Termination and Force Majeure Provisions in PPP Contracts
Review of current European practice and guidance

March 2012
Context and Terms of Use of this Publication

The European PPP Expertise Centre (EPEC) is a joint initiative involving the European Investment Bank (EIB), the European Commission, Member States of the European Union, Candidate States and certain other states. For more information about EPEC and its membership, please visit www.eib.org/epec.

This publication has been prepared to contribute to and stimulate discussions on public-private partnerships (PPPs) as well as to foster the diffusion of good practices in the area. It has been based on a study commissioned by EPEC and carried out by Allen & Overy LLP.

The findings, analysis, interpretations and conclusions contained in this publication do not necessarily reflect the views or policies of the EIB, the European Commission, any EPEC member or Allen & Overy LLP. No EPEC member, including the EIB and the European Commission, nor Allen & Overy LLP, accepts any responsibility regarding the accuracy of the information contained in this publication or any liability for any consequences arising from the use of this publication. The information within this publication does not constitute definitive advice and should not be used as the basis for giving definitive advice without checking the primary sources. Reliance on the information provided in this publication is therefore at the sole risk of the user.

EPEC authorises the users of this publication to access, download, display, reproduce and print its content subject to the following conditions: (i) when using the content of this publication, users should attribute the source of the material and (ii) under no circumstances should there be commercial exploitation of this publication or its content.
**Foreword**

We were delighted when EPEC approached us to assist them with this project and we are likewise pleased to write the foreword to the resulting EPEC paper.

The public-private partnership (PPP) method of delivery of public infrastructure has, over time, become an extremely successful, well-established and much-replicated model. It is regularly adjusted to reflect both two decades of practical experience and new facts and circumstances, but the core concepts invariably remain untouched. In the UK and in the numerous other jurisdictions in Europe and elsewhere in the world that have adopted PPP, government policymakers and their private sector partners are working hard (in the wake of the recent financial crisis whose aftershocks are still being felt in various markets and in the shadow of looming reforms to capital requirements which may make long-term bank debt less attractive to lenders and more expensive for PPP borrowers) to connect sources of finance with the many infrastructure projects that are needed to facilitate everyday life and create economic growth.

Termination and termination compensation forms the commercial backbone to the PPP risk allocation and over the last decade has remained remarkably unaltered, despite the number of new jurisdictions in which PPP has been used. It is, therefore, right that EPEC should take a step back at this juncture and consider whether this aspect of PPP practice could be improved.

EPEC members in different types of jurisdictions may find EPEC’s paper useful in different ways. In jurisdictions in which PPP is well established and into which sponsors and debt providers have already invested repeatedly, policymakers may nevertheless be interested to know, especially in moments in which the global PPP market is not awash in available debt, what other, similarly situated, markets are doing so that they can ensure that to the extent possible they are doing all they can to interest investors in their projects.

For members in jurisdictions in which international sponsors and debt providers are not yet familiar or where PPP has only recently been introduced, the EPEC paper provides an insight into what has worked elsewhere and new jurisdictions are doing to make their PPPs financeable. New entrants to the field may, therefore, find aspects of approaches to termination compensation that work for them and find a more appropriate balance to best position them to attract funds and serve the needs of their constituents.

Even beyond the borders of Europe there is likely to be significant interest in the conclusions in this EPEC paper. There are obviously geographic, political, economic and other differences between EPEC member countries and the countries in Southeast Asia, Africa, Latin America and North America which, having seen the success of the model in the UK and Europe, are rapidly passing laws and otherwise positioning themselves to be the “next big thing” in PPP. Given the diversity of EPEC membership and the fact that in a global economy many of the equity sponsors and debt providers considering investment in PPPs are the same across countries and continents; however, what “works” in European countries may well work, either as is or with a few local adaptations, elsewhere.

Allen & Overy LLP has been involved in PPP since its early days in the UK and has worked on first-of-their-kind PPPs around the world. We can therefore say first hand that the knowledge and experience EPEC is providing its members in this paper will prove to be invaluable, not only to EPEC members but to other governments elsewhere in the world, as well as to the sponsors and funders who are keen to work with them.

David Lee
Partner
Allen & Overy LLP
### Table of contents

Main terms used in this paper 7

Introduction 9

Section 1: Authority default and voluntary termination 13

- Topic 1: Authority default concept 15
- Topic 2: Authority default definition 17
- Topic 3: Voluntary termination 19
- Topic 4: Compensation for Authority default and voluntary termination 21
  - Topic 4.2: Financing-based compensation: equity investors 27
  - Topic 4.3: Compensation for third party costs 29
- Topic 5: When to pay compensation 31

Section 2: Private Partner default 33

- Topic 6: Private Partner default definition 35
- Topic 7: Compensation 39
  - Topic 7.1: ‘Market value’ compensation 41
  - Topic 7.2: ‘Book value’ compensation 43
  - Topic 7.3: ‘Debt’ compensation 45
- Topic 8: How and when to pay compensation 47
- Topic 9: Lenders’ step-in right 49

Section 3: Force majeure 53

- Topic 10: Force majeure: definition and effects 55
- Topic 11: Compensation on termination following force majeure 57
- Topic 12: Insurability issues 59

Conclusion 61
Main terms used in this paper

Authority: The public contracting authority that enters into the PPP contract with the Private Partner.

Compensation: The amounts owed by the Authority to the Private Partner upon termination of the PPP contract.

Cure period: The period of time granted to a defaulting contracting party to cure a default before termination of the PPP contract occurs.

Force majeure provisions: PPP contract terms (or, at times, terms of law) that govern the course of action if unforeseen events that are beyond the control of the contracting parties occur and materially affect performance under the contract.

PPP contract: The long-term contract entered into by the Authority and the Private Partner, which typically provides for the design, construction, operation/maintenance and financing of an asset.

Private Partner: The private company that enters into the PPP contract with the Authority. The Private Partner is often a special-purpose company owned by a group of contractors, operators and/or infrastructure equity funds.

Set-off right: The ability of the Authority to deduct from the compensation sums any amount the Private Partner may owe to it under the PPP contract.

Termination provisions: PPP contract terms (or, at times, terms of law) that regulate proceedings if either contracting party fails to comply with a major obligation.
Uninsurability: The inability of the Private Partner to obtain the project insurance policies required under the PPP contract on reasonable terms or at reasonable cost.
Introduction

Termination and force majeure provisions are issues of great importance in PPP contracts. They are at the heart of the risk-sharing arrangement between the public contracting authority and its private sector partner. They are important value-for-money drivers for the public sector, assist in risk mitigation and are key to attracting private sponsors, equity investors and lenders to PPP projects.

Termination provisions (TPs) consist of specific PPP contract terms (or, at times, terms derived from applicable law) that regulate proceedings if either the public contracting authority (Authority) or the private sector partner (Private Partner) fails to comply with one of its major obligations or if the partnership is terminated voluntarily. Typical examples of this would be a material failure by the Private Partner to supply the services agreed in the PPP contract or an extended failure by the Authority to meet payment obligations.

Force majeure provisions (FMPs) govern the course of action if unforeseen events that are beyond the control of the contractual parties (e.g. floods, war, acts of terrorism) occur and materially affect performance under the PPP contract.

Purpose of the paper

This EPEC paper is primarily aimed at PPP public contracting authorities, PPP policy bodies and public decision-makers generally. Its purpose is twofold:

- it sets out the TPs and FMPs most commonly used across Europe, how they have developed over time and their rationale; and
- in drawing from the experience accumulated in a sample of European countries, it provides guidance which could be useful when considering new PPP contracts (either deal-specific or standard contracts) and deciding which provisions to incorporate into those contracts. In particular, the paper seeks to foster good practice by developing a framework that enables TPs and FMPs to be designed to fit the specific context where they are to be applied.

The paper deals with unforeseen contract termination events. It does not cover the arrangements associated with the planned expiry of PPP contracts and the corresponding handover of the PPP assets by the Private Partner to the Authority.

Finally, the paper has been written with the intention to set out common features and to compare as well as contrast approaches taken in respect of TPs and FMPs across Europe. It does not attempt to provide an exhaustive analysis of TPs and FMPs in individual European countries.

Key principles

In order to deliver value-for-money, most PPP contracts need to run for a significant period of time, typically between 15 and 30 years. However, entering into long-term contracts is challenging as contracts are by nature incomplete. They cannot cover the entire range of possible events that might arise during their lifetime. Before entering into a PPP arrangement, therefore, an Authority has to carefully consider
and provide for all the contingencies that may occur, including failures and unforeseen events which may challenge project performance.

TPs and FMPs ensure that, should the basis of the PPP contract be challenged by events, an orderly process can be invoked. This is important for reducing uncertainty and thereby giving confidence to all the key private stakeholders involved in the project, including sponsors, equity investors, lenders, contractors, service providers and suppliers. Reducing uncertainty will ensure greater value-for-money is achieved, since uncertainty will attract a risk premium. In particular:

- the lenders to a PPP transaction will need to have clarity on what actions will follow if either the Authority or the Private Partner fails to fulfil its key obligations under the PPP contract. Lenders will eventually expect to see the contract terminated and adequate compensation paid if the Authority has breached one of its fundamental obligations and failed to remedy that breach. They will also seek to have some rights of redress and compensation if there has been a major failure by the Private Partner; and

- the stakeholders involved in a PPP project will need comfort that situations that are beyond their immediate control and affect the performance of the contract obligations (i.e. force majeure events) will be dealt with in a way that allows them to arrive at a mutually acceptable solution.

It is important to stress that an Authority will always face a dilemma when a PPP contract is subject to termination. On the one hand, it needs to ensure that public sector interests are protected (e.g. by having redress against a defaulting Private Partner). On the other hand, it has an obligation to ensure that the underlying public services continue to be provided. This challenge means that, in practice, TPs are rarely applied automatically. Whenever possible, the parties to the PPP contract will strive to avoid outright termination and to renegotiate the contract in a way acceptable to all stakeholders, particularly lenders. As a result, when considering how to draft and use TPs and FMPs, Authorities need to focus on providing a framework for negotiation should termination or force majeure events arise.

EPEC work methodology

The paper has been based on a study commissioned by EPEC and carried out by Allen & Overy LLP (A&O), the international law firm. A&O reviewed typical TPs and FMPs in the following 16 jurisdictions:

<table>
<thead>
<tr>
<th>Belgium</th>
<th>France</th>
<th>Italy</th>
<th>Romania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>Germany</td>
<td>Netherlands</td>
<td>Slovakia</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Greece</td>
<td>Poland</td>
<td>Spain</td>
</tr>
<tr>
<td>England¹</td>
<td>Hungary</td>
<td>Portugal</td>
<td>Turkey</td>
</tr>
</tbody>
</table>

¹ Although the A&O study specifically deals with England, most of the contractual provisions on termination and force majeure are the same in the rest of the UK.
The countries in the sample were selected to ensure breadth of coverage so that comparisons could be made, ‘models’ identified and issues highlighted. For instance, the sample includes:

- civil and common law jurisdictions;
- countries with and without a PPP law; and
- mature and emerging PPP markets.

The A&O study focused on PPP contracts that have been successfully signed and/or where standard contracts or guidelines are in place. TPs and FMPs were examined by closely considering the specific context and the broader legal system of which they are part.

In carrying out its work, A&O relied on data provided by their offices or, in a small number of cases, by affiliated law firms. Each office or affiliate was asked to respond to a detailed questionnaire prepared by A&O’s London office. The early findings of the A&O work were presented and discussed with EPEC members and formed the basis for a detailed dialogue with the EPEC team.

While the individual sections of the paper give more detail on country comparisons on specific issues, an overview of the findings of the A&O study is presented in Box 1 below.

**Box 1 – A&O study highlights**

The work carried out by A&O shows that there are differences in the way in which TPs and FMPs are formulated in the 16 countries surveyed. Key differences are observed in particular in respect of how TPs are applied, how compensation amounts due on contract termination are calculated, the actions available in the event of force majeure and step-in rights granted to lenders. These differences are a function of several factors, such as:

- the legal traditions, which vary across the 16 countries covered in the study. In particular, there are differences between common law and civil law countries in terms of both the type of PPP contract used in those jurisdictions and the approach taken on key TP and FMP features; and
- the relative maturity of the PPP market. For instance, TPs and FMPs agreed between the public and private sectors in England have been in place for some time and are now incorporated into standard form documentation, reflecting the fact that more than 600 PPPs have been concluded to date.

The A&O evidence also suggests that the economic cycle and extent to which projects are being developed in an environment where public funding is constrained have an impact on the type of TPs and FMPs used. For example, under current market conditions, the difficulties faced in raising private sector financing for PPP projects mean that TPs tend to be more private-sector friendly.

The EPEC work has inevitably faced some limitations. The A&O analysis was limited to the sample of PPP contracts (and EPEC member input) available to them. The projects reviewed may not necessarily be fully representative of PPP practice in the
country in question. Also, the A&O findings suggest that, in certain countries, significant differences in TPs and FMPs are found from one project to another. As a result, identifying ‘models’ and drawing conclusions for those countries can be difficult.

Structure of the paper

The EPEC work on TPs and FMPs has led to the identification of 18 core topics. For each topic, the paper highlights the key issues at stake, presents the findings of the country analysis (where relevant) and suggests guidance for the public sector. The 18 topics are organised in three sections:

- Section 1 deals with PPP contract termination arrangements following a major Authority default and the right of an Authority to end a PPP contract voluntarily. The key questions tackled in this section include:
  - does the concept of Authority default exist in PPP contracts?
  - what rights does the Authority have to terminate the contract on a voluntary basis?
  - what are the principles for determining the compensation owed to the Private Partner upon Authority default or voluntary termination?

- Section 2 looks at what happens when the Private Partner is in default and the Authority has the right to terminate the PPP contract. The key questions addressed in this section include:
  - how is Private Partner default defined?
  - what rights of redress are granted to the lenders before the PPP contract is terminated?
  - what are the principles for determining the compensation payable by the Authority following termination?

- Section 3 reviews the treatment of force majeure in PPP contracts. The key points covered in this section include:
  - how is force majeure defined and what are the effects of force majeure events?
  - when does force majeure lead to termination of the PPP contract?
  - what are the principles for determining any applicable compensation for the Private Partner in the event of force majeure termination?
  - what is the relationship between force majeure and insurance?
Section 1
Authority default and voluntary termination

This section deals with PPP contract termination arrangements following a major default by the Authority or a decision of the Authority to end the contract voluntarily before it has run its full term. Eight topics have been identified and are discussed in this section.
Topic 1
Authority default concept

Background
It is generally the case under most commercial contracts that if either party fails to meet one of its material obligations, the ‘damaged’ party has the right to terminate the contract. Under a PPP contract, this means that the Private Partner should have the right to terminate if the Authority defaults on one of its key obligations. As PPPs often deal with the provision of basic public services, granting such a right to the Private Partner is sometimes viewed with concern.

Findings
The A&O study confirms that, in most countries, PPP contracts contain explicit termination rights for the Private Partner following a material Authority default. As the table below shows, Portugal and France are notable exceptions.

<table>
<thead>
<tr>
<th>Belgium</th>
<th>France</th>
<th>Italy</th>
<th>Romania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>Germany</td>
<td>Netherlands</td>
<td>Slovakia</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Greece</td>
<td>Poland</td>
<td>Spain</td>
</tr>
<tr>
<td>England</td>
<td>Hungary</td>
<td>Portugal</td>
<td>Turkey</td>
</tr>
</tbody>
</table>

In Portugal, Authority default is not dealt with in the PPP contract. The contracting parties rely on general principles of law or, in certain cases, on specific provisions of the PPP law. In practice though, it is widely believed that the outcome achieved would be similar to that of the majority of jurisdictions where termination rights are spelt out in the PPP contract.

In France, the Private Partner is not entitled to terminate the PPP contract following an Authority failure (see Box 2 below for more detail). The only redress available to it in this case is to bring a legal action before an administrative court that is then able to rule on whether the breach by the Authority is sufficiently material to justify termination (and a compensation payment). While France appears to be unusual in its approach, a Private Partner would, in practice, seek to negotiate a way out rather than simply seek to terminate the PPP contract in the courts (i.e. while the approach is different from other jurisdictions, the outcome - negotiations - may be similar).

EPEC guidance
When negotiating Authority default provisions in a PPP contract, an Authority should take into account the following points:

- **Reviewing the legal framework** – The Authority should verify the extent to which the legal framework (and, if any, the relevant PPP law) caters for Authority defaults and assess whether the provisions are sufficiently clear and workable. Any ambiguity should insofar as possible be addressed in the PPP contract;
– **Aiming at a balanced arrangement** – Granting the Private Partner termination rights is important for fairness (i.e. balanced contract) and rationale of the partnership. These are key features for attracting the private sector to PPP deals. Termination rights provide the Private Partner’s sponsors, investors and lenders with some certainties regarding the course of action in the event of Authority default. This enables them to carry out a more precise risk analysis that can lead to better pricing/value-for-money for the Authority. In practice, market expectations are such that it will be difficult for PPP contracts involving international lenders and investors not to have explicit provisions regarding termination for Authority default; and

– **Relevance of the Authority’s strength** – The relevance of termination rights for the Private Partner is closely linked to the perceived strength and stability of the Authority in question. Indeed, the private sector will more easily accept limited termination rights if the Authority is creditworthy, can be considered a high-quality sovereign risk and if there are protections against changes in its legal status and limitations on the ability to substitute one public body for another. For example, limited termination rights are more likely to be acceptable where the contracting authority is a ministry rather than a local health trust. Therefore, it is important to assess whether the nature and creditworthiness of the Authority can justify limiting the Private Partner’s termination rights.

---

**Box 2 – The French approach on Authority default**

French PPP contracts do not usually recognise the right of a Private Partner to terminate the contract following an Authority default. Authority defaults are not contractually defined. In the event of an Authority breach, the contracting parties are expected to seek an amicable settlement. If this fails, they are expected to resort to the relevant administrative court.

This position stems from the administrative law principles of continuity and adaptability of public services. Under these, public services must be guaranteed by the Authority and must not be threatened by action or inaction of the Private Partner. Interestingly, these principles are also the basis for the Authority’s right to voluntary terminate the PPP contract to cope with evolving needs, technological innovation or changes in the financing terms of the transaction.

Even though the Private Partner has no contractual right to terminate the PPP contract, if the contract were to be ended, compensation would be owed to the Private Partner. The compensation amount would in all likelihood mirror that applicable to termination following a force majeure event.

The position held in France is widely accepted as the French State and most sub-sovereign entities cannot go bankrupt as such. Public sector entities often benefit from a strong support from the State (explicit or implicit guarantees ensuring that they will be helped if they face financial difficulties). In some projects though, the lenders have obtained that changes in the statutes of State-run entities (e.g. public agencies) can trigger the prepayment of their loans and, possibly, the consequential termination of the relevant PPP contract.
Topic 2
Authority default definition

Background
Where the PPP contract provides for the concept of Authority default, it needs to specify what constitutes a default.

Findings
The A&O study shows that two approaches are usually taken: defining the acts or omissions of the Authority that constitute events of default ('itemised list') or relying on a broad definition of default. As shown in the table below, out of the 16 jurisdictions reviewed, nine tend to rely on an itemised list, three use a broad default concept and Poland and Spain use a mix of the two.

<table>
<thead>
<tr>
<th>Belgium</th>
<th>France*</th>
<th>Italy</th>
<th>Romania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>Germany</td>
<td>Netherlands</td>
<td>Slovakia</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Greece</td>
<td>Poland</td>
<td>Spain</td>
</tr>
<tr>
<td>England</td>
<td>Hungary</td>
<td>Portugal*</td>
<td>Turkey</td>
</tr>
</tbody>
</table>

* not relevant

The following events are typically found in the list of itemised defaults:
- expropriation or confiscation of assets or shares of the Private Partner;
- non-payment of sums due to the Private Partner (e.g. availability fee);
- transfer by the Authority of its rights under the PPP contract in violation of the relevant provisions;
- breach of a contractual obligation by the Authority in a manner or to a degree that frustrates the ability of the Private Partner to perform; and
- failure by the Authority to grant relevant project authorisations.

Materiality tests or thresholds are typically applied to the events in an itemised default list. Also, Authorities are in most cases granted a cure period (i.e. the time available to the Authority to rectify the default, where possible, before contract termination effectively takes place).

Where contracts rely on a broad definition for Authority default, the contract wording often refers to 'any material breach' and may therefore be subject to varying interpretations.

Overall, A&O found that while the two approaches appear quite different, in practice they ultimately lead to a somewhat similar outcome. This is due to the fact that itemised lists often include 'catch-all' provisions (e.g. wording such as 'any other material breach').
Perhaps surprisingly in light of the current financial/sovereign crisis, A&O did not find many examples where changes in the legal status or creditworthiness (e.g. change in credit ratings, financial ratios) of the Authority are considered to constitute an Authority default. However, recent evidence suggests that this area is receiving more attention (particularly from lenders) during PPP contract negotiations.

**EPEC guidance**

When negotiating Authority default provisions in PPP contracts, the Authority should take into account the following points:

- **Reducing uncertainties through itemised lists** – In order to reduce uncertainties and avoid contractual disputes, both the Authority and the Private Partner should aim at an itemised list of Authority default events;

- **Private Partner’s preference** – The Private Partner will in general have a preference for defining/spelling out all Authority defaults (i.e. itemised list) and will also seek to include catch-all provisions;

- **Authority’s interest** – It will usually be in the Authority’s interest to opt for a closed list of default events so that it knows more precisely what actions have to be taken, or need to be avoided, to comply with its contractual obligations;

- **Setting out an itemised list** – When defining an itemised list for Authority default, the Authority should carefully consider the events that are truly under its control. A clear dividing line should be drawn between what the Authority has responsibility for and what risks are being transferred to the Private Partner. If the itemised list is too extensive, there is a danger that minor/technical Authority breaches may lead to contract termination;

- **Materiality thresholds and cure periods** – Authority defaults should be qualified by materiality tests and be subject to cure periods;

- **Payment default focus** – In Authority-pay PPPs, the Private Partner will first and foremost be concerned with the Authority’s unwillingness or inability to make payments. Payment default provisions tend to be heavily negotiated, in particular as the Private Partner will need reassurance that a payment default does not compromise the payment of compensation on termination (see Topics 4 and 5). In negotiations, the Private Partner will seek events of default that are early signals of a future possible payment default. It will also seek some back-up to the Authority’s obligation to pay (e.g. from the Ministry of Finance); and

- **Providing for changes in Authority status and creditworthiness** – PPP contract negotiations are likely to place an increasing emphasis on the risk of changes in the legal status or creditworthiness of the Authority throughout the life of the PPP contract. Care should be taken in the drafting of such provisions to avoid tests or mechanisms that are subjective or inappropriate.
Topic 3
Voluntary termination

Background
One of the most important provisions the Authority needs to tackle when drawing up a PPP contract relates to its ability to terminate the contract unilaterally even if the Private Partner has performed satisfactorily.

Findings
In the majority of the jurisdictions covered by the A&O study, the Authority has some ability to terminate the PPP contract voluntarily. Two main approaches are typically taken: the Authority has full freedom to terminate the PPP contract or voluntary termination is qualified by a 'public interest' test.

As the table below shows, countries that cater for termination for any reason include the Czech Republic, England, Greece (in some contracts), the Netherlands, Portugal and Slovakia. Countries where voluntary termination is defined by reference to the public interest include Belgium, Bulgaria, France, Italy, Poland and Spain. In Germany, voluntary termination is only permitted if the event has been provided for in the PPP contract. Voluntary termination is not explicitly regulated in Romania, whereas in Hungary voluntary termination can only take place in specific circumstances.

<table>
<thead>
<tr>
<th>Belgium</th>
<th>France</th>
<th>Italy</th>
<th>Romania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>Germany</td>
<td>Netherlands</td>
<td>Slovakia</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Greece</td>
<td>Poland</td>
<td>Spain</td>
</tr>
<tr>
<td>England</td>
<td>Hungary</td>
<td>Portugal</td>
<td>Turkey*</td>
</tr>
</tbody>
</table>

Public interest is in most cases not in itself a feature of the PPP contract but a general principle of law. Its meaning varies from one country to another but it is often very broadly defined, which in practice allows for a significant element of discretion.

EPEC guidance
When addressing voluntary termination provisions in PPP contracts, the Authority should take into account the following points:

- **Flexibility** – There is a trade-off between the level of flexibility sought by the Authority and the implications that this may have for private sector parties bidding for, financing and operating the PPP contract. In principle, the Authority ought to have a right to terminate a PPP contract on a voluntary basis. It will want to exercise this right if special situations arise (e.g. operational reasons which are such that the services are no longer adequate as originally planned). However, there is a danger in making this right too readily available (e.g. termination for political reasons);
- **Public interest test** – When termination is subject to a public interest test, care should be taken in assessing how the concept of public interest is treated in the legal framework and how it can be applied in practice;

- **Fair compensation** – The Authority will have to pay fair compensation to the Private Partner upon voluntary termination (see Topic 4). In theory, this means that if the compensation is adequate, the Private Partner will not be opposed to the Authority having a voluntary termination right. However, in practice, while the Private Partner can be compensated to some extent, this compensation will rarely cover its full loss (e.g. opportunity costs when a long-term contract is terminated early); and

- **Market confidence** – Voluntary termination, if exercised too frequently, will undermine private sector confidence in the PPP market.

---

**Box 3 – Case study on voluntary termination:**

**Nottingham Express Transit – Phase One (UK)**

Although rare, cases of voluntary termination have occurred in practice. This box deals with the termination of the PPP contract for the Nottingham Express Transit – Phase One project.

The Arrow Light Rail consortium (made up of Transdev, Nottingham City Transport, Bombardier, Carillion, Galaxy and Innisfree) won the PPP contract for the implementation of Line One of the Nottingham Express Transit in 2000. This first tram line served as the foundation for the city’s network but, as the two new light railway lines proposed for Phase Two were too large to be incorporated into the original contract, the Authority invited tenders for a new PPP contract combining the takeover, continued operation and maintenance of Line One with the construction, operation and maintenance of Phase Two.

Although the perception was that the incumbent operator (Arrow Light Rail) would have had an advantage over any rival bidder, the Authority awarded the contract to Tramlink Nottingham in March 2011. Arrow Light Rail was therefore bought out of Line One and the original PPP contract ended with the financial close of the new PPP contract in December 2011.

To achieve financial close for Phase Two, the project parties had to coordinate work on two separate transactions: procurement of Phase Two and the termination of Line One. This required cooperation from Arrow Light Rail (the contracting party for Line One and losing bidder for Phase Two), which needed to be compensated for the early termination of a project that had been successfully constructed and was operating satisfactorily. A detailed assessment and agreement on the condition of the assets at handover were critical to both the winning bidder and the outgoing operator. Under the standard PPP contract in the UK, compensation payments for voluntary termination are calculated under a market valuation approach. Given the substantial traffic risk taken by the private partner in this project, the assumptions underlying such a valuation were critical.

To achieve near-simultaneous termination of Line One and financial close on Phase Two required skilled negotiation, political will and coordination to reach a conclusion satisfactory to all sides, at the same time as achieving financial close amidst turbulent financial markets.

Sources: various, including Inspiratia, June 2012, [http://inspiratia.com/transport/Deal-Focus/read/Nottingham-Express-Transit-Phase-2](http://inspiratia.com/transport/Deal-Focus/read/Nottingham-Express-Transit-Phase-2) (subscription required)
**Background**

The Authority should be liable for the payment of financial compensation to the Private Partner in the event of the PPP contract being terminated voluntarily or as a result of a major Authority default. Compensation is a necessity in these cases as, without it, the Authority would unfairly be getting the benefit of the PPP assets (e.g. a built and functioning project) while failing to bear its agreed burden (e.g. paying the availability fee). Also, without compensation, private investors, sponsors and lenders would be deprived of their investment through no fault of their own and would not be able to recoup their costs and loans or be paid the expected return.

**Findings**

The A&O study shows that compensation for Authority default or voluntary termination applies in all the countries reviewed except France, where compensation is only applicable in the event of voluntary termination. The compensation payable is normally intended to ensure that the Private Partner is neither better off nor worse off as a result of the early termination (i.e. the Private Partner should be compensated as if the PPP contract had run its full term as originally intended).

Two basic approaches are taken in the jurisdictions reviewed:

- **Book value compensation** – In this case, the investment costs incurred for the PPP project are used as the basis for calculating the compensation. A distinction is typically drawn between termination during the construction phase and termination during the operational phase. During construction, the calculation is based on the investments effectively incurred at the date of termination by the Private Partner for the construction of the PPP assets. During operation, the value of the assets is reduced to take account of depreciation; and

- **Financing-based compensation** – In this case, compensation is defined by reference to the financing raised by the Private Partner for the project, typically senior debt, subordinated debt and equity. Topics 4.1 and 4.2 discuss the principles for the calculation of compensation for lenders and equity investors.

In addition to the base amounts mentioned above, compensation also usually covers third-party costs (see Topic 4.3).

As shown in the table below, the financing-based approach tends to prevail across the country sample.

---

2 As mentioned in Topic 1, French PPP contracts do not normally cater for Authority default termination.
When considering compensation provisions for Authority default or voluntary termination, the Authority should take into account the points listed below.

**Basic principles**

- **Principle of compensation** – There is a need to compensate the Private Partner in the event of voluntary or Authority default termination in order to promote fairness and avoid any unjust enrichment for the Authority. The ‘no better and no worse’ principle should ultimately drive the level of compensation payable to the Private Partner;

- **Assessing unjust enrichment** – The Authority should check the applicability of any unjust enrichment principle in its jurisdiction and assess how it may be interpreted when defining compensation provisions;

- **Meeting stakeholders’ needs** – The Private Partner costs subject to compensation need to be carefully considered. Lenders, third party contractors and equity investors will face actual or opportunity costs as a result of early termination that may need to be compensated for (see Topics 4.1, 4.2 and 4.3);

- **Simplicity** – Simple and objective calculation methods will provide greater certainty for the private sector stakeholders (and therefore a better outcome) and will minimise the risk of disputes; and

- **Dealing with cash balances** – At the point of termination, the Private Partner will often have cash standing in a series of bank accounts (e.g. current account, debt service reserve account, maintenance reserve account). The Authority should consider how to treat these cash balances for the purposes of determining the compensation amount due (e.g. netting of monies in the debt service reserve account against the compensation owed to lenders).

---

3 The Private Partner should be put in a position which is neither better nor worse than if the contract had not been terminated.
Book value compensation

- **Over or underpayment** – Book value compensation can lead to perverse incentives or failure to make the lenders whole. Indeed, as this compensation is independent of the financing raised for the PPP project, there is a risk of underpayment (which would create bankability issues for lenders) or overpayment (which may incentivise sponsors to prompt an Authority default). Lenders generally prefer a more transparent calculation, where compensation is based on the value of financing they have provided; and

- **Catering for accounting changes** – Compensation calculations based on book value can be problematic since accounting rules may change over time. As a result, provisions dealing with the effect of changes in accounting rules will need to be set out in the PPP contract.

---

**Box 4 – Capital market funding: compensating bondholders**

Under current financial market conditions, bond financings can play a major role in bridging the financing gap for PPP investments. They however require Authorities to take a different approach to PPP contract terms.

In the event of prepayment, the bond terms will generally call for a prepayment fee in addition to the return of the capital sums outstanding, to put the bondholders in the same position as if the bond had not been prepaid. This prepayment fee is calculated by assuming reinvestment of the prepaid investment for the outstanding period of the original financing (e.g. the so-called “Spens clause” for UK-listed bonds).

In a PPP, the Private Partner may have to voluntarily prepay its bond financing, for example in the event of voluntary or Authority default termination of the PPP contract. In these cases, the termination provisions of the PPP contract need to reflect the prepayment provisions contained in the bond documentation. In the UK for example, the relevant PPP contract clauses follow a “modified-Spens clause” approach, which broadly relies on the Spens clause except for the setting of the reinvestment rate.
**Background**
As discussed in Topic 4, one key element of compensation for voluntary termination and Authority default is often defined by reference to the financing raised for the project. This Topic deals with the compensation amounts payable (indirectly) to the debt providers (e.g. commercial banks, domestic and international financing institutions, bondholders).

Before they undertake to provide finance to a Private Partner, lenders will seek assurances that they will be ‘made whole’ in the event of termination of the PPP contract where the Private Partner is not at fault. Keeping the lenders whole entails paying them all the sums due to them under the financing agreements. Upon termination of the PPP contract, the Private Partner will be required to prepay the financing raised and close any hedging arrangement in place.

**EPEC guidance**
When addressing the issue of lender compensation, the Authority should take into account the following points:

- **Understanding financing agreements** – Given that the Authority may be liable for payments defined by reference to the financing agreements, it is of paramount importance that the Authority and its advisers review the financing agreements before financial close;

- **Promoting transparency and predictability** – The various components of debt subject to Authority compensation need to be clearly defined. To be properly compensated, lenders will typically require full payment of the following amounts:
  - the loans outstanding at the date of the prepayment;
  - interest due up to the date of the prepayment;
  - any delayed interest, penalty on late payments and unpaid fees; and
  - ‘breakage costs’ associated with the hedging agreements and fixed-interest rate loans (see below);

---

4 This paper deals primarily with ‘senior’ debt and the related hedging instruments (see footnote 5).
5 PPP financing packages typically comprise hedging instruments that minimise the Private Partner’s exposure to economic risks, such as interest rate increases, currency fluctuations and inflation. Hedging agreements are typically entered into at financial close between the Private Partner and hedging counterparties (often the commercial banks that are also providing the loan facilities). These agreements include ‘make-whole’ payment obligations if they are terminated early.
– **Allowing for breakage costs** – The amounts payable by the Authority as compensation for the Private Partner’s breakage costs under hedging agreements and fixed-interest rate loans can be substantial. It is therefore important that the financing agreements clearly identify these potential costs and set out how they are calculated. In budgeting/accounting for the PPP, the Authority should take these costs into account as contingent liabilities; and

– **Dealing with breakage profits** – Hedging agreements are reciprocal. If the finance documents in a given transaction allow for it, their early termination may give rise to a breakage profit for the Private Partner (for example, when there has been a fall in interest rates since financial close). The compensation amounts due by the Authority should therefore be reduced by any profit the Private Partner would make as a result of closing the hedging arrangements early.

---

6 It is interesting to note that in France, Authorities are advised not to require Private Partners to put in place hedging arrangements until the period for legal challenges regarding the award of the contract has elapsed and the key public authorisations have been secured. The financial risk of having to terminate hedging agreements is considered greater than that of keeping debt at floating rate for a limited period of time. As a result, Authorities bear the interest rate fluctuation risk until the hedging arrangements become effective.
**Topic 4.2**

**Financing-based compensation:**

**equity investors**

**Background**

As discussed in Topic 4, compensation for Authority default or voluntary termination is often defined by reference to the financing raised for the PPP project. This Topic deals with the compensation amounts owed to the Private Partner to make equity investors (e.g. sponsors, infrastructure funds) whole.

Before committing to invest equity (e.g. share capital or shareholder loans in/to the Private Partner), investors will seek assurances that they will be made whole in the event of early termination of the PPP contract where the Private Partner is not at fault. Keeping equity investors whole entails paying appropriate compensation so that they are neither better off nor worse off than if the PPP contract had not been terminated. Although straightforward in principle, achieving fair compensation for equity investors is complicated in practice.

**Findings**

The A&O study found that three methods are commonly used for determining the quantum of equity compensation:

- **‘Original return’ approach** – In this approach, the compensation sum is the amount which, when taken together with all amounts already paid to the equity investors (e.g. dividends, subordinated debt payments), provides an internal rate of return (over the project life) equal to that agreed at financial close in the original ‘base case’ cash flow projections;

- **‘Market value’ approach** – In this case, the compensation is based on the amount for which the equity could have been sold to a willing buyer at the date of termination. The market valuation reflects the value of expected future cash flows of the Private Partner as well as the value of the assets held by the Private Partner at the termination date; and

- **‘Future return’ approach** – This approach is a mix of the above two. Compensation is derived using the equity return projected in the original base case but only for the period from the date of termination to the end of the PPP contract term.

**EPEC guidance**

When addressing the issue of equity compensation, the Authority should take into account the following points.

**General principles**

- **Choosing a method** – The Authority needs to bear in mind that the different methodologies for deriving equity compensation will lead to different outcomes. The most appropriate method should be selected based on local
market circumstances, taking into account fairness, simplicity and moral hazard;\(^7\) and

- **Attracting equity investors** – Equity investors, in particular those that are independent from the project sponsors (e.g. infrastructure funds), will seek assurance at the outset that they will not be unduly penalised as a result of early termination through no fault of the Private Partner. The extent to which past performance is reflected in the compensation will be important for attracting private sector equity.

**‘Original return’ approach**

- **Positives** – In substance, this method provides equity investors with the return they expected to achieve at financial close. It therefore benefits from a high degree of certainty and simplicity; and

- **Negatives** – This approach does not take into account the actual project performance up to the date of termination (i.e. deviations from the original base case, either positive or negative). It would therefore penalise a well performing Private Partner and overcompensate a poorly performing one. Also, this approach may introduce some moral hazard for the Authority as it may face political pressure to voluntarily terminate the PPP contract to prevent the Private Partner from making a higher return than expected.

**‘Market value’ approach**

- **Positives** – This approach takes into account the actual performance of the Private Partner up to the point of termination. It is therefore fairer than the ‘original return’ approach; and

- **Negatives** – This method offers less certainty for the contracting parties. It may lead to higher payments than the Authority originally expected/accounted for. Equally, investors may feel that their interests are not sufficiently protected in circumstances that are largely beyond their control. Finally, establishing a market value for the equity can be a difficult process and exposes the parties to a risk of disputes.

**‘Future return’ approach**

- **Positives** – This approach partly takes into account the actual performance of the Private Partner up to the point of termination. It is relatively straightforward to implement and less subject to disputes than the ‘market value’ approach; and

- **Negatives** – In this approach, the Private Partner is deprived of the benefits of overperformance it may have secured before termination occurred. It is therefore fairer than the ‘original return’ approach but less so than the ‘market value’ one. Also, as for the ‘market value’ approach it may lead to higher payments than the Authority originally expected/accounted for.

---

\(^7\) In this context, ‘moral hazard’ occurs when the incentives to perform are distorted by removing risks and rewards.
Topic 4.3
Compensation for third party costs

Background
As mentioned in Topic 4, compensating the Private Partner following Authority default or voluntary termination should take into account the costs incurred by third parties as a result of the early termination. For example, the service subcontractors of the Private Partner may have to redeploy staff or make them redundant if their contracts are ended prematurely. As for compensation for lenders and equity investors, the general principle is that the Private Partner and its subcontractors should not be any worse off or better off as a result of the early termination of the PPP contract.

Findings
The A&O study suggests that almost all the jurisdictions reviewed provide for compensation for subcontractor breakage costs, redundancy payments for employees as well as damages as a result of early termination. In most cases, Authorities limit the extent of their liability by defining those costs eligible for compensation rather than by setting financial caps.

EPEC guidance
When addressing the issue of third party costs compensation, the Authority should take into account the following points:

- **Reviewing the main contracts** – Before signing the PPP contract, the Authority should assess the payments that may be due to the Private Partner to compensate it for third party costs. This involves reviewing the main contracts the Private Partner has or plans to enter into and assessing the reasonableness of their early termination provisions;

- **Defining and capping liabilities** – The Authority should set out in the PPP contract the precise scope of the compensation for third party costs. The contract should detail which cost items would be subject to compensation and to what extent. As third party costs can be significant and fluctuate over time, the Authority may wish to seek to cap its liability in this respect;

- **Compensating for loss of profit** – One of the key commercial issues the Authority will need to address is the extent to which compensation should cover the loss of future profits for the subcontractors; and

- **Catering for redundancy costs** – Careful consideration needs to be given to compensation for redundancy of staff employed by the Private Partner and/or its subcontractors. Also, the Authority should ensure that the Private Partner has an obligation to mitigate costs insofar as possible.
Topic 5

When to pay compensation

Background

Once the Authority has defined the quantum of compensation it would owe following a voluntary or Authority default termination, it needs to decide when to pay the Private Partner. The Authority can opt to make payments as a lump sum or over a period of time.

Findings

The A&O study suggests that more countries envisage compensation for Authority default or voluntary termination to be paid as a lump sum than in instalments. This is the case for example in Belgium, Germany, the Netherlands, Poland, Spain and Italy. In contrast, in Slovakia the Authority has the option to pay in instalments over a period of time. In some early Greek projects, the norm was for compensation to be paid in instalments over a period of 18 months.

EPEC guidance

In dealing with the issue of the timing of compensation payments, the Authority should take into account the following points:

- **Authority’s interest** – The Authority will often prefer to pay compensation amounts over time since a lump sum would result in a large outflow of funds that would not normally have been budgeted for or could not readily be funded;

- **Private Partner’s interest** – Paying over time may not be acceptable to the Private Partner sponsors, investors and lenders. For instance, one of the most likely causes of Authority default is the inability to pay, which raises the question of whether the Authority would ever be in a position meet its obligations to pay the compensation. As a result, the Private Partner will often not concede more than a short period of time, sufficient to mobilise the necessary funds. The Private Partner will also prefer to receive a lump sum payment, since neither it nor its lenders will want to have exposure to a project that has been terminated;

- **Conditions applying to payment over time** – As noted above, payment over time will only be appropriate if the PPP contract has not been terminated because of Authority payment default. It will also be important to make sure that the lenders and equity investors are satisfied with (i) the counterparty risk of the Authority, (ii) the timing of payments (which should not be spread beyond the life of the original debt) and (iii) that the compensation amounts generate interest (see below). Finally, the Private Partner and its investors and lenders may be reluctant to release the project assets or security interests over them until full payment has been made. This may make the transfer of project assets back to the Authority upon termination difficult; and
- **Cost of payment over time** – Deferring termination payments will have a cost for the Authority. Private Partners and their financiers will insist that interest be payable on the amount of compensation from the date of crystallisation of such amount to when the payments are effectively made. The Authority will need to agree with the Private Partner and its lenders the interest rate conditions that should apply.
Section 2
Private Partner default

This section deals with PPP contract termination arrangements following a major Private Partner default. Seven topics have been identified and are discussed below.
**Topic 6**

**Private Partner default definition**

**Background**

The PPP contract should clearly set out the grounds on which the Authority can invoke termination for fault of the Private Partner. This entails defining the specific events or breaches (e.g. actions or omissions of the Private Partner) that may lead to termination.

**Findings**

The A&O study shows that two essential approaches are taken: defining the specific default events ('itemised list') or relying on a broader definition of default. As shown in the table below, the vast majority of the jurisdictions surveyed rely on an itemised list. However, in Belgium most PPP contracts rely on a general definition of default.

<table>
<thead>
<tr>
<th>Belgium</th>
<th>France</th>
<th>Italy</th>
<th>Romania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>Germany</td>
<td>Netherlands*</td>
<td>Slovakia</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Greece</td>
<td>Poland</td>
<td>Spain</td>
</tr>
<tr>
<td>England</td>
<td>Hungary</td>
<td>Portugal</td>
<td>Turkey</td>
</tr>
</tbody>
</table>

*no dominant model

Where the PPP contract relies on an itemised default list, that list usually consists of the following events:

- insolvency/bankruptcy of the Private Partner;
- failure of the Private Partner to reach certain construction milestones or project completion;
- failure of the Private Partner to deliver the services according to the agreed specifications;
- penalty points (awarded for intermittent failures to deliver services) that exceed specified thresholds;
- change of ownership of the Private Partner without the consent of the Authority; and
- failure to insure the PPP project assets/business as required.

Itemised default lists are often not ‘closed’ and contain ‘catch-all’ provisions.

Where contracts rely on a broad definition, the contract wording often refers to "any material breach" and can therefore include a much wider set of events and be subject to disputes.
Typically events of default will be subject to materiality thresholds and cure periods before the Authority is entitled to terminate the PPP contract. Cure periods are only allowed where the default is one that can be cured and are either expressed as fixed time periods (e.g. 30 days) or by reference to a period of time that is deemed reasonable.

Note that lenders’ step-in provisions (see Topic 9) have the effect of extending cure periods before the PPP contract can be terminated.

**EPEC guidance**

When negotiating Private Partner default provisions in PPP contracts, the Authority should take into account the following points:

- **Improving bankability and reducing uncertainties** – Defining clear and objective Private Partner default events ensures greater predictability for the Authority and reduces the risk of contractual disputes. A tightly defined list of events will improve bankability and encourage greater interest from private sector investors;

- **Private Partner’s preference** – The Private Partner will in general have a strong preference for clear definitions of all events/actions as well as the process that lead to Private Partner default (e.g. itemised list) and will resist ambiguous contract wording and catch-all provisions;

- **Authority’s interest** – The Authority will tend to favour a long list or open-ended list of default events to ensure that it has control over situations that were not foreseen when the contract was signed. Although a degree of generic default definition may help to cover all possible scenarios, the Authority should aim to be as precise as possible in identifying which events constitute a default;

- **Allocating risks to the party best able to manage them** – It is important to ensure that the events that trigger a Private Partner default only cover the risks which the Private Partner has taken responsibility for under the PPP arrangement;

- **Incentive vs. sanction** – The Private Partner default events should be determined in a way that strikes a balance between incentive to perform and sanction for failure. The Authority should avoid overly prescriptive regimes, since this can increase the perceived risk for the Private Partner and translate into a higher contract price;

- **Materiality thresholds and cure periods** – Private Partner events of default should be qualified by appropriate materiality tests and be subject to cure periods; and

- **Repeated minor breaches** – The Authority will need to address the question of repeated minor breaches by the Private Partner and the extent to which these should give rise to contract termination. This may involve introducing a warning notice/penalty point mechanism.
Box 5 – Case study of Private Partner default:
National Physical Laboratory (UK)

The National Physical Laboratory (NPL) is one of the world’s leading laboratories working on the measurement of physical properties such as time, length and mass.

In July 1998, the Department of Trade and Industry (the Department) and Laser, a special purpose company jointly owned by Serco Group and John Laing, signed a 25-year Private Finance Initiative (PFI) contract. Under the contract Laser was to build and manage new facilities for the NPL, comprising 16 linked modules with over 400 laboratories and replacing many existing buildings. The planned cost of the new buildings was approximately GBP 96 million, financed mainly by loans from commercial banks. The Department was to pay Laser a unitary charge of GBP 11.5 million (1998 prices) a year once the new buildings were ready. At the end of the contract, the unitary charge would cease to be paid and ownership of the buildings would pass to the Department.

The project suffered considerable construction delays and difficulties in achieving the specification for some parts of the buildings. These difficulties delayed the realisation of benefits associated with the new buildings, although mitigating action protected the quality of the scientific research conducted in the existing facilities. In December 2004, the Department and Laser agreed to terminate the PFI contract. The Department paid Laser GBP 75 million for its interest in the new buildings, took over responsibility for completing some outstanding building works and its liability to pay the unitary charge ceased. Laser passed the payment in full to the lenders and was wound up. The termination payment was calculated in accordance with the provisions of the standard PFI contract in place in the UK. The private sector lost a total of GBP 100 million.

NPL was the first termination of a major UK PFI contract involving serious non-performance by the private partner.

Topic 7
Compensation

Background
In early European PPP practice (e.g. UK road projects), the Authority was not always required to compensate the Private Partner following termination for its default. Nowadays, it is widely accepted that, although the shareholders of the Private Partner should not be compensated for failure, a no-compensation regime creates fairness issues (i.e. the Authority would be getting a windfall) and makes it difficult to attract investors and lenders.

Findings
The A&O study shows that PPP contracts typically contemplate some level of compensation payment following termination for Private Partner default. As shown in the table below, three basic approaches are taken:

- ‘Market value’ approach – In this approach, compensation is driven by the market value of the contract at the point of termination. Countries relying on this approach include England, the Netherlands and Belgium. This approach is discussed in detail in Topic 7.1;
- ‘Book value’ approach – Compensation is based on the actual investment costs incurred for the construction of the project. Bulgaria, Italy, Germany and Spain are examples of countries which rely on this calculation method. Topic 7.2 discusses this approach; and
- ‘Debt’ approach – Compensation is calculated by reference to the senior debt outstanding at the time of termination. Countries relying on this approach include Turkey, France (in some government-pay PPPs) and Germany (e.g. road projects). This approach is discussed in detail in Topic 7.3.

<table>
<thead>
<tr>
<th>Belgium</th>
<th>France*</th>
<th>Italy</th>
<th>Romania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>Germany*</td>
<td>Netherlands</td>
<td>Slovakia</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Greece</td>
<td>Poland</td>
<td>Spain</td>
</tr>
<tr>
<td>England</td>
<td>Hungary</td>
<td>Portugal**</td>
<td>Turkey</td>
</tr>
</tbody>
</table>

*mostly **not applicable

In Portugal, compensation provisions are often not stipulated in the PPP contracts. Compensation may be determined by the courts on a case-by-case basis (based on the general law principle of unjust enrichment).
EPEC guidance

When addressing compensation provisions for Private Partner default, the Authority should take into account the following points:

- **Principle of compensation** – Compensating the Private Partner following termination for its default is required in order to avoid any unjust Authority enrichment and attract lenders to PPP projects. However, excessively generous compensation will raise value-for-money concerns and introduce some moral hazard (i.e. the Private Partner and its lenders may not be sufficiently incentivised to perform). Choosing between the three approaches highlighted above therefore implies a proper analysis of the pros and cons of each, taking into account the relevant market/jurisdiction circumstances (see Topics 7.1, 7.2 and 7.3);

- **Simplicity** – Simple and objective calculation methods will provide greater certainty for the private sector stakeholders (and therefore a better outcome) and minimise the risk of disputes;

- **Lender preference** – Lenders are likely to be the main stakeholders involved in discussions regarding compensation upon termination for Private Partner default. They will tend to look for the highest possible recovery rate for their loan and the simplest/most objective solution possible. As a result, debt-driven approaches are likely to be more satisfactory to them; and

- **Eurostat impact** – The Authority should bear in mind that compensation provisions following termination for a Private Partner default are an important driver for the Eurostat statistical treatment of PPP assets. Eurostat considers that compensation provisions may have an impact on the project risk allocation and therefore may influence the government balance sheet treatment of the project assets.
Topic 7.1

‘Market value’ compensation

Background
The market value approach was developed in the UK in the late 1990s. It is based on the principle that any compensation payable to the defaulting Private Partner should be determined by reference to the market value of the PPP contract at the date of termination. With this approach, the terminated contract has to be re-tendered in order to establish its residual value. The compensation payable by the Authority is then the highest bid received following a re-tendering, less the costs incurred by the Authority as a result of the termination (e.g. re-tendering expenses). When re-tendering is not possible, an ‘estimated market value’ is calculated by means of a desktop analysis using the financial model developed for the project.

EPEC guidance
When addressing market value compensation provisions, the Authority should take into account the following points:

- **Fairness** – The market value approach is in principle the fairest, as the Authority is required to pay compensation equivalent to what the impaired contract is effectively worth. As a result, there is a much reduced risk of unjust enrichment or overpayment;

- **Conditions for re-tendering** – The market value with re-tendering approach will only be possible if there is a sufficiently liquid and mature market for PPP contracts at the time of re-tendering. It should therefore only be used in countries that have a well-developed PPP market and a sufficient number of active industry participants. Determining whether there is a liquid market may be difficult in practice. Lenders will often be reluctant to have to rely on re-tendering, as the market may be volatile and yield unfavourable results. Also, re-tendering will involve high transaction costs, skills and time;

- **Deriving the ‘estimated market value’** – A desktop approach can be used as a substitute for re-tendering to determine the market value of the contract. This method may be considerably quicker and cheaper to apply, although it may not reflect the real market value of the contract. A number of issues need to be addressed to define the parameters used in the calculation, in particular:
  - at what level should the new ‘base case’ be set (e.g. to what extent should past performance be taken into account)?
  - how to assess the rectification costs (costs to be incurred so that the project assets are in the required condition) to be netted off against the value of the contract?
  - what discount rate is to be used?

- **Flexibility** – If market value is the chosen approach, the PPP contract should provide for both a re-tendering option and the desktop approach to allow for those situations where a liquid market for similar contracts does not exist. It is important to agree at the outset what criteria lead to choosing one or the other.


**Topic 7.2**

**‘Book value’ compensation**

**Background**

This approach is mostly found in civil law countries and often defined by law rather than by contract. It is a retrospective approach which considers the sums invested by the Private Partner to build the project. It focuses on the value of the project assets rather than the value of the contract in contrast to the market value approach. The calculation of compensation is based on the book value of the PPP assets as determined at the time of termination and with specific accounting rules being applied.

**EPEC guidance**

When tackling book value compensation provisions, the Authority should take the following points into account:

- **Simplicity** – The book value approach is relatively simple to apply and entails minimal costs. It offers a high degree of certainty for the Private Partner and limits the risk of disputes (e.g. no forecasting is required as in the market value approach);

- **Fairness issues and distorted incentives** – However, the book value approach can only be a proxy for the true residual value of the PPP contract. It can lead to perverse incentives. Indeed, as the compensation amount is independent of the financing raised for the PPP project, there is a risk of underpayment (which would create bankability issues for lenders) or overpayment (which may incentivise sponsors or lenders to provoke a Private Partner default). For example, in the event of overpayment, equity investors may recoup part of their investment despite the fact that the Private Partner has failed to perform;

- **Rectification and termination costs** – The book value of the project assets is unlikely to take into account their physical state. Rectification costs may need to be incurred to reinstate the project assets to the required performance level. The compensation amount payable by the Authority should therefore take into account (i.e. subtract from any compensation payable) the rectification and termination costs it will face; and

- **Catering for accounting changes** – Compensation calculations based on book value can be problematic since accounting rules may change over time. As a result, provisions dealing with the effect of changes in accounting rules will need to be set out in the PPP contract.
Topic 7.3

‘Debt’ compensation

Background

This approach looks exclusively at the debt borrowed by the Private Partner and *de facto* excludes any compensation for equity investors. The underlying principles are that equity investors are primarily responsible if the PPP project fails and debt providers should enjoy a preferred position that will result in most (and sometimes all) of the senior debt and associated costs being repaid. Understandably, this form of compensation may be more attractive to lenders and make the PPP contract more bankable.

Debt-based compensation will generally be expressed as a percentage of the debt outstanding at the point of termination (e.g. France, Germany) or, less frequently, will entail full debt compensation (e.g. Turkey). Provisions of this type usually consider the following debt elements:

- the loans outstanding at the date of termination;
- the interest payments due up to the date of termination;
- any delayed interest, penalty on late payments and unpaid fees; and
- ‘breakage costs’ associated with the closing of hedging agreements and fixed-interest rate loans.

EPEC guidance

When tackling debt-based compensation, the Authority should take into account the following points:

- **Bankability** – Bankability of the PPP contract will often be driven by the percentage of debt covered by the compensation and what determines any deductions;

- **Moral hazard** – The Authority should ensure that the lenders remain at risk and incentivised to structure, analyse and monitor the PPP project accordingly. Full compensation provisions are indirect guarantees and may limit the interest lenders have in ensuring that the PPP project performs satisfactorily;

- **Value-for-money** – Ultimately, the compensation amount payable by the Authority should be commensurate with the value of the project the Authority will inherit. It may, however, not be easy to establish a link between sums due to the lenders and the value of the project;

- **Understanding financing agreements** – Given that the Authority may be liable to pay compensation payments defined by reference to the financing agreements, it is of paramount importance that the Authority and its advisers

---

review the financing agreements before financial close. In particular, the various components of senior debt subject to Authority compensation need to be carefully and clearly defined;

- **Allowing for breakage costs** – As in Topic 4.1, the amounts payable by the Authority as compensation for the Private Partner’s breakage costs under hedging agreements and fixed-interest rate loans can be substantial. It is therefore important that the hedging agreements and loan contracts clearly identify these potential costs and that the Authority takes these costs into account as contingent liabilities; and

- **Deductions from compensation sums** – The Authority should ensure that compensation amounts are reduced by:  
  - any ‘breakage profit’ made by the Private Partner due to early termination of the hedging agreements;
  - any amount in the reserve accounts available to the lenders (e.g. debt service reserve account); and
  - any cash and insurance proceeds available to the lenders.

---

**Box 6 – Debt assumption in Turkey**

Since the early 1990s, Turkey has used in some of its PPPs debt-based compensation mechanisms following termination for Private Partner default. This has largely been motivated by the need to attract lenders to PPPs. Debt-based compensation was first used in energy PPP contracts and has recently been proposed for transport and some large-scale healthcare PPP contracts (although these transactions have yet to reach financial close). To date, no project featuring these compensation provisions has been terminated.

In broad terms, the compensation is structured as an assumption by the Turkish Treasury of the outstanding senior debt and some related components (e.g. unpaid fees and accrued interests) of the Private Partner. Equity and subordinated debt are not covered by the mechanism.

Before the loan agreements are signed, the Treasury negotiates and concludes an assumption agreement with the lenders that sets out the compensation procedure. The assumption agreement is signed together with the loan agreements. The mechanism is such that upon termination of the PPP contract, the Authority would take over the PPP assets and the Treasury would assume responsibility for the debt. The Treasury usually would have the option to repay the outstanding debt either as a lump sum or as instalments over time. To avoid over-leveraged projects, the PPP legislation sets an 80/20 cap for the debt/equity ratio.

---

9 It should be noted that rectification costs to be incurred on the project assets are sometimes also deducted from the senior debt amounts, although this is opportunistic rather than based on any logic.
### Topic 8

#### How and when to pay compensation

**Background**

Once the Authority has defined the quantum of compensation it would owe following termination for Private Partner default, it needs to decide when to pay the Private Partner. It can opt to make payments as a lump sum or over a period of time. The Authority will also need to deal with set-off rights (deducting from the compensation sums any amount the Private Partner may owe to the Authority under the PPP contract).

**Findings**

The A&O study shows that in several jurisdictions the timing of termination payments following Private Partner default tracks that applicable for Authority default. In those jurisdictions where there are differences, the Authority usually has to pay compensation as a lump sum after an Authority default but has the option to pay in instalments after a Private Partner default. In contrast, in England and Slovakia, in the event of Private partner default termination the Authority can choose whether to pay in a lump sum or to pay significant portions of the compensation in instalments. In France, compensation is paid in a lump sum.

**EPEC guidance**

When addressing how and when compensation should be paid, the Authority should take into account the following points:

- **Authority’s interest** – The Authority will often prefer paying compensation amounts over time since a lump sum would result in a large outflow of funds that may not be budgeted for or have treasury coverage;

- **Private Partner’s interest** – In the event of termination for Private Partner default, the lenders are likely to be the only private party benefiting from Authority compensation. The lenders will resist payments over time, as they may be reluctant to be exposed to a project whose contract has been terminated and may not be satisfied with the credit risk of the Authority. The lenders will also resist payments that are spread over a period longer than the residual life of the debt;

- **Cost of payment over time** – Deferring termination payments will have a cost for the Authority. Interest will often accrue on the compensation amount from the date the payment is recognised as due until the final payment is effectively made. The Authority will need to agree with the Private Partner and its lenders the interest rate that applies;

- **Transfer of assets** – The lenders may be reluctant to release their security interests on the project assets until compensation payments have been made in full. This may make the transfer of project assets back to the Authority difficult; and

- **Set-off rights** – The lenders will in general resist any set-off rights of the Authority, in particular where compensation is debt-based.
**Topic 9**

**Lenders’ step-in right**

**Background**

Lenders’ step-in rights are important provisions for the bankability of PPP projects. They give the lenders the ability to rescue a project if the Private Partner has defaulted on one of its key obligations by taking remedial action before the Authority terminates the contract. In doing so, lenders will aim to protect their loan. Step-in typically involves the appointment of a suitable substitute Private Partner.

**Findings**

**Form of step-in**

The A&O study shows that most jurisdictions provide for some form of lenders’ step-in rights.

<table>
<thead>
<tr>
<th>Belgium</th>
<th>France</th>
<th>Italy</th>
<th>Romania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria*</td>
<td>Germany</td>
<td>Netherlands</td>
<td>Slovakia</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Greece</td>
<td>Poland</td>
<td>Spain</td>
</tr>
<tr>
<td>England</td>
<td>Hungary</td>
<td>Portugal</td>
<td>Turkey</td>
</tr>
</tbody>
</table>

*No step-in usually provided for

As shown in the above table, Spain, Slovakia and Poland are exceptions to the general rule. These jurisdictions rely on alternative solutions to proper step-in rights, based primarily on the lenders taking ownership of the Private Partner by enforcing the security they have over the shares in the Private Partner.

- In Poland, lenders are given the opportunity to rescue a failing project by taking over the ownership of the shares in the Private Partner;
- In Spain, two options are provided by law: lenders can either be subrogated (under certain circumstances) to the Private Partner’s rights under the PPP contract or be involved by means of enforcement of pledges over the Private Partner’s shares; and
- In Slovakia, lenders are given the opportunity to be involved in a failing project through the enforcement of their share pledge and by means of the rectification plan to be agreed between the lenders and the Authority. Ultimately, the Private Partner continues to perform its obligations under the PPP contract as modified by the rectification plan.

In Bulgaria, step-in rights are rarely granted.
Legal means to step in

As shown in the table below, the A&O study also found that there are two main legal ways to grant lenders step-in rights:

- through a ‘direct agreement’ entered into between the Authority, the lenders and the Private Partner at financial close. This model predominates; and
- through a mix of specific provisions of the PPP contract and law.

<table>
<thead>
<tr>
<th>Belgium</th>
<th>France</th>
<th>Italy</th>
<th>Romania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>Germany</td>
<td>Netherlands</td>
<td>Slovakia</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Greece</td>
<td>Poland</td>
<td>Spain</td>
</tr>
<tr>
<td>England</td>
<td>Hungary</td>
<td>Portugal</td>
<td>Turkey</td>
</tr>
</tbody>
</table>

Lenders' liabilities

The A&O study highlights a number of differences regarding the liability lenders incur whilst stepping in. For example:

- in Hungary, all entities stepping in are made jointly and severally liable for the liabilities of the Private Partner, including those that arose before the step-in;
- in Germany, the party stepping in is not liable for the fulfilment of the former Private Partner’s obligations. However, it has the duty to deal with the circumstances that led to the default; and
- in England and Belgium, lenders and the substitute Private Partner are granted some relief with respect to breaches arising prior to the point of step-in, in consideration for undertaking to rectify those breaches.

Authority consent

The A&O study also points out key differences regarding the extent to which the Authority has a right to consent to a lender’s step-in and/or replacement of a failing Private Partner. For example:

- in France and Germany, the Authority approval is required before step-in can occur;
- in Belgium and the Netherlands, the Authority may only withhold its consent in certain circumstances;
- in England, no Authority consent is required for the basic exercise of the step-in right but consent is required at the point at which lenders, having stepped in, wish to novate the PPP contract to a new Private Partner;
- in Hungary, the Authority’s approval for step-in is not specifically required but the Authority has to consent to the rectification plan that is subsequently proposed; and
- in Italy, the technical and financial standing of the replacement Private Partner must be substantially equivalent to that of the original Private Partner at the time of contract award.
**EPEC guidance**

When addressing lenders’ step-in right issues, the Authority should take into account the following points:

- **Benefits of lenders’ step-in** – Lenders’ step-in rights are market practice and key to the bankability of PPP projects. They can assist all parties: lenders are given a chance to protect their loan, and the Authority and project users can benefit from their attempt to rescue the project. When stepping in, the lenders’ interests and those of the Authority are to a large extent aligned;

- **Reviewing the legal framework** – The Authority should review its legal framework (general or PPP-specific) and assess how, if at all, it caters for lenders’ step-in rights. To the extent that the provisions of the legal framework are not sufficiently clear and precise, the Authority should seek to address the relevant issues through a direct agreement or in the PPP contract. A direct agreement between the Authority and the lenders is an effective means of granting step-in rights to the lenders (who are not usually a party to the PPP contract). However, domestic legal practice and constraints may not always permit/justify a direct agreement;

- **Authority’s interest** – The Authority will want to ensure that, if step-in occurs, both the risk allocation and the service provision are preserved. In particular, the Authority should ensure that someone is accountable for the breaches committed up to and after the point of the step-in;

- **Making lenders’ step-in effective** – To be effective, step-in right provisions need to be workable in practice. This entails in particular:
  - granting sufficient time for the lenders to evaluate their options once the Authority has notified the potential termination;
  - granting sufficient time for the lenders to select and appoint a suitable replacement Private Partner;
  - limiting the lenders’ responsibility for any liability the defaulting Private Partner may have towards the Authority or third parties or for liabilities during step-in;
  - waiving past defaults of the Private Partner;

- **Level of Authority consent required** – The Authority should have a degree of control regarding the identity of the substitute Private Partner proposed by the lenders. The lenders will resist absolute rights of veto but will often be prepared to agree a pre-approved set of selection criteria at financial close; and

- **New proposed EU legislation** – The proposed EU Directives on Public Procurement and Concessions (revising the current EU Directive 2004/18) seek to limit the ability of procuring authorities to change signed contracts significantly without re-tendering them. This is to ensure that important contract features (e.g. value, scope) are not altered in a way which would prove disadvantageous for bidders to the original contract or further enriches the successful bidder. However, it is recognised that issues such as restructuring and insolvency, which often require the replacement of the Private Partner in the case of PPPs, are important contractual issues which can be consistent with the proposed Directives as long as the overall integrity of the contract remains unchanged. Providing for explicit lenders’ step-in rights in the original PPP contract is likely to reinforce this interpretation.
Jarvis was a successful group of companies in the UK, winning PPP contracts across a range of sectors (e.g. rail, emergency service centres and schools). As a result of a rail crash in 2002, in which Jarvis was later found to be negligent, Authorities across the UK began to disregard Jarvis as a Private Partner for their projects, even when the group was offering the best price.

This resulted in a deteriorating financial position, which in turn led Jarvis to breach its main banking covenants in 2004. Despite some major restructuring, Jarvis’ partners (e.g. subcontractors) stopped work or demanded payment in advance for their work. This led to substantial delays in some of the PPP projects under construction in which Jarvis was involved.

As Authorities were eager to see the construction of their projects completed, notably school projects as the start of the school year was approaching, they encouraged lenders to utilise their step-in rights to rescue the projects. Overall, 14 projects under construction were successfully restructured through a range of measures.

From the banks’ point of view, the projects were refinanced through a rescheduling and increase in senior debt within the projects. Although Authorities had to suffer delays to the delivery of the assets, they incurred no financial loss and the projects are now operating normally. Jarvis was eventually declared insolvent in 2010.
Section 3

Force majeure

This section deals with force majeure provisions in PPP projects. Three key topics have been identified and are discussed below.
**Topic 10**

**Force majeure: definition and effects**

**Background**

Force majeure provisions deal with circumstances which are beyond the control of the contracting parties and make it impossible for the affected party to fulfil its contractual obligations. Their aim is to provide relief to the affected party. In a PPP, the occurrence of a force majeure event will raise two important issues: the extent to which the Private Partner is compensated during force majeure events and whether the PPP contract should be terminated if a force majeure event persists for a significant period of time.

**Findings**

The A&O study shows that in all the jurisdictions reviewed force majeure or force majeure-style concepts exist, either in PPP contracts or via reference to general or case law. To avoid uncertainties or delays when relying on the general legal framework, most PPP contracts include specific force majeure provisions. In these cases, A&O found that two main approaches are taken:

- force majeure is given a broad definition, such as in France, where case law defines it as any event that is unforeseeable, beyond the control of the parties and makes it impossible for either party to perform its obligations under the contract; and

- force majeure is defined through an itemised list of events. The typical provisions include natural as well as political events such as war, acts of terrorism, nuclear explosions, natural disasters (e.g. earthquakes, landslides, floods), strikes and protests.

In practice, the two approaches do not differ significantly as itemised lists are often not exhaustive (with some exceptions such as in Belgium) and contain ‘catch-all’ provisions.

The A&O study also shows that:

- different approaches are taken in respect of the payments due during the period when force majeure is frustrating performance under the PPP contract. For example, in Bulgaria the Authority is not obliged to continue to pay the Private Partner during this period, while in the Czech Republic the Private Partner has to be paid as if it were performing. In the Netherlands, an ‘adjusted’ amount is paid to the Private Partner, covering its debt service costs but not the operation and maintenance cost savings that may arise; and

- there is typically a defined period of time before a prolonged force majeure event can lead to termination of the PPP contract. This period is typically defined as lasting between six and 12 months.
EPEC guidance

When addressing force majeure provisions, the Authority should take into account the following points:

- **Reducing uncertainties** – Investors and lenders will be concerned with the extent of coverage they obtain from force majeure provisions. They will seek protection for all unforeseeable events that are beyond the control of the Private Partner. They will have a preference for defining/spelling out force majeure events (e.g. itemised list) and including catch-all provisions. Clear and detailed provisions will therefore help to attract investors and lenders to PPP projects;

- **Reviewing the legal framework** – The Authority should verify the extent to which the applicable legal framework (e.g. the relevant PPP laws if any) caters for force majeure and assess whether the provisions are sufficiently clear and workable. Any gap should be addressed insofar as possible in the PPP contract;

- **Force majeure relief and mitigation** – Force majeure relief should only be granted to the Private Partner provided that the relevant event makes it impossible to comply with all or a material part of the contractual obligations. The Private Partner should be responsible for mitigating the effect of the force majeure event wherever possible;

- **Payments during force majeure events** – As a result of a force majeure event (and while it lasts), the Private Partner may not receive revenues and yet still incur fixed costs (e.g. debt service), which may affect its financial standing. The Authority should assess the extent to which it is prepared to pay compensation to the Private Partner to prevent a default under its project or financing agreements;

- **Insurance** – The relationship between force majeure relief and insurance coverage should be considered with care (see Topic 12); and

- **Prolonged force majeure** – The PPP contract should provide for termination rights following a lasting force majeure. Both contracting parties should be given the opportunity to terminate the contract after a certain period if it is unlikely that the project circumstances will return to normal.

---

**Box 8 – Authority step-in**

Although not force majeure events, specific circumstances may require the Authority to step into the management of a PPP project despite the fact that the Private Partner is not in breach of its contractual obligations. This ‘Authority step-in’ can occur, for example, to mitigate serious risks to health, safety and the environment or to discharge a statutory duty. In certain jurisdictions, the Authority step-in also provides for a right to step into the Private Partner’s subcontracts after the PPP contract has been terminated.

Although the Authority may wish to preserve as much flexibility as possible regarding when and how to step in, its actions may have a significant impact for the PPP and the Private Partner. The Private Partner will therefore seek to limit the scope of the Authority step-in and make sure it is adequately compensated should it occur.
Topic 11

Compensation on termination following force majeure

Background
As mentioned in Topic 10, a prolonged force majeure event should give a right to both contracting parties to terminate the PPP contract. As the Private Partner is not at fault, there is a general consensus that the Authority should pay the Private Partner some compensation. The key question arising from this is whether the Private Partner and its lenders should bear some of the financial consequences resulting from force majeure termination.

Findings
Nearly all the jurisdictions analysed in the A&O study provide for some kind of compensation in the case of force majeure termination. In most jurisdictions it is considered that force majeure is neither party's fault and, therefore, the financial consequences resulting from a force majeure event should be shared. Overall:

- compensation typically covers sums owed to the senior lenders (e.g. debt outstanding, unpaid interest, hedging breakage costs), the equity contributions paid in by investors as well as payments owed to the subcontractors; and

- compensation typically does not provide for any loss of future income. Monies owed to equity investors are net of distribution amounts already paid out (e.g. in Belgium, England, the Czech Republic and Germany).

EPEC guidance
When addressing issues related to compensation for force majeure termination, the Authority should take into account the following points:

- **Lenders’ expectations** – Lenders will almost always not agree to be exposed to financial losses as a result of a force majeure termination. As a result, the Authority should ensure that compensation provisions cover at least all sums owed to the lenders (e.g. debt outstanding, hedging breakage costs); and

- **Balancing interests** – It is widely recognised that the Private Partner should not receive equivalent compensation in force majeure termination compared to Authority default termination. A full pay-out to the Private Partner could represent poor value-for-money for the Authority. However, penalising the Private Partner unduly for events which are beyond its control would equally be untenable.
Topic 12

Insurability issues

Background
PPP contracts typically require the Private Partner to insure key project risks (e.g. accidental damage, third party liabilities). In the early days of PPPs, the definition of force majeure was often based on whether a particular event could be insured against. If there was insurance for a specific political or natural event, it could not be regarded as force majeure. Conversely, uninsurable events tended to be treated as force majeure. Nowadays, the relationship between insurability and force majeure is less straightforward.

Findings
According to the findings of the A&O study, most jurisdictions take account of uninsurability but deal with it on a separate basis to force majeure.

Uninsurability is mostly related to (i) the unavailability of insurance on the international insurance market by insurers of an adequate credit rating or (ii) where insurance premiums are prohibitively high. For example, in Germany, the definition of uninsurability refers to the unavailability of the relevant insurance in the European market or an increase in premium of more than 300%. Similar concepts can be found in Belgium, the Czech Republic, Greece, Hungary, the Netherlands and Slovakia.

A&O highlighted two exceptions:
- Bulgaria, where uninsurability does not appear to be recognised; and
- France, where uninsurability clauses are not common in PPP contracts. Uninsurable risks are covered by the concept of imprévision (i.e. events that are unforeseeable, beyond the control of the parties and have a material impact on the balance of the contract) for which the Private Partner is entitled to compensation.

The effects of uninsurability provisions are that, if a given risk becomes uninsurable, the parties negotiate a mutually satisfactory solution, failing which the Authority is usually given the option to accept the risk itself or to terminate the PPP contract.

EPEC guidance
- Uninsurability clauses – Uninsurability relief should only be granted to the Private Partner provided that insurance does not become unavailable as a result of its action or omission. The PPP contract should set out in detail the grounds on which insurance can be considered unavailable (e.g. minimum increase in premiums);
- Private sector interest – As for force majeure provisions, investors and lenders will be concerned with the extent of coverage they obtain from uninsurability provisions. They will seek protection for the Private Partner in case the required insurance cover becomes unavailable, less extensive or more costly;
- **Authority as insurer** – Uninsurability provisions will often require the Authority to become the insurer of last resort. In doing so, the Authority will be liable for the consequences of the occurrence of a risk which became uninsurable. It is therefore important that the Authority is able to manage the risks transferred to it (for example by taking out insurance policies itself) and has a right to terminate the PPP contract; and

- **Termination for uninsurability and compensation** – As noted above, the PPP contract should provide the Authority with termination rights for uninsurability reasons. Given that the Private Partner should not be unduly penalised for events which are beyond its control, it is widely recognised that it should receive some compensation, in an amount between that for Authority default and that for Private Partner default. In many cases the compensation owed by the Authority following uninsurability termination is identical to that for force majeure termination.
Conclusion

As highlighted in this paper, termination and force majeure provisions are issues of great importance in PPP contracts. They are at the heart of the risk-sharing arrangement between the public contracting authority and its private sector partner. Although this paper may help public decision-makers and procuring authorities to strike the right balance between value-for-money and bankability when devising deal-specific contracts or standard PPP agreements and guidelines, specialist legal advice should be sought.

In addition, it is worth stressing that termination and force majeure provisions are in practice rarely applied as drafted in the PPP contract. This is largely driven by the fact that the public authority will first and foremost be concerned with continuity in the provision of the public service rather than with terminating the PPP arrangement per se. However, setting out suitable provisions in the contract will set the parameters within which negotiations can take place if failures or unforeseen events occur.