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Gruppo Wolters Kluwer

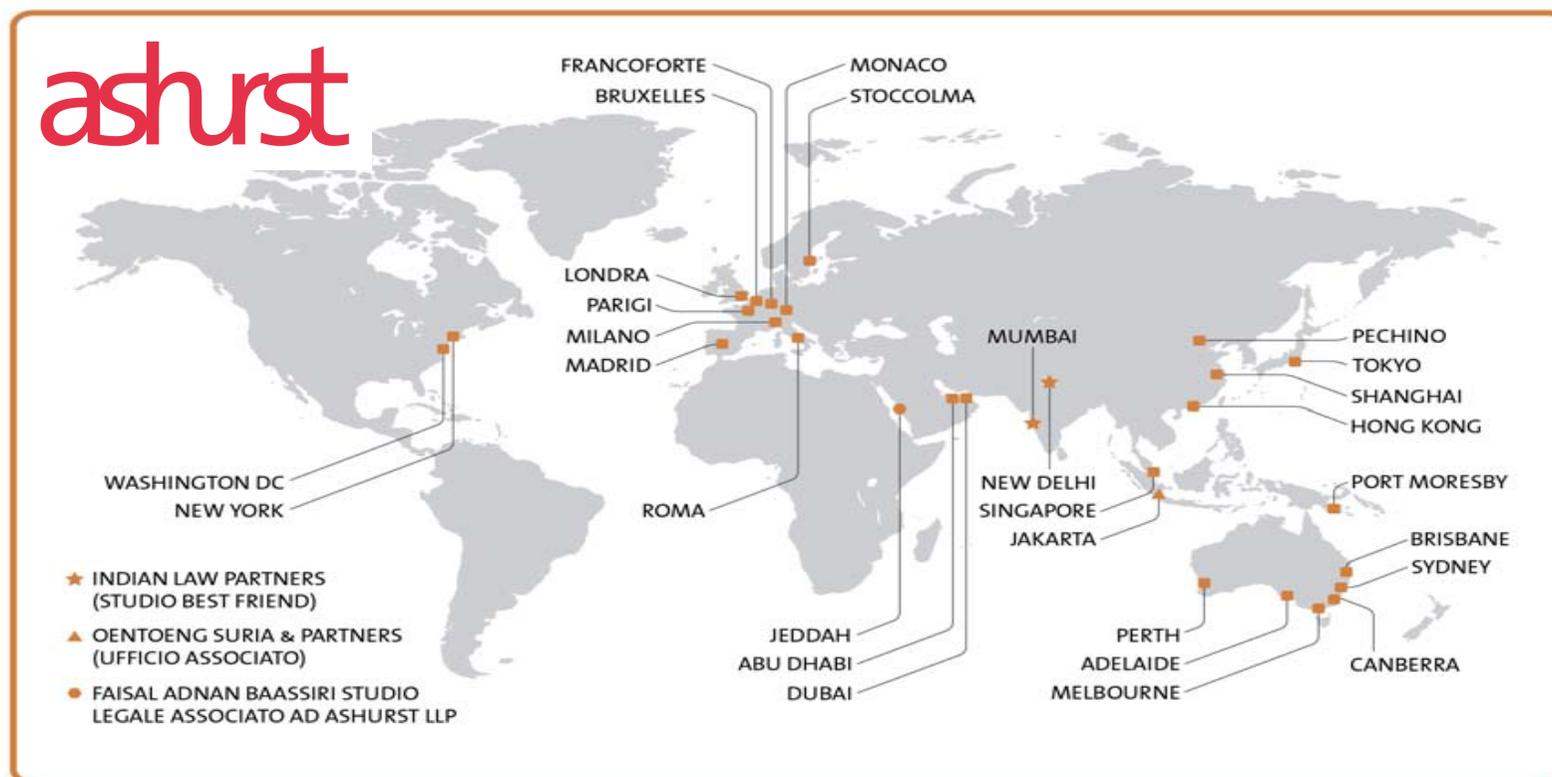
# **IPSOA XV UNITÀ FORMATIVA**

## **TYPICAL PROVISIONS IN INFRASTRUCTURE AND ENERGY CONCESSION AGREEMENTS**

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## Studio Legale Associato ad Ashurst LLP



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## List of contents (1)

- General Introduction to Concession Agreements
- The typical framework of a concession agreement – Financing
- The typical framework of a concession agreement: Contractual Structure
- The typical framework of a concession agreement: Key Players
- The typical framework of a concession agreement: Risk Analysis
- EBRD Requirements

## List of contents (2)

- Concession Agreement: Sample of Contents
- Concession Agreement – in depth analysis of some typical provisions:
  - Parties
  - Price Mechanisms
  - Benchmarking and market testing
  - Force majeure
  - Liquidated damages, penalties and other remedies
  - Exit strategies and termination rights
  - Financial consequences of termination
  - Step-in rights
- **Equator Principals**  
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- Key Italian law provisions

# GENERAL INTRODUCTION TO CONCESSION AGREEMENTS (1)

- BOT (Build-Operate-and-Transfer)
- DBOT (Design- Build-Operate-and-Transfer)
- PFI (Private Finance Initiative)
- Other PPP schemes (BOOT, Public-Private JV, etc. )

## GENERAL INTRODUCTION TO CONCESSION AGREEMENTS (2)

- Concession agreement = Project
- Two stages
  - Construction - cash out
  - Operation - cash in



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# GENERAL INTRODUCTION TO CONCESSION AGREEMENTS (3)

- Green fields v. Brown fields
- The Italian way
- Infrastructure v. Energy

# GENERAL INTRODUCTION TO CONCESSION AGREEMENTS (4)

- Infrastructure
  - Toll roads
  - Railways & subways
  - Undergrounds
  - Ports & Airports
  - Hospitals
  - Schools
  - Prisons
  - Defence
  - etc.
- Energy
  - Waste to Energy
  - Other? e.g.:
  - Oil and Gas?
  - LNG?
  - Gas storage?
  - Renewables?
  - Conventional Power plants?

# THE TYPICAL FRAMEWORK OF A CONCESSION AGREEMENT – FINANCING (1)

- Concession = Project = Project Financing
- Project financing is a financing technique whereby:
  - The debt service is in whole or in an essential part based on the expected cash flow of the project
  - The financing is mainly secured by the project assets

## THE TYPICAL FRAMEWORK OF A CONCESSION AGREEMENT: FINANCING (2)

### Project compared to business

- Business
  - Diverse products and markets
  - High degree of flexibility
- Project
  - Usually one product and one market
  - Limited flexibility
  - No secondary source of repayment

# THE TYPICAL FRAMEWORK OF A CONCESSION AGREEMENT: CONTRACTUAL STRUCTURE

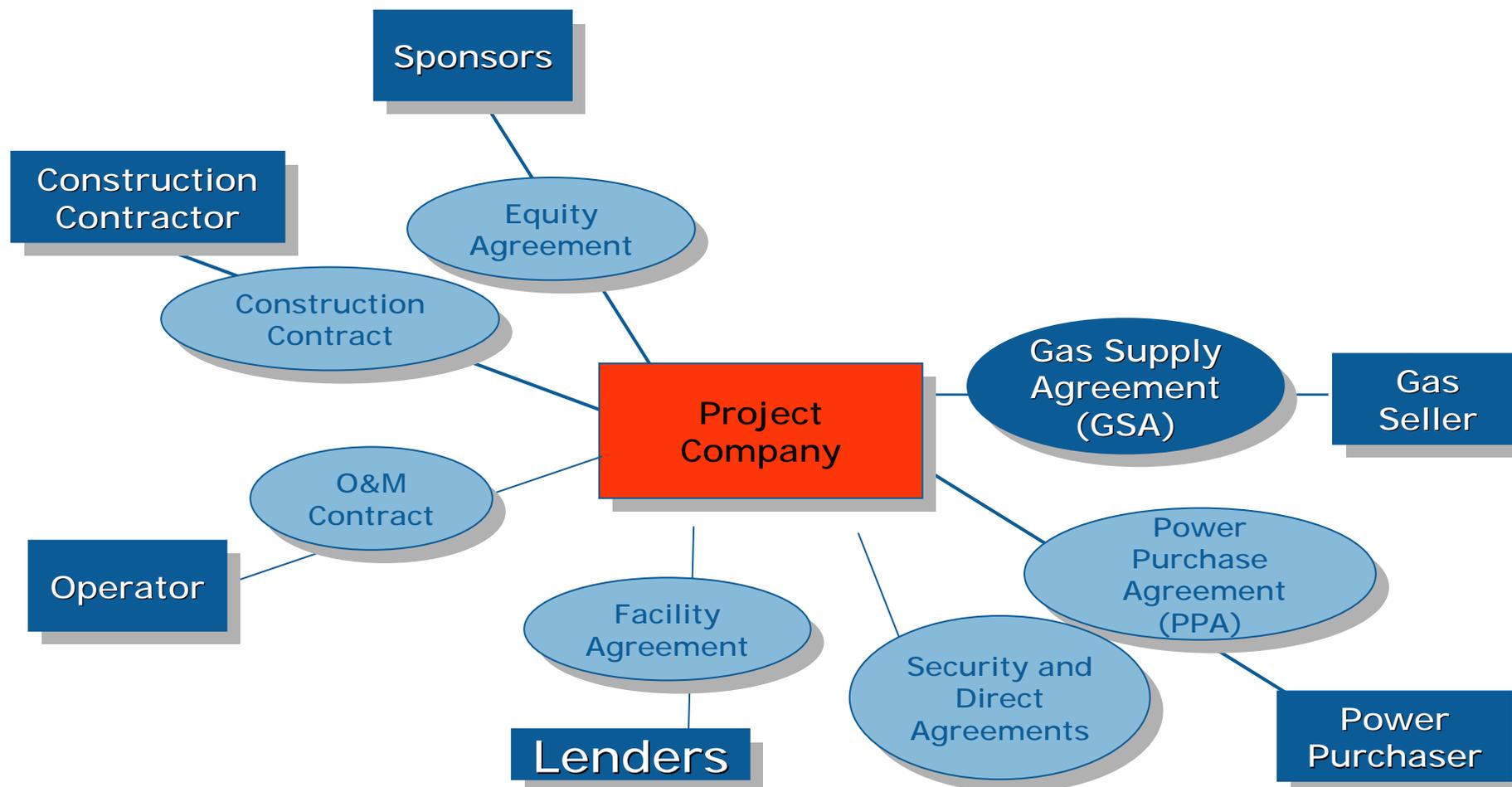
- Infrastructure - PFI
- Energy

## Typical PFI Structure



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# Typical Power Project Structure



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# THE TYPICAL FRAMEWORK OF A CONCESSION AGREEMENT: KEY PLAYERS

- Grantor
- Project Company
- Sponsors
- Lenders
- Contractors / Suppliers / Offtakers

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## Parties – 1: Grantor

- Concession grantor
  - Economic development
  - Deliver project of public interest
  - Cost saving
  - Optimisation of funds
  - Minimise impact on public debt
  - Ensure quality of the facilities and services
  - Address political agenda

## Parties – 2: Project Company

- Lenders lend to special purpose company owned by the Sponsors
- Comprehensive security over company's present and future assets
- Sponsors provide share of finance by subscribing for shares or subordinated loans
- Project Company does nothing else

## Parties – 3: Sponsors

- Profit extraction:
  - Distributions
  - Construction/operating fees
- Risk sharing (anyone but them)
- Retention of control

## Parties – 4: Lenders

- Want to get paid back – compare their risk profile to Sponsors'
- Preserve the project asset – tight control over borrower and its assets
- ECAs – support for own nation companies
- MLAs – development agenda

# THE TYPICAL FRAMEWORK OF A CONCESSION AGREEMENT: RISK ANALYSIS

- The credit risk is based on the project's risk
- Loan drawn pending construction
- Long-term financing
- Identification of risks in the various stages of the project
- Ring-fencing
- Risk coverage and reasonable expectation of outcome

## Risks (1)

- Country risk
- Expropriation risk
- Creditworthiness of the grantor / oftaker
- Change in law
- Force majeure
- Licences, permits and authorisations
- Market - price and demand
- Foreign exchange risk
- Inflation forecast
- Interest rate forecast

## Risks (2)

- Delay in completion
- Defaulting operation
- Liquidated damages and penalties
- Adequate IRR
- Cost overrun
- Debt/equity
- Availability and cost of supplies and materials
- Availability and cost of utilities
- Transportation/transmission/delivery of product/service

## Need for certainty

- Contracts: contract is “king”
- Timetable
- Concession and permits
- Tariff
- Legal framework
- Remedies
- Quick settlement of litigation

## Risk allocation (1)

- Grantor:
  - Change in the project requirements during its term
  - Change in law
  - Force majeure
  - long-term authority affordability of the project;
  - long-term need for the service

but it varies depending on jurisdictions

## Risk allocation (2)

- Concessionaire:
  - design risk;
  - construction risk and completion risks relating to quality, time and cost;
  - operation risks and performance risks;
  - maintenance, latent defect, life cycle risks;
  - depending on the project, demand risk; and
  - financing risk.

## Risk Mitigation (1)

- Feasibility study and Due diligence
- Contract terms
  - Fixed prices, cap to liabilities
  - Pass-through/back-to-back
- Insurance
- Indexation
- Contingencies within the financial model and contingency funding

## Risk Mitigation (2)

- Sponsor support
  - Equity or quasi-equity
  - Credibility-transfer restrictions
- Indexation
- Ring-fencing the project risk by use of a SPV
- Security

## EBRD REQUIREMENTS (1)

- Core principles based on key internationally accepted standards and best practices:
  - Clear policy for private sector participation
  - Sound legislative foundation for concession
  - Clarity of rules
  - Stable and predictable concession legal framework
  - Fairness, transparency and accessibility of concession rules and procedures

## EBRD REQUIREMENTS (2)

- Concession laws consistent with the country's legal system and particular laws
  - Negotiability of concession agreements
  - Enforceable court or arbitral determination;
  - State undertakings and guarantees; and
  - Accommodate security interests.
- 
- Core principles must be complied with to access EBRD funding

## CONCESSION AGREEMENT: sample of contents (1)

- Parties
- Scope
- SPV and transfer of shares
- Covenants of Concessionaire / Requirements
  - Design and Construction
  - operation
- Covenants of Grantor ?
  - Design and Construction
  - Operation

## CONCESSION AGREEMENT: sample of contents (2)

- Time schedule
- Expropriation
- Force Majeure
- Archaeological findings
- Testing and Commissioning
- Variations
- Requirements
  - Design and Construction
  - Operation

## CONCESSION AGREEMENT: sample of contents (3)

- Permits / authorisations
- Payments, Tariff/ Services Remuneration
- Benchmarking and Market Testing
- Public Grant
- Base Case and Adjustments
- Monitoring and Inspections
- Liquidated Damages and Penalties
- Insurance

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## CONCESSION AGREEMENT: sample of contents (4)

- Withdrawal / Termination
- Lenders' Step-in
- Pro-lenders Security
- Performance Bonds
- Term
- Handback/Transfer procedure
- Disputes resolution
- Governing law

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# CONCESSION AGREEMENT – IN DEPTH ANALYSIS OF SOME TYPICAL PROVISIONS:

- Parties
- Price Mechanisms
- Benchmarking and market testing
- Force majeure
- Liquidated damages, penalties and other remedies
- Exit strategies and termination rights
- Financial consequences of termination
- Step-in rights

## PARTIES: Grantor

- Types of Grantors:
  - Governmental Entity
  - Local Entity
  - Company owned by Public Authority
- Creditworthiness
- State Guarantee
- Is it capable of undertaking obligations?
- Immunity?
- Decision making process

## PARTIES: Concessionaire

- Types of Concessionaires:
  - Consortium
  - SPV
- Consortium
  - EPC Contractor
  - O&M Contractors
  - Financial investors
- SPV – set up by the consortium
  - Public Authorities may be shareholders
  - Restrictions to the transfer of shares

## PRICE MECHANISMS (1)

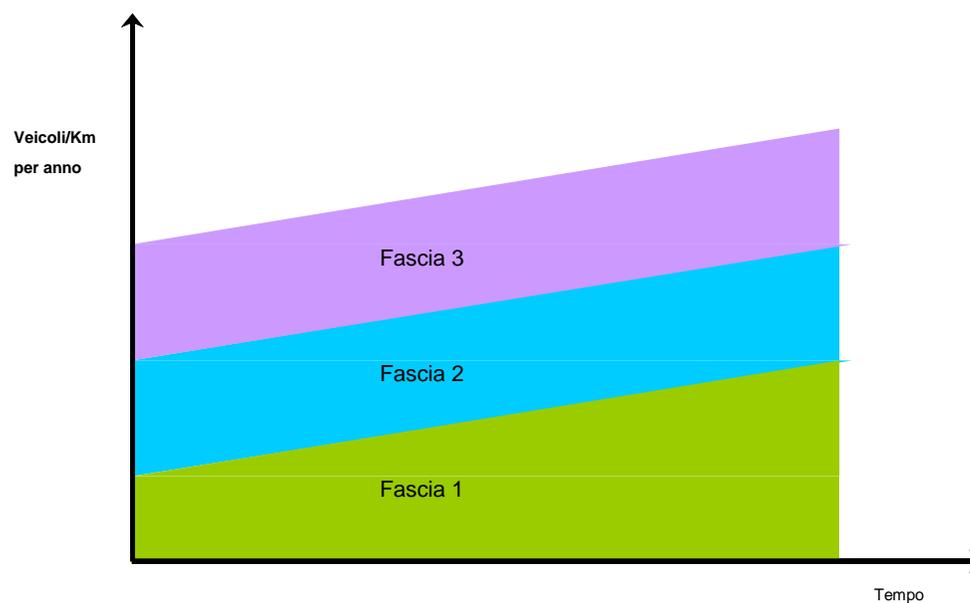
- Construction fully repaid by the Operation
  - Tolls
  - Tariffs
  - Offtake
  - Services fees
- Public grant during construction
  - Advance payment v. Payment upon completion
  - “SAL” Payment on the basis of the works progress
  - Milestone payment

## PRICE MECHANISMS (2)

- Public contribution during operation
  - Price supplement
  - Shadow toll
  - Traffic guarantee / minimum users guarantee
  - Availability fee
  - Lease fee
  - Service fee

## PRICE MECHANISMS (3)

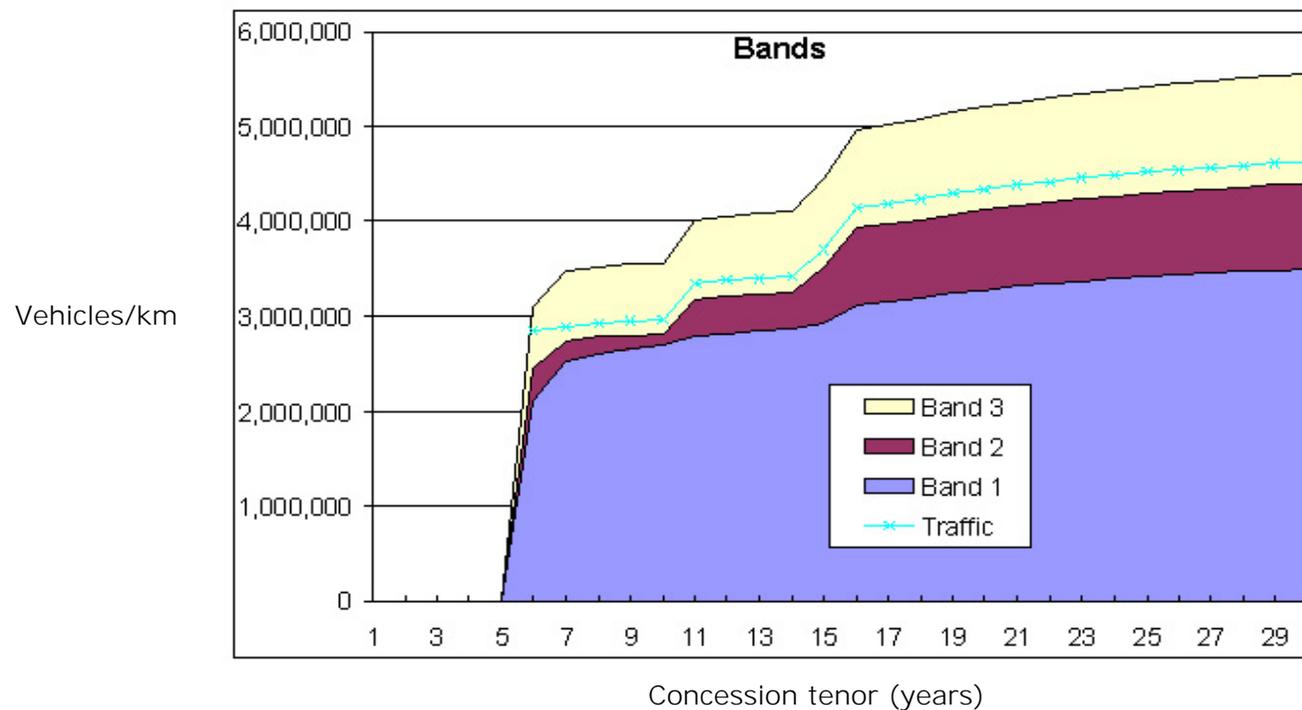
### Shadow toll – Traffic Bands



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## PRICE MECHANISMS (4)

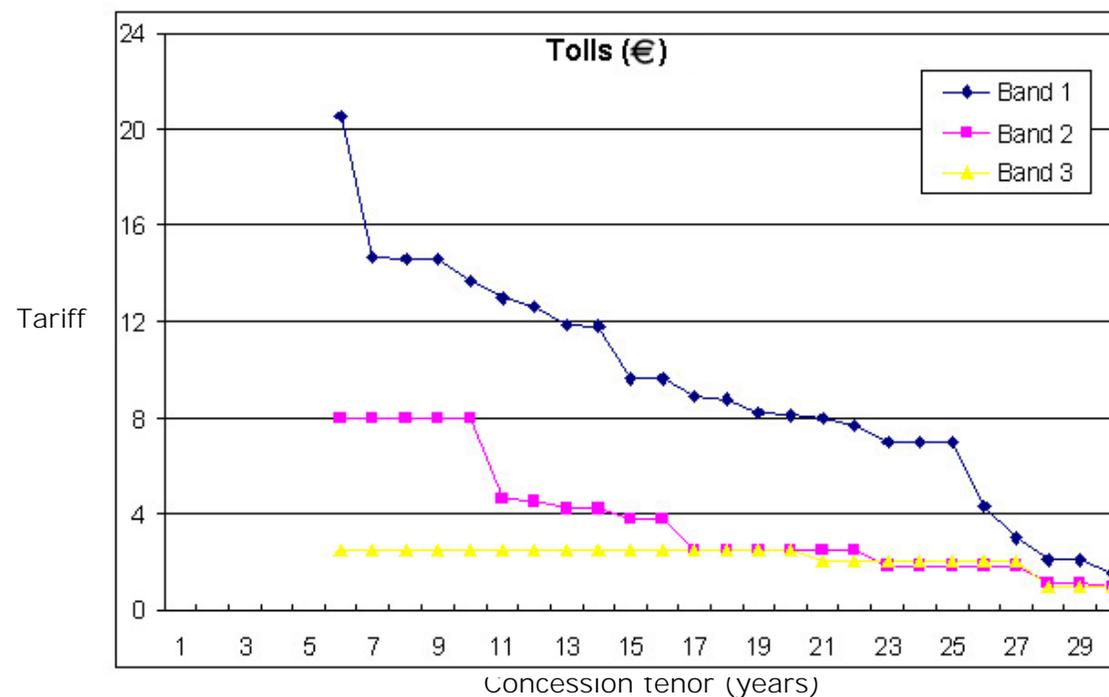
### Shadow toll – Traffic Bands



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## PRICE MECHANISMS (5)

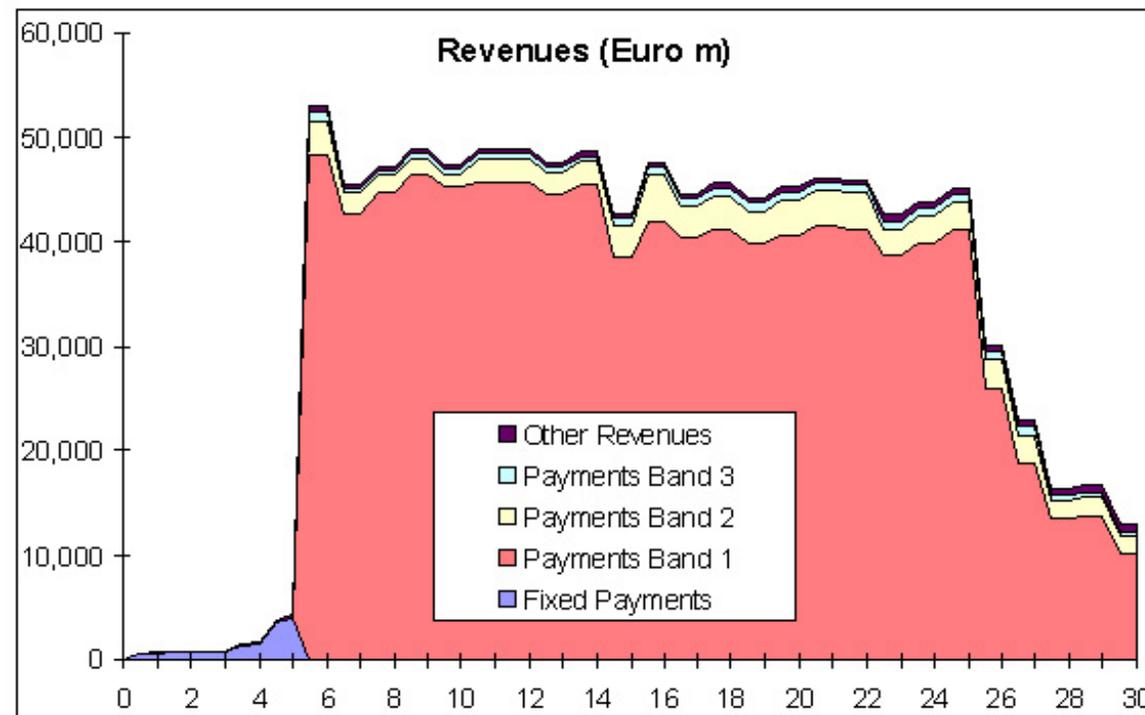
### Shadow toll – Traffic Bands



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## PRICE MECHANISMS (6)

### Shadow toll – Traffic Bands



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## PRICE MECHANISMS (7)

### Availability fees

- CASE STUDY:
  - Construction of civil works, supply of technology and performance of ancillary services
  - “Cold” Project: insufficient revenues from users
- Fees from grantor for ancillary services
- Revenues from commercial activities
- Floor to service fees/ fees paid by users
- Fees based on availability of the facilities/ equipment
- Grant

## PRICE MECHANISMS (8)

### Lease fee

- CASE STUDY:
  - Project involving high technology
  - Construction of civil works, supply of technology and operation
- Lease of Civil Works
- Lease of Technological Equipment
- Global service fees
- Fees based on availability of the facilities/ equipment
- Financing costs accounted in calculation of fees

# BENCHMARKING

- Aims periodical adjustment of prices
- The service is periodically compared with:
  - Similar services
  - Similar facilities
  - Same scope and risk profile
- Identify benchmark price
- Price adjustment if benchmark is outside buffer
- Detailed procedure
- Cooperation and agreement
- Disagreement -> Market Testing

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# MARKET TESTING

- Services are tendered to the market
- Selection of tenderers
- Bidding process
- Award and replacement of subcontractor
- Detailed procedure
- Supervision by Grantor and Lenders

# LIQUIDATED DAMAGES, PENALTIES AND OTHER REMEDIES (1)

## CONSTRUCTION

- Delays
  - Delay damages
  - Price retention
- Defects
  - Duty to remedy /Cure period
  - Warranty period
  - Performance bond
- Loss of the grant – In Italy Sponsors are jointly liable
- Specific Penalties?
- Termination

# LIQUIDATED DAMAGES, PENALTIES AND OTHER REMEDIES (2)

## Operation

- Unavailability
  - Reduction of fees or other payments by the Grantor
  - Penalties
- Poor quality
  - Reduction of fees
  - Penalties
- Enforcement of Performance Bond
- Termination

# FORCE MAJEURE

- List of events: Common Law v. Civil Law approach
- Default of affected party is excused
- Duty to notify, mitigate and restore
- Suspension
- Compensation?
  - Construction
  - Operation
- Risk allocation
- Variation of the Economical and Financial Conditions
- Termination (see below)

# EXIT STRATEGIES AND TERMINATION RIGHTS

- Expiry
  - Full Amortisation of Construction Costs?
  - New concessionaire repays the unamortised costs
- Revocation
  - Exclusive right of the Grantor
- Withdrawal
  - Concessionaire right in case PEF is not updated
- Replacement of the Concessionaire
  - Lenders right in case of default of the Concessionaire
- Termination

## TERMINATION - Grantor Default (1)

- Failure to pay/ Grant at risk
- Material breach of other obligations
- Adverse Law / Bill, Adverse Orders
- Extensive suspension of construction/ operation due to the grantor

## TERMINATION - Grantor Default (2)

- Payment on termination (ITA):
  - after commissioning, value of the works and ancillary costs, not yet amortised, or
  - before commissioning, value of the works actually incurred by the concessionairein each case net of the grant received
  - plus
  - penalties and costs incurred or to be incurred
  - plus
  - 10% of the value of the works to be yet constructed or
  - 10% of the value of the services
- Same rules apply to revocation

## TERMINATION - Concessionaire Default (1)

- Exceeded cap to liability for delay LDs
- Failure to meet LSD
- Ceasing to provide a substantial part of the Services
- Abandonment / Extensive Suspension
- Material breach of other obligations
  - Change of control
  - Corruption
  - Failure to remedy
- Failure points
- Insolvency

## TERMINATION - Concessionaire Default (2)

- Payment on termination (ITA):
- Not expressly regulated but, by analogy
  - after commissioning, value of the works and ancillary costs, not yet amortised, or
  - before commissioning, value of the works actually incurred by the concessionairein each case net of the grant received  
less
  - accrued penalties and costs incurred or to be incurred by the Grantor (e.g. re-tendering)

## TERMINATION – Non-default

- Force Majeure
  - Payment on termination (ITA):
    - after commissioning, value of the works and ancillary costs, not yet amortised, or
    - before commissioning, value of the works actually incurred by the concessionairein each case net of the grant received
- plus
- penalties and costs incurred or to be incurred

# FINANCIAL CONSEQUENCES OF TERMINATION

- Lenders preferred right over the termination payment
- Termination cannot occur before termination payment
- Still, worst case scenario to be prevented / avoided:
  - Default under Loan Agreement
  - Termination payment not enough to repay the debt
  - Security insufficient to repay the debt
  - No recourse on Sponsors
- Lenders control on termination
- Right to remedy
- Step-in right

## STEP-IN RIGHTS

- Lenders may avoid termination by replacing the defaulting concessionaire if:
  - perspective new concessionaire holds substantially equivalent financial and technical qualifications
  - the breach causing the termination ceases within a specified term
- Step-in term
- Step-in procedure procedure
- Direct agreement between Grantor and Lenders

# EQUATOR PRINCIPLES

- Financial industry benchmark for determining, assessing and managing social and environmental risk in project financing
- ESIA
- ESMS
- ESAP
- ESMP
- Other environmental and social requirements

# KEY ITALIAN LAW PROVISIONS

- General Regulation
  - D.Lgs. 163/06 (art.142 e ss) Codice dei Contratti Pubblici
  - DPR 207/2010 e smi Regolamento di attuazione
  - Circolare 27/3/2009 PCM /Decisione Eurostat 11/2/2004
- Specific Regulation
  - Motorways:
    - Legge 24 Novembre 2006, n. 286 e s.m.i. recante approvazione per legge del testo della Convenzione Unica per le autostrade
  - Oil and Gas:
    - D.lgs. 22/2010
    - DM 4/3/2011: Disciplinare tipo per i permessi di prospezione e di ricerca e per le concessioni di coltivazione di idrocarburi liquidi e gassosi in terraferma, nel mare e nella piattaforma continentale
    - Decreto Direttoriale del 22 marzo 2011: Procedure operative per l'affidamento delle concessioni di ricerca e coltivazione
    - Dlgs. 164/2000, artt. 11 - 14 e Decreto Ministero dello sviluppo economico del 21/01/2011: Modalità di conferimento della concessione di stoccaggio di gas naturale in sottterraneo e relativo disciplinare tipo
  - Marine project
    - Codice della Navigazione, artt. 36 e ss.

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