

Chapter 5: Negotiating the Contract

The purpose of this chapter is to outline the steps the municipality should take in approaching the negotiation process and drafting a contract with the selected preferred partner.

They include:

- ❁ Getting Started
- ❁ Establishing the Framework
- ❁ Negotiating the Deal
- ❁ Drafting the Contract and the Transfer Agreement

The Collins English Dictionary defines a contract as “a formal document recording an agreement; an agreement enforceable by law”.

Throughout the whole process of deciding whether to enter into a PPP and the procurement process, getting to the stage where negotiations can begin and a final contract is in sight is one of the significant milestones.

Stages of The Partnership Building Process

**1. Establish the
Internal
Framework**

**2. The Decision to
Partner**

**3. Develop the
Implementation
Plan**

**4. Selecting a
Preferred Partner**

**5.
Negotiating
the
Contract**

**6. Working With
the Partner**

5.1 Getting started

Within the final agreement there may be several different contracts, depending on the complexity of the project. The key to negotiating a successful PPP contract is to keep the municipality's main goals in the forefront, while at the same time maintaining a great deal of flexibility in order to write a final contract that benefits both the municipality and its new partner.

Before the partners sit down to begin the negotiations, they should each attempt to convey their understanding of the nature and extent of the PPP they will be negotiating. They should also outline their expectations for the project, in order to clarify any differences between the public sector approach and the private sector approach right from the beginning.

A. Goals for negotiating a contract

Goals for a successfully negotiated contract include:

- ❁ Making sure that the preferred partner has a clear understanding of the concept of public-private partnering and the type of agreements involved in the final contract, the allocation and assumption of risks, and the scope of work required to complete the contract;
- ❁ Determining that the preferred partner will make the necessary personnel and facilities available to perform the services within the required time, and
- ❁ Agreeing on compensation which is fair and reasonable and takes into account the estimated value, scope, complexity, and nature of the required services.

B. Types of contracts involved in a PPP

The types of contracts involved in a PPP typically include:

- **Privatization/Build-Own-Operate:** Ownership and responsibility for a particular asset or service is transferred from the municipality to the private partner or is built by the private partner in cooperation with the municipality.
- **Build-Own-Operate-Transfer:** The private partner designs and builds a required public service facility and operates it for the municipality for a specified period after which ownership reverts to the municipality
- **Build-Transfer-Operate:** Same as above except ownership of the facility reverts to the municipality prior to the commencement of operations.
- **Lease/Purchase:** The private partner designs and builds

a facility to meet public needs and leases it to the government for a specified period after which ownership vests in the government.

- **Turnkey:** The municipality provides the financing for the project, but engages the private partner to design, construct, and operate it for a specified period of time.
- **Developer Financing:** The private partner assists in financing a project in return for development concessions.
- **Operations and Maintenance:** The municipality engages the private partner to operate and maintain a particular facility or service.

5.2 Types of agreements

Each PPP will require a number of legal agreements, depending on the nature of the partnership.

Types of agreements that can be involved in a PPP include:

- development
- purchase/sale agreement
- operation and maintenance agreement
- corporate or personnel services
- transfer
- lease

Negotiating a contract for a PPP can be complex. However, every contract negotiated will exhibit characteristics of one or more of these contracting options:

A. Fixed price contract

This type of contract is used when managing and operating the facility and/or service is relatively straightforward and changes are unlikely. Every aspect of the work is laid out in drawings or specifications, so the private partner's performance can be measured relatively easily. The benefit of this type of contract is that the municipality is able to benefit from the private partner's unique expertise at a competitive price.

If this type of contract is employed, it is important to monitor the private partner's progress throughout the life of the contract to ensure that any alterations, adaptations, or changes can be made quickly to ensure the on-time delivery of the final product.

- B. Unit price Contract** This type of contract ties compensation to measurable units of service, where a minimum level of service has been determined. These are typically used for service and/or operation types of agreements.
- C. Cost plus fee contract** These contracts are used when the scope of work is not well defined. They can also be used if new or unproven technology will be installed or when the full quantity of the work is unknown at the time the RFP is issued. The private partner presents a fee or profit margin, while the municipality handles all other costs directly or as pass-throughs.
- D. Phased contract** This type of contract can be used as an alternative to a Cost Plus Fee contract in the case of a complex project or one that has not been well defined. The private partner provides the municipality with a fixed price or unit price, combined with details of the work to be performed for each phase of the project.
- If the information provided by the private partner is not acceptable, then the municipality can renegotiate the price, the description of work or both, either with the private partner or with another firm.
- E. Transfer Agreement** A contract must be developed outlining the steps involved in transferring the service or infrastructure from the public sector to the private sector at the beginning of the PPP and back again at the conclusion of the contract. This includes:
- Timing of the transfer;
 - Appointing a contract administrator and allocating the resources required to effect the transfer;
- E.(i) Human Resources Issues**
- Arranging for the relocation of staff to the private partner or to other departments in the municipality (for the transfer from the municipality to the PPP);
 - Ensuring that succession rights for union contracts are properly addressed and that employees transferring to the private partner have wage and benefit guarantees in place;
 - Determining who will bear the cost of staff reductions, and
 - Determining the treatment of employees when the contract is terminated.

Figure 5:1 Type of Contracts Involved in a PPP

	Development	Purchase	Operations & Maintenance	Transfer	Lease
Privatization /B-O-O	X			X	
B-O-O-T	X		X	X	
Lease/ Purchase	X	X		X	X
Turnkey	X		X		
Developer Financing	X				
Operations & Maintenance			X		

No matter what type of agreement is being negotiated, the negotiation process should be a team effort between the municipality and the private partner.

5.3 Establish the framework

The purpose of the negotiation process is to arrive at a reasonable price and agreement on the other terms and conditions of the contract. A reasonable price is defined as the best estimate of the actual allowable costs incurred during the life of the contract, plus a reasonable profit.

It is always wise to maintain the option of negotiating with the private partner who came second in the RFP round. This can be a worthwhile exercise if the original private partner has to withdraw, for some reason, from the negotiation process.

A. Who is negotiating?

Who has control of the contract? Is it the municipality or will the private partner provide a draft contract? (If the private partner provides a draft, it must be given to the municipality's legal advisor for comment.)

If the private partner has been involved in PPPs previously, the municipality should take advantage of that prior

experience by allowing them to submit first drafts of the contract. This provides a jumping-off place for a thorough negotiation process and allows both parties to benefit from the experience the private partner has gained.

Usually the one who has control of the contract has the greatest strength.

Establishing the negotiating teams:

- ❁ On behalf of the municipality (is it a single municipality or is it a number of municipalities working together).
- ❁ On behalf of the private partner (is it a single firm or a consortium).
- ❁ Financial institutions may wish to be involved if the project is privately financed.

Ideally, the chief negotiators for both parties should have the sole authority to bind each party. That way negotiations can proceed smoothly without the negotiator having to leave the room to obtain permission from others in the municipality or in the private partnership in order to proceed to the next step.

It would also be prudent to ensure that there is a second person involved in the negotiation process - someone who, while not directly involved in the day-to-day process, knows exactly what is going on and is able to step in immediately if the senior negotiator is unable to perform their duties.

Identify any external evaluators that may have to be called in during the negotiating process. Depending on the nature of the contract, these advisors may be from the following fields:

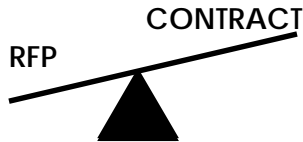
- ◆ Legal, financial, value engineering, insurance, or risk management. (**N.B.** If at all possible, it is advisable to do the majority of the negotiating without having legal advisors present. They can be used as external advisors, but to keep the costs of the negotiating process down, use them only when absolutely necessary.)

When the negotiations have been completed and the contract is ready to be written, then legal counsel should be called in.

B. What are they negotiating?

Determine the non-negotiable and negotiable thresholds in both the general and project specific contract provisions by:

- Identifying similarities between the RFP and the successful proposal;
- Identifying and understanding the differences between the RFP and the proposal. It would be beneficial to clearly summarize these differences and circulate them to all parties prior to sitting down at the negotiating table, especially if the differences related to project structure and risk allocation.



The goal is not to rigidly insist that the proposal be changed to mirror the RFP. Instead, both parties should think of coming together and negotiating a compromise solution that reflects the flexibility and creativity the PPP process is designed to encourage;

- ◆ Identifying obstacles which either party feels might impede the project;
- ◆ Identifying factors which have changed since the RFP was issued and the preferred partner was selected, and
- ◆ Developing a risk management strategy - identify, quantify, and prioritize the issues of variance between the RFP and the proposal under the issues of general contract provisions and project specific contract provisions.

C. Risk management

A risk management strategy is essential so that the chief negotiator for the municipality knows what is negotiable, what is non-negotiable, and the reasonable amount of risk the municipality is willing to take.

The strategy contains three parts. First the municipality identifies what can possibly go wrong - the causes and the results. Then it needs to test potential combinations of loss exposures and determine the impact of these events on design, the construction process, service delivery, partners, and financing.

Secondly, it should evaluate the risks - to determine the cost of the losses. By developing a list of best to worst case scenarios, the municipality can determine the probability of when and the type of losses which might occur. If any of those incidents does occur, then it can forecast the impact on the financial status of the project, on the private partners or on their financial backers.

The final part of the risk management strategy is to plan to negotiate the contract so that risks are avoided, the chances of the identified events occurring have been minimised, and

determine if the municipality will retain or bear the risk, or transfer it to another party, either the private partner or a commercial insurer.

Ideally, the municipality and the private partner should exhibit a willingness to be ready to develop and consider innovative solutions to deal with any differences between the RFP and the winning proposal.

There may be an occasion when trade-offs may have to be made on lesser items, in order to reach agreement on a major element in the contract. The municipality should know beforehand what it is and isn't willing to ease back on.

5.4 Negotiating the deal

It is helpful, before beginning the negotiating process to know the type of contract which will emerge at the other end. Depending on the nature of the PPP, the final document could be a straightforward service agreement or it could be a complex document containing any or all combinations of a development agreement, an operation and maintenance agreement, or a transfer agreement.

The objectives to be achieved during the negotiation process should include:

- ❁ A contract that balances risks and benefits (in terms of financial savings, return on investment, increased service) equitably between the municipality and the private partner;
- ❁ A contract that is negotiated with commitments beforehand from both parties that every effort will be made to complete the contract in a timely fashion.
- ❁ A contract that outlines the responsibilities of both the municipality and the private partner;
- ❁ A contract that clearly states the legal liabilities of the municipality and the private partner;
- ❁ A contract that contains clear standards of performance in a description of the work to be performed which address quality of performance; goods to be delivered or services performed, and delivery or performance dates.
- ❁ A contract that may be structured using incentive and penalty provisions to cover such things as on-time performance, quality, safety, cost control, community relations, compliance, operating, and maintenance requirements.

- ❁ A contract that includes guidelines for performance measuring; monitoring, quality of service delivery, and conflict resolution;
- ❁ A contract that provides off-ramps where either partner can divest themselves from the arrangement, including arrangements for the municipality to buy back facilities if the partnership has to be dissolved.

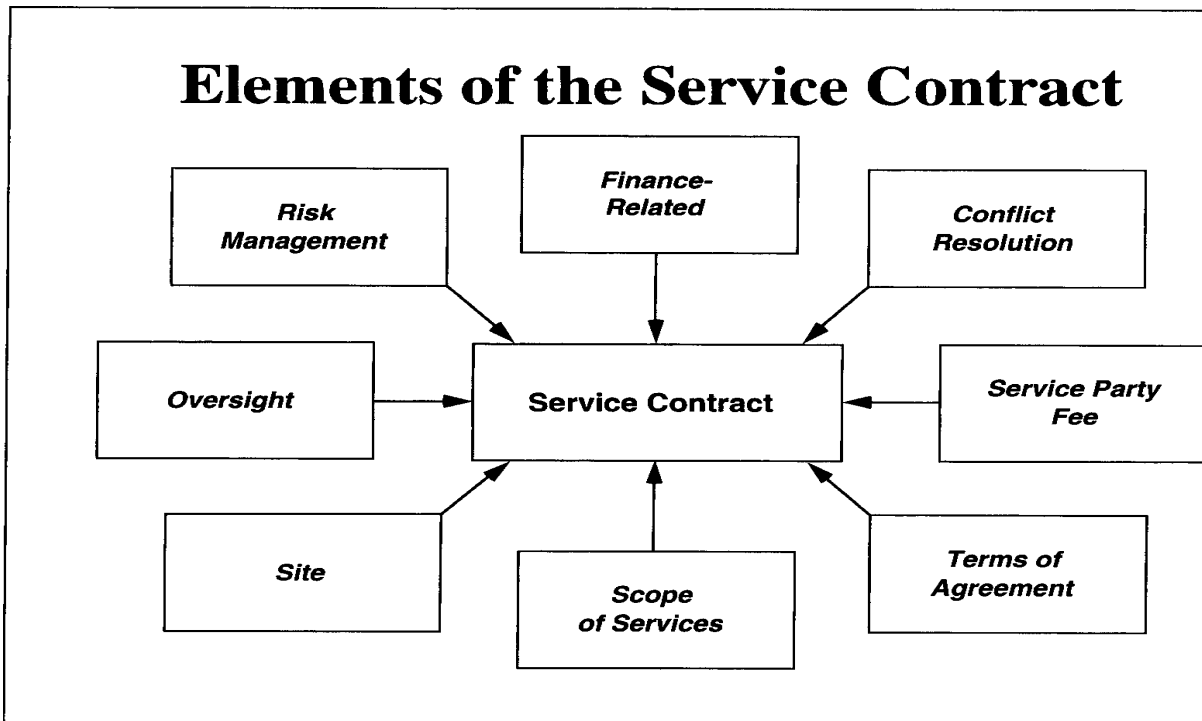
The private partner must agree that a buy-back clause will be included in the contract before negotiations begin.

5.5 Drafting the contract

Once the negotiators have completely formulated the deal, then the next step is to draft the final contract. While each contract negotiated for a PPP is specific to that partnership, there are standard components which make up the contract.

These can be broken down into clauses which are project specific and clauses which are general in nature. (The components of an actual contract can be found in Appendix ?.)

Figure 5.1: Elements of A Service Contract



A. Project specific

- Opening statement: identifying the parties involved in the contract and the objectives of the contract;
- Definitions: defining the terms used in this agreement;
- Description of the project: includes information on the scope of the project; deliverables; the date that the agreement is effective and the term of the contract;
- Ownership of intellectual property, facilities, or new technologies developed during the contract;
- Management structure and administrative details including:
 - roles and responsibilities of the contract managers, both the municipality's and the private partner's;
 - office administration - if a representative of the municipality is required to be on the site, then the responsibilities for such things as office administration and office space, and the party responsible for covering these expenses (generally the private partner) are covered in this clause;
 - replacement of personnel - clauses to ensure that if key personnel on both sides move away from the project, that they will be succeeded by persons having equivalent qualifications, experience, and authority;
 - schedules of meetings, parties who should attend, and provisions for attendance if key team members are unable to attend;
 - naming of the official spokesperson(s) for the project;
 - setting out the requirements for due diligence on behalf of both parties; monitoring requirements, including manuals, a reporting structure for reports to the project manager, senior municipal officials (i.e. town/city/county managers) and to council;
- Use of premises (if a facility is involved) including responsibilities for security, plant and equipment and revenue from programs or events ;
- Variations due to changes in situations, changes in technology, introduction of new/less costly but equivalent in quality materials, health, safety or environmental issues, natural disasters and other unforeseen circumstances;
- Acceptance of deliverables;



- Financing arrangements - invoicing procedures, rates, adjustments and renegotiation;
- Payment;
- Insurance;
- Contract amendments;
- Conditions for termination in case of breach of contract, business failure, termination by the municipality and consequences of termination including provisions for a buy-back (or return of assets) on behalf of the municipality, transfer of the project to another private partner, or for closing it down altogether;
- Method for engaging other private partners;
- Risk management strategy - including identification, risk allocation, insurance, strategies for dealing with force majeure incidents, guarantees and, warranties;
- Off ramps - where either partner can remove themselves from the project;
- Legislative and regulatory requirements;
- Provisions to renegotiate should changes in legislation affect its execution;
- Employment requirements - whether municipal employees will be given first chance at jobs with the private partner, termination of employees (and the payment of severance fees); union and employment equity issues;
- Life of the facility and transfer at the end of the contract - this includes specific criteria for maintenance while the building/road etc. is under the control of the partnership and warranties after it has been transferred back to the municipality;
- User Fees - if they are to be used to generate revenue for the private partner;
- Use of subcontractors;
- Guidelines concerning confidential information, and
- Force majeure - events or circumstances beyond the control of the private partner, including acts of God, war, natural disasters, sabotage, court orders, inability to obtain/curtailment of services and utilities required to construct or oper-

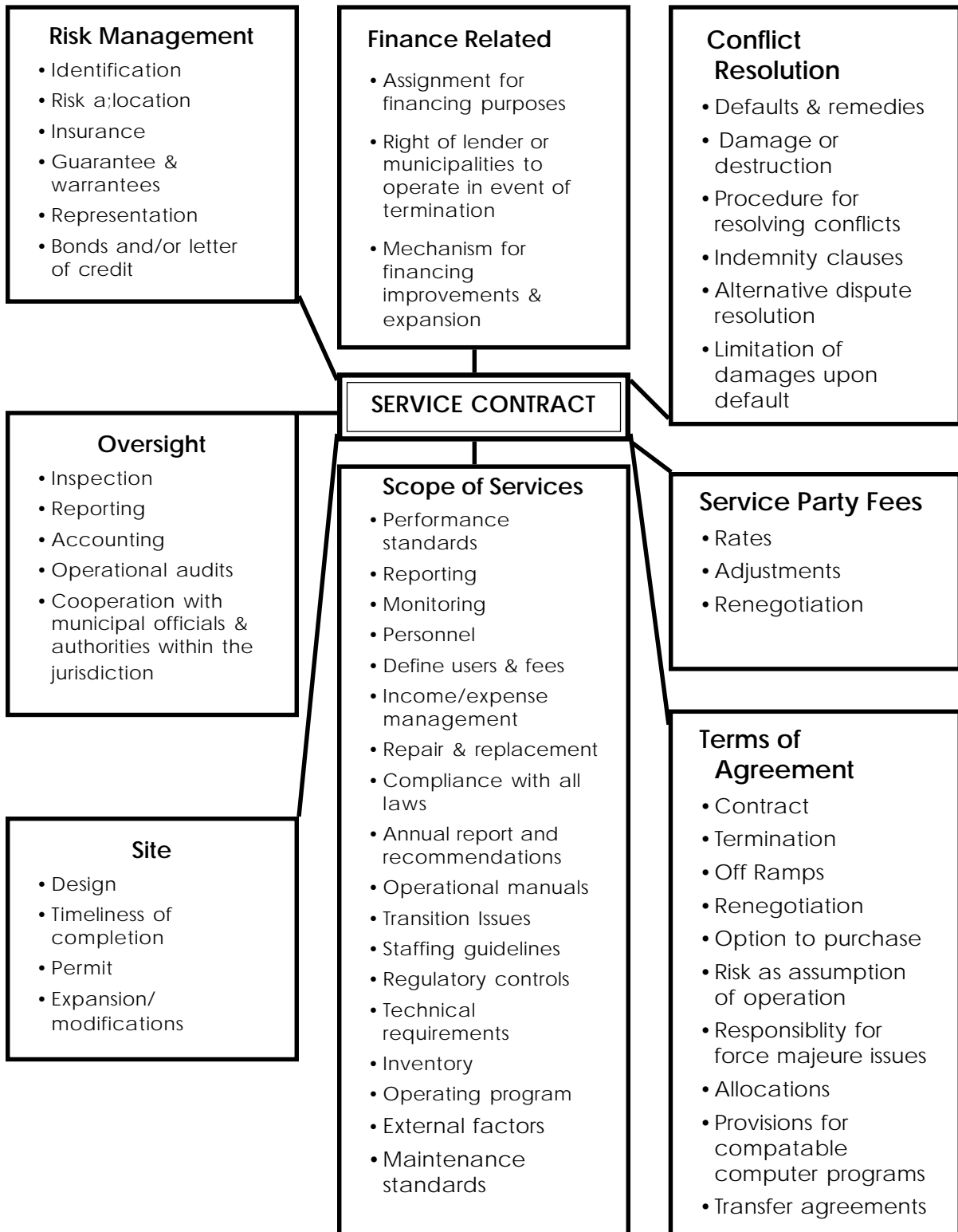
ate the project; or other causes which are beyond the control of the private partner.

- B. General conditions
- Guidelines for conflict resolution which could include defining alternate dispute resolution strategies to be used to resolve conflicts and to lay out a process which must be followed for dispute resolution before either party is allowed to seek recourse through the legal system;
 - Publicity - governs the use of either party's trademarks, logos or other identifying information without prior written consent;
 - Confidentiality - protecting confidential information from third parties and restricting the use of confidential information to the PPP alone;
 - Notices - gives addresses where information is to be sent and conditions setting out when information is deemed to have been received by the other party (via electronic communications, courier or mail delivery);
 - Waivers - defining how rights can or cannot be waived during the length of the agreement;
 - Survival - this clause ensures that any warranties or indemnities in the contract will survive its termination (for any reason);
 - Governing law - states that the contract is governed by the laws of the province and the country;
 - Amending process - states that any amendment of the agreement must be signed by both parties, and
 - Complete agreement between parties - states that the contract is a document that has the complete agreement of both parties.

The final step is to examine the draft of the negotiated contract to ensure that it complies with existing legislation.

5.6 Memorandum of understanding

Once the contract has been fully negotiated, a Memorandum of Understanding can be presented to council. Once that has been given approval in principle by council, the contract can be drafted by the legal advisors for signature by the mayor and chief administrative officer or clerk of the municipality.



BEST PRACTICES

- ◆ The key to negotiating is to achieve the cost/benefits associated with the traditional tender process while preserving the flexibility required to produce the most appropriate mix of facilities and administrative arrangements to solve problems.
- ◆ To avoid contract and payment disputes once service has begun, establish and agree on a comprehensive range of performance measures including reporting requirements and acceptable levels of performance (targets and benefits).
- ◆ Include buy-back options in the contract to permit the municipality to resume operating the facility itself under specified conditions.
- ◆ Incorporate provisions in the contract covering contractor non-performance, dispute resolution mechanisms, and provisions for the smooth hand-over of the activity to another contractor .
- ◆ Give consideration to the applicability of incentive payments in the contract, either by structuring payments in such a way that they are contingent on the achievement of certain levels of service or by offering bonus payments for achievement of service levels above a pre-determined baseline.