

Commercial Principles in Asset Recycling

Full Description

The Relevant Authority should determine key commercial principles that will form the basis of the project structure and the project agreement; the commercial principles should ensure value optimization in terms of financing raised by the Relevant Authority and value proposition (in terms of suitable returns) for the private sector.

- **Concession period:** The term of the contractual arrangement under an asset recycling transaction may be subject to sector specific regulations. In determining the concession period, the Relevant Authority should consider two principles (i) optimizing the funds raised by the Relevant Authority through the asset recycling project (e.g. the upfront fee or revenue share), and (ii) phasing of major capex (if any for future expansion, upgrade, or refurbishment are contemplated). As a general principle, the longer the concession period, the more funds the Relevant Authority can leverage from the project; however, an increase in concession period beyond a certain year may not result in significant increase owing to the discounting effect of cashflows that are in the distant future.
- **Payment mechanism:** The Relevant Authority should determine the optimum mechanism for its receipt of funds from the project, such as minimum upfront fee expected to be paid by the private sector, minimum periodic payments by the private sector, profit sharing or dividend payments, reflecting the asset valuation methodology as discussed previously.
- **Force majeure events:** Force Majeure provisions and how they operate will be fairly typical and reflect risk allocation determined in the project risk matrix. The Relevant Authority will have to determine the extent to which certain government events (such as government actions or inactions and changes in law) will be shared and the protections the private sector should be allowed to safeguard its investment.
- **Default events:** Depending on its severity, a default may be subject to a project default regime, a persistent breach regime or a termination regime. The default regime will involve the Relevant Authority giving notice of the occurrence of a certain default (for example, a serious service failure) and the private party using a cure period to rectify.
- **Termination events:** The Relevant Authority should be able to terminate the contract should certain termination events occur. These should include circumstances where the private partner is abandoning the asset, default events not being cured over a prolonged basis, or an insolvency event in relation to the private partner.
- **Default/ termination payments:** The private partner will not be guaranteed any payment by the Relevant Authority if the concession or lease agreement is terminated as a result of a default by the private party but, conversely, termination payment will be due in certain scenarios such as government default and for certain situations of prolonged government force majeure (including discriminatory changes in law).

- **Government step-in:** The government should be able to step-in and assume some or all the service delivery obligations of the private partner under certain circumstances including when there is an emergency, a serious risk to the environment, the public or users of the facility or a serious risk of material damage to public or private property.
- **Hand back at the end of concession period:** The private partner will ensure that the asset meets the return conditions at end of the concession or lease term.

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