



SOCIETY OF CONSTRUCTION LAW

LEGAL ASPECTS OF PUBLIC PRIVATE PARTNERSHIPS IN IRELAND

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Finola McCarthy

Public Private Partnership (PPP) in Ireland is in Year Two and a stream of projects are beginning to come onto the market. Over the last two years, the process has been developed and adapted to sectors such as education, roads, waste water and transport and it is proposed that the process will be extended to housing and waste this year. In April, the Cross-Departmental Team on Infrastructure and PPPs (a team of senior officials which supports the Cabinet Committee on Infrastructure and PPPs, established in June 1999) published its third progress report and concluded that: 'satisfactory progress is being maintained in implementing the PPP programme'.

PPP is a different method of project procurement and involves changes in approach to the traditional methods. PPP projects give rise to different legal issues. They also create a labyrinth of contractual relationships between a number of different parties which need to be reflected and managed in the documentation.

I want to highlight some of the practical issues to be aware of: what are the documents, how do they work, and what are the legal issues to be aware of?

Types of partnership arrangements

The National Development Plan recognises PPP as an important element and recommends that the essential features of PPP should be:

- the use of the output specification;
- optimal allocation of risk between public and private sectors;
- value for money for the public sector over the lifetime of the project.

At its simplest, a PPP exists wherever the public and private sectors work together closely with a common purpose. There are a number of possible PPP arrangements:

1. ***Joint investment:*** The public body may invest in the private entity and share the risks and rewards in accordance with its shareholding – a recent example is the National Software Development Centre project by the Software Development Centre Limited and Cork Corporation, which has taken a significant shareholding in the company.
2. ***Public sector purchase of services:*** The private sector designs, builds, finances and operates the asset (DBFO) to the public body's requirements and

recovers its costs by way of a unitary payment from the public body, such as the proposed National Maritime College project in Ringaskiddy and the School of Music pilot project in Cork; alternatively, as in the case of many of the waste water projects, design and build (DB) or design, build and operate (DBO).

3. ***Financially free standing projects/public works concessions:*** This is similar to DBFO, except that the private sector recovers its costs entirely through direct end user charges (or perhaps a mix of user charges and public subsidy), eg the East and West Link Bridges in Dublin.

Legal constraints

The success of PPP as a means of procurement of infrastructure projects closely depends on the legal framework which is in place. There are many legal issues which affect PPPs. Several of these were identified by the Irish Business and Employers Confederation/Construction Industry Federation submission to Government in April 1999 and the PricewaterhouseCoopers report *Policy Framework for Public Private Partnership* dated May 2000, relating to the water, waste and roads sectors.

Some of these legal constraints are the capacity of public authorities to enter into PPP project arrangements, property issues, the planning process and the procurement rules.

Contractual capacity of public authorities

A Public Private Partnerships Bill was published on 19 June 2001 and is expected to come into force in the autumn or winter of 2001. The Bill addresses issues which enable local authorities to enter into joint venture arrangements and step-in arrangements with funding institutions. The Bill does not, however, deal with property issues such as landlord and tenant matters which are relevant to PPPs, although specific provisions will be included in legislation amending landlord and tenant law, to be proposed by the Department of Justice.

With regard to rail infrastructure projects, the Transport (Railway Infrastructure) Bill was published in March. The aim of the proposed legislation is to establish the Railway Procurement Agency which will have the power to negotiate, sign and manage primarily PPP rail infrastructure projects, including light rail and metro. Significantly, the Bill proposes streamlining the statutory process involved in order to facilitate possible PPPs. It is hoped that the Bill will be enacted before the end of 2001.

Planning

Planning delays are a potential obstacle to the rolling out of PPP projects under the National Development Plan. Some effort to tackle the issue has been made in the new Planning and Development Act 2000. In the autumn of 2001, the Act is still only partly in force. It was expected that all parts of the Act would be brought into operation by April 2001, however the necessary Regulations have not yet been finalised. According to the Department of the Environment, it is

hoped that the Act will be fully implemented by the end of 2001.

The following will facilitate PPPs:

1. The concept of Strategic Development Zones (SDZs) to facilitate major industrial and infra structural projects and remove the risk of delay by third party objections. One of the first to apply for SDZ status was the Campus Ireland project in Abbotstown.

The relevant provisions are sections 165-171 of the Planning and Development Act, which came into force on 1st November 2000. Following a proposal from the Minister for the Environment, the Government may designate sites as SDZ's for types of development which are of economic or social importance to the national economy. Within two years of designation, the appropriate development agency (which includes local authorities) must prepare a planning scheme for the area indicating the type and extent of the development which will be permitted. The proposed scheme must undergo a public consultation process which can be appealed to *An Bord Pleanala* (Planning Appeals Board) by those who made submissions on the draft scheme and the relevant development agency only.

Once adopted, any planning applications for developments within the SDZ must be submitted to the planning authority in the usual way. Permission must be granted if the development is consistent with the planning scheme and the decision of the planning authority cannot be appealed to *An Bord Pleanala*.

2. There is a strict timetable for development plans – they must be reviewed every six years, and there is a streamlined procedure for varying development plans (sections 9-17).
3. The Minister may direct *An Bord Pleanala* to give priority to developments of special economic importance, such as major infra-structure development (section 126(5)). The Minister may also direct *An Bord Pleanala* to act in divisions where it is necessary for the speedy dispatch of its decisions (section 112).
4. The High Court is obliged to deal expeditiously with judicial review proceedings relating to developments which the Minister has ordered should have priority under section 126.
5. In relation to a planning permission appeal to *An Bord Pleanala*, only those who have previously submitted a written observation on the initial application to the planning authority or who have an interest in the adjoining land are entitled to appeal (section 37).
6. Anyone seeking to challenge the validity of a planning decision by way of judicial review will have to demonstrate that they have a substantial interest in the matter, unless exceptional circumstances can be shown (section 50(4)(b)).

7. There are also some amendments to the compulsory purchase procedures (Part XIV).

The Act also amends some provisions of the Roads Act 1993 in relation to tolling. The decision to enter into toll arrangements with private investors will now be a matter for the National Roads Authority in the case of national roads. Non-national roads will be a matter for the relevant local authority rather than the Minister, as was previously the case (Part X).

It is hoped that the amendments will go some way towards streamlining the planning process, reducing delays and giving greater certainty.

Public procurement

Most PPP projects will be subject to the complex EU public procurement rules. However the existing EU procurement rules were not designed for PPP projects.

The objective under the EU procurement directives is to ensure that public procurement is opened up to European-wide competition with tenderers being given equal opportunity to bid for and win public contracts. The highest value threshold in the directives is for works contracts – currently the threshold is five million euro (approx IR£4m).

At the initial stage, the authority will need to decide which of the EU procurement directives apply: is the contract for works, services or supplies? A DBFO contract for a road will have elements of all three, and in which case the ‘main object’ of the contract needs to be identified and analysed with an assessment of the relative value of each element. It is then necessary to decide which procurement procedure is to be used – open, restricted or negotiated. The wrong choice of directive or procedure are likely grounds for challenging the award of the project.

In the *open procedure*, all interested providers may tender. In the *restricted procedure* all interested providers may request to participate but only those who are short-listed may submit a tender. In the *negotiated procedure* the selection process is similar to the restricted procedure, except that the authority has slightly more flexibility: in addition to pre-qualification criteria, the authority may consult with candidates and negotiate terms. However, this procedure can only be used as an exception.

In the context of PPP, the relevant circumstances are:

- exceptionally, when the nature of the works/services or the risks involved do not permit prior overall pricing;
- with regard to services, when the nature of the service being procured is such that contract specifications can not be established with sufficient precision to permit a contract award using the open restricted procedure.

The procurement directives do not prescribe in any detail the process to be followed in a negotiated procedure, particularly in the phase between pre-qualification and contract award (other than prohibiting discrimination). This

does not mean that the negotiations can be conducted without any structure. The authority must put in place a mechanism for negotiation and in so doing must ensure a fair procedure, taking account of the costs of bidding and the resources required for negotiating. It must be remembered that in negotiations, significant change to the scope of the project or the preferred tenderer's offer is not permitted and could give rise to challenge.

The process will involve detailed discussions between the authority and the bidders. In practice the procedure may also include the presentation of formal written tenders.

The authority must be mindful of concerns about the cost of bidding: the amount of work required by bidders must be proportionate to the value of the project. The authority should take a reasonable approach to the number of formal submissions required. The way submissions are to be made is also an important consideration. Are fully costed bids required at the shortlist stage? Perhaps not, if price is not the only criterion. Whether or not tenderers should be required to carry out a detailed review of the legal documents in the early stages should be dependent on the scale of the project. Heads of terms may be more appropriate, with draft contracts introduced before final bids are submitted, or even after a preferred bidder has been selected. Otherwise it may be necessary to conduct six sets of negotiations, involving six sets of lawyers – a costly exercise, particularly in the absence of any guidance document or model contract.

In the UK, the Treasury task force advocates the use of the negotiated procedure for most PFI projects. Initially, some legal commentators on the PPP process in Ireland expressed concern about the appropriateness of using the negotiated procedure. There appears to be some recognition now that in many PPP projects the negotiated procedure will be appropriate and until the proposed new procedure referred to below is in force, we will see a lot more use of the negotiated procedure.

The EU has recognised that the existing procurement procedures lack flexibility, particularly in projects such as PPPs. In 1999, the Commission issued a new draft Directive which proposes consolidating the Works, Services and Supplies Directives into one (Proposal for a Directive of the European Parliament and of the Council on the co-ordination of procedures for the award of public supply contracts, public service contracts and public works contracts). As well as provisions on electronic procurement it includes provisions on 'competitive dialogue procedures'. It is expected that the Directive will be adopted by June 2002 and implemented by the end of 2003.

Article 30 of the draft Directive permits the negotiated procedure to be used in 'particularly complex public contracts', which are contracts where the authority is not objectively able to define the technical or other means of meeting its requirements or to assess what the market can offer in terms of technical or financial solutions. Specific rules apply. It is proposed that at contract notice stage the authority will define the objectives it wishes to obtain. It can decide that, in addition to the usual documentation required, candidates must also submit an outline solution, ie a preliminary indication of the candidates' proposal and an

estimate of the cost. Alternatively, it may request this following pre-qualification and selection of candidates for negotiation. The authority then commences negotiations, at the end of which it defines the final technical specifications. It will then invite at least three candidates to submit a formal tender. These tenders are to be evaluated on the basis of the award criteria and the contract is awarded without any possibility of further negotiation.

Recital 18 of the draft Directive explains the basis of the proposed new procedure:

In these cases the sole aim of negotiation should be to permit the Contracting Authority through dialogue with the candidate to explain its requirements and define them with the necessary precision so that tenders can be formulated and assessed objectively so as to ascertain the most advantageous tender in economic terms. It should therefore be limited to the phase of the procedure which ends up with the drawing up of the definitive contract documents; tenders drawn up on the basis of those contract documents cannot therefore be open to negotiations. Their flexibility is granted subject to observance of the principles of equal treatment, non-discrimination and transparency.

A number of member states, including Ireland, have made submissions about the competitive dialogue provisions, on the basis that they do not allow the degree of flexibility required by PPP projects. It is hoped that these issues will be addressed in the final Directive.

Contractual structure

Depending on the type of project, the structure can be a very complex package of documentation, where there are several parties involved and the contract is of long duration (eg a 25 year contract involves an assessment of risk over a generation). A diagram of the structure is appended.

What are the principal documents you would expect to see in a PPP DBFO project?

1. ***Project agreement:*** this is the principal document in the project. It must cover all aspects of the relationship between the authority and the project company over the lifetime of the project; it is a book in itself.
2. ***Lease/sub-lease/licence agreement:*** the agreement which deals with the land ownership arrangement during the life of the project. The nature of the document will depend on whether ownership of the land is to be transferred to the project company and revert back to the authority at the end of the project. The project agreement may include provisions dealing with this, rather than there being a separate agreement.
3. ***Funding agreements:*** these are the loan and security documents between the debt funders and the project company.
4. ***Direct agreement:*** a tripartite agreement between the funder, the authority and the project company under which the fund is given a period of advance

notice of termination with the opportunity to take over the project.

5. ***The authority's requirements:*** these will include the output specification detailing all the technical and service requirements of the authority.
6. ***The project company's proposals:*** the project company will need to clarify what it must do to meet the output specification and be satisfied as to what is achievable.
7. ***Design and build subcontract:*** the contract between the project company and the construction company for the construction phase of the project.
8. ***Operation and maintenance subcontract:*** between the project company and the facilities management company for the operational phase of the project.
9. ***Equipment agreement:*** eg in relation to IT equipment for use in the facility.
10. ***Authority's direct agreement:*** between the authority and the subcontractors giving the authority the right to step in to the shoes of the project company if the fund declines to do so.
11. ***Collateral agreements:*** sought by the fund and other entities.
12. ***Consortium agreements*** and ***shareholders agreement*** for the project company.

Model form project agreements are being developed on a sectoral basis arising out of the pilot projects which are currently underway. For example, with regard to education, there is the project agreement prepared for the School of Music and a bundle of schools projects. In the waste water sector, I understand that a model contract is being developed in conjunction with the waste water project in Donegal. It will be quite some time before an 'overall' model contract is developed.

There has been some criticism to date that the drafting of some of the agreements proposed is aggressive, with substantial and unfair risk being allocated to the private sector. There is an onus on the public sector to be willing to accept risk that it has not otherwise been prepared to accept under the traditional procurement process. It is crucial that the model forms are balanced agreements which are commercially acceptable by the private sector, bankable and fairly reflect the 'partnership' aspect of PPP.

Consortia

There are very few organisations that possess the range of skills and resources that a PPP project requires. Therefore most projects will be carried out by consortia, and most likely with international participants. One example is the Dublin Port Tunnel contract, which was awarded to a Japanese, Irish and UK consortium.

What structure should be formed by the ‘alliance’ of participants wishing to get involved in the process? If things go wrong, what law will apply and which courts will have jurisdiction? What is the extent of each participant’s liability? Should each participant be liable for the actions of other members of the consortium?

At the early stages of collaboration it is likely that no formal agreement will be put in place. However as the co-operation becomes more elaborate and the consortium successfully advances along the shortlisting process, a formal arrangement should be put in place between the various entities – a simple contractual joint venture, a corporate joint venture or perhaps an arrangement to execute the project through subcontracting. It is essential to consider the tax implications before choosing the most appropriate formula.

In a *contractual joint venture*, the parties may enter into a bid agreement which will set out the parties’ roles and obligations relating to the bid. It may have a joint venture agreement annexed to it which sets out the terms on which the contract will be carried out if the bid is successful. It will need to address issues such as confidentiality and restriction of competition during the tender process. Also the consequences of the insolvency of a consortium member should be addressed.

In PPP projects where the consortia are submitting a bid as service provider, it will often be a requirement of the authority that the winning consortia enters into a corporate joint venture. This means setting up a *private limited liability company*. The terms of the shareholders agreement will be important.

The advantage of forming a company is that liability is limited, thus protecting the shareholders – the participants in the joint venture – from their own and the other participant’s liabilities. Their exposure to any liability for the company’s losses, and therefore the liabilities that may arise during the operation of the joint venture, is limited to their equity investment in the project company (although this may be a fiction if the parties enter into guarantees for the company’s indebtedness or borrowings). In addition, the corporate joint venture is a flexible medium with the ability to raise capital through various forms of share issue.

For construction professionals, the extent of their involvement is likely to change as the project advances. When an engineer, architect or surveyor is involved in a consortium preparing a PPP tender bid, they will be assisting in formulating the response to the project requirements during the bidding and negotiation process. When the preferred bidder has been chosen, the consortium will be concentrating in greater detail on the design and construction issues. The professional may then become the consultant to the building contractor within the consortium, for example.

Even when the professional is participating in the consortium or corporate joint venture, it is still advisable that a formal consultancy agreement is put in place detailing the scope of the services to be provided. It is also essential that the professional check that his professional indemnity insurance will cover him for the obligations contained in the consultancy agreement.

The project agreement

This agreement (sometimes called the concession agreement) is the core contractual document for the project and covers all aspects of the relationship between the authority and the project company over the lifetime of the project.

What can you expect to see in the project agreement? As an example, a list of provisions in the UK National Health Service standard project agreement is appended.

One of the essential principles of PPP is that risk should be allocated to the person best able to manage it, in order to achieve the lowest cost of addressing the risk. In practice, other factors may also influence the risk allocation process, such as the political and accounting objectives of the public sector.

Each category of project will have its own specific risks and issues. Some of the issues common to all types of PPP can be categorised under the following headings:

1. ***Variations:*** 25 years (the length of a typical contract) is a long time. It is inevitable that the authority's requirements over the life of the project will change. Are variations to be permitted? If so, how will cost be allocated?
2. ***Change of law:*** What happens if the law changes during the life of the project, giving rise to additional cost (eg a law requiring all roads to be lit at night)? The project company will have contracted, to a certain extent, on a type of fixed price basis. Should the payments be adjusted to accommodate such an event?
3. ***Mechanism for performance related payments:*** the payment mechanism is the central provision in the agreement. It gives financial effect to the allocation of risk. The key elements are generally that the private sector only receives payment upon provision of the required services (to incentivise completion on time) and that the public sector only pays for services that meet the service requirements in the output specification (which may be linked to availability of the facility). Payment may also be related to usage (such as 'shadow tolling').
4. ***Force majeure and other events of delay:*** events may occur which will prevent either party from performing its obligations resulting in delay to the programme, additional cost etc. Some of these events may be insurable. Nevertheless, the project agreement needs to address who should bear the financial risk associated with such events. Should the length of the contract term be extended or just the time for completion of construction, should payment to the project company be delayed?
5. ***Termination and compensation:*** the project company will wish to limit the public sector's rights to terminate for default. The consequences of termination will be contentious. Termination will need to trigger the funder's rights to step in pursuant to the direct agreement. The termination provisions will need to cover what happens to the project assets, and how

services are to be maintained in the interim.

Conclusion

PPPs are a new method of procurement, involving new issues and challenges. Centralised policy and co-ordination is key to the overall success of the PPP programme and to the development of best practice.

Not all infrastructure development is suitable for procurement through the PPP process. Relative to other jurisdictions, the early indications in Ireland are that there will be very few projects on the scale of the high value PFI projects seen in the UK. Therefore it is important that the legal structure facilitates PPP projects which are commercially attractive, by minimising bidding costs and encouraging a balanced approach to the allocation of risk.

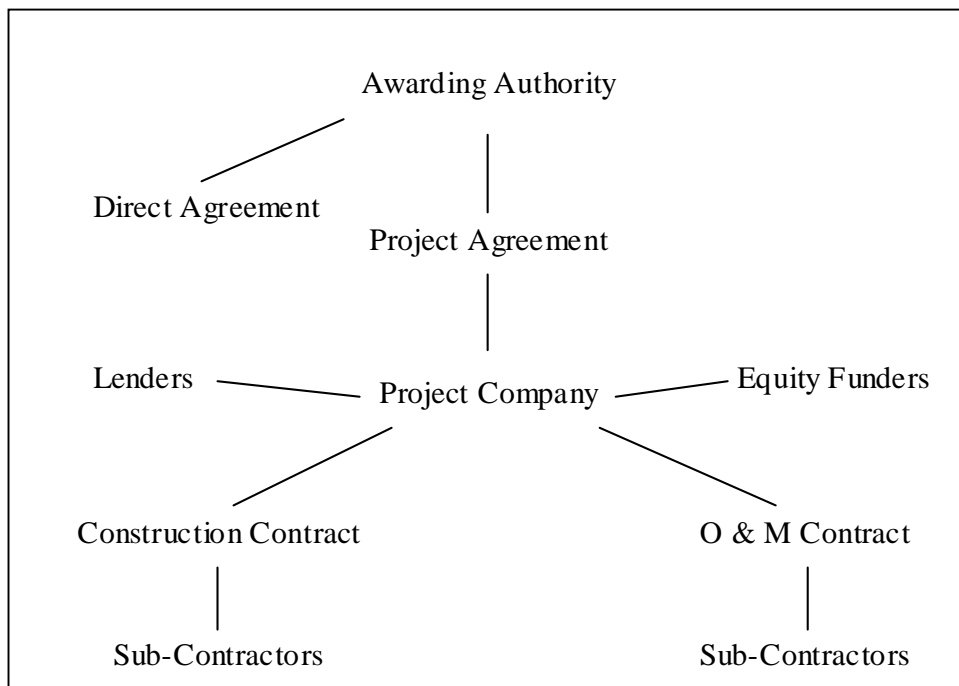
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Public Private Partnerships Contractual Structure



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