

Concession Agreements: Critical Provisions That Require Higher Levels of Consideration

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SUMMARY: A discussion of why a Concession Agreement is a critical document and how the terms within Concession Agreements can work for and against an Owner or Concessionaire within the context of a Public Private Partnership or other contractual structure.

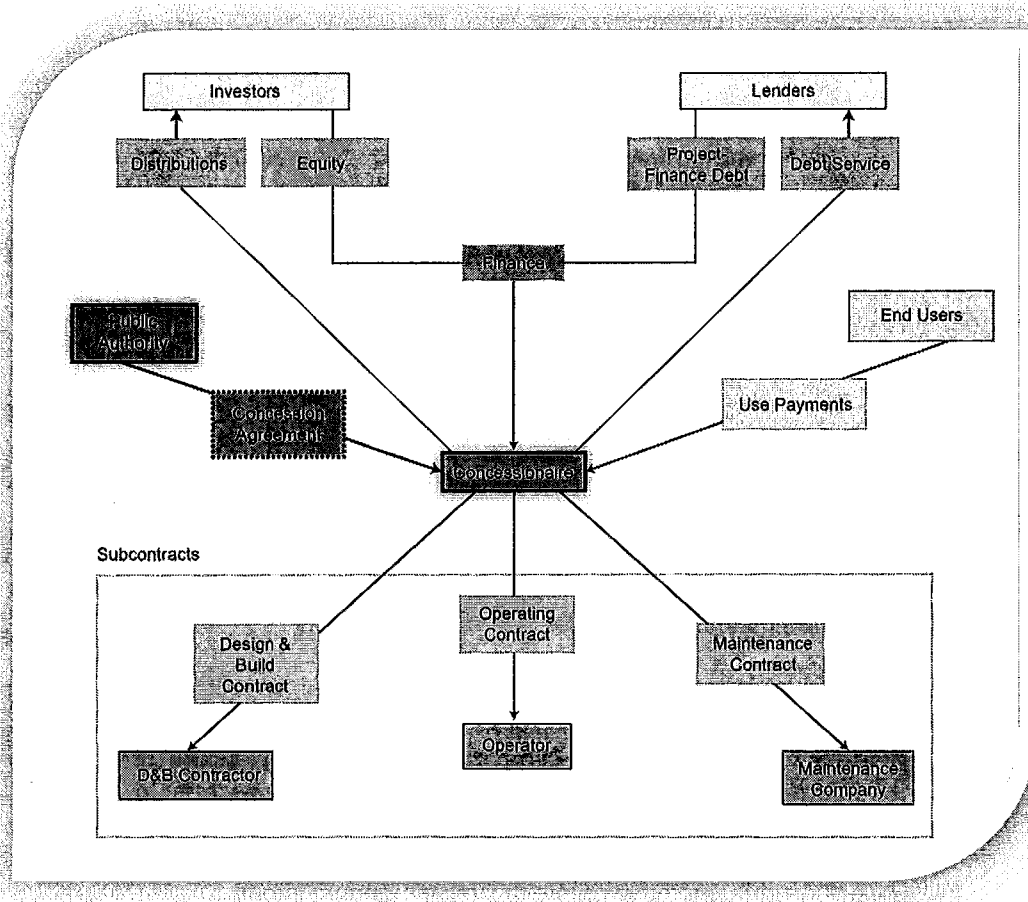
I. Introduction

The contractual framework and structure of a Public Private Partnership (“P3”) is a legal document puzzle. This article focuses on the most essential document that fundamentally defines and incorporates the documents that make up the P3 enterprise, and allows all the other necessary puzzle pieces to fall into place—the Concession Agreement.

The Concession Agreement is the core contract between the public sector entity (the “Owner”), the financing of the improvements, and the private sector entity (the “Concessionaire”) undertaking the procurement of the construction, operation and maintenance of a project, or work and attendant risks – for a price. In contrast to typical contracts that spell out exactly how a service is to be provided, the Concession Agreement also documents performance outcomes the fully realized project should achieve, including operational service level expectations and the mechanisms for governing and rewarding the Concessionaire, who is responsible for developing the means and methods to achieve those defined performance standards.

In a typical P3 structure, the Concessionaire is responsible for most aspects of implementing the project. It usually must obtain both debt and equity financing, documented with a constellation of loan documents and equity investment agreements. The Concessionaire must also have agreements with each of the contractors who will deliver every phase of the project: a design and build contract for project construction; an operating contract with the entity that will operate the asset once built; and a maintenance contract with entities that will maintain the asset during the Agreement’s term. In addition, the Concessionaire will often have some form of agreement entitling it to receive revenues derived from end users. Depicted below is an example of how these relationships fit together in the context of a P3.

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The Owner is typically not a direct party to each of the agreements between the Concessionaire and the financier, contractor, or user, and is buffered from these contractual relationships. What contract gives the Concessionaire the authorization to enter this web of agreements, and how does the Owner exert control over a project without direct contractual leverage? Enter the Concession Agreement.

The Concession Agreement contains the contractual requirements for when the project must be operational (i.e. the schedule), how the project is expected to perform, penalties for failure to deliver on time or perform as expected, as well as revenue streams available to compensate the Concessionaire. These requirements and payment mechanisms then drive the terms of the agreements entered by the Concessionaire with each of the contractors and the terms of the financing available to support the project. Because these agreements flow from, and relate to, the central Concession Agreement between the Owner and Concessionaire, the Concession Agreement is the foundational document for the entire array of contracts amongst the parties who will deliver, operate and maintain the project.

Chief objectives of the Concession Agreement are to define the nature and scope of the project for its life, from design and construction through operations and maintenance and hand-back of the asset to the Owner; to transfer appropriate project risks from the Owner to the Concessionaire, to establish how the parties will relate to each other for the typical 25-30 years of the Agreement; to establish how the Concessionaire will be compensated for taking on investment and performance risks; and to document sufficient certainty of payment streams and safety nets to make lenders willing to finance the project. Ultimately, the Concession Agreement provides a roadmap for how each party will achieve what it wants by the end of the Agreement's term. Typically, the Owner wants an asset that performs as needed and is in good condition, with operational life remaining, while the Concessionaire needs a level of investment return sufficient to warrant its involvement over the term of the relationship.

Because of the breadth, complexity and duration of the undertaking, a well-crafted Concession Agreement is critical. The Owner is putting all its proverbial eggs in a single basket with one Concessionaire, and as in any long term relationship, understanding expectations at the outset is critical because disagreements over the long term are not unreasonable to expect. Divorce, in this context, is costly and full of its own risks, so a document that thoroughly establishes expectations of the parties, defines mutual responsibilities, anticipates and attempts to head off potential problems, and provides mechanisms for resolving disputes can give each party greater confidence and clarity.

In addition, the Concession Agreement is the key control lever each party has for getting what it wants. If the Agreement fails to transfer sufficient risk to the Concessionaire, the Owner may be unwittingly over-rewarding the Concessionaire. Alternatively, if the Agreement is too prescriptive regarding means and methods for achieving outcomes, the Concessionaire may find it lacks sufficient latitude to make the project as profitable as expected, and thus less worth its while. The Concession Agreement governs the dynamics of these bargains, and – from the very outset – the likelihood that each party will achieve its goals.

II. Key Provisions in Concession Agreements

While the specific contents of Concession Agreements vary, certain provisions consistently appear in most, if not all, Concession Agreements. The keystone provisions noted below warrant close scrutiny because they are critical to achieving the parties respective goals.

1. Conditions Precedent – When do you have a deal?

Because the Concession Agreement is the linchpin to many related agreements, it must often be negotiated before other puzzle pieces are in place. Because it is common for P3s to be fluid during the development stages, many elements have yet to gel. Accordingly, there can be significant uncertainty regarding the project that a Concessionaire may not be willing to accept. This natural uncertainty creates the need to include preconditions within the Concession Agreement – an opportunity to postpone or back out of a deal entirely if certain hurdles are not first overcome. This concept is particularly relevant because there may be a lag between Commercial Close (e.g. when the project contracts are executed) but subject to financing and other conditions precedent and Financial Close (e.g. when the Concession Agreement and financing agreements are signed and funding can actually flow). Although specific preconditions vary according to the nature of the deal, common provisions are frequently prominent in Concession Agreements. Following are some of the more frequently encountered and important conditions precedent provisions.

- **Project Documents, including key contracts, construction security, direct agreement among owner, Concessionaire and lender, financing and funding documents:** Although actual funding is typically timed for financial close, the Owner looks for assurance from the Concessionaire that it can fulfill its end of the obligations and put together the entire deal structure and that it has the wherewithal financially to make it happen – a “show me the money” moment. As such, core documents must be in place to ensure proper flow-through of key provisions in the Concession Agreement and the subcontracts with those contractors responsible for each phase of the project’s lifecycle, from design and build through operations and maintenance, as well as evidence that the funding is in place, financial terms are set, and both equity and debt are adequate and confirmed.
- **Financial Model:** Although pro formas are common in any development project, seldom do they need to forecast investments and operational decisions for decades into the future, or to set down in such financial exactitude the relationship between the Owner and Concessionaire. A P3

financial model is truly the “nuts and bolts” of how the project comes to life, the various assumptions everyone has agreed to, the risks borne by each party, the plan for how each party expects to contribute to the project, and how the project’s expenses and revenues are accounted for. In short, unless and until the financial model is finalized, there is no deal.

- **Concessionaire and Owner Opinion Letters:** Because of the magnitude and sensitivity associated with P3s, the up-front investment costs by a Concessionaire, the extensive commitment of Owner resources in sourcing a P3 project, and the challenging political environment in which P3 projects are often launched, opinion letters are critical to prevent any questions of the deal’s legality from being called into question – there is simply too much at stake not to have the assurance provided by opinion letters.
- **Advances or Reimbursements of Costs:** The P3 bidding and selection process can be costly for would-be Concessionaires, and it is not uncommon for the Owner to reimburse some of these up-front development costs as an advance against project funding. This policy enables Concessionaires to recoup early out-of-pocket costs for legal support, financial advisers, and other consultants. long before a project is operational and revenue positive.
- **Any changes to Interest Rates are within established Tolerance Levels:** The Concessionaire cannot stand behind its financial model for the life of the Agreement if a major shift occurs in the financial markets – a worldwide financial meltdown, for example, or a significant scale terrorist attack. Although hedging instruments are available to a degree, a project may simply not be viable under certain financial conditions. As a result, the Concessionaire and Owner typically agree on interest rate parameters that, at their upper limits, remain viable for both parties.

2. Risk/Responsibility for Permits/Govt. Approvals – Who gets the project “shovel-ready?”

Assembling all the required permits and approvals for a complex infrastructure project is a significant undertaking, with the risk that critical permits may be delayed, pushing back project timelines. Which party bears the risk for lining up the necessary approvals, if the permits are not a condition precedent in the Concession Agreement? The following language is an example of how an Owner transfers nearly all this risk to the Concessionaire.

“Except with respect to Owner-Obtained Governmental Approvals and subject to the terms of the Project Documents, Concessionaire shall be solely responsible for securing and obtaining all Governmental Approvals (including any revisions, modification, amendment, supplement, renewal or extension thereof), required in connection with its performance of this Agreement. Notwithstanding the above, the Owner shall obtain for Concessionaire the benefit of each of the Owner-Obtained Governmental Approvals so as to ensure that Concessionaire shall have the use and benefit of the Owner-Obtained Governmental Approvals no later than the Notice to Proceed Date, provided that Concessionaire shall be responsible for obtaining amendments or modifications to any Owner-Obtained Governmental Approvals necessary to reflect the Final Design and/or means and methods, should the Final Design and/or means and methods deviate from the basis upon which the Owner-Obtained Governmental Approvals was initially granted by the Governmental Entity.”

While the Owner typically agrees to help facilitate the process of obtaining necessary approvals, it may lack the significant resources required to effectively manage the lengthy permitting process and considering public sector staffing constraints may be unable to “ramp up” hiring to effectively manage this process. Instead, an Owner usually shifts much of this burden to its Concessionaire agent, effectively

offloading the extensive staffing and other resources needed to the Concessionaire. Note that while the risk of failing to obtain permits is significant and real: failure to obtain the required government approvals is typically defined as a Concessionaire default and can cause significant delay.

3. Handback Requirements – How much useful life is left in the asset?

Think of this provision as analogous to protecting the family car: if you want to make sure the car is still roadworthy for the next sibling in line, make sure your teenager clearly understands how the car should be cared for and what it should look like when you get back the keys. Similarly, an Owner needs to make clear how much life it expects to have left in an asset and anticipate how it should be maintained in preparation for its post-Concession Agreement life. The language below is an example of how an Owner establishes Concessionaire handback requirements for an asset, specifying in particular the remaining life it expects the asset to have when the Agreement expires.

“The Concessionaire shall, on the Expiration Date, hand over and, to the extent not already owned by Owner, transfer ownership of title to the Concessionaire-operated Assets free of all encumbrances and free of charge to Owner in a condition which: (i) could reasonably be expected of an equivalent asset that has been in existence and operated for a period equal to the period during which the Project has been operated and that has been maintained in accordance with the O&M Standards during that period; and (ii) is capable of complying with the O&M Standards (as amended pursuant to the terms of this Agreement) for a period of not less than three years from the Expiration Date. The maintenance or other work of renewal, reconstruction, repair or reinstatement to be carried out by the Concessionaire with respect to the Concessionaire-operated Assets prior to the Expiration Date in order to satisfy the Handback Work Requirements (“Renewal Work”) shall not include those items that Owner elects in writing to defer. In the event of Early Termination, Concessionaire shall only be required to comply with the requirements of this Section to the extent any Renewal Work was scheduled to be performed prior to the Early Termination Date.”

Here, the Owner has specified not only that the asset must be in good enough shape to operate for an additional three years beyond the Agreement’s term, it must operate at a level sufficient to meet the Owner’s performance standards. This type of language prevents problems from arising if a Concessionaire returns the asset sufficiently operable to limp through an additional few years, but clearly not to the operational standards an informed Owner would expect. It also encourages the Concessionaire to avoid skimping on maintenance during the twilight years of the Agreement, a time when it is tempting to reduce further investment in the asset. As the example language alludes, Concessionaires often are required to fulfill additional capital improvements in preparation for handing back the asset – so-called “renewal work”. It is possible the Owner may allow the Concessionaire to defer certain renewal work without penalty, for example when the Owner itself opts to defer the work or when the work would not normally have been completed by the time the Agreement terminates. While all the maintenance and renewal work requirements should be reflected in the project’s financial model, specifying the amount of life and level of asset performance required at handback closes the loop to ensure the budgeted funds are actually expended.

4. Relief/Compensation Events – When is failure to perform excusable and what are the consequences?

Although the Concessionaire shoulders significant risk in a P3 enterprise, and is compensated accordingly, there may be risks a Concessionaire is not willing to bear, or for which it cannot price while still keeping the transaction affordable for the Owner. In such cases, nearly all Concession Agreements

spell out the conditions under which the Concessionaire is excused from performing under the Agreement; these events typically entitle the Concessionaire to additional compensation.

“Relief Event means any of the following: (i) any Force Majeure Event; (ii) any Change in Law; (iii) any accidental loss or damage to the Site or any roads servicing them; (iv) any delay in obtaining Governmental Approval, provided that such delay is beyond the reasonable control of any Concessionaire-related entity; (v) any delay in Owner granting Concessionaire access to the Site; (vi) any failure by a Utility Owner to complete design work related to any Utility Relocation, cooperate in accordance with the applicable Utility Relocation Agreement as necessary, or remove and/or relocate any Owner Relocated Utility; (vii) any unidentified archaeological remains or environmental conditions, geological obstructions, unidentified endangered species; (viii) any interruption or interference to the Work caused by the procurement, design, construction, operation or maintenance of any Other Owner Project; and (ix) the issuance of any preliminary or permanent injunction or temporary restraining order or other similar order, legal restraint or prohibition by a Relevant Owner of competent jurisdiction under applicable law, which issuance is solely as a result of Owner’s actions or omissions (and not Concessionaire’s actions or omissions), which injunction, order, restraint or prohibition materially affects Owner’s or Concessionaire’s performance under this Agreement.”

As is foreseeable, relief event provisions are carefully negotiated simply because they provide exit ramps for the Concessionaire and may subject the Owner to additional costs. The Concessionaire is expected to push for more expansive relief event definitions, while the Owner will negotiate for narrower provisions. The Owner will want to maintain as much pressure as possible on the Concessionaire, for example by structuring the provision to allow an argument that had the Concessionaire adequately performed its obligations, it would have identified the rare indigenous butterfly or the civil war-era burial grounds whose discovery now threatens to derail the project. While most Concessionaires are accustomed to such familiar types of construction risks and can significantly control the number of “surprises,” there is far less they can do to protect against sudden changes in the law, or against an Owner whose work on a nearby project impedes progress on the P3 project, or whose failure to grant access to a site or to assign Owner-obtained permits to the Concessionaire derails the project schedule. Because it would be hard to argue against the fairness of including these situations as relief events, there should be more scrutiny as to how much vs. whether compensation or forgiveness is due the Concessionaire.

5. Financing and Refinancing Risk Provisions – Who brings the money and who has the power to change financial terms?

Although the Concessionaire virtually always brings the financing to the table, and the financing is set and approved at the outset of a project, financial needs and the credit environment will invariably change over the course of the Concession Agreement’s term. What freedom does the Concessionaire have to adjust financing over time, and who bears upside and downside risk? See language below for an example of how an Owner retains discretion over changes in financing that could impact the project’s financial performance and how the Owner in the following example expects to share in any potential upside.

“Concessionaire will be responsible for arranging the Project Financing at its sole risk and expense and in accordance with this Agreement will ensure that it maintains adequate financial resources for the performance of its obligations under this Agreement and the other Project Agreements. No amendment, modification, variation or waiver of any provision of any Credit Agreement (or other financial arrangement) will be made that is

not consistent in all material respects with the Financial Model. The Concessionaire shall notify Owner in writing of any proposed amendment, modification, variation or waiver of any provision of any Credit Agreement at least 14 days prior to the date on which such amendment, modification, variation or waiver is intended to become effective. During such 14-day period, Owner, acting reasonably, shall have the right to verify that the proposed amendment, modification, variation or waiver is consistent in all material respects with the Financial Model. Concessionaire shall obtain the Owner's prior written consent to any Qualifying Refinancing. The Owner shall be entitled to receive a 50% share of any Refinancing Gain arising from a Qualifying Refinancing. Concessionaire shall promptly provide the Owner with full details of any proposed Qualifying Refinancing, including a copy of the proposed Revised Financial Model, and the basis for the assumptions used in the proposed financial model. The Owner shall have unrestricted rights of audit over any financial model and documentation used in connection with that Refinancing whether the Refinancing is a Qualifying Refinancing or not."

Although the Concessionaire puts together the financing and takes the interest rate risk for the deal, within established parameters, the Owner is not necessarily ready to relinquish any upside that may result from future refinancing, based on the argument that had better financial terms been available at the project's outset, its costs would have been lower. Though not contained in all Concession Agreements, provisions that allow sharing of upside refinancing can be considered as part of the overall compensation/risk/reward deal structure. Second, because the parties must strictly adhere to the financial assumptions established in the financial model, the Owner will typically insist on having some control over any changes to financial agreements that would invariably bear on the model's assumptions, and thus the project's financial performance. Some Concession Agreements require Owner consent only for material changes, while others remove all discretion from the process and require full Owner participation and consent in any modification, no matter how minor or material, reinforcing a "full disclosure" approach to overseeing the project financials.

6. Changes in Law/Appropriations Risk – What happens if the rug gets pulled out from under the deal?

Not every legislative body loves P3s. In fact, it should come as no surprise that not all states have P3 enabling laws (e.g. Buildings, Transportation, Water and Utility Infrastructure). Although Concessionaires are commonly expected to absorb the risk of widely applicable changes in laws and regulations (new uniform pollution control standards, for example), some risks may shift back to the Owner if a law specifically targets the project for negative treatment. See the following language for an example of how this burden is shifted.

"If the Parties agree, or it is determined in accordance with the Dispute Resolution Procedure, that a Change in Law constitutes a Discriminatory Change in Law or has a Change in Law Effect, where the terms of the law apply to the Project or to substantially similar projects or to the Concessionaire and such terms are not of general application to other persons (a "Change in Law Change"), the extent to which the cost of carrying out the Change in Law Change is to be borne by Owner and/or the effects of the Change in Law Change on the carrying out of the Work during the Design/Build Period and/or the effects of the Change in Law Change on the operations and maintenance of the Concessionaire-operated Assets during the Operating Period shall be determined in accordance with this Section. Owner and the Concessionaire shall discuss and agree whether an extension of the dates for any Service Target Dates, the Service Deadline Date and/or the Final Completion Deadline Date is necessary as a result of a Change in Law Change. Owner shall pay to the Concessionaire:

(i) the Incurred Costs incurred by the Concessionaire with respect to a Discriminatory Change in Law; (ii) during the Design/Build Period, the Incurred Costs (if any) required to implement a Change in Law Change that is not a Discriminatory Change in Law to the extent such costs exceed [amount] per occurrence or, taken together with all previous amounts determined to qualify under this Section, exceed [amount] in aggregate; and (iii) during the Operating Period, the Incurred Costs (if any) required to implement a Change in Law Change that is not a Discriminatory Change in Law to the extent such costs, as stated in the Change in Law Notice, exceed [amount] annually or, taken together with all previous amounts determined to qualify under this Section, exceed [amount] in aggregate.

(a) Any decrease in the cost of the Work or cost of operating and maintaining the Concessionaire-operated Assets or increase in the amount of gross income calculated pre-tax received by the Concessionaire resulting from any Change in Law that constitutes a Discriminatory Change in Law or has a Change in Law Effect shall be retained by the Concessionaire up to the thresholds referred to above and all amounts of benefit resulting from any Change in Law beyond those thresholds shall be reflected by a reduction commensurate with the amount of such benefit, in the Service Payment so that the Concessionaire does not receive a benefit where the benefit is above those thresholds.

(b) If a payment is to be made by Owner for a Change in Law Change such payment shall become due and payable by the date 60 days after the date set in accordance with the agreement or determination described in this Section or the Service Payment shall be adjusted in accordance with Section X.X as soon as possible but shall be limited to an amount or amounts necessary so as to put the Concessionaire in the same economic position in which it would have been had the Change in Law not been made, provided that the amount and timing of such adjustment shall be determined by reference to the Financial Model so as to maintain the debt service coverage ratios (and/or other financial ratios) required to be maintained under the Credit Agreements.

(c) Owner may elect to require the Concessionaire to provide funding for any Change in Law Change. If Owner makes such election, the Concessionaire shall request from the Lenders or other third party funders or financial institutions the provision of funds to finance the changes required by any Change in Law Change, it being understood that the Lenders may refuse the provision of any such funding in their sole discretion and that the Concessionaire shall be under no additional obligation (and shall not be in breach of any undertaking) in connection with the provision of any funding for implementing any Change in Law Change.

(d) The Concessionaire shall use its reasonable efforts to comply with any conditions to funding placed by the Lenders, including requesting equity support from the Investors, it being understood that the Investors may refuse the provision of any such funding in their sole discretion and that in such a case the Concessionaire shall be under no additional obligation (and shall not be in breach of any undertaking) in connection with the provision of any funding for implementing any Change in Law Change.

(e) If the Lenders or the Investors refuse to provide any funding for the implementation of any Change in Law Change, Owner shall provide funding for the implementation of such Change in Law Change or otherwise adjust the manner of payment such that it is no longer necessary for the Concessionaire to secure additional funding.”

In the language above, if the Concessionaire successfully makes a case for a change in law outside its agreed risk parameters, the costs of accommodating the change in law are compensable by the Owner. But the bar is high, lest the Owner shoulder too much legislative risk that is considered a market risk more appropriately borne by the Concessionaire. The Concessionaire typically must demonstrate that the change in law is specifically targeted at the project, or has a disproportionately negative effect on the project, to shift to the Owner a resulting financial burden. Assuming the change in law is survivable (meaning it does not have the effect of shutting down the project entirely, triggering a relief event), the Owner and Concessionaire generally describe in the Agreement the extent to which these costs will shift to the Owner, if any, at different phases of the project. Language in this provision should clearly establish responsibilities for supplying and paying for any additional required financing.

7. Insurance & Indemnification – How do you avoid coverage gaps, who is on the hook for unanticipated cost increases, and when indemnification may not apply?

Given that the Owner owns the asset, but has no responsibility for building, operating or maintaining it, insurance provisions are highly negotiated to ensure there are no gaps in coverage. Yet the insurance market and associated costs are sure to change over the life of any Concession Agreement, particularly in response to claims arising during the Concessionaire's operation of the asset. An example of how the Owner and Concessionaire navigate those issues is provided below.

“From the Work Effective Date, if applicable, or the Phase 1 Effective Date until the end of the Design/Build Period: (i) Owner shall at its own cost take out and maintain or cause to be maintained policies of insurance which provide cover on the basis set out in this Section; and (ii) the Concessionaire shall at its own cost take out and maintain or cause to be maintained policies of insurance which provide cover on the basis set out in this Section and otherwise as required by Owner in accordance with Section X.X. From the date on which Project achieves its Service Commencement Date until the End Date, the Concessionaire shall at its own cost take out and maintain or cause to be maintained, with respect to the Concessionaire-operated Assets, policies of insurance that provide cover on the basis set out in this Section. If Owner is unable to take out and maintain or cause to be maintained policies of insurance in accordance with Section X.X or otherwise elects to cancel or modify any such policies, then Owner shall give to the Concessionaire written notice either (i) promptly after Owner becomes aware of an Uninsurable Risk or (ii) otherwise no later than 60 days prior to any elective cancellation or modification. In such written notice Owner shall inform the Concessionaire whether Owner will elect to (x) procure alternative insurance coverage, including by way of self-insurance by Owner and/or (y) require the Concessionaire to obtain replacement insurance coverages. If Owner requires the Concessionaire to obtain replacement insurance coverages, then Owner will reimburse the Concessionaire for the actual net cost for any such required replacement insurance and the risk financing costs of a self-insured or large deductible program prorated for the balance of the Design/Build Period.”

Here, the insurance risk during the start-up phase is borne by both the Concessionaire and the Owner, with the entire burden shifting to the Concessionaire during operations, once the design and construction phase is over and service commences – when the Concessionaire has virtually full control over the project. Beyond standard worker's compensation and commercial general liability requirements, insurance provisions in a Concession Agreement commonly address all risk builder's risk, contractor pollution liability, coverage for equipment and the shipping of any stock needed for operations – but who obtains and pays for the coverage is a matter of negotiation. Particularly where an Owner has a robust risk management infrastructure and ready access to resources for managing insurance risk, Owner-procured coverage may lower project costs. Alternatively, many Owners seek complete turnkey

operations, where any incrementally higher project costs for Concessionaire-provided insurance are more than compensated in not having to devote an Owner's resources to managing an insurance program for the project.

Indemnification Provision:

Although Concessionaires typically agree to fairly broad indemnification provisions, given the degree of control they have over the project, there are limits to their magnanimity – the following is sample language for where a Concessionaire has drawn this line.

“Concessionaire shall not be responsible nor obliged to indemnify an Indemnified Party with respect to any Losses under Section X.X to the extent the same arise as a direct result of: a Compensation Event or Relief Event; the fraud, negligence, recklessness, bad faith or willful misconduct of an Indemnified Party; or any performance or non-performance by an Indemnified Party of its obligations under the Project Documents.”

Although most of these clauses are typical of standard contracts, worth noting is the carve-out for compensation and relief events – not only is the indemnification moot when the Owner or other indemnified party is culpable for whatever problem has arisen, but it is similarly of no effect when forces outside the Owner's control – perhaps a change in law, or a third-party's obstruction of the project's efforts – give rise to the issue. The importance of how compensation and relief event clauses are negotiated is thus more far-reaching than relatively straightforward matters of when additional compensation may be owed to the Concessionaire, or additional time added to the schedule without penalty. These defined events flow through multiple layers of the P3 contract structure, including indemnification provisions, which may shift certain risks back to the Owner. Owners are thus well-advised to contemplate the full ramifications of such events, and anticipate how they will make whole any third parties and the Concessionaire when the Concessionaire is not fully bearing this risk, and how they themselves will be made whole in such a situation.

8. Default & Termination Provisions – Whose fault is it and how do you terminate the relationship?

Fraud, failing to pay, and failing to perform are common justifications for terminating an Agreement. But given the complexity of most P3 projects and the long duration of the contractual relationships, other forms of misfeasance or malfeasance can have equally significant impact on the long-term relationship. Following are examples of the kinds of acts considered egregious enough to warrant terminating a Concession Agreement.

Concessionaire Default:

“The occurrence of any one or more of the following events or conditions shall constitute a “Concessionaire Default”: (i) Concessionaire fails to satisfy the applicable conditions to commencement of the Design Work as set forth in Section X.X within sixty (60) days of the Financial Closing Date, except to the extent that such failure arises as a direct result of the occurrence of a Compensation Event or a Relief Event; (ii) Concessionaire fails to begin the applicable portion of the Design Work within thirty (30) days of the Owner's issuance of Notice to Proceed, except to the extent that such failure arises as a direct result of the occurrence of a Compensation Event or a Relief Event; (iii) Concessionaire discontinues the performance of the Work for a period of sixty (60) or more consecutive days, provided that any period that the performance of the Work is discontinued in response to the occurrence of a Compensation Event or a Relief Event shall be deemed not to have occurred for the purposes of this Section; (iv) Concessionaire fails to comply with any Governmental Approvals or Applicable Law in any material respect; (v)

Concessionaire fails in any material respect to make a payment to the Owner under this Agreement when due, provided that the payment is not subject to a good faith Dispute, or fails to deposit funds in the Reserve Account in the amount and within the time period required by this Agreement; (vi) Concessionaire fails to obtain, provide and maintain the Insurance Policies in accordance with the requirements of this Agreement; (vii) any failure by Concessionaire to comply with Assignment Requirements; (viii) a Restricted Change in Ownership occurs; (ix) any representation or warranty made by Concessionaire in the Project Documents or any certificate, schedule, report, instrument or other document delivered to the Owner pursuant to the Project Documents is false in any material respect or materially misleading or inaccurate in any material respect when made or omits material information when made; (x) an Insolvency Event arises with respect to Concessionaire or Borrower; (xi) Any Maintenance Contract is terminated (other than non-default termination on its scheduled termination date) and Concessionaire has not entered into a replacement Maintenance Contract (as relevant) with a reputable counterparty reasonably acceptable to the Owner within sixty (60) days of the termination of the relevant Maintenance Contract; (xii) Concessionaire fails to commence the Construction Work by the Construction Commencement Deadline or to achieve Work Completion by the Long Stop Deadline; or (xiii) a Persistent Breach or Persistent Closure occurs.”

In this example, the Owner guards against Concessionaire failure at all stages of the project – particularly in the initial design and build phase, where the risks are highest and the consequences for failure most costly, but also during ongoing operations, via maintenance contracts. Provisions regarding insolvency events and changes in ownership are designed to ensure the Concessionaire remains the partner the Owner thinks it is getting in all material respects, since the partner’s strength and stability are critical factors in winnowing potential offerors to arrive at the chosen Concessionaire. Cure provisions could be particularly important relative to such clauses as maintaining accurate project documents, applicable insurance, and adequate reserves because an Owner would prefer these items to be fixed without having to terminate a Concessionaire, with the associated risk of jeopardizing the project.

Owner Default:

“The occurrence of any one or more of the following events or conditions shall constitute an “Owner Default”: (i) the Owner fails to make any payment due to Concessionaire (or any permitted assignee thereof) under this Agreement when due, provided that such payment is not subject to a good faith Dispute; (ii) any representation or warranty made by the Owner is false or materially misleading or inaccurate when made in each case in any material respect or omits material information when made; (iii) the Owner or any other Governmental Entity confiscates, sequesters, condemns or appropriates the Project or any material part thereof, or Concessionaire’s Interest or any material part thereof, excluding the exercise of any right set forth in this Agreement; (iv) the Owner has ceased to perform substantially all of its obligations under this Agreement, which substantially frustrates or renders it impossible for Concessionaire to perform its obligations under this Agreement for a continuous period of two (2) months; (v) any failure by the Owner to comply with Assignment Requirements; (vi) the Owner amends (without the prior written consent of Concessionaire) the Project Authorization or the Bond Resolution in a manner that would materially and adversely affect or diminish the rights of Concessionaire under this Agreement or materially and adversely impact the Owner’s ability to comply with its obligations under this Agreement; or (vii) the Owner ceases to be authorized to make any payment to be made by the Owner under this Agreement.”

The Concessionaire shoulders significant risk in any P3, and in return has bargained to be compensated for such risks. Defeating any Owner actions that frustrate the Concessionaire's negotiated returns, or that impede the Concessionaire's ability to perform its own obligations, must be the Concessionaire's highest priority in crafting an effective Owner default clause. While garden-variety failure to pay is to be expected as a cause for default, the Concessionaire must anticipate and protect against methods of infringing upon interests (whether intentional or otherwise) hence prohibitions against modifying bond resolutions, for example, or sequestering any portion of the project. The sample language above nicely captures not only the downstream effect (i.e. the Owner's failure to pay), but also the underlying mechanisms on which the Owner's *ability* to pay is predicated.

Termination for Convenience Clause:

"The Owner may terminate this Agreement at any time on or before the last day of the Term by complying with its obligations under this Section. If the Owner wishes to terminate this Agreement under this Section, it must give a Termination Notice to Concessionaire stating that the Owner is terminating this Agreement under this Section and that this Agreement will terminate on the date specified in the notice, which must be a minimum of twenty (20) Business Days after the date of receipt of the notice. This Agreement will terminate on the date specified in the Termination Notice. If this Agreement is terminated pursuant to this Section, the Owner shall pay the Owner Termination Sum to Concessionaire in accordance with Exhibit X."

Clauses permitting the Owner to terminate for convenience are more the rule than the exception in most Concession Agreements. For political and sometimes statutory reasons, government entities typically need the ability to back out of an Agreement for no other reason than because they have decided to head in a different direction – whether during construction, once a project starts operations, or even in the twilight years of an Agreement's term. After the Concessionaire makes a significant investment in getting a project off the ground and running smoothly, with the expectation of making good returns over the course of a few decades, it may not seem fair for the Owner to prematurely walk away without cause.

P3s, however, would never work if the scales tipped so clearly in the Owner's favor as to make the overall enterprise commercially unreasonable. Thus, wherever a ubiquitous termination for convenience clause appears, it is nearly always accompanied by a "make whole" provision that balances the scales by compensating a Concessionaire whose Agreement is terminated without cause. Compensation may be in the form of start-up costs plus a percentage of anticipated revenues for a certain number of years, a pro rata share of expected returns based on the financial model, or some other variant. Such compensation will typically cover any costs related to breaking financing agreements and paying off debt, and many compensate the investors for reasonable opportunity costs. Because of the ubiquity of termination for convenience clauses, focus is best placed on how the Concessionaire is made whole in such an event, and in ensuring the financial model supports the negotiated terms.

9. Step-in Rights – Who takes control when performance becomes a significant problem?

As discussed previously, the Concessionaire enters the key contracts for designing, building, operating and maintaining the project – the Owner has little day-to-day control over how the work is completed or how the service is provided. All well and good when the Concessionaire performs as desired, but what happens when its performance is dangerously lacking or far short of requirements? What happens when the Owner and Concessionaire disagree about whether the Concessionaire's performance falls short? The example below provides language for how to address this scenario.

"If the Owner reasonably believes that it needs to take action in connection with the Project because an Emergency has arisen; a Concessionaire Default has arisen and has

not been cured within any relevant cure period; or Concessionaire has failed to meet any Safety Standard or comply with any Safety Compliance Order within a reasonable period of time under the circumstances, then, subject to the Direct Agreement, the Owner shall be entitled to take action in accordance with Section X.X below and Concessionaire shall use Reasonable Efforts to give all assistance to the Owner while Owner is taking the Required Action. If Concessionaire is not in breach of its obligations under this Agreement, then for so long as and to the extent that the Required Action is taken, and to the extent this prevents Concessionaire from performing its obligations under this Agreement, Concessionaire shall be relieved from performing its relevant obligations under this Agreement; and with respect to the period in which the Owner is taking the Required Action and; provided that Concessionaire provides the Owner with reasonable assistance (such assistance to be at the expense of the Owner to the extent that incremental costs are incurred), such Required Action shall be deemed to be a Compensation Event for the purposes of this Agreement.

If the Required Action is taken as a result of a breach of the obligations of Concessionaire under this Agreement and following the application of any relevant cure period herein, then for so long as and to the extent that the Required Action is taken, and this prevents Concessionaire from carrying out any part of the Project, Concessionaire shall be relieved of its obligations to carry out such part of the Project; and with respect to the period in which the Owner is taking the Required Action, any Noncompliance Event or Closure that arises as a direct result of the Required Action shall, for the purposes of this Agreement, be deemed to have not occurred, but an amount equal to all the Owner's reasonable and proper costs of operation in taking the Required Action shall be deducted from the Monthly Disbursement."

In the example above, the focus is on the consequences for the Owner's stepping into the Concessionaire's shoes to effectuate the cure. Although the Owner reserves the right to step-in, as it ultimately must since it owns the asset, it is not an appealing prospect for either party; the Owner generally does not typically have the resources or the requisite know-how to run the project itself. A key benefit of a P3, after all, is obtaining the Concessionaire's capabilities. So if an Owner decides to step-in, it is all but bound to interfere with the Concessionaire's performance of its duties. Thus, when the Owner takes action but does so when the precipitating event does not arise out of the Concessionaire's breach, the Owner will often pay a significant penalty – not only is the Concessionaire potentially excused from performance, but it will typically get additional compensation. Even where the event arises from a Concessionaire default, the Owner's interference with the Concessionaire may give the Concessionaire a "pass" on meeting performance requirements that would otherwise trigger financial or other penalties. The bottom line is that neither party wants the Owner to exercise its right to step-in – although it is an important clause to lenders from a financing perspective, as a practical matter between the parties most Concession Agreements make stepping in a sufficiently painful alternative as to spur other resolutions to problems.

10. Dispute Resolution – When should the parties talk, and when (if ever) – do parties sue?

Disputes are inevitable over the course of any long-term relationship, but the extent to which the parties anticipate and provide a framework for resolving conflict is an indicator of the likelihood a successful long-term partnership will be realized. By committing to the equivalent of in-depth relationship counseling before rushing into court, an Owner and Concessionaire should have greater opportunity to reduce litigation costs and increase their investment in finding solutions, resulting in higher levels of trust and resiliency in the partnership. Below are example dispute resolution recipes used in contrasting projects.

Example A:

Five successive levels of dispute resolution: 1) Partnering Program – informal partnering to identify and resolve issues; program requires an official charter, rules, guidelines, kick-off workshops, and regular partner meetings; 2) A designated senior representative for each party meets with her counterpart and attempts to resolve the issue for at least a 15-day period; 3) Separate technical and financial dispute resolution panels, each with three impartial, independent members, hears disputes according to an established submission and hearing process; 4) AAA arbitration; 5) Litigate in court.

Example B:

Three successive levels of dispute resolution: 1) Concessionaire can raise a written protest with the Owner, which alone can accept or deny the complaint; 2) A dispute review board with three independent members, operating under executed agreements, will hear any appeals by the Concessionaire; 3) Litigate in court.

As described above, the approach in Example A favors a heavy reliance on pre-litigation resolution, while the Example B approach is less invested in internal dispute resolution mechanisms. The message conveyed is that the parties in Example A have either invested more heavily in developing a trusting relationship, or that they intend to do so through an elaborate dispute resolution process that discourages quick reliance on litigation, whether via arbitration or court. This process might be particularly well suited to long term projects, or those where there is a higher degree of ambiguity, where the parties must be prepared to commit to each other. On the other hand, for projects where the term is shorter or the deal terms are more straightforward, an extensive dispute resolution process may be perceived as an unnecessary waste of time and energy unwarranted by the nature of the project or deal structure.

11. Site Access & Control – Who has the keys to the kingdom, how many sets are there, and who gets to use them?

Given the broad indemnification provisions a Concessionaire typically provides, the risk it bears for implementing and operating the project, and the role the Concessionaire plays as the Owner's agent in operating the asset, it may not always be clear to the parties themselves or to third parties involved in the project who controls project site(s) and how the Owner and other third parties will interact with the Concessionaire in accessing the site. The language below offers an example of how the Concessionaire is expected to provide and share site access.

“The Concessionaire will grant to Owner, the Independent Engineer, the Project Third Parties and any other Relevant Owner (including all relevant police departments) such access to the Concessionaire-operated Assets and the Sites (including other locations on or off the Sites where materials are stored and facilities are located) as is reasonable in the circumstances for the purposes of carrying out their obligations under this Agreement and the other Project Agreements and monitoring the performance by the Concessionaire of its obligations under this Agreement and the other Project Agreements and as required by applicable law. In addition, the Concessionaire shall grant to Owner such access to the Project Sites as Owner requires in order to operate Owner's Other Services and to procure, construct, update and maintain any Other Owner Project, provided that Owner shall use Reasonable Efforts to mitigate any material impairment, interference, disruption or other adverse impact from Owner's Other Services on the operation and maintenance

of the Project Sites (other than such Reasonable Efforts as would impair Owner's ability to operate such services).

During the Operating Period, upon seven days' prior notice identifying Persons to whom access is to be granted under this Section (or such shorter period as may be reasonable under the circumstances) the Concessionaire shall make available to Owner, other persons acting on its behalf (including Owner's Representative) and any other Relevant Owner, the office space, facilities, storage space and parking areas specified in Section X for the exercise of their rights and obligations relating to the Concessionaire-operated Assets."

An understandable fear of any Concessionaire is having any party unnecessarily interfere or impact the project works by demanding access to the site and complicate the Concessionaire's ability to perform. Yet in the category of "play nice with others," the Concessionaire must cooperate with the Owner and with other Owner agents because it does not alone "own" the site and must allow for the Owner to fulfill its obligations to other projects and provide sufficient opportunity for project oversight. Because of the potential risks to the Concessionaire related to managing the site, the most thorough access provision will typically contain or refer to strict access control protocols and conduct requirements for anyone on the work site. This type of provision must be a flow-down provision and included in all subcontracts.

12. Performance Standards— How do you induce healthy performance anxiety?

An Owner pays a Concessionaire not only for the risk it shoulders on the Owner's behalf, but for providing services to end users that meets the Owner's standards. Most Concession Agreements contain provisions allowing an Owner to reduce payments to a Concessionaire during project operations if the Concessionaire fails to achieve all required performance standards. This lever is particularly important in light of the long duration of a typical Concession Agreement: it is one thing to punish a Concessionaire for failure to deliver or construct a project on time, but when project operations period stretches out for a few decades, the Owner needs a mechanism for keeping the Concessionaire committed and engaged.

Although specific performance standards vary according to the nature of the project, examples of typical performance deduction metrics found in Concession Agreements in detailed operations and maintenance specifications may relate to the number of days equipment is off-line and unavailable for service, the number of incidents where maintenance requirements are not met, a threshold for safety violations is exceeded, or required staffing ratios are not achieved.

Concession Agreements typically contain formulas for how deductions are calculated and how payments can be reduced in any given period; every additional "demerit" earned by the Concessionaire may correspond to a slightly higher performance deduction percentage, or indexed flat rate deductions may be assigned to each type of performance incident - \$8,000 for every hour a toll lane is closed, for example. Some parties negotiate clauses preventing deductions from carrying over to subsequent pay periods, while others may levy escalating penalties for cumulative deductions over several pay periods.

While the formulas and potential penalties vary based on the nature of the project, as well as the parties' relative leverage and negotiating acumen, the Owner's near-universal ability to impact payment to the Concessionaire for failing to meet established standards gives the Owner a meaningful hammer for exerting control over a project despite not having direct operational responsibilities, and without having to resort to claims of Concessionaire default. The goal in wielding such a tool should be to make performance penalties hurt enough to drive desired behavior and achievement of standards, without being so onerous as to hinder the Concessionaire's ability to effectively manage the project.

13. Protection of Intellectual Property – What does the Owner actually own?

Most P3 transactions are sufficiently well papered to make sure key contracts are assignable to the Owner. But particular attention is warranted to make sure the parties agree on how they will handle intellectual property rights arising from the project. Does intellectual property belong to the Owner as owner of the asset, or to the Concessionaire as a business confidential tool for achieving the Owner's desired outcomes? The language below provides an example of how the Owner expects to access intellectual property arising from the transaction.

“As part of the Handback and Reinstatement Work Procedures before the End Date, the Concessionaire shall provide Owner with copies of all Work Products and related documentation prepared in connection with the Project (i) in native format, which is the original format in which materials were developed and maintained, including, if available, in electronic or digital format, and (ii) as Owner may reasonably request, in another format suitable for future use as anticipated by this Agreement. The Concessionaire shall preserve any and all Work Products, including Source Code, prior to provision of such Work Product to Owner as part of the Handback and Reinstatement Work Procedures, and the Concessionaire shall replace any such Work Products that are lost, destroyed or damaged prior to completion of Handback on the End Date to the extent practicable without additional cost to Owner.

The Concessionaire hereby grants to Owner, for the benefit of Owner and its Agents, a fully paid-up, royalty-free, non-exclusive, irrevocable, perpetual license, with the right to sublicense, limited to the territory of the United States of America, to use the Concessionaire Content (not including the Financial Model) for the Project and any Owner-Related Project. The Concessionaire shall obtain, on Owner's behalf, all necessary rights and licenses for the Third Party Materials in accordance with this Section. The Concessionaire shall provide to or obtain for Owner all rights and licenses necessary for Owner and its sublicensees and contractors to use the Third Party Materials for the purposes of the Project, provided that such right to use shall not include the right to create derivative works from Third Party Materials comprised of software or Source Code. The Concessionaire shall (i) assign or transfer to Owner such rights and licenses in and to the Third Party Materials as may validly be assigned or transferred by the Concessionaire to Owner, (ii) acquire for Owner a direct grant of rights or a license to Owner in and to the Third Party Materials, (iii) sublicense to Owner rights and licenses in and to the Third Party Materials, or (iv) take such other action as may be necessary for Owner and its sublicensees and contractors to have the rights and licenses to Use the Third Party Materials for the purposes of the Project in accordance with the immediately preceding sentence. All actions by the Concessionaire under this Section shall be at the cost and expense of the Concessionaire (other than the cost for any additional sublicenses required by Owner other than for Owner itself, the cost and expense of which shall be borne by Owner) and all grants and licenses, and actions taken by the Concessionaire hereunder shall be in form and substance reasonably acceptable to Owner.”

The Owner should make sure it can step in to a project or have a new Concessionaire step in when the Agreement terminates. Getting the “as-builts” is not sufficient for complex projects, which typically have significant technology components for operations and maintenance, even more so when the nature of the project is itself a technology infrastructure installation. In such cases, the Owner needs whatever licenses or software has enabled the Concessionaire to develop and manage the project, reflecting the perspective that the Concessionaire has obtained these rights on behalf of the Owner, as the Owner's agent, and not as the true owner itself of the asset.

14. Revisions to Financial Models – Are there “Mulligans” for pro formas, and when are they allowed?

A Concession Agreement is predicated on a financial model that reflects the terms and assumptions each party agrees are reasonable and likely to produce desired objectives. Delivery and acceptance of this model is a condition precedent to formation of the ultimate Agreement. What happens when forecasts in the financial model are not matching current reality? The sample language below describes how the parties navigate unanticipated changes and when the Concessionaire’s risk may shift.

“Whenever a Relevant Event occurs, the financial consequence shall (save where otherwise provided in this Agreement or where the Parties mutually agree otherwise) be determined in accordance with this Article. Where the Financial Model is to be adjusted by reference to a Relevant Event, this shall be carried out by Concessionaire, in consultation with the Owner, to reflect the impact of the Relevant Event with respect to which such adjustment is being undertaken. In calculating the Change in Costs and/or Revenue Impact and in assessing other adjustments to be made to the Financial Model arising from the Relevant Event, Concessionaire shall be entitled to take into account, inter alia, any Change in Costs and Revenue Impact; provided that the Owner shall not be required (and Concessionaire shall not be entitled) to take into account the financial impact up to or after the date of the Relevant Event of those risks that Concessionaire expressly bears under the terms of this Agreement, including (to the extent so expressly borne by Concessionaire under this Agreement) changes in taxation rates, inflation and the impact of any deductions made by the Owner pursuant to Concessionaire’s failure to meet Performance Standards.

Where either Party is entitled to payment of any sum the assessment of which requires reference to the Financial Model, the adjustment or credits to the payments between the Parties hereunder shall be that required to ensure that Concessionaire and Borrower, taken as a whole, are left in a no better and no worse position than under the version of the Financial Model applicable immediately prior to the relevant adjustment, and shall be ascertained by determining the adjustment or credits to the payments between the Parties hereunder required to maintain Concessionaire and Borrower, taken as a whole, in the financial position they would have been in under the version of the Financial Model applicable immediately prior to the relevant adjustment. Any reference in this Agreement to “no better and no worse” or to leaving Concessionaire in a “no better and no worse position” shall be construed by reference to Concessionaire’s (and, solely with respect to the Financing Documents to which it is a party, Borrower’s): (i) rights, duties and liabilities under or arising pursuant to performance of this Agreement, the Financing Documents and the Key Contracts; and (ii) ability to perform its obligations and exercise its rights under this Agreement, the Financing Documents and the Key Contracts, so as to ensure that Concessionaire and Borrower, taken as a whole, are left in a position which is no better and no worse in relation to the Key Ratios and the Equity IRR by reference to the version of the Financial Model applicable immediately prior to the Relevant Event than had the Relevant Event not occurred; and the ability of Concessionaire to comply with this Agreement is not adversely affected or improved as a consequence of the Relevant Event.”

As noted earlier, the financial model represents in numbers what the Concession Agreement conveys in words – it is at the heart of the transaction. As such, the financial model must be completely transparent to both parties, so the Owner can audit the Concessionaire’s performance against an established benchmark to justify its decision to turn over to a private sector entity the day-to-day control

of, and rights to, an asset typically owned by the government. The Owner must be able to see proof that the Concessionaire is being rewarded as anticipated, and not over, or under, compensated (the former reduces value for the Owner, while the latter could create an incentive for the Concessionaire to provide less than expected to maximize its profit margin). Because of the financial model's significance, the parties must carefully define when changes to the model are permissible. As highlighted in the example above, changes to the model – and thus to the bargain originally struck by the parties – can occur only upon certain defined events, otherwise the Concessionaire retains the risk for project performance. A strength in the example language is that any changes to the financial model must leave the benefit of the bargain unaltered – the Concessionaire is not allowed to benefit from unforeseen windfalls, nor can it be penalized for catastrophes. Within this context, the definition of qualifying events warranting a change to the model are heavily negotiated.

15. Environmental Conditions – What is the condition of the site, is it a greenfield or brownfield, and who bears the risk?

Environmental issues are complicated, but when the Concessionaire takes the risk for delivering a project by a date certain, the Concession Agreement needs to be exceedingly clear who takes responsibility for environmental issues when a site is not in pristine condition. See below for sample language regarding how these risks are allocated.

“The Concessionaire is responsible for any delay to the Original Schedule or Revised Schedule (as applicable), including any impact on the achievement of any Service Commencement Date and/or Final Completion Date, caused by the removal, remediation or clean-up of all Environmental Conditions, except with respect to (i) Unidentified Environmental Conditions and (ii) any Environmental Conditions with respect to which the Environmental Clean-up Work to be performed is Owner Retained Environmental Work. The Concessionaire may claim for a Relief Event where permitted under (i) Section X.X if the Concessionaire encounters any Unidentified Environmental Condition at a Site that delays, or increases the cost of, completion of the Work or causes the Concessionaire to undertake additional Work and (ii) Section X.Y if Owner carries out, or engages third party contractors to carry out, Owner Retained Environmental Work and (i) fails to complete any such Owner Retained Environmental Work by the completion date for such work set forth in the relevant Environmental Condition Clean-up Report delivered by the Concessionaire to Owner or (ii) materially interrupts or interferes with the Concessionaire's performance of its obligations under this Agreement.”

Here, responsibility is placed on the Concessionaire for delivering an on-time project, environmental clean-up notwithstanding. This gives the Concessionaire every incentive to conduct a thorough environmental analyses that it can realistically challenge costs and use to create a schedule for conducting the necessary clean-up work. Nonetheless, because environmental challenges can occur despite comprehensive preparation, a Concessionaire must bargain for appropriate relief provisions. The Concessionaire should have the ability to address impact to schedule, cost or both when intervening events impede its performance. An Owner, however, should thoroughly evaluate the risks associated with conducting any clean-up itself or managing third-party clean-ups, simply because the risks of failure and of hindering the Concessionaire may be too great. The key is to understand who bears the risk associated with environmental issues. Delay associated with environmental issues can be significant, even crippling, because it ultimately impacts opening day and revenue flows.

16. Appropriations Risk – What are the Owner’s obligations and what happens if there is a shortfall?

The Concessionaire brings the project financing to the table, but to the extent either the Concessionaire’s payments or some project funding derive from appropriations, the Concession Agreement should contain measures to ensure the Owner follows through on obtaining the necessary appropriations if possible. Given the uncertainties related to legislative budget processes, however, who bears the risk and what happens in the event of an appropriations shortfall? The sample language below maps out how this scenario could be addressed.

“Owner agrees that the Owner Appropriation Obligations which require funding and are payable or expected to be payable during the following Fiscal Year shall be included in Owner’s annual budget for consideration by the Board for appropriation. Owner agrees that any and all such Owner Appropriation Obligations shall be given priority (to the extent permitted by Law and subject to Owner’s other contractual obligations) within Owner’s annual budget for consideration by the Board for appropriation, and Owner shall use best efforts to ensure the availability of funds to meet such Owner Appropriation Obligations. No provision of this Agreement shall be construed or interpreted as: (i) creating a general obligation, multiple Fiscal Year direct or indirect financial obligation, or other indebtedness of Owner within the meaning of any constitutional or statutory debt limitation; (ii) pledging, or creating a lien on, any class or source of Owner monies or assets; or (iii) restricting or limiting any future issuance of Owner bonds or obligations payable from any class or source of Owner moneys. Owner agrees to use best efforts to allocate funds available to it and to raise debt or other financing in accordance with Law to fund any Owner Appropriation Obligations, including the expenditure of customary financing fees and costs as well as related transaction costs related to such financing, to the extent Owner is permitted to do so pursuant to the Law.

If Owner reasonably anticipates that the Board will not include any Owner Appropriation Obligations that are payable or expected to be payable during the following Fiscal Year in Owner’s annual budget for such Fiscal Year, Owner shall notify the Concessionaire no later than 45 days prior to the start of such Fiscal Year of the amount of such shortfall. As soon as is reasonably practicable under the circumstances, and until the Concessionaire is notified by Owner that such shortfall of Owner Appropriation Obligations has been included in Owner’s annual budget for such Fiscal Year, the Concessionaire (i) shall suspend the Work or, in the case of a partial shortfall of Owner Appropriation Obligations, may suspend the Work and/or (ii) shall suspend or partially suspend operation of the Concessionaire-operated Assets from the date of such notice to the extent and in the manner directed by Owner, and in either case (i) or (ii) such suspension shall be treated as an Owner Proposed Change. Any suspension or partial suspension shall terminate, and the Concessionaire shall resume its obligation to perform the Work and to operate the Concessionaire-operated Assets under this Agreement upon appropriation by the Board of adequate funds to meet such Owner Appropriation Obligations, taking into account any additional Owner Appropriation Obligations for the relevant Fiscal Year that have accrued or arisen since the Board’s original failure to include Owner Appropriation Obligations in its annual budget, including as a consequence of any Owner Proposed Change resulting from such failure, in an amended annual budget, with such resumption to be completed (i) in accordance with the terms of the Owner Proposed Change or (ii) to the extent not established by the Owner Proposed Change, as soon as reasonably practicable under the circumstances and in any event no later than six months after the

date of the Board's appropriation of adequate funds to meet such Owner Appropriation Obligations.”

Critical for the Concessionaire in this language is the ability to stop work and to treat any shortfalls as Owner change orders, which typically compel additional compensation to the Concessionaire. Note also that should the Owner lose its ability to facilitate payments required under the Agreement, left uncured, an Owner default could be triggered. In addition to providing a relief mechanism for the Concessionaire, a provision requiring Owner efforts to appropriate necessary funds may be essential for obtaining financing, allowing lenders to get comfortable that the Owner's feet are held to the funding fire and that payments to the Concessionaire will flow as expected.

17. Change in Concessionaire Control/Ownership and Key Personnel – Who is your partner, who is on your team, and when can they change?

A Concession Agreement documents the long-term commitment of the Owner and Concessionaire, spelling out how these partners will work together and who the key project personnel will be. But the Agreement must also describe the circumstances when the Concessionaire can substitute its project personnel or when, if ever, ownership of the Concessionaire itself is allowed to change. See below for sample language establishing terms for allowing such changes in personnel or Concessionaire ownership.

Change in Ownership:

“A “Restricted Change in Ownership” shall arise if: prior to the second anniversary of the Design and Build Work Completion Date, without the prior written consent of the Owner, any Qualified Investor ceases to own (directly or indirectly) the same percentage of the issued share capital or membership interests in Concessionaire or Borrower that it owned (directly or indirectly) at the date of this Agreement, other than as a result of an Additional Equity Investment; any Change in Ownership occurs that involves the transfer of any shares or membership interests to a Prohibited Person; or any Change in Ownership occurs that would be reasonably likely to have a material adverse effect on Concessionaire's ability to perform its obligations under the Project Documents with respect to the Maintenance Work, taking into account the financial strength and integrity of the transferee, compared to that of the transferor. Any Restricted Change in Ownership will constitute a Concessionaire Default for the purposes of Section X.”

Here, the Owner is focused on stability during the project's initial build-out. Appropriately, the Owner seeks to ensure the partner it has selected stays wedded to the investment through the critical start-up phase. Transfer provisions are eased once the project hits its stride during operations, provided there is no detriment to operational capabilities. A stronger transfer provision would establish objective standards for financial strength or organizational capacity and capabilities for a transferor, to eliminate the possibility of disputes based on subjective judgments of these points.

Key Personnel:

“Concessionaire shall retain, employ and utilize the individuals specifically listed as Key Personnel in Appendix 1 or in the Project Management Plan to fill the corresponding positions until such time as all relevant activities have been completed. Concessionaire shall not, prior to Substantial Completion or Demolition Completion, change or substitute any such individuals, except due to retirement, death, disability, incapacity, or voluntary or involuntary termination of employment or with the prior consent of the Owner (such consent not to be unreasonably withheld, delayed or conditioned if the proposed substitute individual possesses equal or greater experience, skill, knowledge and

professional expertise in the relevant fields than the individual being replaced). Concessionaire shall notify the Owner in writing of any proposed replacement for any Key Personnel position. The Owner shall have the right to review the qualifications and character of each individual to be appointed to a Key Personnel position (including personnel employed by Contractors to fill any such position) as set forth in Section X of the Requirements and Provisions for Work and to approve or disapprove (acting reasonably) use of such individual in such position prior to the commencement of any Works by such individual. Concessionaire shall cause each individual filling a Key Personnel position to dedicate the full amount of time necessary for the proper prosecution and performance of the Works.”

Again, this provision constrains personnel changes most rigidly during the riskier start-up phase of the project, giving the Owner a right of reasonable consent over any changes. Criteria for personnel positions and standards for evaluating proposed personnel are established, providing a better footing for Concessionaires and Owners alike to navigate personnel changes. Any such standards incorporated in a Concession Agreement should strike a balance between providing sufficient guidance and objective benchmarks while not extinguishing the Concessionaire’s ability to flexibly staff as needs demand and change over time.

18. Damage to Assets – Who restores the asset after significant destruction?

If a significant portion of the asset is destroyed, whatever the cause, the Concession Agreement should anticipate how the Owner and Concessionaire will evaluate the feasibility of repairs, how they will cooperate to bring the project back online, what standards will apply to any repairs, and who bears the cost. The language below provides a framework for how an Owner and Concessionaire can deal with, and recover from, unexpected damage to the asset.

“If any part of the Concessionaire-operated Assets shall be damaged or partially destroyed (a *Relevant Incident*, and such part of the Concessionaire-operated Components, the *Affected Portion*), the provisions of this Section shall apply, irrespective of whether such *Relevant Incident* results from a *Relief Event*, a *Concessionaire Termination Event* or a *Force Majeure Event*. Unless Owner agrees otherwise, upon the occurrence of a *Relevant Incident* where the cost of repairing the *Affected Portion* is in excess of either: (i) 5,000,000; or (ii) the likely amount of the *Relevant Proceeds*, the Concessionaire shall prepare and deliver to Owner as soon as practicable a plan (the *Restoration Plan*) prepared by the Concessionaire with the information as set forth in Exhibit X for carrying out the work necessary to repair, reinstate or replace the parts of the *Affected Portion* that have been damaged or destroyed (the *Restoration Work*) for the *Affected Portion* to be restored to a condition to satisfy the applicable Design and Construction Requirements and/or the applicable O&M Standards. (B) Upon the occurrence of a *Relevant Incident* to which the provisions above do not apply, the Concessionaire shall proceed to restore or replace the *Affected Portion* promptly. The Concessionaire shall be entitled to use the *Relevant Proceeds* to fund such restoration or replacement.

Upon receipt of the *Restoration Plan*, Owner shall consider the feasibility of carrying out the *Restoration Work*, taking into consideration the factors as set forth in Exhibit Y. If, acting reasonably, Owner determines that the *Restoration Plan* is not feasible and the *Relevant Incident* constitutes or results from: (i) a *Force Majeure Event*, either Party may at its discretion terminate this Agreement in its entirety by written notice to the other Party pursuant to Section X (provided the other requirements of Section X are satisfied);

or (ii) a Concessionaire Termination Event, Owner may terminate this Agreement pursuant to Section Y; provided that Owner shall not be required to serve notice of default on the Concessionaire requiring the Concessionaire to remedy the breach or to propose a reasonable plan for the remedying of the breach.

If Owner determines that the Restoration Plan is feasible: (i) the Parties agree and undertake that, subject to compliance by the other Party with its obligations under this Section, neither Party shall exercise any right which it might otherwise have to terminate this Agreement by virtue of the Relevant Incident; (ii) the Restoration Plan will be adopted; provided that if Owner disagrees with any part of the Restoration Plan, either Party may refer the matters in dispute for resolution in accordance with the Dispute Resolution Procedure; (iii) the Concessionaire shall enter into contractual arrangements to effect the Restoration Work on the basis specified in the Restoration Plan and approved by Owner or as determined in accordance with the Dispute Resolution Procedure; (iv) the Concessionaire shall provide to Owner a bond, letter of credit or other surety in a form substantially similar to the form of the Construction Security; (v) the cost of performing the Restoration Plan shall be funded by: (A) to the extent Relevant Proceeds are available, the Relevant Proceeds; and (B) to the extent Relevant Proceeds are not available or are insufficient to fund the total costs of performing the Restoration Plan, Owner.”

As seen in the provision above, the highest priority is getting the asset operational. Whatever the cause of the damage, both parties recognize that neither benefits from prolonged finger-pointing in lieu of prompt repairs. For this reason, a provision empowering the Concessionaire to make necessary repairs up to a given threshold without the Owner’s prior blessing could be critical to a project’s ability to recover from a disaster. A provision allowing the Owner to terminate the Concessionaire for a Concession-caused damage event without having to comply with typical notice and cure provisions can speed the Owner’s ability to implement a solution, whether in the form of taking over the project itself or bringing in a new Concessionaire. Note that any repair provision should allocate risk for covering shortfalls in insurance proceeds; here, the Owner retains the risk for repairs if “Relevant Proceeds” are insufficient to cover the expenses.

19. Exclusivity – Who can compete against the Concessionaire?

A P3, depending upon its size and type, is a commitment that could be impacted by competing projects. But the Owner may exert control over the market (i.e. regional transportation development). In these situations, the Concessionaire may consider requesting protection in the form of exclusivity provisions: In short, the Owner will avoid creating alternative projects or sell rights to an asset that would directly compete with the project in question, drawing anticipated users or revenues away from the Concessionaire-operated project. Not all Owner-driven projects are likely to create problems of unfair competition, however Owner-developed toll lanes adjacent to an existing Concessionaire-operated toll road or new free road built adjacent to a Concessionaire-operated toll road may cause different levels of concern.

Concession Agreements may set out broad parameters for exclusive uses enjoyed by the Concessionaire, although specific prohibitions against other Owner projects may be viewed as either contrary to the public interest or too politically charged. More likely, the Concession Agreement will make clear the hazards of enticing potential users away from the project in the form of how relief events are defined and how the Concessionaire is compensated when they arise.

III. Conclusion

Concession agreements are complex documents containing pitfalls that may not be realized until long after the project is in place. Properly crafted Concession Agreements, however, can be documents that act as a constitution for a long-term productive relationship. The following resources provide useful information for those interested in reading additional project documents where a Concession Agreement would come into play:

Federal Highway Administration:

<http://www.fhwa.dot.gov/ipd/p3/agreements>

California – Presidio Parkway:

http://www.dot.ca.gov/hq/esc/oe/project_ads_addenda/04/04-1637U4/P3Agt_Executed/P3_Agt_Executed_010311.pdf

Colorado – U.S. 36 Managed Lane/ Bus Rapid Transit Project Phase 2:

<http://www.coloradodot.info/programs/high-performance-transportation-enterprise-hpte/projects/us-36/us-36-phase-ii/p-3/us-36-public-private-partnership-executed-concession-agreement/amended-and-restated-concession-agreement.pdf>

Colorado - Eagle P3 Project:

http://rtd-fastracks.com/ep3_18

Colorado – Northwest Parkway:

<http://www.northwestparkway.org/PDF/FinalCLA.pdf>

Florida – 595 Express Operations:

<http://595express.info/documents.shtm>

Illinois – Chicago Skyway:

http://www.cityofchicago.org/content/dam/city/depts/fin/supp_info/AssetLeaseAgreements/Skyway/Skyway_Ordinance.pdf

Indiana – Toll Road:

<http://www.in.gov/ifa/2328.htm>

Texas – North Tarrant Express:

<http://www.txdot.gov/government/partnerships/current-cda/north-tarrant-express/nte-cda.html#concession>

Texas – State Highway 130:

<http://www.txdot.gov/government/partnerships/current-cda/sh-130.html>

