the PPP Vendor of its obligation to take out and maintain Required Insurances.

19.2.2.2. Other events of default may be included on a project-specific basis. If the Nodal Agency places restrictions on assignment, change in ownership or replacement of Sub-Contractors, then it may be appropriate to include a corresponding event of default for breach of such restrictions (see Sections 16 (Sub-Contractors, Employees and Documentary Changes) and 17 (Assignment)). Similarly, if the Project is in a security-sensitive sector, breach of specific security requirements might be included. Generally, it is not necessary to include non-payment of sums by the PPP Vendor as a PPP Vendor Default as the PPP Vendor's payment obligations are limited and the Nodal Agency should have the ability to set off certain amounts (see Section 12 (Payments and Set-off)), although particular projects may require this (e.g. where the Project has significant third party income).

19.2.2.3. Generally, insolvency events of default should not be extended to include Sub-Contractor's or the PPP Vendor's shareholders. This is because the PPP Vendor will in any event be incentivised to replace the Sub-PPP Vendor concerned to ensure performance of the Contract. An exception to this would be where the contractual structures concerned make it necessary that such parties owe unusually significant financial or contractual obligations to the PPP Vendor (or the Nodal Agency) and no replacement can be found who would match such obligations.

19.2.2.4. Termination should be subject to any rectification procedures (see Section 19.2.4 (Rectification)). Accrued performance points should not generally be altered on appointment of a replacement Sub-Contractor (see Section 9.3 (Replacement of Sub-Contractors)).

19.2.2.5. These events are not mutually exclusive, since breaches covered under certain events (e.g. performance point limit) can still be caught under other default events.

### **19.2.3. Termination for Persistent Breach by the PPP Vendor**

19.2.3.1. The Contract should dis-incentivize the PPP Vendor in some way in respect of any breach by the PPP Vendor, however minor. There are various means to deal with the persistent occurrence of minor defaults. The recommended approach is to impose performance points in respect of all types of minor defaults. This is a particularly effective means of dis-incentivizing the PPP Vendor when coupled with a right to terminate the Contract if the total number of performance points accrued exceeds a certain level (see above).

19.2.3.2. It may not be feasible in every case to negotiate an all-encompassing performance points regime. This could leave the Nodal Agency exposed to a situation in which minor breaches are occurring persistently or being left un-remedied, but as they have no effect on the Unitary Charge, the Nodal Agency will have little ability to influence the PPP Vendor to perform. If such circumstances are likely to exist, the Nodal Agency should retain a right to terminate the Contract for Persistent Breach. The PPP Vendor will be anxious to avoid a "hair trigger" default and will wish to ensure the mechanics relating to this default are as objective as possible.

19.2.3.3. The Contract should therefore include a warning procedure which provides that the PPP Vendor is served a formal preliminary notice that a certain type of breach has been persistently occurring. The PPP Vendor should in any case be aware of such breaches already. If such breach continues to occur persistently in, say, the 12 months following such notice (allowing a short rectification period), a final notice is served warning the PPP Vendor that any further single occurrence of such breach in, say, the following 6 months will entitle the Nodal Agency to terminate the contract. This then gives the PPP Vendor the opportunity to remedy. The Nodal Agency should consider whether it requires a persistent breach remedy during the solution development period as well as the operational period. The concerns of the Nodal Agency in the solution development period are likely to be greater when the Nodal Agency shares the site during that period.

#### **ILLUSTRATIVE DRAFTING:**

##### **“Persistent Breach”**

means a breach for which a final warning notice (referred to in paragraph (b) of Clause 21.2.3 (Persistent Breach)) has been issued, which has continued for more than [ ] days or recurred in [ ] or more months within the [six] month period after the date on which such final warning notice is served on the PPP Vendor<sup>85</sup>;

##### **Persistent Breach**

- (a) If a particular breach, other than any breach for which performance point deductions could have been awarded and/or availability deductions could have been made, has continued for more than [ ] days or occurred more than [ ] times in any [ ] month period then the Nodal Agency may serve a notice on the PPP Vendor:
  - (i) specifying that it is a formal warning notice;
  - (ii) giving reasonable details of the breach; and
  - (iii) stating that such breach is a breach which, if it recurs frequently or continues, may result in a termination of this Contract.
- (b) If, following service of such a warning notice, the breach specified has continued beyond 30 days or recurred in [ ] or more months<sup>86</sup> within the [ ] month period after the date of service, then the Nodal Agency may serve another notice on the PPP Vendor:
  - (i) specifying that it is a final warning notice;
  - (ii) stating that the breach specified has been the subject of a warning notice served within the [twelve] month period prior to the date of service of the final warning notice; and

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<sup>85</sup> This event of default addresses “Persistent Breaches” of the same type where each single breach may in itself not constitute a material breach but the persistent nature renders the contractual relationship untenable. This type of default should be used where the performance regime is not able to cover all types of breaches and the Nodal Agency would otherwise be left with no sanction for persistent failure by the PPP Vendor to perform. This does not address the Persistent Breaches of different types (since persistent service failures covered by the performance regime are excluded by the definition). This does not mean that the Persistent Breach Clause should itself include wording to the effect that the relationship between the Nodal Agency and the PPP Vendor has become untenable, which is in itself highly subjective. The mechanism in Clause 21.2.3 relating to warning notices, and final warning notices, leading to termination, in itself demonstrates that the relationship between the parties has become untenable. Neither should the Clause be amended to the effect that the Nodal Agency, in terminating the Contract for Persistent Breach, is acting in a “reasonable and proportionate manner”. Again, the detailed mechanism in Clause 21.2.3 is itself sufficient in ensuring that the right to terminate is only exercised for repeated failures following service of a series of warnings, and final warning notices, to the PPP Vendor

<sup>86</sup> This will depend on the particular breach concerned, but a certain number of recurrences should be specified. In paragraph (b) (but not in (a)) it is provided that the persistent breach should occur across a number of months in order for it to accrue towards possible termination.



- (iii) stating that if such breach continues for more than [ ] days or recurs in [ ] or more months within the [six] month period after the date of service of the final warning notice, the Contract may be terminated.
- (c) A warning notice may not be served in respect of any breach which has previously been counted in the making of a separate warning notice.

19.2.3.4. Once a termination notice is served for a Persistent Breach, the PPP Vendor should not be entitled to any further rectification period.

#### **19.2.4. Rectification**

19.2.4.1. The Nodal Agency should afford the PPP Vendor the opportunity of remedying any breach capable of remedy and/or financially compensating the Nodal Agency for the effects of the breach. As stated in Section 19.2.1 (Introduction), termination should only be used as a last resort. Accordingly, the Contract should set out a mechanism allowing the PPP Vendor the opportunity to remedy breaches which are capable of remedy to avoid termination. Rectification will not be appropriate in respect of all types of breach. Some breaches may not be capable of remedy (for example, failure to complete solution development by the long-stop date) and some events may only qualify as termination events after some kind of grace has already been given (e.g. after the accrual of a specified level of performance points or because of the tolerances contained in the Persistent Breach concept).

#### **ILLUSTRATIVE DRAFTING:**

##### **Rectification**

- a) If a PPP Vendor Default has occurred and the Nodal Agency wishes to terminate the Contract, it must serve a termination notice<sup>87</sup> on the PPP Vendor.
- b) The termination notice must specify:
  - (i) the type and nature of PPP Vendor Default that has occurred, giving reasonable details; and
  - (ii) that in the case of any PPP Vendor Default falling within (a), (d), (e), (f) and (k) of the definition of PPP Vendor Default this Agreement will terminate on the day falling [sixty] days after the date of the date the PPP Vendor received the termination notice, unless:
    - A) in the case of a breach under (a) of the definition of PPP Vendor Default the PPP Vendor puts forward an acceptable rectification programme within [thirty] days after the date the PPP Vendor receives the Termination Notice (and implements such programme in accordance with its terms and rectifies the PPP Vendor Default in accordance with the programme); or
    - B) in the case of any PPP Vendor Default falling with the (a), (d), (e), (f) and (k) of the definition of PPP Vendor Default the PPP Vendor rectifies the PPP Vendor

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<sup>87</sup> This notice will specify at least the information in paragraph (b).

Default within [sixty] days after the date the PPP Vendor receives the Termination Notice; or

- (iii) that in the case of any other PPP Vendor Default (not being (a), (d), (e), (f) or (k)), this Agreement will terminate on the date falling [thirty] days after the date the PPP Vendor receives the termination notice.
- c) If the PPP Vendor either rectifies the PPP Vendor Default within the time period specified in the termination notice, or implements the rectification programme, if applicable, in accordance with its terms, the termination notice will be deemed to be revoked and the Contract will continue.
- d) If:
  - (i) in the case of a PPP Vendor Default within (a) of the definition of that term no acceptable rectification programme has been put forward pursuant to Clause 21.2.4(b)
  - (ii) (A) and the PPP Vendor fails to rectify the PPP Vendor Default within the time period specified in the termination notice; or
  - (ii) in the case of a PPP Vendor Default falling within (d), (e), (f), or (k) of the definition of PPP Vendor Default, the PPP Vendor fails to rectify the PPP Vendor Default within the time period specified in the termination notice,the Nodal Agency may give notice stating that the Contract will terminate on the date falling [seven] days after the date of receipt of such notice.
- e) If the PPP Vendor fails to implement any rectification programme in accordance with its terms, the Contract will, terminate on the date falling [seven] days after the date of notification by the Nodal Agency to the PPP Vendor of such failure to implement the rectification programme in accordance with its terms.

19.2.4.2. The rectification procedure should allow the PPP Vendor to propose a rectification programme which the Nodal Agency may comment on and approve. There will usually be a fixed period within which such programme must be carried out, although it may be appropriate to agree a different, reasonable, period in circumstances where the period set out in the Contract is agreed to be inappropriate, taking into account the nature of the specific breach.

19.2.4.3. During the rectification period it will be to the PPP Vendor's benefit to claim that a Relief Event has occurred. It is for this reason that wilful acts and defaults of the PPP Vendor are excepted from the definition of Relief Events (see Section 5.3.2 (Scope of Relief Events)). Failure to rectify the default within the agreed period will lead to termination.

### **19.2.5. Compensation on Termination for PPP Vendor Default**

19.2.5.1. One question that may be asked is why compensation should be paid to the PPP Vendor when it has failed to perform in accordance with the Contract. Under a typical service contract, not only would no compensation be paid but the non-performing party could expect the innocent party to bring claims for damages. The reason that compensation is paid is that a failure to compensate could unfairly benefit the Nodal Agency. This would be the case, for example, where a particular asset is developed to deliver a particular service and the Nodal Agency is entitled to have the asset transferred to it on a termination without compensating the PPP Vendor for its value. The question

that is then relevant is how best to assess what an appropriate level of compensation is for PPP Vendor Default.

19.2.5.2. The amount of compensation payable on PPP Vendor Default termination is one of the key commercial issues for all parties concerned. The market value approach described below is the required approach for all PPP projects.

19.2.5.3. In order to understand why the market value principle has been adopted, and accepted by the PPP market, it is helpful to understand the variety of alternatives which preceded it. These ranged from early roads projects, which provided for no compensation for PPP Vendor Default, prisons projects, which offered no compensation for termination, early accommodation, schools and hospital projects, which were based on a wide range of calculations usually linked to capital costs less rectification costs and during the Service Period to the NPV of future cashflows, and some contracts which virtually guaranteed (implicitly or explicitly) full payout of debt.

19.2.5.4. The market value approach represents a balance between protecting the Nodal Agency's interests and not imposing unreasonable deductions on the PPP Vendor for its default.

19.2.5.5. The "no compensation" models have been driven by a proper concern. They do expose, however, the public sector to the charge that it is seeking a possible gain in the event that termination occurs (e.g. if it takes over a valuable asset), although this may be refuted by the Nodal Agency agreeing to pay the market value for any assets to be transferred to it.

They may also serve to increase the cost of projects to the public sector by forcing bidders to take a conservative approach to risk pricing, liquidated damages and the limits on liability they require from their Sub-Contractors.

**19.2.5.6.** On the other hand, calculations based on the NPV of future cashflows proved extremely complex and difficult to negotiate. In practice, they are unlikely to take full account either of the performance history of the defaulting Project (and so expectations of future performance), the extra costs accruing to the Nodal Agency over the period of the Contract or of the risk transfer to the PPP Vendor (particularly in relation to whole life costing).

## **19.3. Termination on Force Majeure**

### **19.3.1. Failure to agree**

19.3.1.1. As set out in Section 5.4 (Force Majeure Events), the Contract should define the Force Majeure Events that can lead to termination and determine the rights of the relevant parties if this occurs. If a Force Majeure Event occurs and the parties cannot agree a solution within a specified period (6 months is typical), either party is entitled to terminate the Contract with compensation payable to the PPP Vendor as set out in Section 19.3.2 (Compensation on Termination for Force Majeure). The Contract should, however, give the Nodal Agency the right to prevent termination by

paying the PPP Vendor as if the Service were being fully provided after such period. In such circumstances the Nodal Agency should specify a fixed period for which it will make such payment, before reconsidering the situation, so that the PPP Vendor can plan accordingly.

### **ILLUSTRATIVE DRAFTING:**

#### **Termination on Force Majeure**

- (a) No party shall be entitled to bring a claim for a breach of obligations under the Contract by the other party or incur any liability to the other party for any losses or damages incurred by that other party to the extent that a Force Majeure Event occurs and it is prevented from carrying out obligations by that Force Majeure Event. For the avoidance of doubt (but without prejudice to Clauses 21.3(e) or 21.3(g)), the Nodal Agency shall not be entitled to terminate this Agreement for a PPP Vendor Default if such PPP Vendor Default arises from a Force Majeure Event.
- (b) Nothing in paragraph (a) above shall affect any entitlement to make deductions or any deductions made as a result of [Section 5 (Price and Payment Mechanism)] in the period during which the Force Majeure Event is subsisting.
- (c) On the occurrence of a Force Majeure Event, the Affected Party shall notify the other party as soon as practicable. The notification shall include details of the Force Majeure Event, including evidence of its effect on the obligations of the Affected Party and any action proposed to mitigate its effect.
- (d) As soon as practicable following such notification, the parties shall consult with each other in good faith and use all reasonable endeavours to agree appropriate terms to mitigate the effects of the Force Majeure Event and facilitate the continued performance of the Contract.
- (e) If no such terms are agreed on or before the date falling [120] days after the date of the commencement of the Force Majeure Event and such Force Majeure Event is continuing or its consequence remains such that the Affected Party is unable to comply with its obligations under this Contract for a period of more than [180] days, then, subject to paragraph (f) below, either party may terminate the Contract by giving [30] days' written notice to the other party.
- (f) If the Contract is terminated under paragraph (e) above or (g) below:
  - (i) compensation shall be payable by the Nodal Agency in accordance with Clause 21.3.2 (Compensation on Termination for Force Majeure); and
  - (ii) the Nodal Agency may require the PPP Vendor to transfer its title, interest and rights in and to any Assets to the Nodal Agency.
- (g) If the PPP Vendor gives notice to the Nodal Agency under paragraph (e) above that it wishes to terminate the Contract, then the Nodal Agency has the option either to accept such

notice or to respond in writing on or before the date falling [10] days after the date of its receipt stating that it requires the Contract to continue. If the Nodal Agency gives the PPP Vendor such notice, then:

- (i) the Nodal Agency shall pay to the PPP Vendor the Unitary Charge from the day after the date on which the Contract would have terminated under paragraph (e) as if the Service was being fully provided; and
  - (ii) the Contract will not terminate until expiry of written notice (of at least [30] days) from the Nodal Agency to the PPP Vendor that it wishes the Contract to terminate.
- (h) The parties shall at all times following the occurrence of a Force Majeure Event use all reasonable endeavours to prevent and mitigate the effects of any delay and the PPP Vendor shall at all times during which a Force Majeure Event is subsisting take all steps in accordance with industry good practice to overcome or minimize the consequences of the Force Majeure Event.
- (i) The Affected Party shall notify the other party as soon as practicable after the Force Majeure Event ceases or no longer causes the Affected Party to be unable to comply with its obligations under this Contract. Following such notification the Contract shall continue to be performed on the terms existing immediately prior to the occurrence of the Force Majeure Event.

### **19.3.2. Compensation on Termination for Force Majeure**

19.3.2.1. If the Contract terminates for Force Majeure, the Nodal Agency should pay compensation to the PPP Vendor reflecting the principle that Force Majeure is neither party's fault and the financial consequences should to some extent be shared. There is, however, no equitable reason for "full" compensation as this would involve the Nodal Agency in bearing all the pain.

19.3.2.2. The Contract should in addition provide the Nodal Agency with the option to retain or walk away from the Assets. Whatever the Nodal Agency decides, only the payment outlined in Clause 21.3.2 (Compensation on Termination for Force Majeure) should be made.

### **ILLUSTRATIVE DRAFTING:**

#### **Compensation on Termination for Force Majeure**

- (a) On termination of the Contract under Clause 21.3 (Termination on Force Majeure), the Nodal Agency shall pay to the PPP Vendor the "Force Majeure Termination Sum" in accordance with [Section 20 (Calculation and Payment of Early Termination Payments)]. Subject to paragraphs (c) to (e) below the Force Majeure Termination Sum shall be the amount equal to the aggregate of:
- (i) the Termination Amount;
  - (ii) redundancy payments for employees of the PPP Vendor that have been or will be reasonably incurred by the PPP Vendor as a direct result of termination of the Contract and any Sub-Contractor Breakage Costs.

- (b) If the amounts referred to in paragraphs (a) are less than zero, then, for the purposes of the calculation in paragraph (a) they shall be deemed to be zero.
- (c) On termination, the Nodal Agency shall have the option to require the PPP Vendor to transfer to the Nodal Agency all of its right, title and interest in and to the Assets.

## 19.4. Termination on Corrupt Gifts and Fraud

### 19.4.1. Introduction

19.4.1.1. The Contract must deal comprehensively with termination as a result of corrupt acts or fraud involving the PPP Vendor, any sub-Contractor and any Public Servant.

19.4.1.2. A balance must be struck between the Nodal Agency's proper desire for the right to free itself from a corrupt or fraudulent partner.

### **ILLUSTRATIVE DRAFTING:**

#### **"Prohibited Act"**

means

- (a) offering giving or agreeing to give to [any Public Servant] any gift or consideration of any kind as an inducement or reward:
  - (i) for doing or not doing (or for having done or not having done) any act in relation to the obtaining or performance of this Contract or any other contract with the Nodal Agency / concerned department; or;
  - (ii) for showing or not showing favour or disfavour to any person in relation to this Contract or any other contract with the Nodal Agency / concerned department;
- (b) entering into this Contract or any other contract with the Nodal Agency / concerned department in connection with which commission has been paid or has been agreed to be paid by the PPP Vendor or on its behalf, or to its knowledge, unless before the relevant contract is entered into particulars of any such commission and of the terms and conditions of any such contract for the payment thereof have been disclosed in writing to the Nodal Agency;
- (c) committing any offence:
  - (i) under the Prevention of Corruption Act;
  - (ii) under Legislation creating offences in respect of fraudulent acts, or
  - (iii) at common law in respect of fraudulent acts in relation to this Contract or any other contract Nodal Agency/concerned department; or
- (d) defrauding or attempting to defraud or conspiring to defraud the Crown.

### 19.4.2. Scope of Corrupt Gifts and Fraud

19.4.2.1. The corrupt gifts and fraud provision is aimed at all types of bribery, corruption and fraudulent acts perpetrated against the Nodal Agency, in connection with the procurement of the Contract and the ongoing contractual relationship.

19.4.2.2. As the Nodal Agency's ultimate sanction to terminate for such acts is severe, the recommended approach allows the PPP Vendor the opportunity to avoid termination where the act has been carried out by a sub-Contractor or employee acting on his own. Within a specified reasonable time period, the PPP Vendor has to ensure that any relationship with the relevant party is terminated and, if applicable, a replacement procured for such party.

19.4.2.3. The following approach is the most appropriate way of dealing with the issue:

- if the relevant breach is committed by the PPP Vendor or one of its employees and this is not the action of an employee acting independently, the Nodal Agency may terminate the Contract on payment of Termination Amount and can recover from the PPP Vendor either any losses it suffers as a result of the breach or the amount of the value of the corrupt gift in question. If the breach is the result of the action of an employee acting independently, then the PPP Vendor should terminate the person's employment and procure a replacement within [30] days of notice of the breach. If this is not done, then the Contract can be terminated on payment of the Termination Amount and recovery of the Nodal Agency's losses;
- if the breach is committed by one of the PPP Vendor's main Sub-Contractors (e.g. Sub-Contractor) or their employee and this is not the action of an employee acting independently, the Nodal Agency may terminate the Contract as above, unless the PPP Vendor terminates the relevant main Sub-Contract and procures the performance of such service by another person within [30] days of notice of the breach. If the breach is the result of the action of an employee acting independently, then the Sub- PPP Vendor should terminate that person's employment and procure a replacement within [30] days of notice of the breach. If this is not done, then the Contract can be terminated on payment of the Termination Amount and recovery of the Nodal Agency's losses;
- if the breach is committed by any other party, the Nodal Agency may terminate as above unless within 30 days of notice of the breach the PPP Vendor procures the termination of the employment of such person and of their employer (if not employed by the PPP Vendor or its main Sub-Contractors) and the performance of such service by another person.

#### **ILLUSTRATIVE DRAFTING:**

##### **Corrupt Gifts and Fraud**

The PPP Vendor warrants that in entering the Contract it has not committed any Prohibited Act.

##### **Termination for Corrupt Gifts and Fraud**

- (a) If the PPP Vendor or any Sub-Contractor (or anyone employed by or acting on behalf of any of them) or any of its or their agents or shareholders commits any Prohibited Act, then the Nodal Agency shall be entitled to act in accordance with paragraphs (b) to (g) below.

- (b) If a Prohibited Act is committed by the PPP Vendor or by an employee not acting independently of the PPP Vendor, then the Nodal Agency may terminate the Contract by giving notice to the PPP Vendor.
- (c) If the Prohibited Act is committed by an employee of the PPP Vendor acting independently of the PPP Vendor, then the Nodal Agency may give notice to the PPP Vendor of termination and the Contract will terminate, unless within [30] days of receipt of such notice the PPP Vendor terminates the employee's employment.
- (d) If the Prohibited Act is committed by a Sub-Contractor or by an employee of that Sub-Contractor not acting independently of that Sub-PPP Vendor, then the Nodal Agency may give notice to the PPP Vendor of termination and the Contract will terminate, unless within [30] days of receipt of such notice the PPP Vendor terminates the relevant Project Document.
- (e) If the Prohibited Act is committed by an employee of a Sub-Contractor acting independently of that Sub-Contractor, then the Nodal Agency may give notice to the PPP Vendor of termination and the Contract will terminate, unless within [30] days of receipt of such notice the Sub-PPP Vendor terminates the employee's employment and (if necessary) procures the performance of such part of the Works and/or Service by another person.
- (f) If the Prohibited Act is committed by any other person not specified in paragraphs (b) to (e) above, then the Nodal Agency may give notice to the PPP Vendor of termination and the Contract will terminate unless within [30 days] of receipt of such notice, the PPP Vendor procures the termination of such person's employment and of the appointment of their employer (where not employed by the PPP Vendor or the Sub-Contractors).
- (g) any notice of termination under this Clause shall specify:
  - (i) the nature of the Prohibited Act;
  - (ii) the identity of the party whom the Nodal Agency believes has committed the Prohibited Act;
  - (iii) the date on which the Contract will terminate, in accordance with the applicable provision of this Clause; and
  - (iv) the Nodal Agency's chosen option under Clause 21.4.3 (Compensation on Termination for Corrupt Gifts and Fraud).

#### **19.4.3. Compensation on Termination for Corrupt Gifts and Fraud**

19.4.3.1. Regardless of whether or not the Assets have any alternative use, only the Termination Amount should be paid out on a termination for Corrupt Gifts or Fraud. If the Nodal Agency wishes to have the right to terminate, it should accept such level of compensation.

#### **ILLUSTRATIVE DRAFTING:**

##### **Compensation on Termination for Corrupt Gifts and Fraud**

- (a) On termination of the Contract in accordance with Clause 21.4.3 (Termination for Corrupt Gifts and Fraud), then the Nodal Agency shall pay the PPP Vendor an amount equal to the Termination Amount.



- (b) Such amount shall be determined and paid in accordance with [Section 20 (Calculation and Payment of Early Termination Payments)].
- (c) If termination occurs then the Nodal Agency may require the PPP Vendor to transfer its rights, title and interest in and to the Assets to the Nodal Agency.

## 19.5. Voluntary Termination by Nodal Agency

### 19.5.1. Introduction

The intention of all parties to a Contract should be that it will run its full course. There may be circumstances, however, in which the Nodal Agency is no longer able to continue the relationship it has with the PPP Vendor under a Contract. For example, there may be a policy change which makes further provision of the Service redundant. In order to cater for such circumstances, the Nodal Agency may wish to retain the right to terminate the contract voluntarily.

### 19.5.2. Consequences of Voluntary Termination

19.5.2.1. The PPP Vendor should not object to the Nodal Agency having such a right provided that it is compensated in full if such right is exercised.

### 19.5.3. Compensation for Voluntary Termination

19.5.3.1. The PPP Vendor should receive a termination payment which leaves it in the position it would have been in had the Contract run its full course.

19.5.3.2. Regardless of whether or not the asset has any alternative use, the level of compensation on a voluntary termination should be the same as the level proposed on a termination for Nodal Agency default (see Section 19.1.3 (Compensation on Termination for Nodal Agency Default)).

19.5.3.3. Again, the Contract should clarify what happens to the asset following such full payout. It would usually be expected to revert to the Nodal Agency.

### **ILLUSTRATIVE DRAFTING:**

#### **Voluntary Termination by the Nodal Agency**

- (a) The Nodal Agency may terminate the Contract at any time on or before its Expiry Date by complying with its obligations under paragraphs (b) to (d) below<sup>88</sup>.
- (b) If the Nodal Agency wishes to terminate the Contract under this Clause, it must give notice to the PPP Vendor stating:
  - (i) that the Nodal Agency is terminating the Contract under this Clause 21.5.1 (Voluntary Termination by Nodal Agency);
  - (ii) that the Contract will terminate on the date specified in the notice, which must be a minimum of [30] days after the date of receipt of the notice; and
  - (iii) whether the Nodal Agency has chosen to exercise its option under paragraph (c) below.

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<sup>88</sup> This could arise, for example, if the Nodal Agency did not wish the Project to continue for reasons unconnected with the PPP Vendor

- (c) On termination, the Nodal Agency shall have the option to require the PPP Vendor to transfer its right, title and interest in and to the Assets to the Nodal Agency or as directed by the Nodal Agency.
- (d) The Contract will terminate on the date specified in the notice referred to in paragraph (b) above;

#### **19.5.2 Compensation on Voluntary Termination**

On termination under Clause 21.5.1(d) above, the Nodal Agency shall pay the PPP Vendor an amount equal to the amount payable under Clause 21.1 (Nodal Agency Default) in accordance with [Section 20 (Calculation and Payment of Early Termination Payments)].

## 20. CALCULATION & PAYMENT OF EARLY TERMINATION PAYMENTS

### 20.1. Introduction

20.1.1. This Section sets out the principles which should apply to termination payments.

### 20.2. Method of Payment

20.2.1. Where an incoming PPP Vendor pays market value on PPP Vendor Default termination, or the Contract is terminated for Nodal Agency Default, the Nodal Agency should pay the PPP Vendor by way of a lump sum.

20.2.2. On other types of termination, the Contract should deal with how compensation is paid. Value for money issues should be taken into consideration which in most cases will mean that compensation payments by lump sum will be the appropriate position. Value for money is unlikely to be achieved if the Nodal Agency repays such amounts over time (i.e. in installments), as interest will continue to accrue on the compensation.

20.2.3. While the above is the general position, Nodal Agency may wish to reserve the option to pay over time due to affordability constraints, particularly as their ability to generate funds at short notice may be limited. Therefore, where a Nodal Agency seeks the right to pay compensation by installments.

20.2.3.1. The PPP Vendor will require the Nodal Agency to pay interest on any outstanding balance at the rate the Government provides interest on tax refunds.

#### **ILLUSTRATIVE DRAFTING:**

##### **Method of Payment**

The Nodal Agency shall pay to the PPP Vendor the Termination Sum, together with interest on any Termination Amount, on or before the date falling 60 days after the Notice Date.

### 20.3. Retention of Assets by PPP Vendor on Termination

20.3.1. To the extent the PPP Vendor retains Assets on a termination, then their value should be deducted from any compensation payments made. The value of the Assets will be close to zero in the case of Assets with no alternative use and so there may be no need to deal with this issue in the Contract. Where residual value exists the Nodal Agency should, however, carefully consider likely residual value out-turns, as the commercial incentives can be different if the residual value were to be significant. In certain scenarios (e.g. if residual value could exceed the original return) residual value could distort the effect of any compensation payment (e.g. for PPP Vendor Default) and reduce the incentives to perform that would otherwise exist.



## 21. INDEMNITIES, GUARANTEES AND CONTRACTUAL CLAIMS

### 21.1. Introduction

21.1.1. The Nodal Agency will often be contracting with a PPP Vendor (which may be in the shape of an SPV) with no track record of public service delivery and whose main asset is the Contract. The Nodal Agency will therefore require comfort that the PPP Vendor and its Sub-Contractors will be able to meet their contractual obligations to provide the Service and any corresponding financial liabilities.

21.1.2. In a traditional procurement, such comfort would normally take the form of guarantees, indemnities and collateral warranties to the Nodal Agency provided by the principal PPP Vendor, its parent company and Sub-Contractors. Under PPP, where the PPP Vendor is not paid if the Service is not delivered, such extensive direct comfort will not normally be necessary or appropriate.

21.1.3. The Nodal Agency will, however, require certain types of comfort from the PPP Vendor. This Section advises on the type of comfort the Nodal Agency should normally expect.

### 21.2. Guarantees

21.2.1. Nodal Agency will have to be sure that continuity of service supply is maintained even if their counterparty is insolvent. In many service contracts this can be done by way of a guarantee by a parent company (whether this company is the ultimate parent company in a group or a sufficiently claim worthy person will be a matter for negotiation). In a Contract for the period of time that PPP contracts are typically provided for, such guarantees can be of much less value.

21.2.2. In case the PPP vendor is a limited liability company (which generally is the case), or a SPV is formed after the contract is awarded, it results in isolating and limiting the liabilities of the Project from those of the shareholders. Consequently, the obtaining of direct guarantees by the Nodal Agency is not normally appropriate. The Nodal Agency should generally not insist on receiving guarantees from the parent companies of a Sub-Contractor or the PPP Vendor's shareholders in respect of the obligations of the PPP Vendor.

21.2.3. A well-advised Nodal Agency can usually obtain sufficient comfort from ensuring that the PPP Vendors and its Sub-Contractors have a suitable track record and financial standing, that the levels of equity are sufficient to demonstrate a commitment of shareholders to the Project and the rest of the financing structure is sufficiently robust. Appropriate levels of equity may well differ in the operating period from the development or solution development period and will vary from project to project. This involves an analysis of the entirety of the structure (including the Contract, all Project Documents and any limits on liability of the PPP Vendor, Sub-Contractors under their Sub-Contracts) and any liability interfaces (such as which Sub-Contractor is liable in the period between completion of solution development and commencement of operation).

21.2.4. If the PPP Vendor is funding the Project from its own internal resources and there is no third party debt being provided to the PPP Vendor, the Nodal Agency should:

- assess the credit strength of the PPP Vendor and consider whether or not it should require the PPP Vendor to provide it with a guarantee from its parent or strongest credit within its group; and
- consider whether or not it should require the PPP Vendor to maintain financial covenants throughout the term of the Contract.

### 21.3. Indemnities

21.3.1. The Nodal Agency will want to ensure the Contract requires the PPP Vendor to indemnify the Nodal Agency against certain costs and the PPP Vendor will make provision for such contingent liability in its bid price.

21.3.2. The general principle in e-Governance procurement is that there should be no limit on indemnities provided to the Nodal Agency. This principle can be overridden, however, if commercial necessities demand.

21.3.3. An analysis of the limits on liabilities under the Contract will be part of the assessment by the Nodal Agency of the strength of its counterparty. The existence and extent of any indemnity should be considered in conjunction with other obligations imposed on the PPP Vendor and Sub-Contractor (e.g. under collateral warranties). In this context Section 21.5 (Damages Claims) is relevant. The levels of insurance in respect of any likely claim are also relevant and the PPP Vendor should always set these at a level sufficient to compensate it for foreseeable loss.

21.3.4. Broadly, there are four heads of liability that the Nodal Agency will be concerned to be indemnified against if the liability arises as a result of the PPP Vendor's operations. These are:

- death and personal injury;
- property damage;
- breach of statutory duty; and
- third party claims.

Liability for death and personal injury cannot, at law, be capped, and an Nodal Agency should only allow caps or restrictions on other heads of claim if they believe this offers clear value for money benefits. Nodal Agency should not offer such caps as a matter of course. As regards personal claims a PPP Vendor enjoys no cap on the actions, claims, etc., made directly against it by third parties, and should set its insurance at whatever level it feels necessary to protect itself. It may not therefore provide any additional value for money to allow a PPP Vendor to cap the identical liability which it may suffer indirectly through the Nodal Agency, in circumstances where the claimant makes its claim against the Nodal Agency and the Nodal Agency seeks to recoup its loss from the PPP Vendor.

21.3.5. The Nodal Agency should not generally use the indemnity provisions in the Contract as an additional layer of protection for specific remedies set out in the Contract. For example, if the deductions being made to the Unitary Charge under the performance mechanism are a genuine

reflection of the losses that the Nodal Agency will incur as a result of the PPP Vendor's nonperformance, the Nodal Agency should not generally seek to rely on the indemnity as an additional or alternative means of claiming against the PPP Vendor in respect of that loss.

21.3.6. Given the project specific nature of many of the employment issues that arise on projects no guidance can be given on either employment indemnities.

21.3.7. The Nodal Agency may be faced with a request for a reciprocal indemnity from the PPP Vendor. A general indemnity from the Nodal Agency should not be offered in response to such a request. If the request relates to possible breach of the Nodal Agency's obligations under the Contract, this should be dealt with under Compensation Events (see Section 5.2.1.4). Exceptionally an Nodal Agency may be faced with project specific issues which require it to offer a reciprocal indemnity, in which case the Nodal Agency should ensure that the indemnity is limited to the specific issue.

#### **ILLUSTRATIVE DRAFTING:**

##### **Indemnity**

- (a) The PPP Vendor shall, subject to paragraph (b), be responsible for, and shall release and indemnify the Nodal Agency, its employees, agents and contractors on demand from and against, all liability for:
- (i) death or personal injury;
  - (ii) loss of or damage to property (including property belonging to the Nodal Agency or for which it is responsible "Nodal Agency Property");
  - (iii) breach of statutory duty; and
  - (iv) actions, claims, demands, costs, charges and expenses (including legal expenses on an indemnity basis),

which may arise out of, or in consequence of, the design, solution development, operation or maintenance of the assets or the performance<sup>6</sup> or non-performance by the PPP Vendor of its obligations under this Contract or the presence on the Nodal Agency's property of the PPP Vendor, a sub-PPP Vendor of the PPP Vendor, their employees or agents.

- (b) The PPP Vendor shall not be responsible or be obliged to indemnify the Nodal Agency for:
- (i) any of the matters referred to in paragraphs (a)(i) to (iv) above which arises as a direct result of the PPP Vendor acting on the instruction of the Nodal Agency;
  - (ii) any injury, loss, damage, cost and expense caused by the negligence or wilful misconduct of the Nodal Agency, its employees, agents or contractors or by the breach by the Nodal Agency of its obligations under this Contract; [or
  - (iii) any claims made under Clause 24.3(a)[(iii)] in excess of [ ].]<sup>7</sup>
- (c) An indemnity by either party under any provision of this Contract shall be without limitation to any indemnity by that party under any other provision of this Contract.

21.3.8. This Clause will also need to deal with:

- giving notice of claims (stating in reasonable detail the nature of the matter and the amount claimed). This will enable the proceedings to be contested before any judgment in respect of such proceedings is given;

- taking any action insurers may request to dispute the matter or enforce rights against any person;
- the exclusive conduct of the proceedings by the party giving the indemnity although it may be that certain politically sensitive issues would require the Nodal Agency to control proceedings which will require specific agreement; and
- there being no admission of liability or settlement of the matter without the consent of the indemnifying party.

## 21.4. Collateral Warranties

21.4.1. An Nodal Agency should seek a collateral warranty (i.e. a direct contractual undertaking) from each of the Sub-Contractors and other key sub-contractors, giving direct claims and the ability to step-in to the relevant sub-contracts in some circumstances. Provided that the content of any undertakings requested dovetail with the overall approach to the Project structure. That is they should not be used to increase levels of liability or impose obligations where none would otherwise exist (see Sections 21.3 (Indemnities) and 21.5 (Damages Claims))

21.4.2. The Nodal Agency should consider the strength of the covenant of the counterparty in the light of the obligation in the warranty. It may be that the Sub-Contract warranties are required to be guaranteed by the parent companies (or other companies of substance within the group) of the relevant Sub-Contractors. Except in the case of rights that exist to protect the position of the Nodal Agency, the rights of the Nodal Agency to bring an action under these collateral warranties should, however, be exercisable only on an early termination.

## 21.5. Damages Claims

21.5.1. It is common practice to limit the ability of the Nodal Agency and the PPP Vendor to make claims against each other for breach of obligation under the Contract. The rationale for limiting this ability is that the Contract payment mechanism is structured to ensure that there is an incentive to perform and that any deduction as a result of the payment mechanism reflects the loss to the Nodal Agency and so should usually be the exclusive remedy of the Nodal Agency. See Clause 7.8 (Payment Mechanism: No double remedy).

21.5.2. The issues here are similar to those in Section 4.2 (Liquidated Damages). This is because the issue of when liquidated damages and general damages claims are appropriate are closely connected. The Nodal Agency should strive to ensure that the performance payment mechanism works in such a way as to ensure that during the term of the Contract the absence of the Service reflects the costs the Nodal Agency incurs in not receiving the Service.

21.5.3. There will, as described in Section 4.2 (Liquidated Damages), be circumstances in which relying on the non-payment of the Unitary Charge is insufficient to compensate the Nodal Agency for its loss. For the reasons given in that Section, liquidated damages may be appropriate. A general damages claim for service failures is not something that the Nodal Agency should seek to obtain or



preserve. A combination of the payment mechanism and market value assessment should deal with issues that are required to be covered. To the extent particular categories of claim need special treatment, they should explicitly be dealt with in Clause 24.3 (Indemnity).

21.5.4. On a termination for PPP Vendor Default, the PPP Vendor will have an ability to pursue claims against Sub-Contractors. This can lead to the Nodal Agency reasoning that it should have a right to claim in such a situation too. This may be the case in some situations (as described above), but in many cases (and probably most cases) the deductions from termination compensation payments will reflect any amount which, in traditional procurement, the Nodal Agency would normally expect to claim from the PPP Vendor.

21.5.5. On termination for PPP Vendor Default, not all amounts which the Nodal Agency could claim on a termination are reflected in a reduced market value compensation payment. Examples would include claims under Clauses 24.3 (Indemnity), 26 (Information and Confidentiality) and Sections 24 (Intellectual Property Rights) and claims against the Nodal Agency by third parties. To the extent these claims are not deducted from the market value payment (for example for reasons set out in Section 12 (Payments and Set-off)), they should continue to be exercisable after termination. Such rights should therefore if relevant be included in any collateral warranties.

21.5.6. The limits on liability within collateral warranties should be within the overall required limits on indemnities within the Contract (and, by implication, the Sub-Contracts) (see Sections 21.3 (Indemnities) and 21.4.1 (Collateral Warranties)). Accordingly, claims against indemnities which reduce the capped liability within the Contract should have the same effect on the maximum liabilities under the collateral warranties and vice-versa. The Nodal Agency should assess the optimum level of such a limit, taking into account all circumstances, such as value for money, consideration of specific rules and the issues referred to above.

21.5.7. Care should be taken to ensure that amounts dealt with under the payment mechanism or market value compensation on termination payment are not capable of being claimed, as this could result in double counting.

## 22. INSURANCE

### 22.1. Introduction

22.1.1. Traditionally, Central government has chosen not to take out commercial insurance against insurable risks retained under conventional procurement techniques, as the premiums payable have not been seen to represent good value for money compared to self-insurance.

22.1.2. Nodal Agencies and other public bodies sometimes elect to insure some of their assets in the commercial insurance market, though typically this is with very high deductibles and a significant level of self-insurance.

22.1.3. The position is different under PPP, because insurable risks are transferred to the PPP Vendor which may have limited free financial resources, particularly if it is a SPV. Moreover, the need to ensure continuity of service means that self-insurance by such a PPP Vendor for the full range of insurable risks is, generally, not appropriate. The Risk Management prudence of the PPP Vendor require more extensive insurance cover than that required by the Nodal Agency. Nonetheless, the Nodal Agency should not rely on the PPP Vendor to look after the Nodal Agency's own insurance interests, and it is essential for the Nodal Agency to seek professional insurance advice on what insurance requirements should be imposed on the PPP Vendor at an early stage in the procurement process (before issuing the tender documents) and during subsequent negotiations.

22.1.4. The main issues which the Nodal Agency will need to consider with its insurance advisers are:

- whether and the extent to which the Nodal Agency should require the PPP Vendor to take out and maintain certain insurances as a means of managing particular risks, and how these may change over time.
- ensuring that the proceeds of any claim under any required insurance are used correctly by the PPP Vendor;
- Nodal Agency control of litigation where the PPP Vendor is the principal party insured;
- whether the Nodal Agency should share significant increases and decreases in the market-wide cost of maintaining the PPP Vendor's operating period insurances;
- what should happen if a risk for which insurance is to be effected and maintained in accordance with the required insurance schedule in the Contract becomes uninsurable; and
- what should happen if any required insurance term becomes unavailable

Insurance lies at the heart of the PPP Vendor's risk management strategy and, in turn, efficient risk management lies at the heart of the value for money benefits of PPP that derive from long-term Asset ownership and stewardship by investors. The PPP Vendor's approach to insurance is inseparable from its approach to Asset design, solution development, choice of materials and maintenance regimes etc. Accordingly, Nodal Agency and their advisers should take care not to disturb the transfer of this integral package of risks, nor to disturb incentives that ensure these risks

are efficiently priced and managed. Moreover it is essential that the Nodal Agency's insurance requirements and associated contractual provisions are clearly stated in the tender documents and that bidders are required to price these matters within their responses to the tender documents.

22.1.5. The Nodal Agency's insurance requirements in Clause 25.2 will represent a minimum degree of cover which the Nodal Agency expects to see maintained by the PPP Vendor. It is, of course, for the PPP Vendor to determine the overall insurance programme to be implemented, consistent with the Nodal Agency's respective requirements. To ensure delivery of value for money, the Contract should incentivize (or, as appropriate, require) the PPP Vendor at all times to:

- ensure full integration between the insurance programme and their overall risk management strategy,
- make cost-effective trade-offs between lower deductibles and increased insurance premiums (within the constraints specified by the Nodal Agency);
- procure insurance from good quality and cost-effective suppliers; and look only to the Nodal Agency for cover in relation to unavailability of insurances as a last resort.

Under exceptional circumstances it may not be value for money for the private sector to bear all the risks associated with placing an insurance programme itself (e.g. in the event of (i) non availability of insurance or (ii) excessive market wide increases in insurance costs) and it is likely to be better value for money if an Nodal Agency provides a limited level of protection under specific circumstances. Factors which should incentivize the PPP Vendor to manage risks effectively and discourage the PPP Vendor from seeking protection from the Nodal Agency, unless in exceptional circumstances and as a last resort, include the following:-

- the PPP Vendor remains liable for deductible related losses;
- in the event of uninsurability and an uninsured risk materialising, the Nodal Agency may have the ability to terminate the Contract; and furthermore, the amount payable by the Nodal Agency to the PPP Vendor upon such termination will be the same as that payable upon termination in the event of Force Majeure; and
- in respect of the operating period insurance premium risk sharing arrangement, protection is limited to general market wide changes in insurance costs. Furthermore the PPP Vendor takes the first 30% of any relevant change in insurance cost, as well as 15% of any relevant change in insurance cost in excess of 30%.

## 22.2. Nodal Agency's Requirements

22.2.1. In general terms, the PPP Vendor will be expected to insure in accordance with good industry practice. However, in addition to the statutory insurances, there will be a number of required insurances which the Nodal Agency will want to know are being taken out and maintained by the PPP Vendor, to ensure that insurance proceeds are available to cover certain types of claims. Such required insurances should include third-party liability insurance, Contractors' "all risks" insurance and property damage insurance during operation.

22.2.2. Only those risks which are to be covered by the Required Insurances and insurances required by law (see Clause 25.2(a) and (b)) will attract uninsurability protection. It is therefore

important that apart from delay in start up and business interruption insurance (see Section 22.2.3 below), only those insurances from which the Nodal Agency derives a benefit as a co-insured party should be designated Required Insurances. Furthermore, in respect of those risks that the PPP Vendor is required to insure against, the Nodal Agency should ensure that the uninsurability protection does not extend to cover risks if it would have the effect of undermining the essence of the commercial principle that the risk being covered is a risk that the PPP Vendor is required to manage. For example, if professional indemnity insurance or non-vitiation protection become unavailable, the Nodal Agency should not provide such cover since it would insure the PPP Vendor against claims relating to the PPP Vendor's (or its Sub-Contractors') negligence. Nodal Agency should therefore ensure that any professional indemnity insurance does not feature as a Required Insurance and non-vitiation protection is carved out of the uninsurability protection provided under Clause 25.9.

22.2.3. The PPP Vendor will like to take get delay in start-up and business interruption insurance. The effect of these insurances is to ensure that during any period of reinstatement of physical damage to the Project, the PPP Vendor will be able to meet its unavoidable running costs and obligations. If such insurances become unavailable in the market and material damage to the Project subsequently arises, the PPP Vendor may (depending on the period of reinstatement) have adverse effect on its financial and may eventually default . Without the benefit of uninsurability protection for delay in start-up and business interruption insurances, PPP vendors are likely to **require contingencies** to be put in place by the PPP Vendor to cover such eventualities. It is thus preferable that the Nodal Agency should, on value for money grounds, extend uninsurability protection in the Contract to cover business interruption insurance and delay in start-up insurance. It is important to remember that delay in start-up and business interruption insurances only respond in circumstances where an underlying policy covering material damage to the Project also responds, or would have responded in the case that this cover is also unavailable.

22.2.4. Insurance requirements should reflect the degree of risk transfer, the ability of the PPP Vendor to make the premium payments (relative to the size of the risks), value for money considerations and the specifics of the Project. There are, of course, standard insurances that are required during the solution development and operating phases of all projects, although the full scope of cover (e.g. the insured risks, the exclusions, the endorsements, the amounts of cover and the deductibles) will vary from project to project. Whilst the solution development phase insurances typically cover the whole of the solution development phase, the operational insurance are renewed periodically (mostly annually). It is important that the renewal process starts well in advance of the renewal date.

22.2.5. Insurers should inform the Nodal Agency of changes in the policy.

22.2.6. If the Nodal Agency wishes to increase the limits or scope of the insurances during the life of the Contract, then this should be treated as an Nodal Agency change in Service (see Section 13.2 (A Typology of Changes)).

22.2.7. As central Government generally self-insures, there should be no requirement for insurances to cover those risks retained under the Project by a central Government Nodal Agency. It is, however, reasonable to seek third-party public liability insurance where appropriate.

22.2.8. The Nodal Agency should protect its position by being a co-insured for its own interests (where it has an insurable interest) and requiring its interests to be noted as appropriate on the insurances taken out by the PPP Vendor. This should be acceptable to the PPP Vendor.

22.2.9. The Nodal Agency should consider the value for money benefits of requiring the PPP Vendor to take out “non-vitiation” protection in respect of certain required insurances. Non-vitiation protection allows the Nodal Agency to claim as a co-insured under a policy even if the insurer would be able to avoid a claim made by the PPP Vendor on the basis that the PPP Vendor, for example, withheld material information from the insurer. However, absence of such cover shall not be covered by the uninsurability protection given to the PPP Vendor in respect of unavailability of insurance cover.

#### **ILLUSTRATIVE DRAFTING:**

##### **Insurance**

(a) The PPP Vendor shall, prior to the Service Commencement Date, take out and maintain or procure the maintenance of the insurances described in [Part 1 of Annex 1 (Required Insurances)] and any other insurances as may be required by law. These insurances must be effective in each case not later than the date on which the relevant risk commences.

(b) The PPP Vendor shall during the Service Period take out and maintain or procure the maintenance of the insurances (Required Insurances) and any other insurances as may be required by law.

(c) No party to this Contract shall take any action or fail to take any reasonable action, or (insofar as it is reasonably within its power) permit anything to occur in relation to it, which would entitle any insurer to refuse to pay any claim under any insurance policy in which that party is an insured, a co-insured or additional insured person.

(d) With the exception of any insurances required by law, the insurances referred to in paragraphs (a) and (b) shall:

(i) subject to paragraph (e) below, name the PPP Vendor as co-insured with any other party maintaining the insurance;

(ii) [provide for non-vitiation protection in respect of any claim made by the Nodal Agency as co-insured in accordance with Endorsement

(iii) contain a clause waiving the insurers’ subrogation rights against the Nodal Agency, its employees and agents in accordance with Endorsement [2] in Part 3 of [Annex 1];

(iv) provide for 30 days prior written notice of their cancellation, non-renewal or amendment to be given to the Nodal Agency in accordance with Endorsement ; and

(v) in respect of the Physical Damage Policies provide for payment of any proceeds received by the PPP Vendor

(e) Wherever possible, the insurances referred to in paragraphs (a) and (b) shall name the Nodal Agency as a co-insured for its separate interest.

(f) The PPP Vendor shall provide to the Nodal Agency:

- (i) copies on request of all insurance policies referred to in paragraphs (a) and
- (b) (together with any other information reasonably requested by the Nodal Agency relating to such insurance policies) and the Nodal Agency shall be entitled to inspect them during ordinary business hours; and
- (ii) evidence that the premiums payable under all insurance policies have been paid and that the insurances are in full force and effect in accordance with the requirements of this Clause 25.2 (Insurance).
- (g) Renewal certificates in relation to the insurances referred to in paragraphs (a) and
- (b) shall be obtained as and when necessary and copies (certified in a manner acceptable to the Nodal Agency) shall be forwarded to the Nodal Agency as soon as possible but in any event on or before the renewal date.
- (h) If the PPP Vendor is in breach of paragraphs (a) or (b) above, the Nodal Agency may pay any premiums required to keep such insurance in force or itself procure such insurance and may in either case recover such amounts from the PPP Vendor on written demand.
- (i) The PPP Vendor shall give the Nodal Agency notification within 30 days after any claim in excess of INR. [ ] on any of the insurance policies referred to in this Clause accompanied by full details of the incident giving rise to the claim.
- (j) Neither failure to comply nor full compliance with the insurance provisions of this Contract shall limit or relieve the PPP Vendor of its liabilities and obligations under this Contract.
- (k) The insurance premiums in respect of the insurances referred to in paragraphs (a) and (b) shall be the responsibility of the PPP Vendor.

## 23. INFORMATION AND CONFIDENTIALITY

### 23.1. Introduction

23.1.1. The Contract should include provisions dealing with records, provision of information, personal data, publicity and confidentiality.

### 23.2. PPP Vendor's Records and Provision of Information

#### **ILLUSTRATIVE DRAFTING:**

##### **PPP Vendor's Records and Provision of Information**

- (a) The PPP Vendor shall:
  - (i) at all times maintain a full record of particulars of the costs of performing the Service, including those relating to the design, solution development, maintenance, operation and finance;
  - (ii) when requested by the Nodal Agency, provide a summary of any of the costs referred to in paragraph (i), including details of any funds held by the PPP Vendor specifically to cover such costs, in such form and detail as the Nodal Agency may reasonably require to enable the Nodal Agency to monitor the performance by the PPP Vendor of its obligations under this Contract; and
  - (iii) provide such facilities as the Nodal Agency may reasonably require for its representatives to visit any place where the records are held and examine the records maintained under this Clause.
- (b) Compliance with the above shall require the PPP Vendor to keep (and where appropriate to procure that the sub-contractors shall keep) books of account in accordance with best accountancy practice with respect to the Contract showing in detail:
  - (i) administrative overheads;
  - (ii) payments made to Sub-Contractors and to sub-contractors;
  - (iii) capital and revenue expenditure;
  - (iv) such other items as the Nodal Agency may reasonably require to conduct cost audits for verification of cost expenditure or estimated expenditure, for the purpose of Clause 5.2 (Delays in Service Commencement due to a Compensation Event), [Section] 13 (Change in Service), Clause 14.8 (Qualifying Change in Law), Clause 15.4 (Market Testing) and [Section 15.5] (Benchmarking), and the PPP Vendor shall have (and procure that the sub-contractors shall have) the books of account evidencing the items listed in paragraphs (i) to (iv) available for inspection by the Nodal Agency (and any expert) upon reasonable notice, and shall present a report of these to the Nodal Agency as and when requested.
- (c) The PPP Vendor shall maintain or procure that the following are maintained.
  - (i) a full record of all incidents relating to health, safety and security which occur during the term of the Contract; and
  - (ii) full records of all maintenance procedures carried out during the term of the Contract, and the PPP Vendor shall have the items referred to in paragraphs (i) and (ii) available

- for inspection by the Nodal Agency upon reasonable notice, and shall present a report of them to the Nodal Agency as and when requested.
- (d) The PPP Vendor shall permit records referred to in this Clause to be examined and copied by the representatives of the Nodal Agency, and by [the Comptroller and Auditor General and his representatives].
  - (e) The records referred to in this Clause shall be retained for a period of at least [5] years after the PPP Vendor's obligations under the Contract have come to an end.
  - (f) Upon termination of the Contract, and in the event that the Nodal Agency wishes to enter into another contract for the operation and management of the Project, the PPP Vendor shall (and shall ensure that the sub-contractors will) comply with all reasonable requests of the Nodal Agency to provide information relating to the PPP Vendor's costs of operating and maintaining the Project.
  - (g) The PPP Vendor shall:
    - (iii) provide to the Nodal Agency on 31 March, 30 June, 30 September and 31 December each year a document listing all information pertaining to legal and commercial implications during the preceding three month period;
    - (iv) provide to the Nodal Agency copies of its annual report and accounts within 30 days of publication;
    - (v) provide to the Nodal Agency a copy of the Financial Model at Financial Close and (as the same may be amended) within 30 days of any amendment thereto;
    - (vi) use all reasonable endeavours to assist the Nodal Agency in its preparation of any report required by [Department], from time to time;
  - (h) The Nodal Agency may, in the circumstances referred to in paragraph (g) (iv) above require the PPP Vendor to provide an Interim Project Report and to attend, such meetings as the Nodal Agency may convene to discuss such Interim Project Report and the circumstances giving rise to it.

### 23.3. Public Relations and Publicity

#### **ILLUSTRATIVE DRAFTING:**

##### **Public Relations and Publicity**

- (a) The PPP Vendor shall not by itself, its employees or agents and procure that its subcontractors shall not communicate with representatives of the press, television, radio or other communications media on any matter concerning the Contract without the prior written approval of the Nodal Agency.
- (b) No facilities to photograph or film in or upon any property used in relation to the Project shall be given or permitted by the PPP Vendor unless the Nodal Agency has given its prior written approval.



### 23.4. Confidentiality

The Contract should determine whether information provided by the Nodal Agency to the PPP Vendor and vice versa is to be treated as confidential. It should also specify the extent to which details in the Contract itself are confidential.

### 23.5. Government Openness

23.5.1. The Right to Information Act (“RTI”) came into force on 12<sup>th</sup> October 2005. Its underlying premise is that the approach to release of information should be based on the assumption that information should be released.

23.5.2. In case PPP Contracts are placed in the public domain<sup>89</sup>, then PPP vendor has to assist/support in providing the information. Only “commercially sensitive” information, information the dissemination of which is contrary to the public interest or information which is personally private should be withheld. In the PPP context the key concern relates generally to “commercially sensitive” information and issues of national security.

23.5.3. **26.5.3** Extensive guidance on Right to Information is available from the Department of Personnel & Training (GoI) website.

### 23.6. Related Matters

23.6.1. Stock Exchanges have publicity requirements with which listed companies are required to comply. Companies raising finance through capital markets (e.g. through bond issues), in particular, must disclose details of Contracts and related documents. There are some exceptions to disclosure requirements, for example, where national security would be prejudiced..

23.6.2. Nodal Agency should recognise in any event that attempts to keep contractual terms confidential amongst the private sector and financial community are to some extent cosmetic, as details of signed contracts will often become known over time. The advantage of greater openness on the public sector side is that Nodal Agency planning projects should benefit similarly from gaining knowledge of positions PPP Vendor investment and returns on projects similar to those planned and to gain the benefits of competition, there is some advantage in making positions known. If there is a public offering or wide syndication, the prospectus or information memorandum will usually contain a great deal of detail on the contents of the Contract and other documents.

23.6.3. PPP Vendors should note that the CAG will require access to all relevant information from the Contracts which it requires for its audit purposes, irrespective of whether it is confidential or sensitive. The CAG may also publish any information (including key contract terms, the contract price

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<sup>89</sup> Currently the PPP projects are not covered under RTI, but it is a possibility that they would come in due course. Even in the case, it does not come under RTI, it is expected that the PPP Vendor should support the Nodal Agency in encouraging transparency.

and results of bid evaluations) in its reports to Parliament. The Contract should ensure that the Comptroller and Auditor General is entitled to examine the PPP Vendor's records.

23.6.4. The Nodal Agency should make it a condition of it becoming involved in the underlying financing that the Nodal Agency is entitled to receive from the PPP Vendor a copy of any information memorandum, prospectus or other similar document containing information relating to the Project. Such information, where necessary, will be treated as Commercially Sensitive Information.

### **ILLUSTRATIVE DRAFTING:**

#### **Confidentiality**

(a)

- (i) The parties agree that provisions of this Contract and each Project Document shall, subject to sub-paragraph (ii) below, not be treated as Confidential Information and may be disclosed without restriction.
- (ii) Sub-paragraph (i) above shall not apply to provisions of this Contract or a Project Document<sup>12</sup> designated as Commercially Sensitive Information and listed in Part I of Schedule [ ] (Commercially Sensitive Information) to this Contract<sup>13</sup> which shall, subject to sub-paragraph (b) below, be kept confidential for the periods specified in that Part.
- (iii) the parties shall keep confidential all Confidential Information received by one party from the other party relating to this Contract and Project Documents or the Project and shall use all reasonable endeavours to prevent their employees and agents from making any disclosure to any person of any such Confidential Information.

(b) Paragraphs (a) (ii) and (iii), shall not apply to:

- (i) any disclosure of information that is reasonably required by any person engaged in the performance of their obligations under the Contract for the performance of those obligations;
- (ii) any matter which a party can demonstrate is already or becomes generally available in the public domain otherwise than as a result of a breach of this Clause;
- (iii) any disclosure to enable a determination to be made under Clause 25 (Dispute Resolution) or in connection with a dispute between the PPP Vendor and any of its subcontractors;
- (iv) any disclosure which is required pursuant to any statutory, legal (including any order of a court of competent jurisdiction) or Parliamentary obligation placed upon the party making the disclosure or the rules of any stock exchange or governmental or regulatory Nodal Agency having the force of law or if not having the force of law, compliance with which is in accordance with the general practice of persons subject to the stock exchange or governmental or regulatory Nodal Agency concerned;
- (v) any disclosure of information which is already lawfully in the possession of the receiving party, prior to its disclosure by the disclosing party;
- (vi) any provision of information to the parties' own professional advisers or insurance advisers or, where it is proposed that a person should or may provide funds (whether directly or indirectly and whether by loan, equity participation or otherwise) to the PPP Vendor to enable it to carry out its obligations under the Contract, or may wish to acquire shares in the PPP Vendor [and/or Holding company] in accordance with the provisions of this Contract to

- that person or their respective professional advisers but only to the extent reasonably necessary to enable a decision to be taken on the proposal;
- (vii) any disclosure by the Nodal Agency of information relating to the design, solution development, operation and maintenance of the Project and such other information as may be reasonably required for the purpose of conducting a due diligence exercise, to:
- A. any proposed new PPP Vendor and its advisers, should the Nodal Agency decide to retender the Contract; or
  - B. any person in connection with [Clause 15.5 (Benchmarking)] or Clause [15.4] (Market Testing);
- (viii) any registration or recording of the Consents and property registration required;
- (ix) any disclosure of information by the Nodal Agency to any other department, office or agency of the Government or their respective advisers or to any person engaged in providing services to the Nodal Agency for any purpose related to or ancillary to the Contract; or
- (x) any disclosure for the purpose of:
- A. the examination and certification of the Nodal Agency's or the PPP Vendor's accounts;
  - B. complying with a proper request from either party's insurance adviser, or insurer on placing or renewing any insurance policies; or
  - C. (without prejudice to the generality of paragraph (b)(iv) above) compliance with the RTI, provided that, for the avoidance of doubt, neither paragraph (x) (D) nor paragraph (iv) above shall permit disclosure of Confidential Information otherwise prohibited by RTI.
- (c) Where disclosure is permitted under paragraph (b), other than paragraphs (ii), (iv), (v), (viii) and (x), the party providing the information shall procure that the recipient of the information shall be subject to the same obligation of confidentiality as that contained in this Contract.
- (d) For the purposes of the audit, the Auditor may examine such documents as he may reasonably require which are owned, held or otherwise within the control of the PPP Vendor and any sub-PPP Vendor and may require the PPP Vendor and any sub-PPP Vendor to produce such oral or written explanations as he considers necessary.
- (e) The PPP Vendor shall not make use of the Contract or any information issued or provided by or on behalf of the Nodal Agency in connection with the Contract otherwise than for the purpose of the Contract, except with the written consent of the Nodal Agency.
- (f) Where the PPP Vendor, in carrying out its obligations under the Contract, is provided with information relating to [people/users], the PPP Vendor shall not disclose or make use of any such information otherwise than for the purpose for which it was provided, unless the PPP Vendor has sought the prior written consent of that [person/user] and has obtained the prior written consent of the Nodal Agency.
- (g) On or before the Expiry Date, the PPP Vendor shall ensure that all documents or computer records in its possession, custody or control, which contain information relating to [people/users e.g. prisoners/patients/pupils] including any documents in the possession, custody or control of a sub-PPP Vendor, are delivered up to the Nodal Agency.
- (h) The parties acknowledge that the CAG has the right to publish details of the Contract (including Commercially Sensitive Information) in its relevant reports to Parliament.

**“Commercially Sensitive Information”** means the sub-set of Confidential Information listed in column 1 of Part 1 (Commercially Sensitive Contractual Provisions) and column 1 of Part 2

(Commercially Sensitive Material) of Schedule [ ] (Commercially Sensitive Information) in each case for the period specified in column 2 of Parts 1 and 2 of Schedule [ ].

**“Confidential Information”** means:

- (a) information that ought to be considered as confidential (however it is conveyed or on whatever media it is stored) and may include information whose disclosure would, or would be likely to, prejudice the commercial interests of any person, trade secrets, Intellectual Property Rights and know-how of either party and all personal data and sensitive personal data; and
- (b) Commercially Sensitive Information.

## 23.7. Freedom of Information

### **ILLUSTRATIVE DRAFTING:**

#### **Freedom of Information**

- (a) The PPP Vendor acknowledges that the Nodal Agency is subject to the requirements of the RTI and shall facilitate the Nodal Agency’s compliance with its Information disclosure requirements pursuant to the same in the manner provided for in paragraphs (b) to (g) (inclusive) below.
- (b) Where the Nodal Agency receives a Request for Information in relation to Information that the PPP Vendor is holding on its behalf and which the Nodal Agency does not hold itself the Nodal Agency shall refer to the PPP Vendor such Request for Information that it receives as soon as practicable and in any event within [ten] Business Days of receiving a Request for Information and the PPP Vendor shall:
  - (i) provide the Nodal Agency with a copy of all such Information in the form that the Nodal Agency requires as soon as practicable and in any event within [ten] Business Days (or such other period as the Nodal Agency acting reasonably may specify) of the Nodal Agency’s request; and
  - (ii) provide all necessary assistance as reasonably requested by the Nodal Agency in connection with any such Information, to enable the Nodal Agency to respond to a Request for Information within the time for compliance of the RTI.
- (c) Following notification under Clause 26.10 (b), and up until such time as the PPP Vendor has provided the Nodal Agency with all the Information specified in Clause 26.10 (b) (i), the PPP Vendor may make representations to the Nodal Agency as to whether or not or on what basis Information requested should be disclosed, and whether further information should reasonably be provided in order to identify and locate the information requested, provided always that the Nodal Agency shall be responsible for determining at its absolute discretion:-
  - (i) whether Information is exempt from disclosure under the RTI; and
  - (ii) whether Information is to be disclosed in response to a Request for Information, and in no event shall the PPP Vendor respond directly, or allow its sub-contractors to respond directly, to a Request for Information unless expressly authorised to do so by the Nodal Agency.

- (d) The PPP Vendor shall ensure that all Information held on behalf of the Nodal Agency is retained for disclosure for at least [ ] years (from the date it is acquired) and shall permit the Nodal Agency to inspect such Information as requested from time to time.
- (e) The PPP Vendor shall transfer to the Nodal Agency any Request for Information received by the PPP Vendor as soon as practicable and in any event within 2 Business Days of receiving it.
- (f) The PPP Vendor acknowledges that any lists provided by him listing or outlining Confidential Information, are of indicative value only and that the Nodal Agency may nevertheless be obliged to disclose Confidential Information in accordance with the requirements of the RTI.
- (g) In the event of a request from the Nodal Agency pursuant to clause 26.10 (b) above, the PPP Vendor shall as soon as practicable, and in any event within [10] Business Days of receipt of such request, inform the Nodal Agency of the PPP Vendor's estimated costs of complying with the request to the extent these would be recoverable if incurred by the Nodal Agency under RTI Fees. Where such costs (either on their own or in conjunction with the Nodal Agency's own such costs in respect of such Request for Information) will exceed the appropriate limit referred to in RTI, the Nodal Agency shall inform the PPP Vendor in writing whether or not it still requires the PPP Vendor to comply with the request and where it does require the PPP Vendor to comply with the request within the 10 Business Days period for compliance shall be extended by such number of additional days for compliance as the Nodal Agency is entitled to under the RTI. In such case, the Nodal Agency shall notify the PPP Vendor of such additional days as soon as practicable after becoming aware of them and shall reimburse the PPP Vendor for such costs as the PPP Vendor incurs in complying with the request to the extent it is itself entitled to reimbursement of such costs in accordance with the RTI.

## 24. INTELLECTUAL PROPERTY RIGHTS

### 24.1. Introduction

24.1.1. In most projects, the PPP Vendor will need to use some type of Intellectual Property (“IP”) in order to deliver the Service. The PPP Vendor may use IP developed by a third party or by itself. Such IP may have a general application or may be specifically developed for the relevant Project. If the PPP Vendor uses IP developed by and belonging to a third party, the PPP Vendor will need a licence to use such IP<sup>90</sup>.

24.1.2. The Contract must require the parties not to breach any terms of any licence to use IP and not to infringe the Intellectual Property Rights (“IPR”) of any owner of IP used. The Contract must set out what happens if any breach or infringement of IPR occurs.

24.1.3. The Nodal Agency does not need to own the IPR, though the Nodal Agency may inherit free, or have an option to purchase IPR which is the core to the continuity of the Service (e.g. specially written software). Irrespective of who “owns” the IP, however, the Contract must ensure that the Nodal Agency is able to use any IP required to provide the Service if it takes over the Service or employs/procures a third party to perform the Service (e.g. on expiry or early termination of the Contract).

### 24.2. Infringement of IPR by the PPP Vendor

24.2.1. The general principle is that any costs resulting from infringement by the PPP Vendor of IPR should be borne by the PPP Vendor. It should be responsible for any costs of the owner of the IPR and the Nodal Agency. This will normally require the PPP Vendor to offer an indemnity to the Nodal Agency.

24.2.2. If the infringement or related legal action threatens the delivery of the Service, the Nodal Agency should be notified as soon as possible. The Nodal Agency should be obliged to provide reasonable assistance to the PPP Vendor in defending any legal action, but this should not extend to meeting any costs of the PPP Vendor’s defence.

### 24.3. Infringement of IPR by the Nodal Agency

24.3.1. If the Nodal Agency infringes IPR, it should generally bear any resulting costs. The Nodal Agency should bear the owner’s costs and any costs incurred by the PPP Vendor (e.g. if sued by the owner or if it has to procure a licence of different IPR from another party). This will normally require the Nodal Agency to offer an indemnity to the PPP Vendor.

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<sup>90</sup> If the Nodal Agency owns IPR that will be required by the PPP Vendor in order to carry out the Project, the Nodal Agency should consider how it intends to allow the PPP Vendor to use such IPR during the term of the Contract.

24.3.2. The Nodal Agency may contribute IP to the Project for the PPP Vendor to use. If it does not own the relevant IPR, it must ensure that it is entitled to pass it on to the PPP Vendor (e.g. by way of sub-licence). If the Nodal Agency infringes the owner's IPR by passing the relevant IP on to the PPP Vendor, the Nodal Agency should be liable for any resulting costs unless Section 24.3.3 applies.

24.3.3. If the PPP Vendor uses any IP which the Nodal Agency has brought into the Project, it should ensure that it is entitled to do so. It will be liable for any infringement by it unless it is unable (acting reasonably) to verify such matter.

## **24.4. Rights to IPR on Expiry or Termination**

24.4.1. The Contract will also need to deal with what happens to IPR on a termination (whether early (see Section 19 (Early Termination)) or on expiry of the Contract (see Section 18 (Termination of Assets on Expiry of Service Period))), particularly in circumstances in which software or similar assets have been developed for the specific project. Examples of this could be a simulator training project or a similar project, where if the Project is to be transferred to the Nodal Agency on a termination then IPR should also be transferred as the Project would be unworkable without this.

24.4.2. Generally, the Nodal Agency should be entitled to a free and perpetual licence of IPR specifically developed for the Project (e.g. specially bespoke software) for use in that project only (either by it or an alternative provider of the Service). The Nodal Agency should not usually attempt to extend its right to use such IPR in other projects but should be entitled to negotiate a price for its use on other projects<sup>91</sup>, having taken into account any development costs incurred in producing that software. Particular issues may arise on certain projects that make such licences impossible to obtain.

24.4.3. In respect of other IPR central to the Project such as third party software licences, the PPP Vendor should ensure that the Nodal Agency is either entitled to a novation of such licences or has the right to obtain a licence of such software at commercial rates. It is for the PPP Vendor to ensure that any licence it (or its sub-contractors) enters into reflects these requirements. If the PPP Vendor is unable to ensure that the Nodal Agency will have the benefit of all necessary IPR, it must indemnify the Nodal Agency against any costs incurred due to such non-availability. For example, if the PPP Vendor chooses to use proprietary software, it must bear the risk if the owner will not agree to licence such software to the Nodal Agency or replacement PPP Vendor. Similarly, the PPP Vendor must bear the risk of the owner of the relevant IPR being prevented from licensing such IPR to the Nodal Agency or replacement PPP Vendor due to trade restrictions imposed by its Government. If the PPP Vendor does not want to bear such risks, it should find alternative IPR which is capable of being licensed to the Nodal Agency.

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<sup>91</sup> If it is likely that the PPP Vendor will be able to commercially exploit any IPR developed for the Project, the Nodal Agency should consider whether or not revenues from IPR exploitation are likely to be significant and whether it should require the PPP Vendor share any such revenues with the Nodal Agency.

24.4.4. In addition to ensuring that the Nodal Agency has the right to use IPR required to continue provision of the Service (e.g. on expiry, early termination or Nodal Agency step-in), arrangements should wherever possible be put in place to ensure that the Nodal Agency has immediate access to such IPR and any information required to operate it. For example, source codes of IT products should be held in escrow by an independent party (e.g. the NIC or for a State Government it could be an State IT Agency). It should be noted that an additional or new service provider will need access to IPR in advance of the Expiry Date or the commencement of its service contract in order to acquaint itself with the Service and allow a smooth handover and such access rights should be negotiated in advance, rather than left to be resolved on termination.



## 25. DISPUTE RESOLUTION

### 25.1. Introduction

25.1.1. The Contract must specify a procedure for handling disputes under the terms of the Contract.

### 25.2. Dispute Resolution Procedure

25.2.1. As going through the courts may not be appropriate for the disputes that can arise under a PPP contract, an alternative formal dispute resolution procedure may offer a more efficient and cost-effective method of resolving disputes.

25.2.2. A common form of dispute resolution involves a three stage process as follows:

- the Nodal Agency and PPP Vendor consult with each other for a fixed time period (possibly involving different levels of internal consultation) in an attempt to come to a mutually satisfactory agreement;
- if consultation fails, the parties may then (except in the case of certain types of dispute) put their case before an expert to decide. The expert is appointed from a panel (e.g. of solution development or operation experts) whose appointment is regulated by the Contract. It may be appropriate in certain circumstances to substitute other forms of Alternative Dispute Resolution ("ADR")<sup>92</sup> for this type of expert determination. Disputes relating to the mechanics of price variations may go to a financial expert agreed between the parties at the time<sup>93</sup>, and
- if either party is dissatisfied with the expert's decision, it may refer the matter either to arbitration (itself a form of ADR) or to the courts for a final and binding decision. The method of appointing the arbitrator should be set out in the Contract.

25.2.3. It is often proposed that a fast-track dispute resolution process is included in the contract to deal with certain pressing issues. The drafting included below reflects the procedure to fast track.

### 25.3. Joinder of Sub-Contract Disputes

25.3.1. The PPP Vendor and its Sub-Contractors may request the right to join their disputes into a dispute under the Contract if the same issues are involved. This should generally be resisted by the Nodal Agency as it will only increase the time and cost of the process for the Nodal Agency. The Nodal Agency should not automatically become embroiled in the PPP Vendor's disputes with its Sub-

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<sup>92</sup> Other forms of ADR which may be considered include mediation, conciliation and neutral evaluation

<sup>93</sup> To enable the financial expert to reach an appropriate resolution (particularly where the dispute concerns the pricing of a change in accordance with Section 13 (Change in Service) which may result in the PPP Vendor implementing a change at a price it considers too low) suitable terms of reference should be agreed in advance and provided to the expert in accordance with the relevant approach taken to such changes in the Contract (see Section 5.2.3 (Calculation of Compensation)). As Section 5.2.3 (Calculation of Compensation) makes clear, the agreed approach will depend on the risk profile of the Project, and the pricing approach adopted in the Contracts and Sub-Contracts.

Contractors, particularly as the PPP Vendor should in any case ensure that, as far as possible, decisions under the Contract flow down the contractual chain. This is achieved through proper structuring of the Sub-Contracts. It may, however, be possible to agree joinder in relation to certain limited matters (such as disputes arising out of the User Acceptance Tests referred to in Section 3.6 (Acceptance and Service Commencement)).

25.3.2. The Nodal Agency should adopt a compromise position. This allows the Sub-Contractors the right to make written representations to the arbitrator/adjudicator as part of the PPP Vendor's case in a dispute under the Contract where that dispute relates to issues in dispute under the relevant Sub-Contract. The arbitrator/adjudicator will not determine the Sub-Contract dispute itself, so in order for his decision on the Contract dispute to be binding on the PPP Vendor and the Sub-Contractor, they must separately agree to be bound by the decision of the arbitrator/adjudicator in respect of that matter as between themselves.

## **25.4. Delays Caused by Disputes**

25.4.1. PPP Vendors may try to include disputes between the Nodal Agency and the PPP Vendor under the Contract in the list of Relief Events on the basis that they cannot continue work until the dispute is resolved. This issue arises during the solution development phase in particular. This should not be allowed. The PPP Vendor (and the Sub-Contractors) should not be permitted to "down tools" just because a dispute has arisen. If no other course of action can be taken (usually towards the end of the solution development phase, but also at critical stages), then the issues involved can give rise to relief.

25.4.2. The PPP Vendor must be under an obligation to carry on with the Service in accordance with the Nodal Agency's wishes while any dispute is being carried on. The PPP Vendor must rely on the expert or arbitrator awarding adequate compensation if the dispute is resolved in the PPP Vendor's favour.

25.4.3. The Nodal Agency should recognise that if the dispute is resolved in the PPP Vendor's favour, the Nodal Agency will typically be liable for the PPP Vendor's costs. These could include any extra costs incurred in rebuilding (such as manpower costs and materials costs) and any resulting costs incurred by the PPP Vendor if a delay to Service Commencement results. Delays caused by the Nodal Agency failing to comply with the relevant dispute resolution procedure should be taken into account in the arbitrator's determination.

### **ILLUSTRATIVE DRAFTING:**

#### **Dispute Resolution**

- (a) Any dispute arising in relation to any aspect of the Contract shall be resolved in accordance with this Clause.
- (b) If a dispute arises in relation to any aspect of this Contract, the PPP Vendor and the Nodal Agency shall consult in good faith in an attempt to come to an agreement in relation to the disputed matter.

(c) Without prejudice to paragraph (b) above, either party may give the other notice of intention to refer the dispute to adjudication and the adjudicator shall be selected in accordance with paragraph (d) below.

(d) The Adjudicator nominated to consider a dispute referred to him shall be selected on a strictly rotational basis from the relevant panel of experts appointed in accordance with the following:

(i) there shall be two panels of experts, one in respect of solution development matters (the “Solution development Panel”) and one in respect of operational and maintenance matters (the “Operational Panel”)<sup>94</sup>. All the experts on each panel shall be

wholly independent of the PPP Vendor, the Nodal Agency, the relevant Sub-Contractor and any of the major competitors of the PPP Vendor or relevant Sub-Contractor;

(ii) the Solution development Panel shall be comprised of [3] experts who shall be appointed jointly by the PPP Vendor and the Nodal Agency. Such appointments shall take place within [28] days of the date of this Contract<sup>95</sup>,

(iii) the Operational Panel shall be comprised of [3] experts who shall be appointed jointly by the PPP Vendor and the Nodal Agency. Such appointments shall take place on or before the Service Commencement Date<sup>96</sup>,

(iv) if any member of a panel resigns during the term of the Contract, a replacement expert shall be appointed by the PPP Vendor and the Nodal Agency as soon as practicable;

(v) if the Nodal Agency and the PPP Vendor are unable to agree on the identity of the experts to be appointed to the panel(s), [ ] shall appoint such expert(s) within 30 days of any application for such appointment by either party.

(e) Within 7 days of appointment in relation to a particular dispute, the Adjudicator shall require the parties to submit in writing their respective arguments. The Adjudicator shall, in his absolute discretion, consider whether a hearing is necessary in order to resolve the dispute.

(f) In any event, the Adjudicator shall provide to both parties his written decision on the dispute, within 28 days of appointment (or such other period as the parties may agree after the reference, or 42 days from the date of reference if the party which referred the dispute agrees). Unless the parties otherwise agree, the Adjudicator shall give reasons for his decision<sup>97</sup>. Unless and until revised, cancelled or varied by the Arbitrator, the Adjudicator’s decision shall be binding on both parties who shall forthwith give effect to the decision.

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<sup>94</sup> The parties shall consider how they wish to deal with disputes of a financial (rather than solution development or operational) nature and ensure the Contract contains appropriate provisions. The parties may want to appoint a panel of financial experts in the way set out in Clause 25(d) or may prefer to appoint a financial expert by mutual agreement at the time of the dispute. As currently drafted, financial disputes could be referred straight to arbitration (see Clause 25(l)(i)) so parties may prefer to include an intermediate level of dispute resolution. The parties should also consider the likelihood of overlapping disputes arising of both a solution development and operational nature. If such disputes are likely, a procedure will need to be developed for deciding which of the Solution development Panel or Operational Panel should preside over the dispute’s resolution.

<sup>95</sup> It is essential that such appointments are made as soon as possible after Contract signature so that the panel is in place in time to deal with any solution development disputes arising.

<sup>96</sup> If operational disputes are capable of arising prior to the Services Commencement Date, an earlier date should be specified for such appointments

<sup>97</sup> The reverse can be specified. It is up to the parties to choose whether or not they wish reasons to be given. The parties should ensure that the relevant insurers and insurance policies will recognise the Adjudicator’s decision and process claims accordingly if this is the case, as this could have important implications for both parties.

(g) The Adjudicator's costs of any reference shall be borne as the Adjudicator shall specify or, in default, equally by the parties. Each party shall bear its own costs arising out of the reference, including legal costs and the costs and expenses of any witnesses.

(h) The Adjudicator shall be deemed not to be an arbitrator but shall render his decision as an expert and the provisions of the Arbitration Act 1996 and the law relating to arbitration shall not apply to the Adjudicator or his determination or the procedure by which he reached his determination.

(i) The Adjudicator shall act impartially and may take the initiative in ascertaining the facts and the law. The Adjudicator shall have the power to open up, review and revise any opinion, certificate, instruction, determination or decision of whatever nature given or made under this Contract.

(j) All information, data or documentation disclosed or delivered by a party to the Adjudicator in consequence of or in connection with his appointment as Adjudicator shall be treated as confidential. The Adjudicator shall not, save as permitted by Clause 26.9 (Confidentiality), disclose to any person or company any such information, data or documentation and all such information, data or documentation shall remain the property of the party disclosing or delivering the same and all copies shall be returned to such party on completion of the Adjudicator's work.

(k) The Adjudicator is not liable for anything done or omitted in the discharge or purported discharge of his functions as Adjudicator unless the act or omission is in bad faith. Any employee or agent of the Adjudicator is similarly protected from liability.

(l) If:

(i) there is any dispute in respect of matters referred to in [Section 13 (Change in Service)], [Clause 14 (Change in Law)], [Clause 15 (Price Variation)], Clause 21.1.3 (Compensation on Nodal Agency Default), [Section 19.2.5 (Compensation on Termination for PPP Vendor Default)], Clause 21.3.4 (Compensation on Termination for Force Majeure), [Section 19.4.4 (Compensation on Termination for Corrupt Gifts and Fraud)] Clause 21.5.2 (Compensation on Voluntary Termination); or

(ii) either party is dissatisfied with or otherwise wishes to challenge the Adjudicator's decision made in accordance with Clause [ ]; or

(iii) both parties agree, then either party may (within [28] days of receipt of the Adjudicator's decision, where appropriate), notify the other party of its intention to refer the dispute to arbitration<sup>98</sup>. Such notification shall invite the other party to concur in the appointment of a sole arbitrator who shall be a solicitor, barrister or arbitrator recognised by the [ ] of not less than 10 years' standing. If the parties are unable within 14 days to agree the identity of the Arbitrator either party may request the [ ] to make the appointment.

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<sup>98</sup> The parties may incorporate provisions to go to court at this stage instead of arbitration if appropriate. In addition, the parties may wish to address expressly the right to apply to the courts for interlocutory relief at any stage in support of the adjudication or arbitration (assuming the arbitrator does not have such powers). If so, the need to appoint agents for service of process on overseas parties will arise.

(m) The Arbitrator shall have the power to open up, review and revise any opinion, certificate, instruction, determination or decision of whatever nature given or made under this Contract, to vary or cancel the decision of the Adjudicator and, where appropriate, to order financial compensation to be paid by one party to the other. The arbitration shall take place in [City/Location ].

(n) The Arbitrator shall in his absolute discretion, make such procedural directions as he considers necessary such as ordering the parties to provide written submissions within such time period as he considers appropriate and/or to attend such hearings as he deems necessary.

(o) The Arbitrator shall deliver his decision on any matter referred to him within 28 days of concluding any hearings which may have been held in connection with the matter and in any event within 3 months (or such other period as the parties may agree) of his appointment. The Arbitrator's decision shall be in writing and shall state his reasons for his decision. The decision of the Arbitrator shall be final and binding on both parties. The costs of the arbitration will be in the discretion of the Arbitrator.

(p) The parties shall continue to comply with, observe and perform all their obligations hereunder regardless of the nature of the dispute and notwithstanding the referral of the dispute for resolution under this Clause and shall give effect forthwith to every decision of the Adjudicator and the Arbitrator delivered under this Clause.

(q) If any dispute arising under this Contract raises issues which relate to:

(i) any dispute between the PPP Vendor and the Sub-Contractor arising under the Sub-Contract or otherwise affects the relationship or rights of the PPP Vendor and/or the Sub-Contractor under the Sub-Contract (the "Sub-Contract Dispute"); or

(ii) any dispute between the PPP Vendor and the Operating Sub-Contractor arising under the Operating Sub-Contract or otherwise affects the relationship or rights of the PPP Vendor and/or the Operating Sub-Contractor under the Operating Sub-Contract (the "Operating Sub-Contract Dispute"), then the PPP Vendor may include as part of its submissions made to the Adjudicator or to the Arbitrator, where the dispute is referred to arbitration, submissions made by the Sub-Contractor or by the Operating Sub-Contractor as appropriate.

(r) The Adjudicator or the Arbitrator, as appropriate, shall not have jurisdiction to determine the Sub-Contract Dispute or the Operating Sub-Contract Dispute but the decision of the Adjudicator or the Arbitrator shall, subject to Clause 25(1), be binding on the PPP Vendor and the Sub-Contractor insofar as it determines the issues relating to the Sub-Contract Dispute and on the PPP Vendor and the Operating Sub-Contractor insofar as it determines the issues relating to the Operating Sub-Contract Dispute.

(s) Any submissions made by the Sub-Contractor or the Operating Sub-Contractor shall:

(i) be made within the time limits applicable to the delivery of submissions by the PPP Vendor; and

(ii) concern only those matters which relate to the dispute between the Nodal Agency and the PPP Vendor under this Contract.

(t) Where the Sub-Contractor or the Operating Sub-Contractor makes submissions in any reference before:

- (i) the Adjudicator, the Adjudicator's costs of such reference shall be borne as the Adjudicator shall specify, or in default, one-third by the Nodal Agency and two-thirds by the PPP Vendor; and
- (ii) the Arbitrator, the costs of the arbitration shall be in the discretion of the Arbitrator.

(u) The Nodal Agency shall have no liability to the Sub-Contractor or the Operating Sub-Contractor arising out of or in connection with any decision of the Adjudicator or Arbitrator or in respect of the costs of the Sub-Contractor or the Operating Sub-Contractor in participating in the resolution of any dispute under this Contract.

(v) The PPP Vendor shall not allow the Sub-Contractor or the Operating Sub-Contractor access to any document relevant to the issues in dispute between the Nodal Agency and the PPP Vendor save where:

(i) the document is relevant also to the issues relating to the Sub-Contract Dispute or the Operating Sub-Contract Dispute as the case may be; and

(ii) the PPP Vendor has first delivered to the Nodal Agency a written undertaking from the Sub-Contractor and/or the Operating Sub-Contractor (as appropriate) addressed to the Nodal Agency that they shall not use any such document otherwise than for the purpose of the dispute resolution proceedings under this Contract and that they shall not disclose such documents or any information contained therein to any third party other than the Adjudicator or Arbitrator or any professional adviser engaged by the Sub-Contractor or the Operating Sub-Contractor (as appropriate) to advise in connection with the dispute.

## 26. NODAL AGENCY STEP-IN

### 26.1. Introduction

26.1.1. In some circumstances, the Nodal Agency may wish to take action itself in relation to the Service if there is a need to prevent or mitigate a serious risk to health, safety (person or property) or the environment or to discharge a statutory duty. Such a right may arise due to matters outside the scope of the work of the PPP Vendor or may arise due to the PPP Vendor being in breach of certain of its obligations under the Contract.

26.1.2. Such a right of the Nodal Agency is often referred to as “step-in” (and this is the terminology used here for that reason), as it involves the Nodal Agency taking over some or all of the obligations of the PPP Vendor for a period. It should, however, be viewed as being entirely different in nature and purpose from the PPP Vendor Default provisions (see Section 19.2 (Termination on PPP Vendor Default)). Essentially, the focus of the right is a serious short term problem that can or must be solved quickly, where the Nodal Agency is in a better position to do this than the PPP Vendor. The Nodal Agency should not in any situation be obliged to step-in.

### 26.2. Step-In – General

#### ILLUSTRATIVE DRAFTING:

##### **Nodal Agency Step-In**

- (a) If the Nodal Agency reasonably believes that it needs to take action in connection with the Service:
  - (i) because a serious risk exists to the health or safety of persons or property or to the environment; and/or
  - (ii) to discharge a statutory duty, then the Nodal Agency shall be entitled to take action in accordance with paragraphs (b) to (e) below.
- (b) If paragraph (a) applies and the Nodal Agency wishes to take action, the Nodal Agency shall notify the PPP Vendor in writing of the following:
  - (i) the action it wishes to take;
  - (ii) the reason for such action;
  - (iii) the date it wishes to commence such action;
  - (iv) the time period which it believes will be necessary for such action; and
  - (v) to the extent practicable, the effect on the PPP Vendor and its obligation to provide the Service during the period such action is being taken.
- (c) Following service of such notice, the Nodal Agency shall take such action as notified under paragraph (b) above and any consequential additional action as it reasonably believes is necessary (together, the “**Required Action**”) and the PPP Vendor shall give all reasonable assistance to the Nodal Agency while it is taking such Required Action.

### 26.3. Step-in without PPP Vendor Breach

26.3.1. If there has been no breach, in the circumstances set out above (i.e. those set out in Clause 29(a) (Nodal Agency Step-In)) the Nodal Agency should notify the PPP Vendor that it plans to step-in and the extent of such step-in. To the extent the Nodal Agency steps in, it will be effectively removing any obligations affected by such step-in from the PPP Vendor and performing them itself.

26.3.2. During its step-in, as the Nodal Agency needs to act for reasons external to the Contract, the Nodal Agency should pay for the Service as if the Service had been fully performed, subject only to any deductions to be made in respect of parts of the Service still provided by the PPP Vendor (e.g. to reflect performance on that part) and unaffected by the Nodal Agency's step-in. To the extent aspects of the Service are affected by the Nodal Agency's step-in, the Nodal Agency should make full payment in respect of such aspects and the PPP Vendor's obligation to perform such part of the Services should be suspended. Payment should also be conditional upon the PPP Vendor agreeing to provide reasonable assistance to the Nodal Agency at this time (provided the Nodal Agency reimburses the PPP Vendor for any extra costs it incurs).

26.3.3. The Nodal Agency should bear all its own costs incurred by stepping-in, in this circumstance.

#### **ILLUSTRATIVE DRAFTING:**

If the PPP Vendor is not in breach of its obligations under the Contract, then for so long as and to the extent that the Required Action is taken, and this prevents the PPP Vendor from providing any part of the Service:

- (i) the PPP Vendor shall be relieved from its obligations to provide such part of the Service; and
- (ii) in respect of the period in which the Nodal Agency is taking the Required Action and provided that the PPP Vendor provides the Nodal Agency with reasonable assistance (such assistance to be at the expense of the Nodal Agency to the extent incremental costs are incurred), the Unitary Charge due from the Nodal Agency to the PPP Vendor shall equal the amount the PPP Vendor would receive if it were satisfying all its obligations and providing the Service affected by the Required Action in full over that period.

### 26.4. Step-in on PPP Vendor Breach

26.4.1. If the PPP Vendor is in breach of an obligation under the Contract, the Nodal Agency should notify the PPP Vendor of such breach. This will generally occur through the monitoring arrangements and, in such circumstances, it is then up to the PPP Vendor to rectify the breach within the agreed timetable.

26.4.2. If the breach gives rise to a need for the Nodal Agency to step-in in the circumstances set out above (i.e. those set out in Clause 29 (a) (Nodal Agency Step-In)) and the PPP Vendor has failed to remedy the breach within the agreed time period, the Nodal Agency should have the right to



step-in and carry out such rectification itself (for example, using a third party) at the PPP Vendor's expense.

26.4.3. Where the Nodal Agency steps-in upon PPP Vendor breach, the Nodal Agency should continue to pay the PPP Vendor as where there is no breach (see Section 26.3.2). In addition, subject to Section 26.4.4 below, the full Unitary Charge should be paid for all aspects of the Service that are affected by the Nodal Agency's step-in, subject again here to the obligation on the PPP Vendor to provide reasonable assistance to the Nodal Agency. The PPP Vendor's obligation to perform such part of the Services should be suspended, though any existing right of the Nodal Agency to terminate for breach by the PPP Vendor should not be affected.

26.4.4. The Nodal Agency should, however, be entitled to set off any costs it incurs in stepping-in such circumstances (i.e. for both costs of work and advice and for time devoted to running the operations) against the Unitary Charge payable to the PPP Vendor. The PPP Vendor should be relieved of its obligations to continue the running of the relevant part of the operation concerned while the Nodal Agency has stepped in.

#### **ILLUSTRATIVE DRAFTING:**

- (a) If the Required Action is taken as a result of a breach of the obligations of the PPP Vendor under the Contract, then for so long as and to the extent that the Required Action is taken, and this prevents the PPP Vendor from providing any part of the Service:
  - (i) the PPP Vendor shall be relieved of its obligations to provide such part of the Service; and
  - (ii) in respect of the period in which the Nodal Agency is taking Required Action, the Unitary Charge due from the Nodal Agency to the PPP Vendor shall equal the amount the PPP Vendor would receive if it were satisfying all its obligations and providing the Service affected by the Required Action in full over that period, less an amount equal to all the Nodal Agency's costs of operation in taking the Required Action.

26.4.5. The Nodal Agency should behave in a reasonable manner, taking into account the relevant circumstances (e.g. it should try to avoid action which would detrimentally affect any compensation payable to the PPP Vendor on a termination) but an indemnity is only appropriate where the PPP Vendor is not in breach.

26.4.6. The rights referred to here should not be used as a means to undermine the carefully structured termination arrangements and should tie in with such arrangements. If the breach subsists following the Nodal Agency's step-in, the Nodal Agency should be entitled to terminate for PPP Vendor Default (see Section 19.2 (Termination on PPP Vendor Default)).

## **26.5. Related Issues**

26.5.1. Having stepped-in, in circumstances where there is no breach by the PPP Vendor, the Nodal Agency should act in accordance with good industry practice and to the extent there is a failure to

do so, then it should indemnify the PPP Vendor for any effects (including for any detrimental effect on any termination payment). Liability amounts should be outside any indemnity cap (for both parties).

26.5.2. The Nodal Agency should not be particularly concerned about such an indemnity being required as the price for a right of step-in. This is because to the extent the PPP Vendor is not in breach the Nodal Agency should honour the contractual structure and risk allocation in the Contract. If the PPP Vendor is in breach, then the termination provisions should ordinarily be sufficient to protect the Nodal Agency (with no indemnity) without any additional involvement of the Nodal Agency through step-in.

## 26.6. Rights of Access

26.6.1. An issue related to step-in rights (and at times confused with them) is that of rights of access of the Nodal Agency to the facilities.

26.6.2. This right exists in part to give the Nodal Agency the ability to monitor performance (see Section 10 (Payment Mechanism Management and Monitoring)) and carry out spot checks, to the extent required by the Contract.

### **ILLUSTRATIVE DRAFTING:**

#### **Rights of Access**

- (a) The Nodal Agency or a representative of the Nodal Agency may enter upon any property used by the PPP Vendor to perform the Service, to inspect the solution development, operation and maintenance of the Project and to monitor compliance by the PPP Vendor with its obligations.
- (b) The Nodal Agency and a representative of the Nodal Agency may at all times enter upon any property used by the PPP Vendor as training or workshop facilities and places where work is being prepared or materials being obtained for the Project.
- (c) The PPP Vendor shall procure that satisfactory facilities are made available to the Nodal Agency and any representative of the Nodal Agency and that reasonable assistance is given for the purposes of paragraphs (a) and (b) above, subject to the PPP Vendor's and Sub-Contractors' solution development or operational requirements not being adversely affected and to reimbursement of any reasonable costs or expenses of the PPP Vendor.
- (d) If the Nodal Agency is or becomes aware of a breach by the PPP Vendor of its obligations under Clause 11.1 (Maintenance) then the Nodal Agency may exercise its right of access and remedy such breach and shall be entitled to recover any costs or expenses incurred from the PPP Vendor.
- (e) The Nodal Agency and its representative shall at all times comply with any health and safety requirements when exercising its rights under this Clause.

- (f) If the Nodal Agency or its representative causes material damage to any asset in exercising any right under this Clause, then the Nodal Agency shall be liable to the PPP Vendor for the reasonable costs directly caused by such damage.

## 27. MISCELLANEOUS PROVISIONS

**30.1** The Contract will also contain a number of relatively standard positions. The following suggests how some of these should be drafted:

### 27.1. Waiver

- (a) No term or provision of this Contract shall be considered as waived by any party to this Contract unless a waiver is given in writing by that party.
- (b) No waiver under paragraph (a) shall be a waiver of a past or future default or breach, nor shall it amend, delete or add to the terms, conditions or provisions of this Contract unless (and then only to the extent) expressly stated in that waiver.

### 27.2. Severability

If any term, condition or provision contained in this Contract shall be held to be invalid, unlawful or unenforceable to any extent, such term, condition or provision shall not affect the validity, legality or enforceability of the remaining parts of this Contract.

### 27.3. Counterparts

This Contract may be executed in any number of counterparts, all of which when taken together shall constitute one and the same instrument.

### 27.4. Law of the Contract and Jurisdiction

This Agreement shall all be governed and construed in accordance with the laws of India applicable to agreements made and to be performed in India [and subject to Clause 25 (Dispute Resolution), the parties submit to the exclusive jurisdiction of the [ Court].

### 27.5. Third Party Rights

No term of this Contract is enforceable under the by a person who is not a party to this Contract.

### 27.6. Interest on Late Payments

The parties will pay interest on any amount payable under this Contract not paid on the due date, for the period from that date to the date of payment at a rate equal to [ ]% above [ ] .

### 27.7. Continuing Obligations

Save as otherwise expressly provided in this Contract or as already taken into account in the calculation of any Termination Sum or other payment of compensation on termination pursuant to this Contract:

- (a) termination of the Service Period shall be without prejudice to any accrued rights and obligations under this Contract as at the Termination Date; and

- (b) termination of the Service Period shall not affect the continuing rights of the Nodal Agency and the PPP Vendor under Clauses [ ] or under any other provision of this Contract which is expressed to survive termination or which is required to give effect to such termination or the consequences of such termination.