Contract Management in Asset Recycling

Guidelines for Implementing Asset Recycling Transactions

Contract Management

Find guidelines in identifying, monitoring and managing contractual risk on project objectives in the section below or click on the link to find more on Implementing Asset Recycling Transactions.

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*The **Guidelines to Implementing Asset Recycling Transactions** is intended to be a living document and will be reviewed at regular intervals. Visit the **Asset Recycling: Decision maker's notes** for a practitioner's overview of Asset Recycling programs. To find more, check out the **Content Outline**.*

Asset recycling transactions involving a long-term concession or lease of an asset to a private partner constitute a long-term commitment by the private sector to operate and maintain, and sometimes redevelop and/or expand, a Relevant Authority's existing infrastructure project to deliver services to the public or the Relevant Authority. These activities are governed by the project agreements.

As a result, effective delivery of the transaction hinges on the ability of both the Relevant Authority and the private sector party to execute their responsibilities, as outlined in the project agreements. Even if a contract is drafted in accordance with international best practice and industry standards, the parties' objectives may not be achieved if the contract is not underpinned by effective contract management and performance monitoring over the life of the project.

This calls for an effective approach for managing the project agreements / contracts at every stage of the project term.

Contract management overview

Contract management defines the processes and procedures which the contracting parties follow in order to:

- meet their respective obligations;
- demonstrate their compliance with these obligations to their counterparts; and
- monitor the compliance of their counterparts with the counterparts' obligations.

Collectively, these efforts are intended to ensure that the contracting parties work towards the project objectives. Effective contract management ensures that the users of the project (the general public, customers, riders or, in some cases, the Relevant Authority itself) continue to obtain the services set out in the output specification of the project agreement. The contract management process should also set out relevant measures that can be used to monitor the risk profile of the project.

This section details the guidelines for effective contract management, which will identify, monitor and manage all risks over the life of the contract to assist in achieving project objectives.

For those projects deemed to have medium to high-climate related risks it is wise to include climate change / climate resilience expertise as part of the contract management team.

1. **Understand the stakeholders and the contracts**

Prior to the contract management strategy being developed, the Relevant Authority should confirm an overall understanding of:

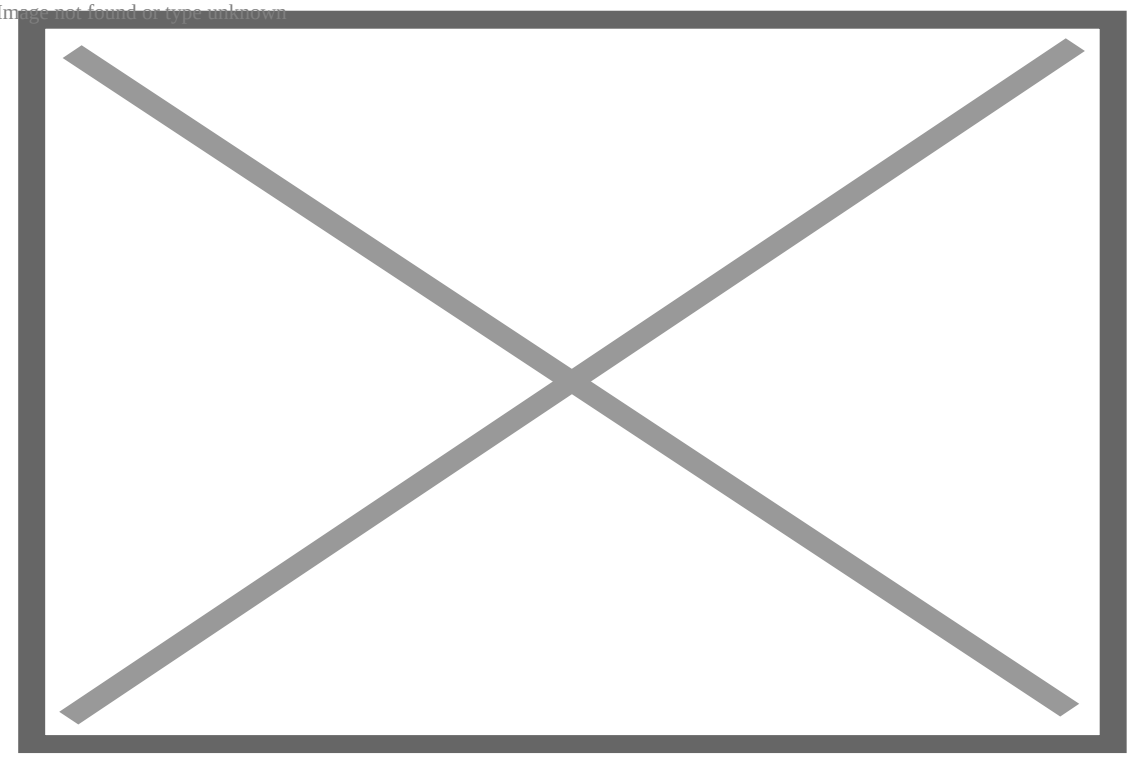
- The various stakeholders in the project agreements: the stakeholders include direct parties to the agreements as well as other parties (such as other government bodies and the local community) that have an interest in the project and the parties' performance of their respective duties and obligations.
- The express terms of the project agreements: the terms outline the powers, obligations and responsibilities of the parties to the contract. The understanding of the relationships between all parties is vital as each party may have conflicting goals that may not necessarily align to achieving the project objectives.

While the Relevant Authority must adopt an approach that is in line with applicable regulations and guidelines; there is no generic 'one size fits all' approach. Rather, the contract management approach must be developed for each specific project, in a manner consistent with project's specific characteristics and requirements.

For reference, the typical parties to a concession or lease agreement are shown in the diagram below.

Figure 7: Stakeholders in a Concession / Lease Agreement

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The Private Sector may enter into an operations sub-contract under which it subcontracts its obligation to operate and maintain the asset to an operator. The operator either performs the maintenance activities itself, if it has the capability to do so, or it subcontracts these activities to the rolling stock and systems supplier.

The Direct Agreement is a tripartite agreement between the Relevant Authority, the private sector participant, and the lenders. It provides the lenders with some right to take over the project where the private sector participant has failed to fulfil its obligations under the concession or lease agreement. This can include in circumstances of insolvency as well as other serious breaches. It allows the lenders to 'step-in' and assume the role of the private sector participant to give it the opportunity to rectify the breaches to avoid termination of concession or lease.

As detailed under legal and commercial structuring options, there are potential variations from the basic structure illustrated above. These may include:

- Inclusion of ancillary agreements with subsidiaries and affiliates of the Relevant Authority.
- Use of a shareholders/ joint venture agreement as the primary agreement between the Relevant Authority and the private sector in case the transaction is structured as a joint venture.

2. **Establish the contract management team**

Under the project agreement, the private sector is contractually bound to deliver the required services in accordance with the standards defined in the contract. An effective contract management process is aimed at ensuring that the private sector delivers to the standards defined in the contract.

The Relevant Authority should establish a contract management team to monitor operations under the project agreements and undertake regular reviews and performance monitoring to ensure compliance with the agreements. The contract management team should consist of experienced personnel with relevant skill set to manage these contracts.

Team members should consist of a range of specialists and technical advisors, if required. The contract management team's initial role after contracts have been signed will be supervising the handover of the asset from the Relevant Authority to private sector in accordance with the contract terms.

After that, the team's focus should be on ensuring management and operations of the asset (i.e., the availability of asset to users and delivery of the services) to the required standards. If the project scope includes significant capital expenditure, during these activities the contract management team may need to also monitor quality and timelines. However, it should be noted that as revenue risk falls mostly to the private sector, this should be done on a light touch basis. At the end of the contract period, the focus will shift to the handover of the asset from the private sector to the Relevant Authority.

The overall size and complexity of the project would be the key variable in determining the size and skill set required by the contract management team. The size and composition of the contract management team may evolve through the project lifecycle.

An overview of the types of skills required include:

- Business and product assurance
- Facilities and services management
- Statutory safety and regulatory responsibilities
- Asset management and maintenance
- Legal and regulatory; and
- Finance

3. **Identify contract management team responsibilities**

The contract management team should be headed by a project manager. The project manager should be an employee of the Relevant Authority, not an external advisor, and should have sufficient authority to carry out the role effectively.

The key responsibilities of the contract management team should include:

- Developing and implementing the contract management plan
- Ensuring that both parties meet their contractual obligations and ensuring performance specifications are achieved
- Monitoring private sector performance and enforcing remediation steps where necessary
- Administering institutional obligations and protect institutional rights in the contract
- Managing risks and preventing and/or resolving disputes; and
- Managing approved changes/variations

4. **Develop the Contract Management Plan**

The contract management plan should include the following:

- Describe required tools and processes – The contract management team should identify the necessary tools and processes needed to manage the contract during the lifecycle of the transaction (e.g., monitoring of performance standards). These tools and processes should be comprehensive and outline measures to identify potential risks. Consideration should be given to both the types of performance standards, the frequency of reporting and remediation steps if there is deficiency in performance. The tools and process must align with the project's performance monitoring approach as described in subsequent sections.
- Assess resource availability – Relevant resources to administer the contract management framework should be specified. Staff with the requisite expertise should be appointed at the Relevant Authority to be involved in the contract management process. This should be supported by financial resources (i.e., budget related to contract management) and technological resources (i.e. systems and software for monitoring the contract performance).
- Timeline for the development of tools and processes - The contract management plan should contain the timeline needed to develop and implement these tools and resources.

Environmental considerations for Contract Management Plan and Operation:

- Climate Risks Mitigation and Adaptation Plan for the whole concession period, that should be approved by the corresponding Relevant Authority, which is required to be updated
- Review and approval, of an Emergency Preparedness and Response (ERP) plan
- Maintenance plan that addresses climate risks
- Renewable energy, waste and water management commitments
- Bonds-related financing schemes for investments within concession scope must be green / social / sustainable labeled according to the ICMA principles

Gender Equality considerations for Contract Management Plan and Operation:

- Minimum commitment to gender equality in the total workforce
- Minimum commitment to gender equality in top management
- Gender Salary equality for similar positions
- Appropriate maternity/ paternity schemes

5. **Monitoring and reporting strategy**

An effective performance monitoring and reporting strategy has to incorporate the following elements:

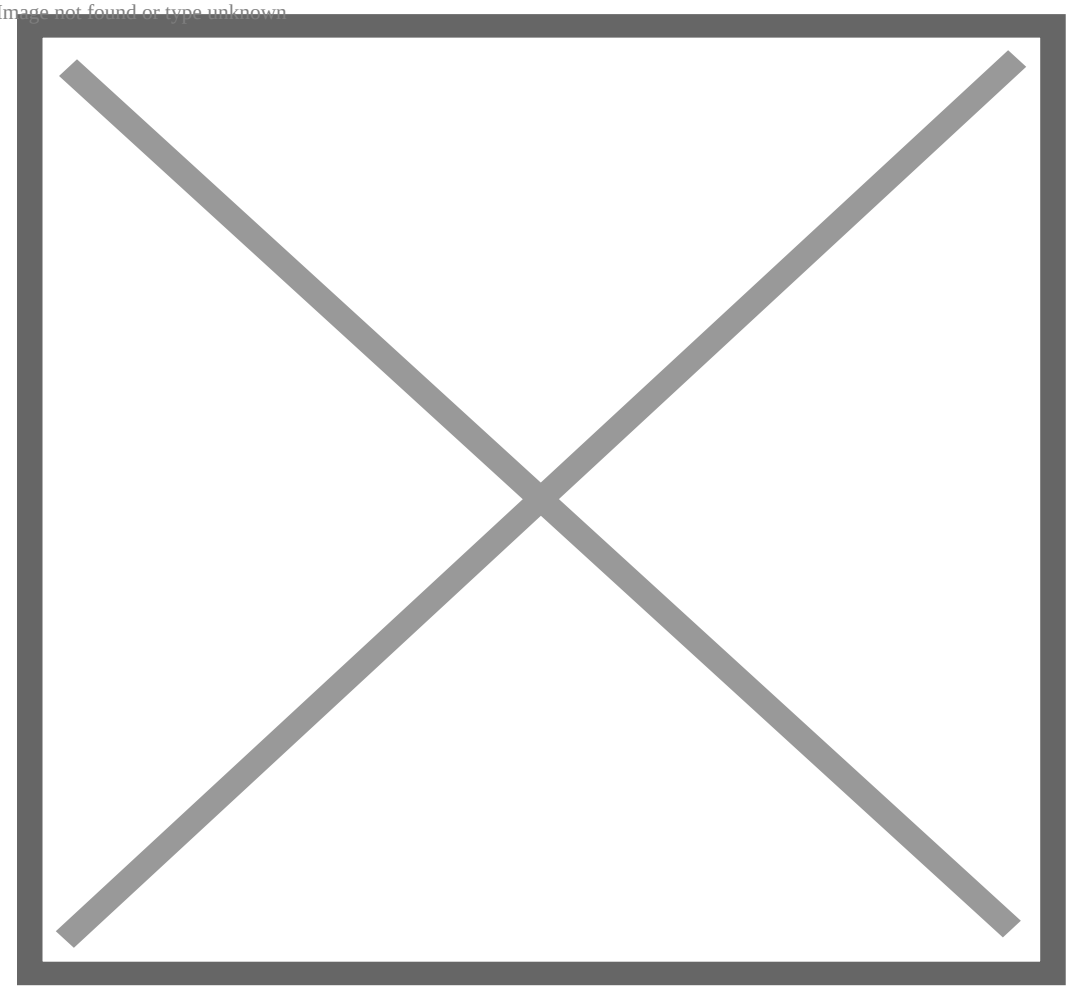
- Understanding of the business environment and the objectives of the project contract – Definition of various performance measures hinges upon a solid understanding of the various elements contained within the project agreement.
- Understanding the private sector's internal operating environment and management team – the Relevant Authority should ensure that it understands the business and cash flow model of the private partner's business model.
- Timely quality measurement – the Relevant Authority should proactively and regularly monitor and measure the quality of service against predetermined KPIs and output specifications.
- Understanding all obligations of the Relevant Authority (if any) and the timelines for delivering on the same.
- Reporting the outcome of performance monitoring regularly. While the frequency of such reports would depend on the project, but typically, such reports should be prepared and shared with all stakeholders at least on a monthly or quarterly basis.
- Concession agreement should include obligations for environmental management, monitoring, and reporting to Relevant Authority that owns the asset, as well as required biannual reporting to local environmental agency on environmental instrument implementation (AMDAL/ RKL/ RPL or UKL-UPL).
- Annual sustainability report.

6. **Performance monitoring process**

The contract management team should develop a process to monitor performance. An illustration of a typical process for doing so is contained in the diagram below.

Figure 8: Performance Monitoring Process

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If the failure to meet contractual requirements is persistent over time, the Relevant Authority should seek to understand the cause of this. If the failure is due to a contractual requirement becoming inappropriate over time, the contractual variations process should be activated. The contract variation process involves modifying the contractual requirements to align with the then current appropriate standards.

Performance monitoring should be carried out periodically. This can be carried out in the form of either reports or meetings, examination of financial data and inspections. The Relevant Authority will also reserve the right to carry out audits or surprise spot checks.

7. **Penalties for Non-delivery in Asset Recycling**

In addition to the payment mechanism employed in the project contract when the private sector is fully performing its obligations, the contract will also stipulate financial penalties and consequences for non-delivery of contractual services or standards. Such penalties are intended to incentivise the private sector to deliver outputs or services according to contractual standards. However, usually prior to activating such penalties, the Contract Management team would identify the lapses or shortfalls in service delivery, inform the private sector of the same and provide a certain rectification period within which the private party is expected to address these deficiencies.

8. **Hand-back Procedure in Asset Recycling**

At the end of the concession or lease term, there should be a set of obligations that both the private sector and the Relevant Authority have to fulfil. The contract management team needs to monitor the private sector's compliance with the exit obligations under the transaction contract.

The contract management team should manage the handover of relevant documents and records. Further at this stage, the contract management team should plan for the continuity of service delivery and maintenance of service standards.

The project contract should include well-defined performance standards for the asset at the time of handover. In case of sub-optimal asset quality at handover, procedures should be defined to determine the assessment of actual quality and the rectification cost payable. This may involve an independent process to conduct handover checks.

9. **Dispute Resolution in Asset Recycling**

The Relevant Authority's contract management team should build agreed mechanisms for settling disputes into the contracts. A proper dispute resolution framework will lead to a quicker resolution of issues. There are a number of existing dispute resolution approaches which may be included in the project's dispute resolution framework:

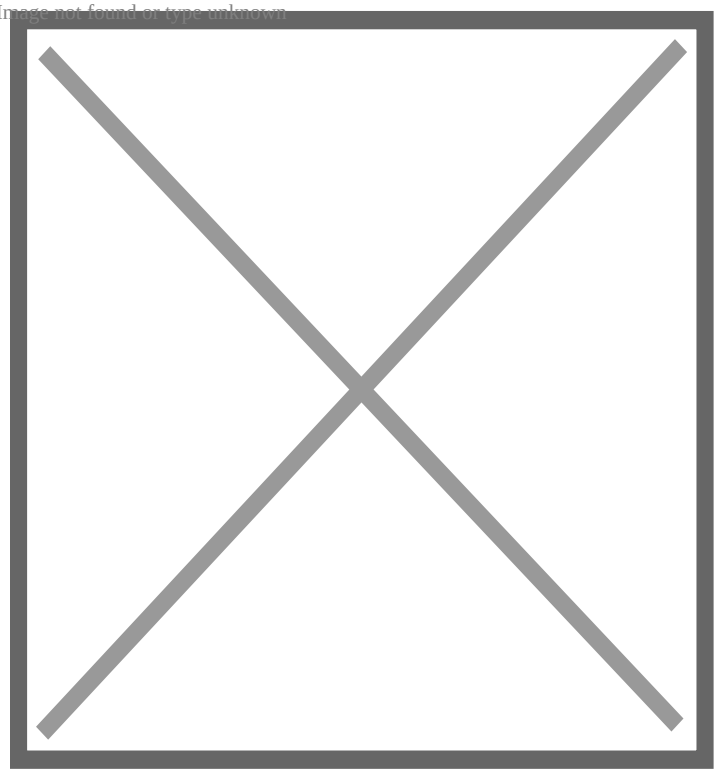
- Discussion between both parties, including escalation to senior management of both parties
- Expert determination
- Mediation or conciliation; and
- Arbitration or courts.

It should be ensured that relevant disputes resolution clauses are incorporated within the project contract. The precise drafting of the dispute resolution clauses should be the responsibility of the legal advisor.

Typically, adjudication by an arbitral forum or courts of law will be considered as the last resort. An illustration of the way a dispute can be escalated under a dispute resolution clause is presented below. The details of any escalation process will depend on the details contained in the precise clause governing the contract.

Figure 9: Escalation Process of Dispute Resolution

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This section has not been prepared with any specific transaction in mind and are meant to serve only as general guidance. It is therefore critical that the content will be reviewed and adapted for specific transactions.

This is a new section of the website and is currently in draft form. For feedback on the content of this section or to suggest additional links or materials, please contact the PPP Resource Center using the feedback form.

