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CONTRACT MANAGEMENT

Municipal Public-Private Partnership Framework

12

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1.0

Purpose of this Module

This module provides guidance on contract management over the PPP project life cycle—what activities and risks should be monitored and managed during various stages of project implementation. There is a tendency in PPP projects to focus efforts on the procurement process, award, and financial close. However, the real work starts during implementation, when the parties must deliver on their obligations. The municipality has a critical role to play during implementation. This module provides guidance on how the municipality can manage implementation of the PPP to improve the likelihood of success.

For further discussion of PPP contract management, see:

- World Bank. n.d. “Managing PPP Contracts”. PPP Reference Guide 3.0. Accessed July 19, 2019. <https://pppknowledgelab.org/guide/sections/73-managing-ppp-contracts>.
- Global Infrastructure Hub. 2018b. “Disputes”. PPP Contract Management Report. <https://managingppp.gihub.org/report/disputes/>.
- European PPP Expertise Centre. 2014. Managing PPPs during Their Contract Life, Guidance for Sound Management. <https://ppp.worldbank.org/public-private-partnership/library/managingppps-during-their-contract-life-guidance-soundmanagement>.
- Dombkins, David. 2019. United Nations. Public Private Partnership Contract Management Manual. <https://www.unece.org/info/ece-homepage.html>.
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- 4ps. 2007. *A Guide to Contract Management for PFI and PPP Projects*. London: Public-Private Partnerships Programme. <http://docplayer.net/9794015-A-guide-to-contract-management-for-pfi-and-ppp-projects.html>.

2.0

Contract Management Plan and Organizational Approach

Establishing the PPP CMU

The CMU is responsible for monitoring performance, ensuring that the parties comply with the terms and conditions of the PPP contract and that specific changes, such as adjustments in tariffs or prices, are properly analyzed and implemented. Key decisions about whether or by how much tariffs and prices should be adjusted are generally contained within specific formulas in the PPP contract.

The municipality must design the PPP project's performance monitoring plan. The staffing and operation of the CMU is the institutional responsibility of the municipality. The municipality must ensure continuity of knowledge and key staff and plan for staff turnover.

PPP CMUs require capable staff, adequate information technology systems, and the budget resources needed to gather and verify technical, operational, financial, and legal performance data, in particular the following:

- Gathering and verifying data on the technical performance of a PPP, as specified by the key performance indicators and 'outputs' required by the PPP agreement.
- Gathering and verifying financial and cost performance data of PPP projects.
- Monitoring and ensuring compliance with and enforcement of the legal terms and conditions of the PPP agreement.
- Coordinating with other relevant compliance bodies and regulators or outside monitoring specialists, such as specialized outside lawyers, engineers, environmental specialists, or other experts retained to advise on specific PPP performance issues.

For smaller, uncomplicated PPPs, the CMU could consist of just a single individual. A single contract management officer would usually be supported by qualified, part-time, outside specialists, as needed, to address specific technical, legal, or other performance issues. For larger and more complex PPPs, a CMU often requires a team of different specialists responsible for monitoring technical,

financial, legal, consumer service or other areas of performance.

CMUs need to gather specific data and information on the actual level of performance being delivered by the PSP. Examples of some of the kinds of performance data gathered by CMU staff include the following:

- The volume of services being provided or volume of end users being served.
- The percentage of time that the project is available for users.
- The proven ability of a new project or service, through commissioning tests, to operate at its intended and contracted capacity.
- The number of proven and justified complaints received from end users for inadequate service.

CMUs ensure that the contract's key payment formulas are implemented.

The CMU should be in place before the PPP contract is signed, to allow the CMU to understand the formulation of the project and enable it to start implementation processes as soon as possible. It is easy to delay setting up the CMU in the frenzy leading up to financial close.

The CMU will need to establish balance, accessing enough information to ensure the project is well implemented without impeding the ability of the PSP to perform its obligations and in view of the limited capacity of the CMU.

A contract management manual¹ will cover all relevant topics and provide a guide to the CMU staff to ensure that key issues are addressed on time. It will also help integrate CMU activities with those of other municipal staff in related areas. Constant communication is key—with municipal staff, the PSP, and any PPP unit or national authority—to ensure sharing of lessons learned and early identification and management of conflict.

¹ See: European PPP Expertise Centre. 2014. Managing PPPs during Their Contract Life, Guidance for Sound Management. <https://ppp.worldbank.org/public-private-partnership/library/managingppps-during-their-contract-life-guidance-soundmanagement> (providing an outline at page 30 for the possible content of a contract management manual).

3.0 Contract Management over the PPP Project Life Cycle

This section describes activities undertaken by the municipality and the PSP and project risks to be monitored and managed across different implementation stages of the PPP project.²

3.1 Pre-Construction Stage

During pre-construction, the CMU ensures that the municipality and the PSP comply with their contractual commitments.

Table 1 lists the activities of each party in the PPP agreement during pre-construction that need to be monitored:

Table 1: Compliance Monitoring

Aspect	Activities ³
Ensuring compliance by municipality	<ul style="list-style-type: none"> • Handover of the project site and access to the project site within the agreed schedule. • Approvals, authorizations, and permits that are the responsibility of the municipality. • Review of technical designs. • Delivery of associated infrastructure to be delivered by the municipality.
Monitoring compliance by the PSP	<ul style="list-style-type: none"> • Preparation and submission of detailed designs. • All approvals and permits (other than those which are the responsibility of the municipality). • Arrangement of the financial resources needed for the project (financial close). • Project insurance. • Arrangement of utilities (electricity connection and construction water supply). • Submission of performance/security bonds and guarantees. • Bank account and escrow arrangements.

² See: European PPP Expertise Centre. 2014. Managing PPPs during Their Contract Life, Guidance for Sound Management. <https://ppp.worldbank.org/public-private-partnership/library/managingppps-during-their-contract-life-guidance-soundmanagement> (providing a checklist of tasks involved in the operational management of the different phases of a PPP project after contract signature).

³ The responsibilities mentioned in this table and in succeeding tables relate to typical PPP projects and may vary from project to project.

The CMU should be apprised of project financing negotiations to ensure that the PSP complies with its obligations. The municipality should stand ready to respond to requests from lenders for additional information. Typically, lenders will hire their own advisers and sector experts to verify all background information.

Failure to reach financial closure is a costly experience for all parties. While private bidders risk losing their performance bond as well as writing off the value of several years of preparation and development costs, the municipality faces significant new delays in the provision of important new public facilities and services. Even lenders risk losing the value of their own time and expenses invested in due diligence and negotiating with investors. The municipality should carefully evaluate the reasons why financial closure was not reached.

These could include the following:

- Lack of prior experience in raising project-backed financing.
- The project is not sufficiently financially robust or is otherwise too risky for lenders to finance.
- The financial market has shifted in appetite or available terms
- One of the private investors dropped out of the consortium.

The CMU will require regular progress reports from the PSP. These reports help the CMU identify challenges early. The CMU should be proactive in working with the PSP to resolve challenges and identify innovative methods of overcoming obstacles.

3.2 Construction Stage

At this stage, the key objective is to ensure that construction timelines/deadlines are met based on the approved design. The activities to be monitored for this stage are described in Table 2.

Table 2: Verifying Compliance during Construction

Aspect	Activities
Ensuring compliance of municipality's responsibilities	<ul style="list-style-type: none"> • Payment of capital grants based on the contractual milestones. • Access to the site. • In-kind contributions, including materials, equipment, or existing facilities. • Approvals of tests and commissioning.
Monitoring compliance by the PSP	<ul style="list-style-type: none"> • Reports and as-built drawings. • Construction progress against milestones. • Construction implementation against approved designs. • Independent engineer (if any) reports. • Testing and results.

The main risks to be monitored and managed at this stage include the risk that:

- Approved design of the project is defective;
- Actual cost of construction is significantly higher than envisaged, creating a likelihood of default;
- The completion will be delayed beyond the targeted schedule;
- The social or environmental impacts of the project construction are more than expected and/or mitigation strategy is not effective; and
- There is widespread public opposition to the project.

During the construction stage, the CMU will monitor key performance indicators including:

- Obtaining required permits and licenses (environmental permits, zoning permits, building permits, import approvals, and so on), on schedule;

- Stakeholder consultation;
- Delivery of interconnection facilities, such as approach roads to the site or electricity, water, and sewerage interconnections, completed on schedule;
- Delivery of detailed designs and as-built drawings reviewed by the municipality;
- Financial close, including all conditions precedent to effectiveness of finance agreements;
- Delivery of performance bond (or conversion of bid bond to performance bond);
- Time for completion and milestones;
- Testing of works and materials; and
- Commissioning of works and readiness for commercial operation.

3.3 Operations Stage

This stage includes the commissioning of the PPP project until the expiry of contract or its early termination, as the case maybe. The CMU's focus during this stage is to ensure that the performance

of the municipality and the PSP meets the expected standards, and the users' rights and interests are protected. The activities of the contracting parties during the operations stage are listed in Table 3.

Table 3: Verifying Compliance during Operation

Aspect	Responsibilities
Ensuring compliance of municipality's responsibilities	<ul style="list-style-type: none"> • Payment of operation period grants, if any. • Compliance with commitments of the municipality, such as <ul style="list-style-type: none"> ◦ Not allowing the development of competing facilities during the project tenure. ◦ Coordinating with other government departments for connecting infrastructure facilities and services. • Continuity of services.

Aspect	Responsibilities
Monitoring compliance by the PSP	<ul style="list-style-type: none"> • Performance against defined output standards. • Project financials to ensure no looming default. • User experience/grievances. • Review of the maintenance activities. • Planned maintenance and replacement activities. • Usage and performance data and revenues reported by the PSP. • Payment of revenue share (if any).

Penalty regimes for PSP failure to achieve performance targets are best used as an incentive to improve performance rather than a punishment. The risks that need to be monitored and managed during operations include the risk that:

- The actual demand of the project facilities/ services is higher or lower than expected;
- The actual revenues of the project are lower/ higher than expected;
- The revenue leakage is higher than expected (for example, where tolls are charged but do not reach the project accounts or where bill collection falls behind expectations);
- The operating cost for the project is higher or lower than expected;
- The project may not be able to deliver the expected performance;
- The cost of financing during the operations period is higher than expected (this may or may not be available to the CMU, but the CMU should be aware of the market conditions and work with the PSP to identify any forthcoming challenges);
- Conflicts are not identified and managed early and therefore become disputes; and

- The project will not be able to service the project debt (including working with the lenders to help address any potential events of default under the financing agreements).

During the operation stage, the CMU will monitor key performance indicators including:

- Maintaining of licenses and permits;
- Performance testing of completed works;
- Monitoring of service and performance standards;
- Periodic testing of the works, to ensure quality and maintenance standards;
- Reporting by the PSP to the municipality;
- Whether demand is meeting forecasts;
- Stakeholder engagement;
- Monitoring of scope changes;
- Condition of assets against handback standards;
- Implementation of the maintenance regime;
- Tariff levels and review;
- Changes in laws and regulations and any implications for the project.

3.4 Handback Stage

Project facilities are handed back to the municipality (or to a new PSP) at the expiry of the contract or at termination of the contract (in conformity with the terms of the PPP agreement). At the handover

stage, the key focus is to ensure that project facilities are handed over in a pre-agreed condition and in a way consistent with the PPP agreement, including those listed in Table 4.

Table 4: Verifying Compliance during Handback

Aspect	Responsibilities
Ensuring compliance of municipality's responsibilities	<ul style="list-style-type: none"> • Handover payments, if required, in particular for project equipment, spares, or materials that the municipality wants to purchase. • Taking over possession of the project facilities. • Ensuring that there is no disruption in service during the handover. • Initiating the bid process to appoint a new PSP (optional).
Monitoring compliance by the PSP	<ul style="list-style-type: none"> • Performance against defined output standards. • Project financials to ensure no looming default. • User experience/grievances. • Review of the maintenance activities. • Planned maintenance and replacement activities. • Usage and performance data and revenues reported by the PSP. • Payment of revenue share (if any).

The key risks that need to be monitored and managed at this stage include the risk that:

- The project facilities at the end of the contract period do not meet the prescribed condition;
- The PSP will need to spend a higher-than-expected amount to bring the project facilities up to the required operating standards; and
- The service is disrupted during the handover.

As the project approaches handover stage, the municipality has four main options:

- (1) **The municipality takes over delivery of the project services:** The municipality will need to verify that the facilities are in good condition and assess how much additional investment will be needed to bring the facilities up to current requirements and to deliver services to standard.
- (2) **The municipality conducts an open competitive tender for a new PSP to deliver the services:** The municipality will need to gather data on the project and the facilities to inform the bidding process.

- (3) **The municipality negotiates with the current PSP to extend the contract, including new investments if needed:** This can create a moral hazard for the municipality where a reasonable arrangement cannot be achieved; the municipality may want to use this approach only where an open competition is unsuccessful.
- (4) **The PSP maintains the assets and the municipality allows the contract to expire:** Most infrastructure assets are meant to deliver services over the long term, well beyond the end of the project, but some assets may be short-term in nature, for example information, communication and technology, and therefore after the end of the period, the municipality may prefer to leave the assets in the hands of the PSP to manage their remediation.

The municipality should conduct a new feasibility analysis for the project to systematically evaluate which option provides the best value for the public's money.

4.0

Management of Contract Variations

The municipality or PSP submits a variation proposal describing the nature of the variation and an assessment of the technical, financial, contractual, and time implications of the proposed variation. Payment for the variation can be made by adjustments to tariffs, availability payments, government support payments, or other payments contemplated in the PPP agreement. The parties discuss and agree variations in accordance with the PPP agreement. A variation or amendment of the PPP agreement may respond to changes in circumstances not contemplated in the PPP agreement, or where the original project design is flawed. The CMU will need to assess any proposed amendment or variation to assess whether it complies with the agreement, and whether it will provide (1) VFM, (2) affordability, and (3) appropriate

risk-sharing between the parties. Below are some indicative procedures that can serve as a guide in proceeding with these variations:

- (1) Variations involving no additional costs: If the variation will result in a reduction in costs, the parties need to agree on a distribution of the savings. For variations proposed by the municipality net savings should accrue to the municipality, while savings from a variation proposed by the PSP should be divided between the municipality and the PSP.
- (2) Small works variations: The PSP should provide a schedule of rates for small works each year, or the parties can agree on such a schedule as and when needed. Small works can be priced according to such a schedule.

5.0 Management of Contingencies

PPP contracts generally provide for relief for the PSP for specified contingency events: (1) change in law, (2) force majeure events, and (3) termination.⁴

5.1 Change in Law

A change in law event is generally defined as a material change in the legal or regulatory framework that governs the project and has a material impact on the parties. The management of change in law involves the following:

- **Definition of change in law:** Typically as set out in the PPP agreement.
- **Notice of change in law:** The party that is affected by the change in law is expected to issue a written notice to the other party communicating that a change in law has occurred and also estimating the financial impact that the change in law event may cause.
- **Approval of change in law:** The CMU must, on receipt of a change in law notice, review

the change in law event from the following perspective:

- o Does the event meet the defined criteria of change in law?
- o What is the impact of the change in law event?
- o What compensation/relief does the PPP agreement award for the change in law event?

Based on the review, the CMU recommends a solution. Based on CMU advice, the municipality decides whether to recognize the change in law event and compensate the PSP. External experts may likewise be consulted. Where the parties cannot agree, this issue will be submitted to the disputes review process.

5.2 Force Majeure Events

Force majeure events are generally defined as unforeseen circumstances that materially affect the ability of the contracting parties to perform their contractual responsibilities. The management of the force majeure regime will involve the following:

- **Notice of force majeure event:**
The party becoming aware of the force majeure event prepares a written notice describing the event and the likely impact on the project. The CMU will review the notice to ensure that the event in question meets the criteria of a force majeure event.

- **End of force majeure event:** When the party affected by the force majeure event is aware that the event has concluded, it should send a notice to the other party.

The CMU advises on the liabilities of the municipality for compensation payable to the counterparty (if applicable), according to the PPP agreement. The force majeure event can trigger termination under certain circumstances.

5.3 Contract Termination

Contract termination refers to the severing of the contractual relationship before the term of the PPP agreement expires. There are several situations: where termination can be initiated by either party.

- (1) If the termination is initiated by the municipality, the CMU will provide a detailed notice, including supporting evidence and will be issued to the PSP.
- (2) If the termination is initiated by the PSP, the contract manager will review the termination notice to assess

- (a) If the reasons for termination are valid and eligible under the terms of the PPP agreement; and
- (b) If there are any alternatives to termination.

The CMU will work with the PSP to find an agreed solution, and will advise the municipality on a response to the notice.

The municipality will determine the likely value of the termination compensation, and will seek sources to finance such payments.

⁴ See the checklist of issues to manage in a dispute negotiation in: Global Infrastructure Hub. 2018b. "Disputes". PPP Contract Management Report. <https://managingppp.github.org/report/disputes/>

6.0

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