



ISSUE 4/NOVEMBER 2020

Projects Global Insight

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5G Contracts: The new Colombian infrastructure programs

Cost plus fee contracts in the era of COVID-19

Brazil's new basic sanitation legal framework

Corporate PPAs in New Zealand

PFI and PPP in the UK – is it time to talk about handback?

Foreword



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In what is undoubtedly one of the most testing periods for, amongst others, the infrastructure and construction industry, key stakeholders continue to focus on delivering resilient, adaptable and fit-for-purpose assets and services in extremely challenging conditions. Our [Coronavirus Resource Center](#) continues to provide advice on force majeure in supply chains, employment matters, and other coronavirus-related issues. For further insight on how infrastructure, transport and construction are adjusting to the changes brought about globally by the COVID-19 pandemic, subscribe to the [DLA Piper Infrastructure Podcast here](#). Additionally, the DLA Piper Project Simulator (DPS) has now gone virtual, enabling participants to replicate real-life circumstances of risk and project distress management – which is highly relevant in the current global climate – in a safe, virtual environment. If you are interested in scheduling a simulation session or would like to find out more please contact dps@dlapiper.com.

In this edition of the PGI we take a look at new global initiatives and opportunities that serve to provide some stability and prospects for growth to the industry as a whole. Our first insight takes us to Colombia. We provide an in-depth analysis of the 5G Colombian concession programme, focussing on key features and challenges. The program has the reactivation of the Colombian economy as a major aim, with a pipeline of approximately 22 projects totalling investments of close to USD17.3 billion.

COVID-19 has also impacted the construction sector, especially the contractual obligations. However, new opportunities arise with the implementation of cost plus fee contracts which provide more flexibility and, unlike with fixed-price contracts, the clients can avoid payment of the contingency risk premiums. With an estimated 10-25% activity decrease in the sector, transparency of cost plus fee arrangements can bring mutual benefits, including timely delivery, target price and reduced construction cost uncertainty.

We then review the new sanitation legal framework in Brazil, considering the pathway for the transformation of the sanitation sector and the role private investors can take. The new sanitation legal framework seeks to universalise sanitation and water supply in Brazil by 2033, by attracting investments of USD128 billion. Part of this initiative includes creating a business environment that promotes competition and provides legal certainty.

We also explore the potential rise of renewable energy power purchase agreements (PPAs) in the New Zealand market. In our article we discuss why PPAs have become so popular around the world and how we see them fitting within the New Zealand market. This includes an analysis of the various sectors that may seek to exploit opportunities available, as well as the advantages they present to users.

We then arrive at our final stop – the UK, where we consider the opportunities and challenges that are likely to be thrown up by handback of assets on expiry of PFI and PPP contracts. The National Audit Office estimates that some 200 UK private finance projects will expire over the next ten years. Our article considers the impact of handback on the market, what lessons have been learned from early transitions of some projects, and a look-forward at the assurance lifecycle.

We welcome your comments on this issue and suggestions for future topics.
Get in touch at fp-enquiry@dlapiper.com.

A glance into the 5G Colombian concession program – features and challenges

In brief...

Historically relied on as an anti-cyclic economic boost, infrastructure development has found a renewed role in reactivating the Colombian economy recently affected by the COVID-19 pandemic. The Colombian government's launch of the 5G concession program sets forth an opportunity to reactivate the Colombian economy. This new program comprises approximately 22 projects, and, according to the National Infrastructure Agency (*Agencia Nacional de Infraestructura* or ANI), the agency in charge of structuring, awarding and supervising national concession projects, the 5G concession program will entail investments close to USD17.3 billion.



ANI published the new 5G program's template for the concession agreement (the 5G Contract), which is intended to be implemented in different kinds of transportation infrastructure projects (toll roads, airports, railways or waterways), and is based on the 4G program toll road concession agreement. However, the new template includes certain new features to take into account, which are intended to address the difficulties encountered under the 4G program.

Below we highlight and briefly analyze the new main features of the 5G Contract, which we breakdown into two main sections, namely: (i) the main features of the 5G Contract; and (ii) the bankability features.

Main features of the 5G Contract

Risk allocation

Risk allocation in the 5G Contract remains essentially similar to the risk allocation provided for under the 4G program. Nevertheless, there are certain new features related to the contractual risk management mechanism under the 5G Contract that we highlight below:

Land acquisition requirements

The 5G Contract provides major changes to address land acquisition requirements; in particular, with respect to the certification of the termination of the functional units¹ of the project, which has been a recurring issue for concessionaires. Under the 4G program, concessionaires are required to certify property titles to 100% of the required land for a functional unit, in order to be able to have ANI certify the completion of such functional unit, while the 5G Contract allows to certify the completion of such functional units without having property titles to 100% of the required land to be acquired to construct the functional unit. In addition to the foregoing, the 5G Contract also allows for any punch list items pending to be completed after 180 days following the completion of the functional units, including land acquisition and environmental pending items.

As such, in the new 5G Contract, once completion of a functional unit is certified, concessionaires will have 180 days to certify the initiation of the acquisition of all required land (via purchase offers, land awards or land assignment proceedings). After the 180-day period, if land has not been entirely acquired, a new deduction

from contract payments will apply for a period of 12 months. If concessionaires do not certify they have initiated all land acquisition proceedings after the first 12-month period, a partial suspension of payments in respect of the functional unit will be applied by ANI.

After the first 12-month period, if the concessionaire has certified the initiation of all land acquisition proceedings, but has not been able to obtain property title to 100% of the land, a percentage of the payments in respect of functional unit will be withheld by ANI in the same proportion as per the land not yet obtained, until the concessionaire certifies property title to 100% of the land. However, if the concessionaire has been unable to obtain property title to 100% of the required land after the 12-month period, the concessionaire will breach this obligation under the concession agreement.

This new feature addresses the complexities of the land acquisition proceedings in Colombia and allows payments allocated to a specific functional unit to be released earlier, as opposed to the 4G program concession agreements. In addition, this feature allows concessionaires to have more flexibility in reaching the project completion date, which became a recurrent problem in financings under the 4G program.

Implementation of new technologies

The concessionaire is required to implement a protocol for electronic toll-road revenue collection. If the concessionaire incurs any cost overruns, ANI will compensate the concessionaire using funds from the Colombian National Contingency Fund (*Fondo Nacional de Contingencias*). Under the 4G program, ANI compensated concessionaires using funds from the surplus account in the concession trust, or from its budget, if funds in such surplus subaccount were insufficient.

Prior consultation

Under the 5G Contract, ANI will carry out all prior consultation proceedings with ethnic communities located in the project's corridor before the procurement process begins, limiting the risk for concessionaires to carry out such processes. Under the 4G program, this risk was exclusively allocated to the concessionaire, which in turn, implied an administrative burden.

¹ Currently, the national concession projects under a PPP regime are subdivided into independent, fully functional infrastructure sub-divisions called functional units which, upon completion, have a participation percentage in the calculation of the concessionaire's revenues.

Nevertheless, the concessionaire is still responsible for overseeing and conducting all prior consultation processes to be carried out once the concession agreement has been awarded. This new approach implies that any new initial consultation required for the project will be overseen by the concessionaire, but with a limited budget to close the concessionaire's liability.

Network relocation and environmental permitting plans

New features to the network relocation and environmental plan were introduced in the 5G Contract. These plans require making a detailed description of applicable arrangements, mechanisms and a timeline of the necessary documentation required for each procedure, looking to provide ANI and the contract auditor with better tools to assess the concessionaire's performance and an efficient planning instrument to the concessionaire.

In terms of cost overruns, the scheme is basically the same as the one provided for under the 4G program. Thus, under the 5G Contract, if the estimated amount for land acquisition and socio-economic compensation, environmental compensation and network relocation costs is exceeded, the concessionaire will bear up to 144% of the cost overruns, and any cost overruns above the 144% will be borne by ANI.

Designs and studies

ANI is in charge of producing all geometric designs and detail studies based on feasibility features available from the procurement process. And the concessionaire is required to carry out the final studies based on ANI's information, which in turn provides the concessionaire a more detailed and complete base of information to produce their final studies.

Payment scheme

The concessionaire's payment is based on infrastructure availability. Toll revenues, ANI contributions and commercial revenues are the main revenue sources for each project; however, such payment is subject to any applicable fines, discounts, and deductions, similar to what was established under the 4G program concession agreements.

Notwithstanding the foregoing, the 5G Contract provides that ANI would be entitled to withhold a portion of the payment for each functional unit until all outstanding items are completed for such functional unit. The concessionaire will be allowed, however, to receive the bulk of the payment once the outstanding items are completed, as opposed to the 4G program, which provided for completion of outstanding items in a 180-day period after delivery of a functional unit, failure of which will result in the concessionaire being eligible to only the portion of the payment that corresponds to the completed items of the functional unit, until all items are completed. This new feature is certainly an aspect for lenders to take into consideration in their respective bankability analysis of the projects.

On the other hand, in terms of commercial revenues, a larger amount of commercial revenues is awarded by ANI (50%) as opposed to the 4G program concession agreements (2.2%), seeking to increase commercial efforts by concessionaires in the projects.

Force majeure

The 5G Contract contains the same force majeure events included under the 4G program concession agreement; however, it provides for certain amendments in the treatment of such force majeure events and the addition of a general force majeure event for any proceeding taking place with governmental authorities.

The general force majeure event includes any event in which more than 150% of the legal term concludes a proceeding against a governmental authority is surpassed. Nevertheless, it is relevant to mention that the limit in time was reduced in some cases (such as environmental matters).

In addition, new circumstances, such as delays in expropriation and public land assignment, have been added as new land acquisition force majeure events.

Sustainability

Many of the new features under the 5G Contract are aimed at developing sustainability and environmental aspects of the project, some of which we briefly analyze below:

- **Greenhouse Gas Mitigation Plan:** If financial close is not reached with a multilateral institution (which requires the concessionaire to have a greenhouse gas mitigation plan), concessionaires must create and apply a plan of their own.
- **Climate Change and Social Works Subaccount:** The concessionaire must create a climate change subaccount in the concession trust in order to receive payments from collaborating entities to finance climate change mitigation programs. Additionally, it must create a social works subaccount which will have a limited amount of funds destined to carry out socially oriented works requested by communities with the project's area of influence.
- **Environmental Permitting Plan:** As mentioned above, the 5G Contract has introduced an environmental permitting plan which has to be handed to ANI and the contract auditor detailing every environmental and social permitting action to be undertaken by the concessionaire, according to the applicable works for milestone. This allows the concessionaire to have a clearer plan to obtain the required permits and facilitates the compliance of construction obligations in a timely manner.

These new features address issues that in prior programs (such as the 4G program) were hard to overcome by concessionaires and unbalanced the risk allocation of the project, making the 5G Contract more interesting for all prospective sponsors.

Liability exemption events

The 4G concession agreement provided for the possibility for either party to terminate the concession early if a liability exemption event (i.e. a utilities relocation, environmental and social or land acquisition force majeure event) occurred and was not overcome in a 90-day period. The 5G Contract provides that the parties have to mutually agree to the early termination of the concession or seek approval from a mechanism similar to the dispute resolution boards (*amigable*

componedor) prior to early termination, limiting the parties' ability to terminate the concession early upon the occurrence of a liability exemption event. Thus, lenders will have to take account of this new early termination event in their respective bankability analysis of each project.

Bankability issues

The new 5G Contract seeks to apply sustainability on four different levels:

- the institutional level, seeking the implementation of government and inter-institutional cooperation standards;
- the environmental level, seeking to migrate to climate change adaptative infrastructure;
- the economic and social level, seeking to promote inclusion, communication, and support from communities within the 5G projects' areas of influence; and
- the financial level, seeking to assure compensation and an efficient risk allocation.

ANI has published the 5G Contract for the toll road concession agreement, which is based on the 4G toll road concession agreement, but includes certain new features to take into account in the bankability analysis of such agreement, some of which we briefly highlight below.

VPIP Termination

The 4G concession agreement provided for a minimum term of 25 years, which could be extended to up to 29 years if the present value of the toll revenue expected to be collected during the term of the concession (VPIP) is not reached during the minimum 25-year term of the concession. However, the concession would not terminate early if the VPIP reached before the end of the 25-year term of the concession. The 5G Contract toll road concession agreement template provides for a concession term of 29 years. Aside from the four-year extension to the initial concession term under the 4G infrastructure program, the 5G Program concession term will not be subject to extensions (even if VPIP has not yet been reached) and if the VPIP is reached before the end of the 29-year concession term, the concession automatically terminates. Ultimately, they exclusively allocate the risk of reaching the VPIP to the concessionaire, which in turn may have a negative impact on project cash flows.

Payment top-ups (*SopORTE de Ingresos*)

The 4G concession agreement provided for a top-up payment mechanism (*diferencia de recaudo*) that allowed concessionaires to receive payments top-up from ANI at certain year-milestones of the O&M stage of the concession, for a limited period of time, to compensate for any difference between the VPIP and the actual toll revenue collected at such year-milestones. The 5G Contract provides a new mechanism in which such difference will be calculated on a yearly basis during the O&M stage of the concession and ANI will make payments top-up (*soportes de ingresos*) for each year in which such difference is positive. This new mechanism will provide annual income support to concessionaires during a certain period of the O&M stage of the concession, which in turn, reduces their need for liquidity instruments to compensate for low toll revenue periods and, consequently, their funding costs.

However, it is important to note that the first project tendered under the 5G program did not include payments top-up, given the road's historic high traffic. Unfortunately, under the current pandemic circumstances and with limited mobility in the country, there is uncertainty as to whether such historic high traffic will be maintained.

Financial close

The 4G infrastructure program provided a specific term for the concessionaire to reach financial close by delivery ANI (i) the executed credit agreement; or (ii) a certification by each lender containing a minimum of terms (such as term, economic conditions, security package and disbursement conditions). The 5G Contract maintains the same terms and conditions to reach financial close under the concession agreement but substitutes the certification for a firm commitment by each lender and states that if financial close is evidenced via a firm commitment, the concessionaire has nine months as of financial close to deliver the executed credit agreement. This new timeframe per achieving financial close will add pressure to closing financings within a specific deadline.

Step-in rights

The 5G Program toll road concession agreement template includes a new event that triggers step-in rights under the concession agreement as a result of the banning by a Colombian competent authority to contract with the Colombian government. This new step-in rights event is the direct result of the constant amendments concessionaires had to negotiate with ANI under the 4G infrastructure program due to the requests from lenders to make the project bankable in this regard.

Termination payment

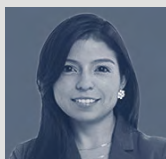
Under the 4G program, the termination payment was calculated as:

- the concessionaire's aggregate investment in the project discounted at a pre-set discount rate; plus
- amounts owed by ANI to the concessionaire at the termination of the concession agreement; minus
- the sum of:
 - payments made to the concessionaire; and
 - any applicable deductions, penalties and fines.

Under the 5G Contract, the concessionaire's discounted investment amount will be replaced by the lower of (i) such investment amount and (ii) the sum of equity contributions made and, during the construction and O&M stages, the principal amount of project debt outstanding on the date of termination. This does not mean, however, that the termination payment will in all cases be at least equal to the outstanding principal amount of project debt.

Conclusion

Given the importance of the reactivation of the economy, in part through infrastructure projects, we recommend that investors look into the issues of the 5G Contract raised in this update. Also, we recommend reviewing, on a case-by-case basis, the new provisions of each concession agreement, taking into account that the clauses may vary depending on the previous studies and the type of project.



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Cost plus fee contracts in the era of COVID-19

In brief...

COVID-19 has changed the certainty of much of the economic spectrum. For construction contracts it has affected its most important variables; cost and time. In this context, cost plus fee contracts can be used as a way to prevent, mitigate and backstop distressed infrastructure projects, since they permit the parties to undertake projects that involve substantial uncertainties.¹

¹ Nash, R. C., Cibinic, J. C., & Cibinic, J. J. (2014). *Cost-Reimbursement Contracting*. Wolters Kluwer.

Cost plus fee (or cost reimbursement contracts) are those in which the client pays the contractor all the costs of construction – which include direct and overhead costs – plus a fixed fee. The contractor is assured of earning a fee and enjoying the income attributes of the fee, while the client is more likely to receive the lowest construction cost. In contrast to fixed-price construction contracts, the client avoids payment of the contingency risk premium but assumes the risk of an increase in construction cost.²

In the current context of increased uncertainty in construction contracts, the performance of the contractor has been and is variable, which leads to an increase in the real cost of the works in the projects under construction. And under the current circumstances, when entering new contracts, the real cost of the works cannot be exactly determined either, as it could increase due to new measures or protocols issued by local governments, resulting in greater financial pressure on the contractor in fixed-price contracts. In this scenario, a cost plus fee contract will allow a well-balanced allocation of risk.

COVID-19 has significantly affected the projects under construction with delays and disruptions in their schedules due to issues such as the decrease and loss of labor, equipment and material available to execute the works as planned. It is estimated that over the coming years construction activity will decrease by 10-25% in 2020 compared to 2019. This decrease will be generally due to:

- project delays due to national lockdowns or construction slowdowns that are generating a 20-60% activity loss;

- productivity losses of approximately 25-40% and cost increases of EUR300-350 per worker and per month from the implementation of new health and safety protocols; and
- supply chain disruptions as a consequence of border shutdowns and SMEs' weak financial health.³

As mentioned above, the main difference of the cost plus fee contract pricing method is that the client will bear the risk of an increase in the cost of construction over those anticipated at the time of the conclusion of the contract. To reduce this risk, the contract should establish a guaranteed maximum price that serves as a limit of the risk of increase in construction costs, so if the cost exceeds it, the contractor will absorb these costs, up to the amount of its construction fee. This modified version is known as cost plus fee contract with target price.

To motivate the contractor to keep costs low in cost plus fee contracts with target price, the parties should agree:

- if the actual costs exceed the target price, the contractor is only to be paid a percentage of that excess;
- to include a provision that establishes that the savings as compared with the target price will be split between the parties; and
- penalties and/or bonuses for budget or schedule performance.

² Hoffman, Scott L., *The Law and Business of International Project Finance* (p. 171). Cambridge University Press. Kindle Edition.

³ <https://web-assets.bcg.com/8c/27/46c1a7604def9e0246de5eefa8a1/bcg-report-return-to-work-in-ec-sector-august3-n.pdf>

Should fixed-price contracts be renegotiated to cost plus fee with target price?

This pricing method suits the current circumstances, and could be modified in private contracts with the agreement of the parties. In public construction contracts, however, this will be a longer and more complicated procedure, as a result of local regulations that apply to these types of contract. In those cases where there is no legislative framework for cost plus fee contracts, then modifying the pricing method will not be possible.

Recently, in Peru there have been renegotiations of the payment method of fixed-price private contracts to a cost plus fee model. This inevitably leads to the amendments of different provisions of the contract such as extensions of time, suspension of the works, variations, additional costs and force majeure. Changes were initiated by the contractors, who sought to perform under this cost plus fee with target price to recover the costs incurred of the contract and decrease their financial risks while allowing the client to have a cap for the cost of the works, and also share the benefits

for savings related to the maximum price, in addition to the schedule incentive fees for the contractor in case of early completion of the works.

A widely used construction agreement of this kind is the NEC suite of contracts, which is based on a collaborative approach to contracting that has proven to deliver benefits for both parties. The Peruvian government recently announced that Lines 3 and 4 of the Subway of Lima and Callao will be contracted under Government-to-Government procurement, which aims to replicate the successful experience of the works for the Pan-American Games in 2019, where NEC models were used.

In the era of COVID-19, where uncertainty increases with each passing day and where in most if not all contracts there is variable performance by the contractors, the parties need a collaborative and non-adversarial model like cost plus fee with a target price. The open book nature of cost plus fee contracts provide transparency in the contract that will create mutual benefits in the contractual relationship while decreasing construction cost uncertainty and delivering infrastructure on time.



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Brazil's new sanitation legal framework

A pathway for the transformation of the sanitation sector in Brazil and for private investors to be part of the change.

In brief...

In July 2020, Brazil's New Sanitation Legal Framework was approved. It aims at the universalization of sanitation and water supply in Brazil by 2033 by attracting investment of USD128 billion. The new regulatory framework is expected to transform the nation's water and sanitation sector, creating a business environment with more competition and legal certainty, and fostering domestic and foreign private investment in the sector.

Introduction

On 15 July 2020, Brazilian President, Jair Bolsonaro, sanctioned Federal Law No. 14.026/2020, also called as Brazil's New Sanitation Legal Framework. This new regulation was being awaited with great anticipation and promises to change the way water and sanitation services are provided in the country by bringing more stability and legal certainty and enabling domestic and foreign private investment in the sector.

Main changes and goals

The New Sanitation Legal Framework aims at a great transformation of the sanitation sector in Brazil.

The main changes brought by the new law are related to the universalization of the services, the creation of bidding and awarding procedures and the standardization of the regulation.

UNIVERSALIZATION.

The main objective of the new regulation is the universalization of sanitation and water supply. The goal is that, by March 2033, 99% of the population is supplied with drinking water, and 90% of the population is supplied with sewage collection and treatment. It is important to highlight that, according to the National Sanitation Information System (SNIS)'s 2018 database, half of the Brazilian population (more than 100 million people) did not have access to the sewage system, while 16% (almost 35 million people) had no access to treated water.

The Brazilian government estimates that to achieve this goal, investments – both public and private – of about USD128 billion will be required in the next ten years.

BIDDING AND AWARDING PROCEDURES

Aiming at attracting private investments to the sector, one of the key points of the new regulatory framework is the reform in the public concession of the sanitation and waters services. Currently, the concession for the supply of such services is carried out through the called program agreements (*contratos de programa*), i.e., contracts entered between the holders of such services (cities and states) and concessionaries (public or semi-public companies), without competition and bidding process. The new legal framework has the goal to modify such dynamic, by prohibiting the provision of sanitation services through program agreements and establishing that the concession of the services must be carried out through public bidding process with participation of public and private companies.

The expectation is that, as a consequence of the institutionalization of the bidding and awarding processes for the concession agreements and the creation of a more transparent competition environment, local and foreign private investors will feel more encouraged to invest in the sector.

STANDARDIZATION OF THE REGULATION

In addition to the reform in the contracting of the water and sanitation services, the New Sanitation Legal Framework has also the intention to establish new guidelines for the federal regulatory institution, the National Waters Agency (ANA). As for the changes brought by the new regulation, ANA shall have the competence to institute reference standards for the regulation of public basic sanitation services by their holders and their regulatory and supervisory entities, such as, for example, regarding standards of quality and efficiency in the provision, maintenance and operation of services, tariff regulation, standardization of contractual instruments and universalization goals.

This is an important change for the sector, since the water and sanitation services were being regulated locally, which led to dispersed and unbalanced rules, creating inefficiencies and regulatory risks. The new sanitation law is expected to change that and create a steadier business environment.

Expectations

The New Sanitation Legal Framework and its goals are crucial from both social and economic standpoints. From the social perspective, there is no doubt that the universalization of the access to sanitation and water services is pressing and that achieving this goal will dramatically change Brazilian public health landscape, finally putting an end to a long lasting problem that affects the populations' quality of life, life expectancy, education and even productivity.

From an economic point of view, the new regulation paves the way for private investments and is being considered key by the Brazilian government to help the country's economic recovery in the post-pandemic. The expectation of the Ministry of Economy is that, in addition to attracting about USD128 billion in investments, the new legal framework will enable the creation of 700 thousand direct and indirect jobs in the next 14 years.

It is also expected that the universalization of water and sewage services will reduce annual health costs by up to USD265 million and save millions of dollars spent for the prevention of diseases caused by the lack of such service.

Some say that this new regulatory framework is expected to trigger a transformation in Brazil's water supply and sanitation sector similar to the one that led to the reorganization of the country's telecom industry in the late 90s through a wave of privatizations.

Some state-owned companies are already structuring their privatizations with the assistance of the National Bank for Economic and Social Development (BNDES),

which is considered the main financing agent for development and infrastructure in Brazil. BNDES sees the water and sanitation sector as a priority on the Bank's agenda for the coming years and has more than USD9 billion reserved for financing of sanitation projects.

The New Sanitation Legal Framework is expected to transform the water and sanitation sector in Brazil and to have a significant impact in the country's economy and its recovery post COVID-19 pandemic. Domestic and foreign investors are sure to benefit from the great opportunities in the years to come.



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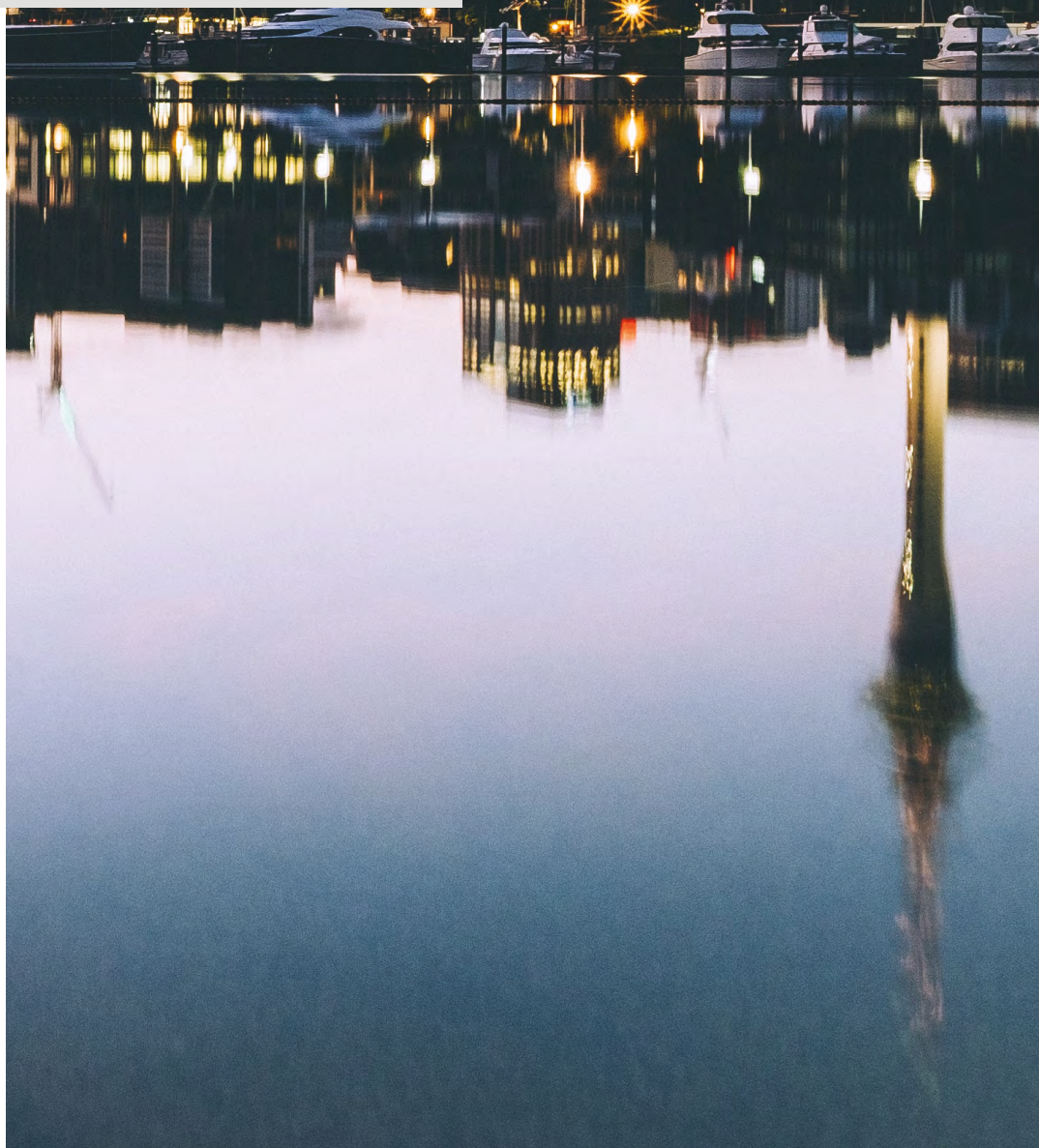
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Corporate PPAs in New Zealand

In brief...

We explore the potential rise of renewable energy power purchase agreements (PPAs) in the New Zealand market. In this article we discuss why PPAs have become so popular around the world and how we see them fitting in within the New Zealand market and also look at the various sectors that we have seen participate in the PPA market to date. So, what are PPAs, what is their relevance in New Zealand and what advantages do they present to electricity users?



Globally, PPAs have become one of the most common ways for renewable energy projects to achieve long-term price security. These structured agreements provide project revenue certainty for investors and developers, removing a significant roadblock to financing and building new renewable energy facilities.

A corporate PPA is a long-term contract under which a business agrees to purchase electricity directly from a generator of renewable energy, usually at a fixed price. This differs from the traditional approach of simply buying electricity from retailers on short or medium terms at fluctuating market prices (often known as a utility PPA). This article does not discuss utility PPAs but instead focuses on the renewable energy corporate PPA.

PPAs are very well established in the US and many European markets. They are not entirely new to New Zealand either and we have seen a recent uptake in attention across the country. For example, last year Tilt Renewables entered into a PPA with utility Genesis Energy for the output of its 130MW Waverley Wind Farm. The Ministry of Business, Innovation and Employment (MBIE) is also currently investigating the incorporation of PPAs into the national energy framework via the establishment of a PPA platform.

In comparison to the US and Europe, the New Zealand PPA market is in a relatively nascent stage. However, it seems only a matter of time before the use of PPAs becomes more common across the country. The increasing frequency with which large, well-known corporates have entered into PPAs and invested in generation assets of their own, stems from both the economic and environmental benefits they provide. This appears to be no exception in New Zealand as many of the major energy developers and consumers are exploring the possibility of incorporating PPAs into their energy strategies.

As global business becomes more environmentally conscious, our clients have become increasingly keen to source their power from green sources. This movement was initially led by the Big Tech companies in the US and Europe, and with the arrival of Microsoft's datacentre in New Zealand it seems likely that a similar trend will take place here. New Zealand's share of renewable electricity is strong – however, only 40% of primary energy supply comes from renewable sources. For many businesses, therefore, taking power from the grid does not satisfy their internal or external sustainability commitments.

Corporate PPA Contracting Structures

There are three typical contract structures for a corporate PPA: Physical PPAs, Synthetic PPAs and Private Wire PPAs.

PHYSICAL PPA

In a physical PPA, the corporate offtaker (being the energy purchaser) will enter into a long-term PPA (commonly with a term in excess of 10 to 15 years) with a renewable energy generator to take some or all of the energy generated by the generator's renewable energy project (or portfolio of projects) with a defined amount of power sold at a fixed price per MWh.

The PPA will contain provisions for the sale and purchase of electricity and the allocation of any applicable renewable energy benefits (such as green certificates), and all of the provisions governing that sale and purchase. The delivery of renewable energy is notional in most cases.

In certain jurisdictions, including New Zealand, these PPAs will also include obligations to provide or procure certain metering and ancillary activities that are undertaken by experienced third parties. As such, if the generator does not have the capacity to fulfil these obligations, the corporate offtaker may need to enter into a back-to-back agreement with a third party under which the third party commits to undertake these relevant obligations.

In parallel with this PPA, in many jurisdictions, the corporate offtaker will have an electricity supply agreement with an electricity retailer under which electricity may be supplied to meet the offtaker's energy demands from time to time. The terms of supply under such agreement will take into account the electricity purchased under the PPA and passed through the grid to the offtaker. This ensures that the corporate has the benefit of the fixed pricing for renewable energy under the PPA but the reliability of a supply agreement with an electricity retailer to meet its day-to-day energy demands.

SYNTHETIC/FINANCIAL PPA

Synthetic PPAs are, at present, the most common form of PPA in New Zealand. In a synthetic PPA structure no power is physically traded. Instead, the agreement functions with a derivative contract structure where the corporate offtaker and renewable energy generator agree a defined strike price for power generated by the

generator’s renewable energy project. The corporate offtaker will enter into a separate agreement with their electricity retailer to acquire electricity at the spot price.

The PPA then works as a financial hedge:

- if the spot price in a settlement period exceeds the PPA defined strike price, the generator pays the excess amount to the offtaker for power generated in that period; and
- if the spot price is less than the strike price in a settlement period, the offtaker pays the shortfall amount to the generator for power generated in that period.

PRIVATE WIRE PPA

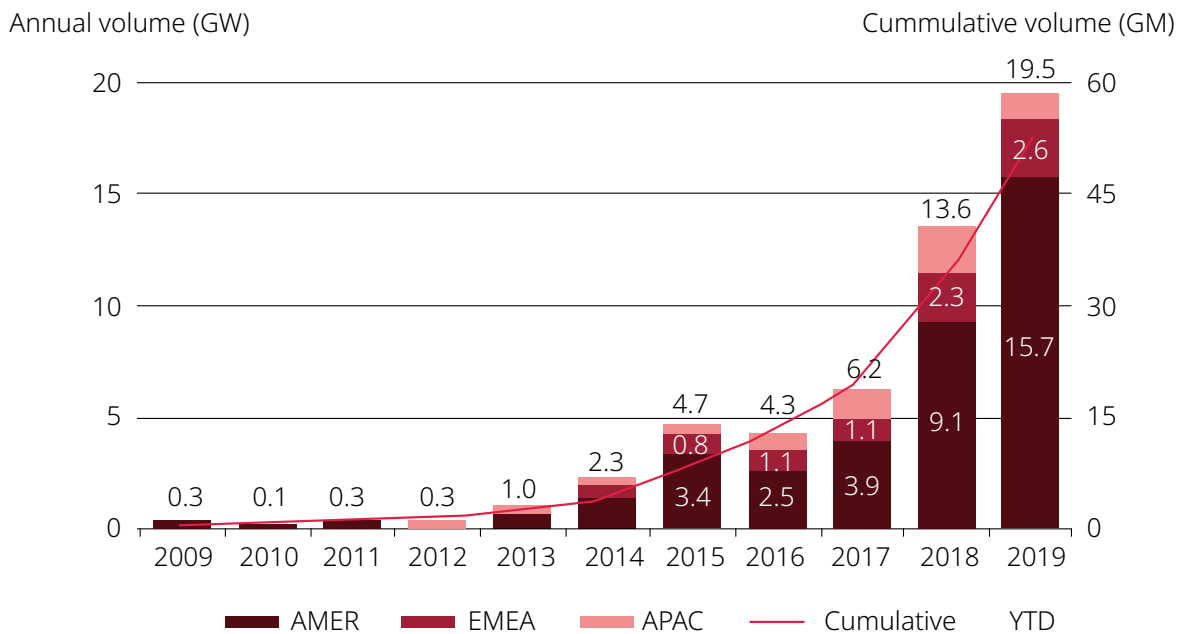
Private Wire PPAs, unlike Physical PPAs, address transfer of electrify directly from the generator’s facility to the corporate offtaker, rather than being notionally passed through a national power grid. The renewable energy generating facility will be located at, or close to, the offtaker’s assets and will usually only supply power to the offtaker.

Private Wire PPAs may often be used in conditions where the offtaker wishes to secure its own source of power (e.g. for use in a factory or an off-grid location).

HOW CAN CORPORATE OFFTAKERS BENEFIT FROM PPAs?

Companies will have a variety of different reasons to source power from renewables, but the possibility of securing lower and fixed electricity costs is a major factor in their growing popularity. Indeed, a recent survey of 1,200 companies found that 92% that were sourcing from renewable energy technologies were doing so to reduce their electricity costs¹. In the face of a steep global decline in the price of renewables, companies are entering the PPA market to take control of their electricity costs². Demand from corporates worldwide for renewable energy is now exceeding supply³.

We have seen that PPAs can potentially provide offtakers with savings of up to 45% on their electricity bills. In this context, PPAs offer a sustainable way of hedging the future cost of electricity against volatility in the market. The below graph from the International Energy Agency and Bloomberg NEF highlights the global rise of the corporate PPAs (shown as agreements by volume of contracted offtake):



Source: BloombergNEF. Note: Data are through 2019, reported in MW DC capacity. Onsite PPAs are not included. Australia sleeved PPAs are not included. APAC number is an estimate. Pre-market reform Mexico PPAs are not included. These figures are subject to change and may be updated as more information is made available.

1 <https://www.baywa-re.de/en/energy-report-2019/>
 2 <https://about.bnef.com/blog/corporate-clean-energy-buying-leapt-44-in-2019-sets-new-record/>
 3 BNEF, 2H 2020 Corporate Energy Market Outlook.

Despite the falling cost of renewables, users of electricity via the spot market in New Zealand are exposed to periods of unpredictably high electricity prices. Recently, there have been various incidents of market volatility that have pushed the market power price upwards. They can come in various shapes and forms. For instance, natural events: this year the North Island suffered its worst drought in 50 years, with clear implications on the price of hydroelectricity. Alternatively, there are arguments that high prices can be caused by human intervention. For example, earlier this Winter the Electricity Authority issued its preliminary decision on an Unfavourable Trading Situation (UTS) in which it is alleged that certain Gentailers unnecessarily spilt water from their hydro facilities which could have been used for generation. The authority has suggested that this UTS might have costed other electricity retailers an extra NZD80 million for power on the wholesale market.

In the face of similar peaks of market volatility in other countries, a longer-term market hedge against power prices has been attractive to a number of our clients.

PPAs are also helping companies to meet their sustainability commitments. In 2019 almost 400 companies around the world agreed to set science-based targets for their environmental commitments, more than doubling the total number of companies with such goals. Through entering into direct agreements with renewable energy facilities, companies can verify the renewable source of their electricity and also their contribution to the development of a specific project. For this reason, PPAs have been an essential component in the energy strategies of many [RE100 companies](#) who wish to demonstrate additionality in their green contributions.

Which sectors are using corporate PPA?

We have advised on a wide variety of significant PPAs since we worked on the first European PPA in 2013. Originally demand was led by Big Tech offtakers, although the large industrial users of electricity soon entered the market. However, over the last five years, we have seen an exponential increase in the introduction of other sector participants to the PPA market. As the benefits of these arrangements have become better understood, they have become increasingly common across the board. We are now advising clients on transactions incorporating PPAs into a range of markets, including retail, government, education, agriculture and financial and professional services.

In New Zealand the PPA market is currently in a relatively nascent stage. However, this is expected to change. There has been particular interest from the agriculture and industrial sectors. A group of New Zealand's largest energy users has announced its intention to procure a large proportion of their electricity from renewable electricity sources. This would be achieved via PPAs. The group is proposed to include Fonterra, pulp and paper manufacturer Oji Fibre Solutions, forestry and timber company Pan Pac Forest Products, and metals industry companies New Zealand Steel and Pacific Steel. This procurement project, which is being led by the [Major Electricity Users Group \(MEUG\)](#), will seek to buy electricity from a range of new projects, potentially including geothermal, solar and wind sources.

However, we do not expect the rise of the NZ PPA to be restricted to the industrial and agriculture sectors. For example, Microsoft has announced its intention to develop a data centre in Aotearoa. Microsoft has procured more than 1.9GW of renewable energy globally in its places of operation and will likely implement a similar strategy again in New Zealand. Throughout the world we have seen Big Tech companies leading the way in developing the PPA market, and so it seems likely that the New Zealand market will follow suit.

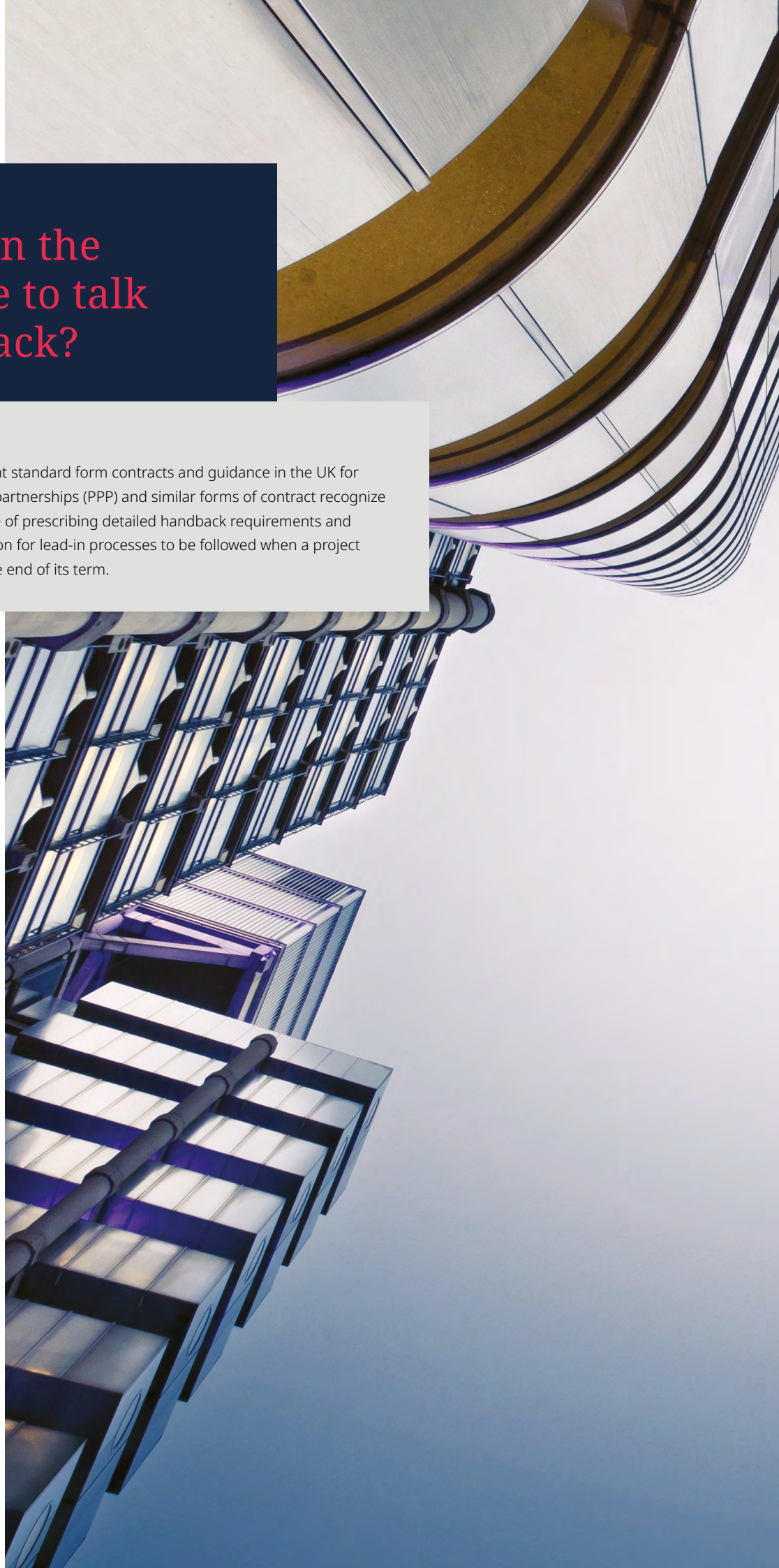


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PFI and PPP in the UK – is it time to talk about handback?

In brief...

The most recent standard form contracts and guidance in the UK for public-private partnerships (PPP) and similar forms of contract recognize the importance of prescribing detailed handback requirements and making provision for lead-in processes to be followed when a project approaches the end of its term.



In accommodation projects (e.g. those in the health and education sectors), it is anticipated that new technologies, such as Building Information Modelling (BIM), will have a key role to play in testing the condition of assets and the building's thermal and energy performance will be given further attention. This may bode well for clarity of requirements, quality assurance and continuity of service in 20 years plus, but what about those reaching expiry now?

Earlier private finance initiative (PFI) contracts are unlikely to benefit from the same level of specification. Some of the very first PFI contracts which have expired or are due to come to an end in the near future have little, if any, provision made for handback of infrastructure assets to the public sector.

In fact, in some early PFI contracts, the relevant assets may not require to be "handed over" to the public sector at all (as is the case for current Design, Build, Finance and Maintain (DBFM) models in the UK).

With authorities managing PFI/ PPP contracts being encouraged by the Infrastructure Projects Authority (IPA) to start handback preparations some seven years in advance of the anticipated expiry date, this is an area that we expect will require significant industry focus from the public sector, sponsors, service providers and senior funders alike in the coming months and years. The IPA is not alone in its calls for "early" handback planning, with Highways England suggesting an eight-year period and the Scottish Futures Trust (SFT) a five to ten year period (depending on the complexity of the infrastructure asset in question).

Lessons learned?

When we look back, this impending wave of handbacks is likely to be a pivotal point for the PPP industry. With early contracts sparse on handback detail, successful outcomes hang in the balance, yet it may be the point at which the industry showcases what has always been heralded as one of the key pillars of PPP – value for money through a whole life approach.

So, to achieve successful outcomes, what lessons can we learn from some of the early transitions?

The National Audit Office recently published a report "*Managing PFI assets and services as contracts end*" (June 5, 2020) (the NAO Report), which provides some helpful initial insight and learning. The report was based on a survey of over 100 contracts, 18 of which had expired, and is a useful source of information for the sector as a whole.

Some particularly poignant points of note from the NAO Report, include:

- In response to general portfolio approaches across the private sector, there is a call, on the IPA in particular, to plan and develop a program of support for authorities and consider a centralized approach. This is already underway, with the IPA gearing up to deliver.
- It recognizes a need for sufficiently early preparations and planning for handback, to mitigate against service disruptions, manage costs and allow sufficient time for any disputes to be addressed.
- The report acknowledges the reality that public and private sector goals and drivers in planning for contract expiry will often be different and, as such, this is an area with heightened scope for disputes.
- Similarly, with handback provisions not always being clearly defined, the report notes ambiguity is another reason for disputes in this area, but that proactive engagement can mitigate the risk of legal proceedings.

- It acknowledges that authorities have different rights to information on asset condition under different contracts and how the approach to information sharing and knowledge within the public sector can affect asset condition at handback.
- The NAO Report also recognizes the resource-intensive nature of handback preparations.

Looking forward – the assurance lifecycle

Industry experience shows that well-managed contracts with adequate assurance measures in place (at all levels), can mitigate against the risk of infrastructure assets being below standard and also reduce the scope for lengthy and costly disputes.

It is perhaps here, more than anywhere, that all parties' interests in PPP or PFI contracts are aligned, i.e. act now and don't pay later!

The latest focus on handback in the industry is very much a natural progression of the quality, assurance and preparedness themes we have seen running through other reports in the sector, seeking to draw on lessons learned from contractor insolvencies or assets with significant defects. Examples of such reports include the 2017 Report of the Independent Inquiry into the Construction of Edinburgh Schools, Professor John Cole CBE and the National Audit Office's 2018 report on the Investigation into the handling of the collapse of Carillion and the June 2020 Independent Review into the Queen Elizabeth University Hospital (ultimately implemented as a D&B Contract).

A "cradle to grave" approach to assurance is encouraged, from all parties' perspectives in PPP to ensure delivery of successful projects.

This begins of course with the drafting of the underlying contract documents and specifications and this has been an increasing area of focus for our public sector clients in recent times.

We are also seeing additional practical assurance measures being put in place by authorities to provide regular "health checks" on projects – not just on handback. This includes, for example, enhanced provision for independent testing during construction,

commissioning and ultimately on sign-off of infrastructure facilities moving into operation. Too often in the past, issues have arisen where projects have been allowed to move to the operational phase with defects or significant snagging in order to trigger availability payment. Increased assurance throughout the life of the project is seen as part of the "fix" to avoid escalation of issues further down the line.

Project sponsors are also becoming more keen to carry out checks on the condition of assets, particularly in the run-up to the expiry of defects liability periods under construction contracts. Surveys are now often being undertaken a good number of years in advance of expiry of the typical 12-year liability period, for similar reasons that early handback preparations are beneficial to the public sector.

PFI and PPP project agreements of all ages generally make specific provision for ongoing assurance processes, typically with a focus on self-monitoring and with recourse available to authorities where Project Companies (through their maintenance contractors or otherwise) do not comply with such obligations. However, in our experience, authorities can take quite different approaches to monitoring and carrying out their own surveys.

Needless to say, the more rigorous the approach to assurance from all sides during the construction phase and through the operational period of a project, the less likely issues and costly disputes will arise during the handback process.

Many PFI/ PPP contracts will make specific provision for handback surveys to be undertaken from six months to two years in advance of the contract expiry date. Such periods are likely to fall after the term of the senior debt has been repaid, so handback provisions may not always have been at the forefront of senior lenders' minds. However, with the drive from organizations such as the IPA, SFT and Local Partnerships for handback preparations to begin anywhere from five to ten years before contract expiry (and ongoing monitoring of asset condition being actively encouraged), senior lender involvement will more than likely be required in some discussions relating to handback.

Concluding remarks

The natural starting point with review of handback is to understand exactly how an authority will wish to use the asset (if at all) after the existing PPP contract expires. Key provisions need to be considered, including those dealing with: whether the asset is to be handed over; the condition the asset should be in if handed over; the processes to be undertaken (such as surveying); the position of employees; transfer of equipment, data and warranties; resolution of disputes; costs any compensation payable; and any rights of retention.

In some cases, it may be appropriate to consider contract variations or opportunities for contract extensions and in this respect, statistical treatment and procurement implications will need to be considered.

Whilst many have argued in the past a successful project is a project where the contract stays in the drawer, experience in recent years suggests it should most definitely be taken out of the drawer from time

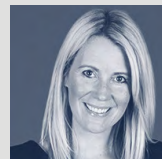
to time – and it is important to know which drawer it is in! For all parties, careful reference to their own contracts and early collaboration will be a critical part of the assurance process, to avoid potentially costly and relationship breaking disputes further down the line. With this may also come potential opportunities to extend partnering arrangements and to meet the challenges of the current sustainability agenda.

Experience has shown that where there is ambiguity in standards to be applied, processes to be followed or contractual gaps, agreeing joint approaches to interpretation and recording mutually agreed protocols can be beneficial for sponsors, authorities, contractors and senior lenders alike.

The success or otherwise of handback in the next few years is likely to be critical for the industry as a whole and creates an opportunity to define the benefits of the PPP model and secure the “additionality”, whole life model for future generations.



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