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Designing PPP Contracts

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The PPP contract is at the center of the partnership, defining the relationship between the parties, their respective rights and responsibilities, allocating risk, and providing mechanisms for dealing with change. In practice, the PPP contract can encompass several documents and agreements, as described in What is the PPP Contract?

Most PPP projects present a contractual term between 20 and 30 years; others have shorter terms; and a few last longer than 30 years. The term should always be long enough for the private party to adopt a whole-life costing approach to project design and service management, guaranteeing service performance at the lowest cost. The term depends on the type of project and on policy considerations—the project should be needed over the term of the contract, the private party should be able to accept responsibility for service delivery over its term, and the procuring authority should be able to commit to the project for its term. The availability of finance, and its conditions, may also influence the term of the PPP contract.

What is the PPP Contract?

This section uses the term *PPP contract* to mean the contractual documents that govern the relationship between the public and private parties to a PPP. In practice, the PPP contract may comprise more than one document. For example, a PPP to design, build, finance, operate, and maintain a new power plant, with power supplied in bulk to a government-owned transmission company may be governed by a power purchase agreement (PPA) between the transmission company and the PPP company, as well as an implementation agreement between the responsible government ministry and the PPP company. Each agreement may, in turn, refer to schedules or annexes to set out particular details—for example, detailed performance requirements and measures.

In addition to the PPP contract, there will also be numerous contracts between the SPV and its suppliers and financiers. Chief among them would be financing agreements between the SPV and its lenders, and shareholder agreements between equity investors (see How PPPs Are Financed for more on the PPP contractual structure). The PPP contract may not be effective until these other contractual agreements are in place**.** The **EPEC Guide to Guidance** (EPEC 2011b, 23) lists topics that should be covered in a typical PPP contract—the Examples of Standardized PPP Contracts and Contract Clauses provide further examples. The **PPIAF Toolkit for PPP in Highways** (WB 2009a) section on contracts describes the range of contractual agreements typically involved for different types of PPP.

As shown in PPP Contract Design Stage, the draft PPP contract is generally needed before a Request for Proposal (RFP) is issued. Detailed contract design takes significant time and resources—including from expert advisors. Approval is often required before embarking on detailed design and investing these resources.

The draft PPP contract is typically included with the RFP sent to prospective bidders. In some cases, the PPP contract issued with the RFP cannot be changed. In others, it may be changed because of interaction with bidders during the transaction process. Australia National PPP Guidelines Roadmap (AU 2015) and the South Africa PPP Manual (ZA 2004a) provide an overview of PPP contract development and how it

progresses at each stage of implementing the PPP.

PPP Contract Design Stage

PPP Contract Design Stage
Aim of PPP contract design

A well-designed contract is clear, comprehensive, and creates certainty for the contracting parties. Because PPPs are long-term, risky, and complex, PPP contracts are necessarily incomplete—that is, they cannot fully predict future conditions. This means the PPP contract needs to have flexibility built in to enable changing circumstances to be dealt with as far as possible within the contract, rather than resulting in renegotiation or termination.

The aim of PPP contract design is therefore to create certainty where possible, and bounded flexibility where needed—thereby retaining clarity and limiting uncertainty for both parties. This is achieved by creating a clear process and boundaries for change. To implement this style of contract in practice requires strong contract management institutions, as described in Managing PPP Contracts. Where possible, involving the future contract manager in designing or reviewing the PPP contract can help ensure that change management processes are implementable in practice. PPP contract design is a complex task. This section briefly sets out some key considerations—and provides links to tools, examples, and further resources—in five areas of PPP contract design:

- **Performance requirements**—defining the required quality and quantity of assets and services, along with monitoring and enforcement mechanisms, including penalties
- **Payment mechanisms**—defining how the private party will be paid, through user charges, government payments based on usage or availability, or a combination, and how bonuses and penalties can be built in
- **Adjustment mechanisms**—building into the contract mechanisms for handling changes, such as extraordinary reviews of tariffs, or changing service requirements
- **Dispute resolution procedures**—defining institutional mechanisms for how contractual disputes will be resolved, such as the role of the regulator and courts, or the use of expert panels or international arbitration
- **Termination provisions**—defining the contract term, handover provisions, and circumstances and implications of early termination

Together, these sets of provisions define the risk allocation under the contract. Obviously, the aim must be to draft these provisions so that the risk allocation chosen (as set out in Structuring PPP Projects) is achieved. The provisions dealing with adjustment mechanisms and dispute resolution are intended to avoid the need for renegotiation, by allowing changes to be made, and problems resolved, within the framework provided by the contract.

Some countries have made efforts to standardize elements of PPP contract design to reduce the considerable time and cost frequently involved in preparing and finalizing a given PPP contract. They have developed standardized contractual provisions or even complete standardized PPP contracts—Examples of Standardized PPP Contracts and Contract Clauses provides some examples. Other countries have chosen to incorporate certain elements of PPP contract design in legislation that governs all PPP contracts, as described in PPP Legal Framework.

For example, in Chile the dispute resolution mechanism is established in the Concessions Law. The World Bank Group's Report on Recommended PPP Contractual Provisions (WB 2017e) sets out and analyzes certain contractual provisions dealing with particular legal issues encountered in virtually every PPP contract, such as *force majeure*, termination rights and dispute resolution. Another useful resource is the World Bank's online PPP in Infrastructure Resource Center (PPPLRC-Types)—this website hosts a collection of actual PPP

contracts and sample agreements for a range of contract types and sectors. To review the impact of contractual clauses on statistical classification, the **2016 Eurostat Guide to the Statistical Treatment of PPPs** (EPEC 2016) reviews a large set of PPP contractual provisions typical in European government-pays PPP contracts.

Examples of Standardized PPP Contracts and Contract Clauses

JURISDICTION	STANDARD	LINKS
Australia	Guidelines issued by Infrastructure Australia on standard commercial principles for social and economic infrastructure PPPs	Infrastructure Australia's PPP Guidelines (AU 2017): Volume 3 on social infrastructure and Volume 7 on economic infrastructure.
India	Descriptions of model agreements for PPP in a range of transport sectors	Former Planning Commission (IN 2014d), (IN 2009)
Netherlands	Standard PPP contract for DBFM in buildings and DBFMO in infrastructure	Ministry of Finance Publications (NL 2017)
New Zealand	Draft standard PPP contract	National Infrastructure Unit (NZ 2013)
Philippines	Sample contracts for PPP in bulk water supply, ICT, solid waste management, and urban mass transit. The PPP Center is currently developing standardized terms for broader application	Public-Private Partnership Center: PEGR Sample Contracts (PEGR 2009)
South Africa	Standardized PPP provisions published alongside the South Africa PPP Manual	National Treasury Standardized PPP Provisions (ZA 2004c)
United Kingdom	Standardized contracts for PFI projects; includes extensive guidance on each element of the contract	Her Majesty’s Treasury: *Standardized contracts* (UK 2012c)

Key References

Designing PPP Contracts

- EPEC. 2011b. *The Guide to Guidance: How to Prepare, Procure, and Deliver PPP Projects.* Luxembourg: European Investment Bank, European PPP Expertise Centre. Section 2.2.5 on preparing the draft contract briefly describes typical contract content; Box 3 provides more detail on defining payment mechanisms. Section 4 on project implementation describes dealing with change within the contract, dispute resolution, and termination.
- WB. 2009a. "Toolkit for Public-Private Partnerships in Roads and Highways." World Bank. URL. Module 4: “Laws and Contracts” includes a section on contracts describing PPP contract types and typical contract contents and provisions, including sample boiler plate clauses. The section on agreements, bonds and guarantees describes other common elements of the contractual structure, including agreements with lenders.
- AU Guidelines. Accessed March 20, 2017. “National Guidelines for Infrastructure Project Delivery.” Canberra: Australian Government, Department of Infrastructure and Regional Development. URL. Set out why and how key risks and responsibilities should be allocated in the contract, for social infrastructure (government pays) (AU 2008) and economic infrastructure (user pays) (AU 2011b). The

roadmap document (AU 2011a) describes the...

- PPPLRC-Types. Accessed March 13, 2017. "PPP Arrangements / Types of Public-Private Partnership Agreements." Public-Private Partnership in Infrastructure Resource Center. URL. The PPP in Infrastructure Resource Center hosts a collection of actual PPP contracts and sample agreements for a range of contract types and sectors.
- Farquharson, Edward, Clemencia Torres de Mästle, E. R. Yescombe, and Javier Encinas. 2011. *How to Engage with the Private Sector in Public-Private Partnerships in Emerging Markets*. Washington, DC: World Bank. Chapter 4 on selecting projects includes a section on specifying output requirements, and defines and provides examples of SMART output specifications.
- HK. 2007. *Serving the Community By Using the Private Sector: A User Guide to Contract Management*. Hong Kong, China: Efficiency Unit. Guide to contract management, in the context of outsourcing services. Includes several sections relevant to designing PPP contracts, including developing service specifications, and dealing with termination and dispute resolution.
- UK. 2010a. *Output-Based Specifications for PFI/PPP Projects: Version 0.2 Consultation Draft*. London: Ministry of Defence. Provides detailed guidance on output-based specification, and a process for developing the specification for a PPP project.
- Iossa, Elisabetta, Giancarlo Spagnolo, and Mercedes Vellez. 2007. *Best Practices on Contract Design in Public-Private Partnerships*. Washington, DC: World Bank. Provides guidance on several elements of contract design, including risk allocation, designing the payment mechanism, building in flexibility and avoiding renegotiation, contract duration, and other contractual issues to do with dealing with change.
- UK. 2007. *Standardization of PFI Contracts: Version 4*. London: UK Government, HM Treasury. Provides detailed guidance and standard wording where appropriate on every aspect of the PPP contracts used for United Kingdom PFI PPPs (predominantly user-pays). The website http://www.hm-treasury.gov.uk/ppp_standardised_contracts.htm provides additional materials, including marked up versions showing changes made to previous versions.
- Kerf, Michael, R. David Gray, Timothy Irwin, Celine Levesque, Robert R. Taylor, and Michael Klein. 1998. "Concessions for Infrastructure: A guide to their design and award." World Bank Technical Paper No. 399. Washington, DC: World Bank. Section 3: “Concession Design” provides detailed guidance on designing PPP contracts, focusing on contracts in which the private party provides services directly to users. Topics covered include allocating responsibilities, price setting and adjustment, performance targets, penalties and bonuses, termination, dealing with unforeseen changes, and dispute settlement
- 4ps. 2005. *4ps Review of Operational PFI and PPP Projects*. London: Public-Private Partnerships Programme. Summarizes the results of interviews with stakeholders in operational PPP projects in the United Kingdom. Includes sections with lessons learned on output specification, payment mechanisms, and contract flexibility
- ZA. 2004a. *Public Private Partnership Manual*. Pretoria: South African Government, National Treasury. Module 6 of the manual, “Managing the PPP Agreement” briefly outlines how performance requirements, monitoring and enforcement mechanisms should be established. The standardized PPP provisions set out and explain key provisions across all elements of the PPP contract.
- SCT. 2004. *Output Specification – Building our Future: Scotland's School Estate*. Edinburgh: Scottish Executive. Sets out model output specifications for schools PPP projects as well as some guidance on key issues in defining output-based specifications.
- US. 2011. *Key Performance Indicators in Public-Private Partnerships: A State-of-the-Practice Report*. Washington, DC: United States Government, Department of Transportation, Federal Highway Administration. A state-of-the practice description of domestic and international practices for key performance indicators in PPPs, based on a comprehensive literature review and eight case studies from Australia, British Columbia, the United Kingdom and the United States.
- PPIAF. 2006. *Approaches to Private Sector Participation in Water Services: A Toolkit*. Washington, DC: Public-Private Infrastructure Advisory Facility. Section 6.3: “Designing Risk Allocation Rules” describes several aspects of PPP contract design for user-pays PPPs—including payment mechanisms,

and termination clauses. Section 7 on developing institutions to manage the relationship includes a discussion on dispute resolution.

- Irwin, Timothy C. 2003. "Public Money for Private Infrastructure: Deciding When to Offer Guarantees, Output-Based Subsidies, and Other Fiscal Support." Working Paper No. 10. Washington, DC: World Bank. Describes different payment mechanism for subsidies to infrastructure projects—including output-based payments and upfront capital subsidies—and how the government can decide which is most appropriate.
- Yescombe, E.R. 2007. *Public-Private Partnerships: Principles of Policy and Finance*. Oxford: Butterworth-Heinemann. Chapter 13: “Service-fee Mechanism” describes the different possible payment mechanisms (focusing on government-pays PPPs) and their implications for risk allocation and bankability. Chapter 15: “Changes in Circumstances and Termination” describes mechanisms to deal with changing costs and risks (compensation and relief events), step-in and substitution, and termination payment provisions for...
- SCT. 2007. *Briefing Note 1: Payment Mechanisms in Operational PPP Projects*. Edinburgh: Scottish Government. Describes experience with defining and implementing government-pays payment mechanisms in PPPs.
- HK. 2008. *An Introductory Guide to Public Private Partnerships*. Hong Kong, China: Efficiency Unit. Section 9: “Changes of Circumstance” provides guidance on the types of changes that the PPP contract should be able to deal with.
- Jadresic, Alejandro. 2007. "Expert Panels in Regulation of Infrastructure in Chile." Working Paper No. 2. Washington, DC: Public-Private Infrastructure Advisory Facility. Describe the expert panel approach used in Chile to deal with regulatory conflict. Section 6 focuses on the use of expert panels in public works concession contracts.
- Ehrhardt, David, and Timothy C. Irwin. 2004. "Avoiding Customer and Taxpayer Bailouts in Private Infrastructure Projects: Policy toward Leverage, Risk allocation, and Bankruptcy." World Bank Policy Research Working Paper 3274. Washington, DC: World Bank. Describes the problems associated with protecting lenders from losses in case of termination due to private party default, and provides some policy suggestions for alternatives.
- EBRD. 2007. *Law in Transition 2007: Public-private partnerships and legal reform in Russia*. London: European Bank for Reconstruction and Development. Clement Davies' paper discusses some of the main issues in developing concession agreements in transition countries—including risk allocation, tariff structure, performance standards, dealing with change, termination and step-in rights for lenders.
- Cassagne, Juan Carlos, and Gaspar Ariño-Ortiz. 2005. *Servicios Públicos: Regulación y Renegociación* . Buenos Aires: Abeledo-Perrot. Clement Davies' paper discusses some of the main issues in developing concession agreements in transition countries—including risk allocation, tariff structure, performance standards, dealing with change, termination and step-in rights for lenders.

Visit the PPP Online Reference Guide section to find out more.

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- Standardized Agreements, Bidding Documents and Guidance Manuals
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