



CCA

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**A guide to
public-private partnerships
in Canada**

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1.0 INTRODUCTION

This Guide is prepared for CCA members who may wish to consider participating in a Public-Private Partnership (P3) project. It highlights some of the unique risks that Contractors face during the procurement and contracting phases of P3 projects as well as best practices to mitigate risks.

This Guide is not intended to promote or discourage participation in P3 projects. Rather, it is designed to provide information to support the decision-making process of interested parties. Whereas CCA generally recognizes the legitimacy of alternative project delivery models such as P3, it does not endorse any particular model as a panacea.

2.0 WHAT IS A P3?

2.1 Definition

The Canadian Council for Public-Private Partnerships (CCPPP) defines P3 as:

“A cooperative venture between the public and private sectors built on the expertise of each partner that best meets clearly defined public needs through the appropriate allocation of resources, risks, and rewards.”

In effect, a P3 is a business arrangement where in Canada the project is normally owned by the government, and a Concessionaire owned private entity that is established as Special Purpose Vehicle (SPV) by a consortium of companies and is typically awarded a long-term contract to design, build, operate, maintain, and finance the project. It should be noted that other jurisdictions are increasingly having the private sector own the asset. The contract between the parties is for a finite period, and payment is generally based on performance/availability (including operation and maintenance) or some form of usage payment. The private sector partner is then able to obtain third party financing for the project and repay it, together with profit and return on equity from certain progress payments and long term operation and maintenance revenues, which may include additional third party revenue from ancillary services such as a coffee shop. However the financing, operation, and maintenance aspects of the contractual obligation are usually for a lengthy period of time (e.g. 30 years).

P3 projects in relation to public infrastructure may be used to achieve the construction of a variety of different types of infrastructures such as hospitals, schools, prisons, courts, fire stations, and highways.

2.2 Typical P3 Contractual Structure

See Appendix.

2.3 Typical P3 Project Players

On any given project, the parties involved and their roles will be shaped by the physical nature of the construction to be built, and financial, legal, technical, and operational requirements necessary to support the project. Moreover there will be multiple agreements affecting the roles and responsibilities of each party. It is important for Contractors to not only actively negotiate the terms and conditions of their contract, but also to appreciate the complexities and interplay between the various agreements, and ultimately understand the nature and extent of their rights and responsibilities and manage them accordingly with their own consultants, subcontractors and suppliers.

The primary parties involved in the concession agreement for a P3 project are the public entity and the Consortium/Concessionaire; however, the Design-Builder and the Service Provider are also vital players in most P3s as they account for the largest element of the cost of the project over the life of the concession and have the biggest impact on the Concessionaire's ability to raise and secure competitive financing and to deliver the project and the services and to ultimately secure the success of the project. Depending on the nature of the project and financing arrangements, examples of other parties likely to be engaged include a financier, subcontractors, and suppliers. Though the technical expertise that each party is expected to bring to the project does not differ from the ordinary course of their respective business services offered, it is the unique structure of the P3 contractual arrangements that will distinguish and dictate the roles and obligations of each party. For example, Contractors need to understand user groups, design development, commissioning, testing and handover, transition arrangements and interfaces with Service Provider and impacts on whole life cost, user operational policies and issues such as clinical functionality, adjacencies, infection control in hospitals, etc.

3.0 OPPORTUNITIES AND RISKS FOR CONTRACTORS

Before deciding whether to participate in P3 projects, a contractor must undertake all appropriate due diligence measures, including a comprehensive cost-benefit analysis. This should entail weighing each potential risk and reward with the greatest precision possible.

3.1 Roles for Contractors

3.1.1 Design-Builder

Contractors can participate in P3 projects through:

- Partnering with a developer, concessionaire, financier, engineer, supplier, or other team members.
- Contracting with the concessionaire as Design-Builder.
- Undertaking by the way of contributing equity and assuming the role of the concessionaire to design, build, operate, and maintain the project for a public entity wherein the long-term physical performance risks are shifted to the operator.
- Having Service Provider businesses, which is quite common for European contractors.

3.1.2 Subcontractors

There are two types of subcontractors in a design-build project: traditional subcontractors who provide only construction services, and design-build subcontractors who provide design and construction services.

The role of a subcontractor in a design-build, finance, maintain project does not differ significantly from the traditional design-bid-build project. Many subcontractors are selected using the lowest bid method. Standard subcontract forms can be used for this purpose.

In addition to performing construction work, design-build subcontractors can also provide design services. To fully utilize their expertise, design-build subcontractors must be included in the design-build team as early in the process as possible, because they take a very active role in the proposal and design phases and provide input at all design development meetings. Design-build subcontractors may often be selected using the best value selection method, and the design-builder should carefully define the scope of the design and strike a balance between fee paid and services provided.

Subcontractors should be aware of the risks that are often transferred from the Contractors and inherit the risks in any subcontract agreement that they may be required to enter into before they consider participating in a P3 project. Moreover, the impact of these risks on their rights must be carefully analyzed and inform their decision-making process.

3.2 Potential Rewards

- A construction contract and a long-term service contract for the entire span of the project. It should be noted that although the service contract is usually designed to last for the life of the concession, the main obligations under the construction contract often terminate at

construction completion, however, some significant residual obligations continue during the life of the project.?

- A potentially higher profit margin as a reward for assuming the associated higher risks.
- Lesser number of competitors compared with traditional design-bid-build projects.
- More control of the design/construction/operation/maintenance process, which is similar to design-build projects.

3.3 Risks

There are a myriad of unique risks likely to be associated with every different P3 project. For each project, the Contractor and Service Provider should evaluate both the typical construction risks and the atypical risks (such as long-term maintenance requirements), and work to reduce these risks. Because each P3 is uniquely structured, it is important for Contractors to know exactly who they are working for, what risks they have assumed, and to recognize long-term liabilities that may be assigned or transferred by contract.

When Contractors consider participating in a P3 project, they face new risks and new opportunities. Many of the risks to Contractors (general, trade, heavy and roadbuilding construction) inherent in P3 projects are similar to those in design-build projects, except in amplified degree in that P3 projects are quite often larger, more complex, include lenders and other parties..

It is important for Contractors to negotiate against any risks that are unfairly transferred to them being cognizant that in concession contracts, the Concessionaire will typically pass risk down in circumstances in which there may be little opportunity to negotiate risk transfer. All risks should be allocated to the parties that are in the best position to manage them.

- **Pursuit Cost.** The cost to put together a Design-Build proposal is high given the resources required to prepare a proposal, the multitude of players involved, a typical contractual rights and obligations (for example, special ‘step-in’ rights of certain parties such as the lender and public authority), and the coordination of these players. The preparation of proposals also takes significant time and resources. Outside of Quebec, the honouraria to proponents tend to be very low in comparison to those costs. Contractors should establish a realistic budget for responding to an RFP, the cost of which will be incurred whether or not they are successful. If Design-Build costs present barriers to entry, then Contractors may wish to consider subcontract or consulting roles.
- **Financial Risks.** In addition to the traditional risk of non-payment, financial risks on P3 projects are more complex with add-on features of finance, own, operate, and maintain, etc. Security packages required by lenders can also often be significant barriers of entry for some Contractors.

- **Lack of knowledge, resources and experience.** Contractors new to P3 may not have the knowledge and resources to assess and manage the risks involved, particularly with respect to the relationship of various parties in the complex legal and financial organizational structure. This risk is compounded when the public sector side has poor advisors or unrealistic policies and has been a significant issue in certain Canada jurisdictions.
- **Special Terms and Conditions in Request for Proposal (“RFP”).** The risks and potential liabilities may extend well beyond those found in ordinary Design-Build projects, particularly if they involve long-term commitments assumed by members of the team for the operation and maintenance of the facility.
- **Interpretation of Owner’s Statement of Requirements.** Requirement to provide a firm price under the challenge of working with missing or incomplete information, interpretation of owner requirements of “fitness for purpose”, large volumes of documentation, performance-based project requirements, state of existing facilities to be incorporated into the work (since many P3 projects are not green field projects), and on-going changes in conceptual design and documentation.
- **Team commitment.** The commitment from all team members (finance, design, construction, maintenance, operations) is important for a successful P3 project. Any team members that withdraws during the process will affect the whole team in their pursuit of the project. Teaming or pre-bid agreements are important to ensure that if the team is successful in its proposal all team members will participate in the project and not be excluded.
- **Foreign players.** Foreign concessionaires and contractors bring with them different business practices and approaches. There is often a different culture at work in the practices utilized by many foreign participants that may be problematic for Canadian Contractors. It is therefore important for Canadian contractors/subcontractors to appreciate these differences and to ensure that some form of Pre-Bid Agreement is in place when they are approached for pricing.
- **Changing financial markets.** P3 projects are extremely dependent upon the relative stability of financial markets over the extended duration of procurement. Dramatic changes in financial markets and the cost of credit especially during an economic crisis such as existed in 2009 can very quickly cause problems with the financial closure of P3 projects, which may result in the cancellation, restructuring or deferral of the project. In some cases, it may even require Contractors to invest equity in projects in order to secure financing.
- **Risk Transfer.** P3 projects are characterized by the transfer of substantial risks from the public sector to the private sector concessionaire, who in turn tends to transfer these risks (by contract) to Contractors.

- **Non-standard construction documents.** Most P3 projects (particularly those with foreign concessionaires and contractors) do not use standard construction documents. Although experiences vary, examples of onerous contract conditions may include:
 - Requirements for higher limits, and broader coverage for Errors and Omissions Insurance which are not typically provided in the Canadian market;
 - Payment provisions that are contingent upon project performance instead of Contractors' work;
 - Substantial liquidated damages specified for late completion;
 - Force Majeure clauses that require Contractors to be solely liable for natural disasters such as floods, earthquakes, and other "acts of God," as well as uncontrollable events such as war and terrorist attacks; and
 - Extended warranties beyond the standard one-year period after Substantial Performance of the Work.

- **Contractor's insurance.** Many of the common construction risks are insurable. After thoroughly analyzing the risks associated with a project and determining whether the insurance is sufficient to cover worst-case scenarios, a contractor may wish to purchase additional coverage to meet the needs of a specific project.

- **Contract security.** The Canadian construction industry like its U.S. counterpart has traditionally looked to surety bonds as the preferred mode of contract security. Surety bonding has enabled Contractorsto significantly leverage their balance sheets without the need to build the asset base typically required to obtain letters of credit and other forms of cash or liquid security that are required on P3 projects. Foreign companies/contractors on the other hand are accustomed to asset-based credit arrangements due to their reliance on Letters of Credit as the predominant form of contract security rather than surety bonds. The reality is that lenders and rating agencies prefer letters of credit given their liquidity.?

- **Inflation.** P3 projects, like any other long-term undertakings, are more susceptible to the ravages of inflation particularly in uncertain economic times. When planning for inflation and allocating risks, Contractors should consider such factors as the supply of and demand for materials, the future stability of the marketplace, labour availability, expiry dates of union contracts, and incipient changes in legislation.

The following is a comparison of the potential risk exposure of a typical Contractor and a P3 contractor:

Potential Risks	Typical Design-Bid-Build Contractor Responsibility	Shifted to Design-Builder	Shifted to PPP Contractor
1. Major environmental permits	No	Maybe	Maybe
2. Usage rates and traffic and revenue	Never	Maybe	Maybe
3. Conflicts and delays from unknown historical conditions	No	Maybe	Maybe
4. Conflicts and delays from unknown endangered species conditions	No	Maybe	Maybe
5. Conflicts and delays from unknown utility conditions	Maybe	Maybe	Maybe
6. Cost and delays from hazardous waste unidentified and not caused by contractor	No	Likely	Likely
7. Accuracy of design and survey data initially supplied	No	Maybe	Maybe
8. Geotechnical and soil conditions	No	Maybe	Maybe
9. Differing site conditions	No	Maybe	Maybe
10. Delays from legal action against the project	No	Maybe	Maybe
11. Delays from public interference	No	Maybe	Maybe
12. Changes in zoning, laws or rules that may affect the project	No	Maybe	Maybe
13. Delays by the grantor and/or other agencies	No	No	Maybe
14. Up front costs to design and develop projects	No	Likely	Likely
15. Long-term liability exposure for maintenance, structures	Maybe	Maybe	Maybe
16. Long-term liability exposure to litigation	Maybe	Maybe	Maybe
17. High and unusual liquidated damages for delays	No	Likely	Likely
18. Extraordinary guarantees such as substantial letters of credit in addition to surety bonds	No	Maybe	Likely

3.4 Best Practices

Best practices for P3 projects are quite similar to those for design-build projects. However, the following recommendations are specific to P3 projects:

- Professional advice should be sought on such fundamental issues as contract terms and conditions, financial structure, legal, insurance and surety requirements, etc.
- A mechanism should be established whereby an Owner would accept all signed-off construction documents as deemed to be meeting the Owner's Statement of Requirements.
- Appropriate contract terms and conditions should be negotiated.
- The 'right team' should be formed in pursuing P3 projects.

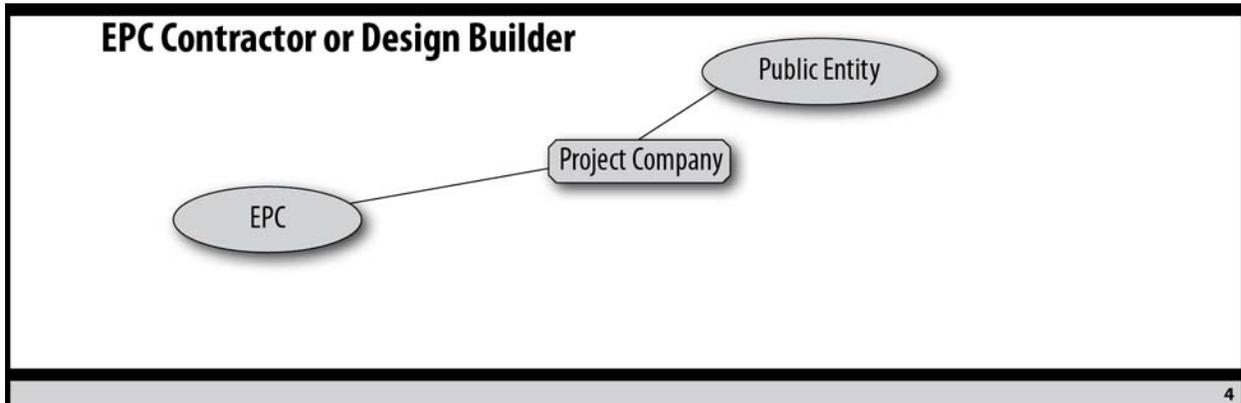
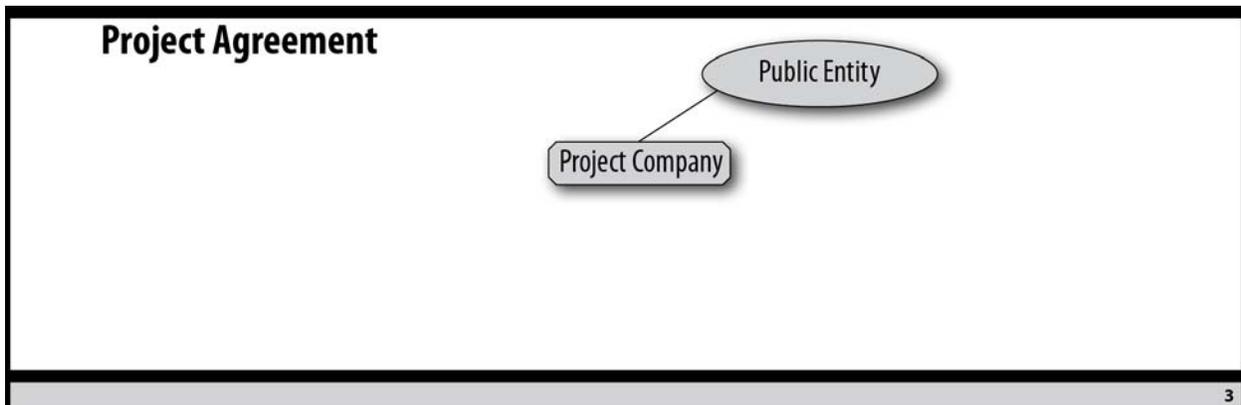
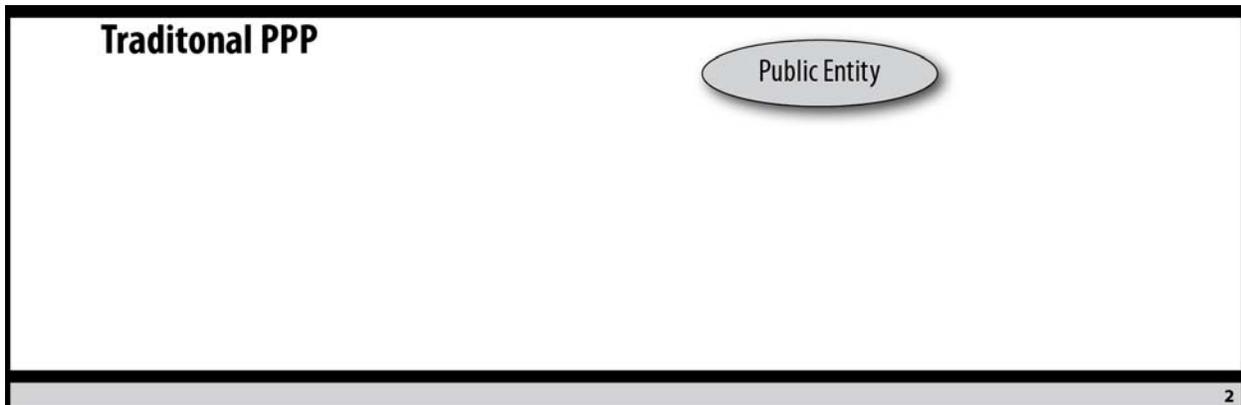
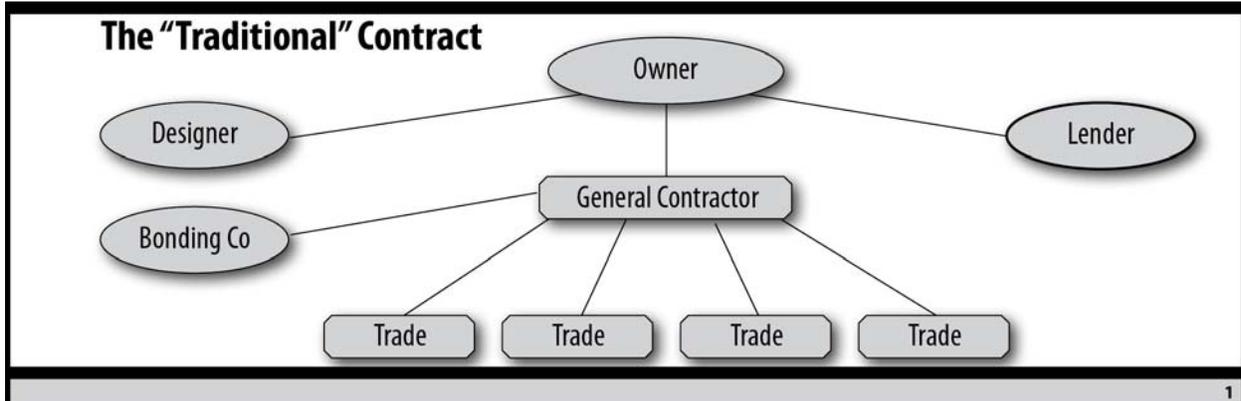
3.5 Teaming Agreement

Once team members are identified, contracts should be written and executed before the contractor makes any commitment in response to either an RFQ or RFP. Each contract should address, at a minimum, the following:

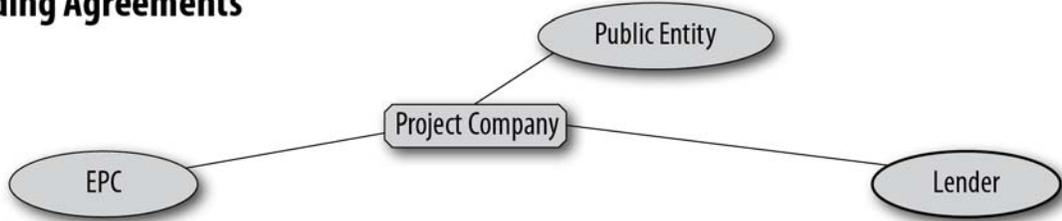
- Identification of the parties;
- Identification and limitations of the roles of each party;
- Contract duration;
- Deliverables;
- Payment provisions, including honoraria;
- Changes;
- Termination for cause;
- Termination for convenience;
- Reporting structures;
- Confidentiality and non-disclosure;
- Schedule maintenance and consequences for non-compliance;
- Budget adherence requirements and consequences for non-compliance;
- Quality assurance and quality control;
- Licensing requirements and maintenance of licenses in good standing;
- Subcontractor participation;
- Insurance provisions;
- Warranty; and
- Security expectations for financing.

In addition, the RFP should be carefully scrutinized for special or non-standard provisions that would impact the services of the project team. The responsibility for delivering these special or non-standard provisions should be delegated to the appropriate team member.

APPENDIX – TYPICAL P3 CONTRACTUAL STRUCTURE

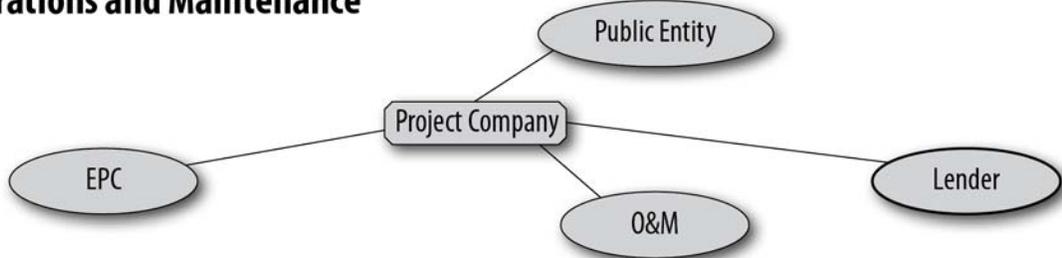


Lending Agreements



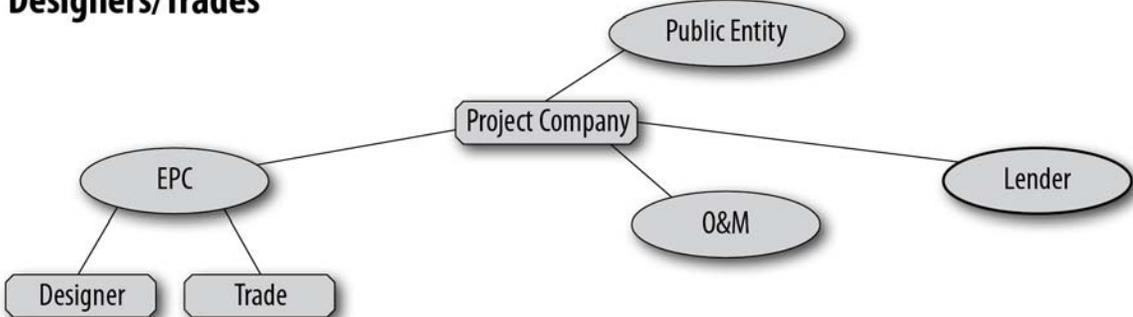
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Operations and Maintenance



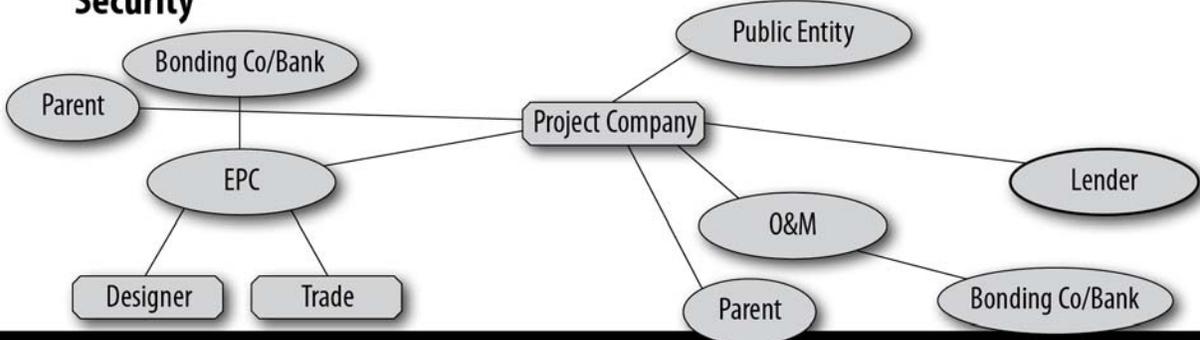
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Designers/Trades



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Security



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