

Effective ways to support procurement process in Korea

- Focusing on Standardization of PPP contracts-

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❖ PPP Scope under the Act on Public-Private Partnerships in Infrastructure
 ("PPP Act")

Concept	Definition
<u>Concession agreement</u>	means a contract concluded <u>between the competent authority and a potential concessionaire</u> to implement a <u>public-private partnership project</u> concerning the conditions, etc. for the implementation of the project as prescribed in this Act
<u>Infrastructure project</u>	means projects involving work, such as <u>construction, expansion, renovation or operation of infrastructure</u>
<u>Concessionaire</u>	means a corporation, <u>other than those in the public sector</u> , which is designated as a <u>concessionaire</u> under this Act, and which implements a <u>public-private partnership project</u>
<u>Competent authority</u>	means the <u>head of an administrative agency</u> in charge of the affairs concerning <u>infrastructure projects</u> pursuant to the related statutes

❖ PPP Scope under the *Act on Public-Private Partnerships in Infrastructure*
 ("PPP Act")

Concept	Definition (Article 4 of PPP Act)
BTO	The mode (excluding cases falling under subparagraph 2) by which the <u>ownership of the infrastructure shall be transferred to the State or a local government upon the completion of construction, and the concessionaire shall have the rights to manage and operate the infrastructure</u> for a specified period
BTL	The mode by which the <u>ownership of the infrastructure shall be transferred to the State or a local government upon the completion of construction, and the concessionaire shall have the rights to manage and operate the infrastructure for a specified period, but the State or a local government, etc. shall rent them for a specified period as provided for in the agreement, and use them and make profits;</u>

❖ Payment type & Demand risk

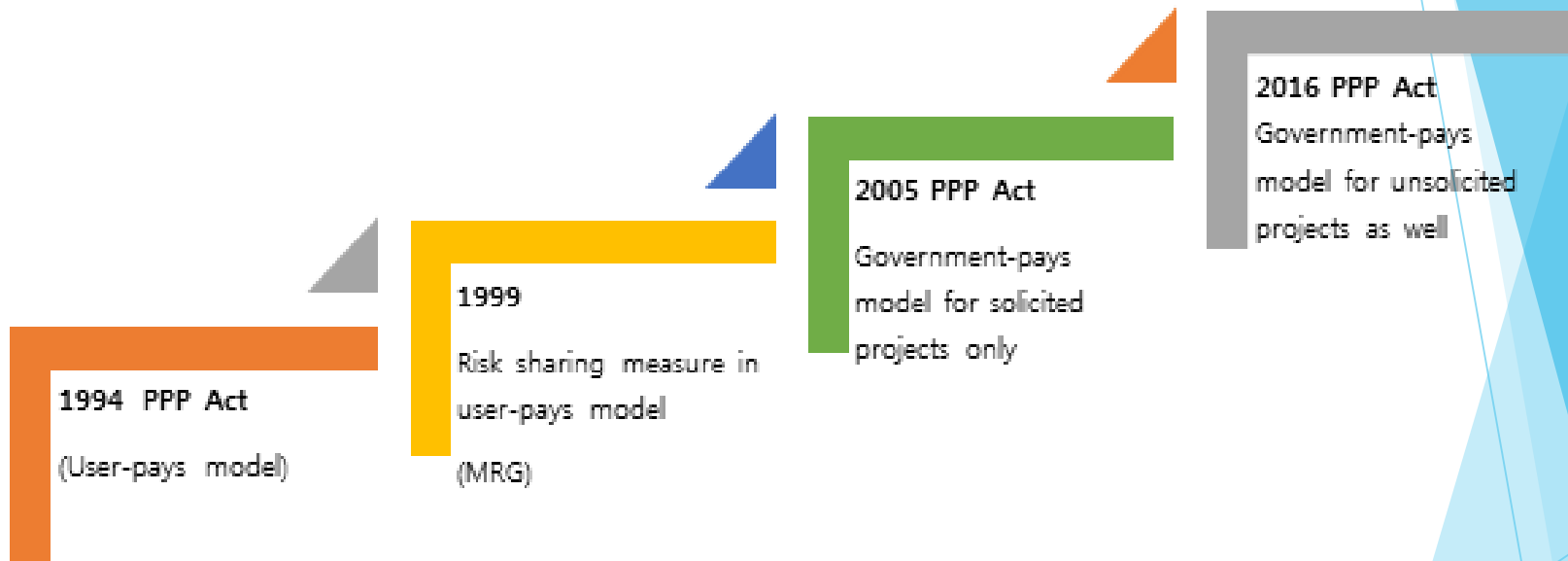
User-pays model	Concessionaire's investment is recovered from user fee	Build-Transfer-Operate	Concessionaire's demand risk ✓ Government's risk sharing
Government-pays model	Concessionaire's investment is recovered from government's remuneration	Build-Transfer-Lease	No Concessionaire's demand risk

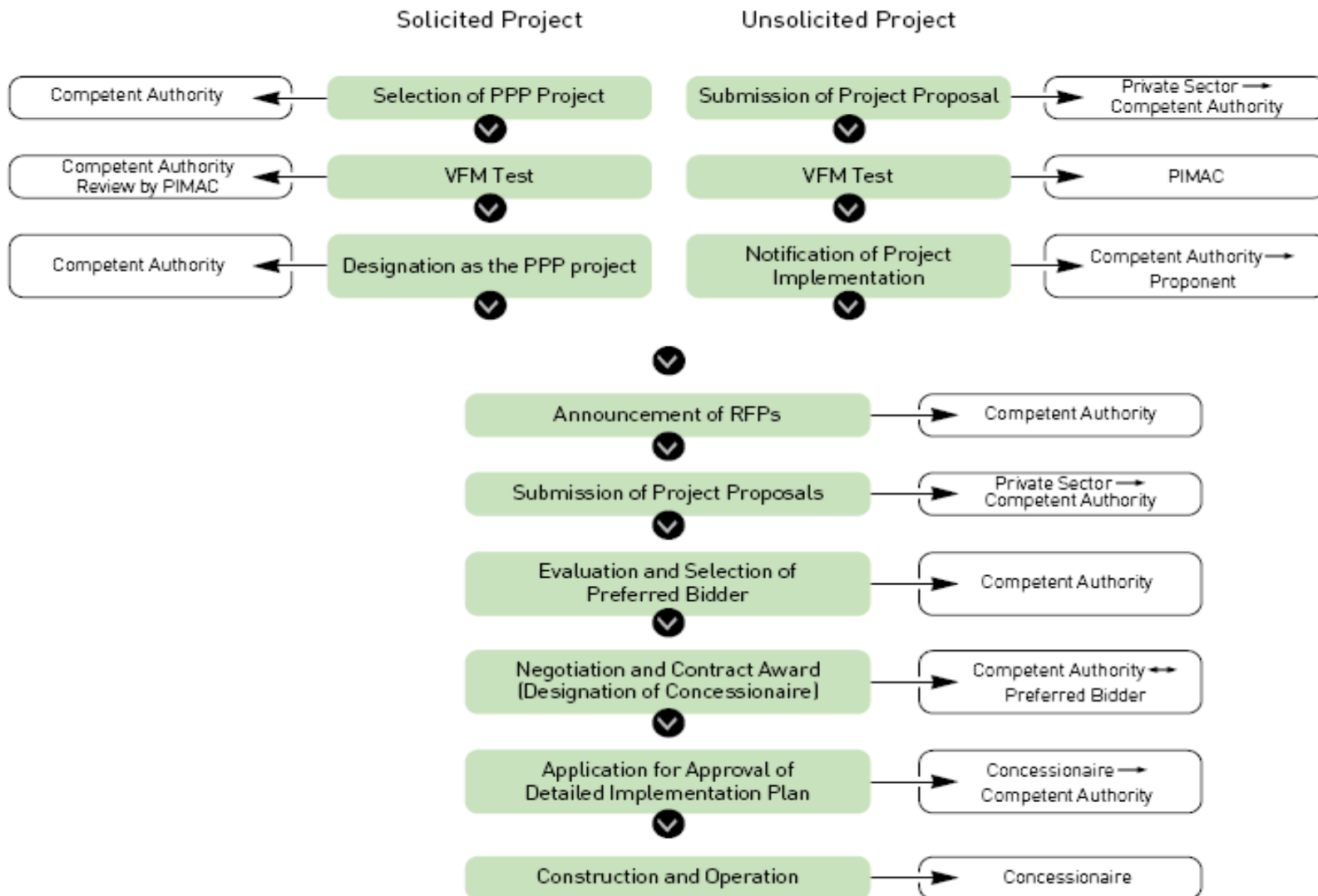
❖ Payment type & legal tradition

Legal Traditions and PPP Types in Civil and Common Law Countries		
Legal Tradition	Civil Law	Common Law
PPP Types		
User-pays PPPs (Concessions and similar contracts)	Historically France, Spain, and other civil law jurisdictions	<i>Later development of the framework</i>
Government-pays PPPs (PFI-style contracts)	<i>Later development of the framework</i>	Historically UK and Australia

Source The APMG PPP Certification Guide

❖ Evolution of payment type





- ❖ PPP procurement process
 - Mandatory Negotiation & concession agreement process under the PPP Act
 - ✓ Potential concessionaire must be designated as a negotiation parties among the proposers (Article 13 (Designation of Concessionaire) of the PPP Act)
 - ✓ Concessionaire is designated by making a concession agreement

❖ Comparison with Traditional procurement

	Traditional Procurement	PPP Procurement
Law	Act on Contracts to which the State is a Party	PPP Act
Area	Public service works or construction works	PPP projects (Life cycle project (construction to operation))
Analysis for project selection	Applicable in accordance with National Finance Act	Feasibility Analysis required in accordance with PPP Basic Plan
Unsolicited Proposal	Not admissible	Admissible
Competitive Bidding	Competitive bidding process in principle, but in a special case, private contract is admissible	Request for proposals is required even in unsolicited projects
Negotiation	Not required	Mandatory process

Standardization of PPP contract

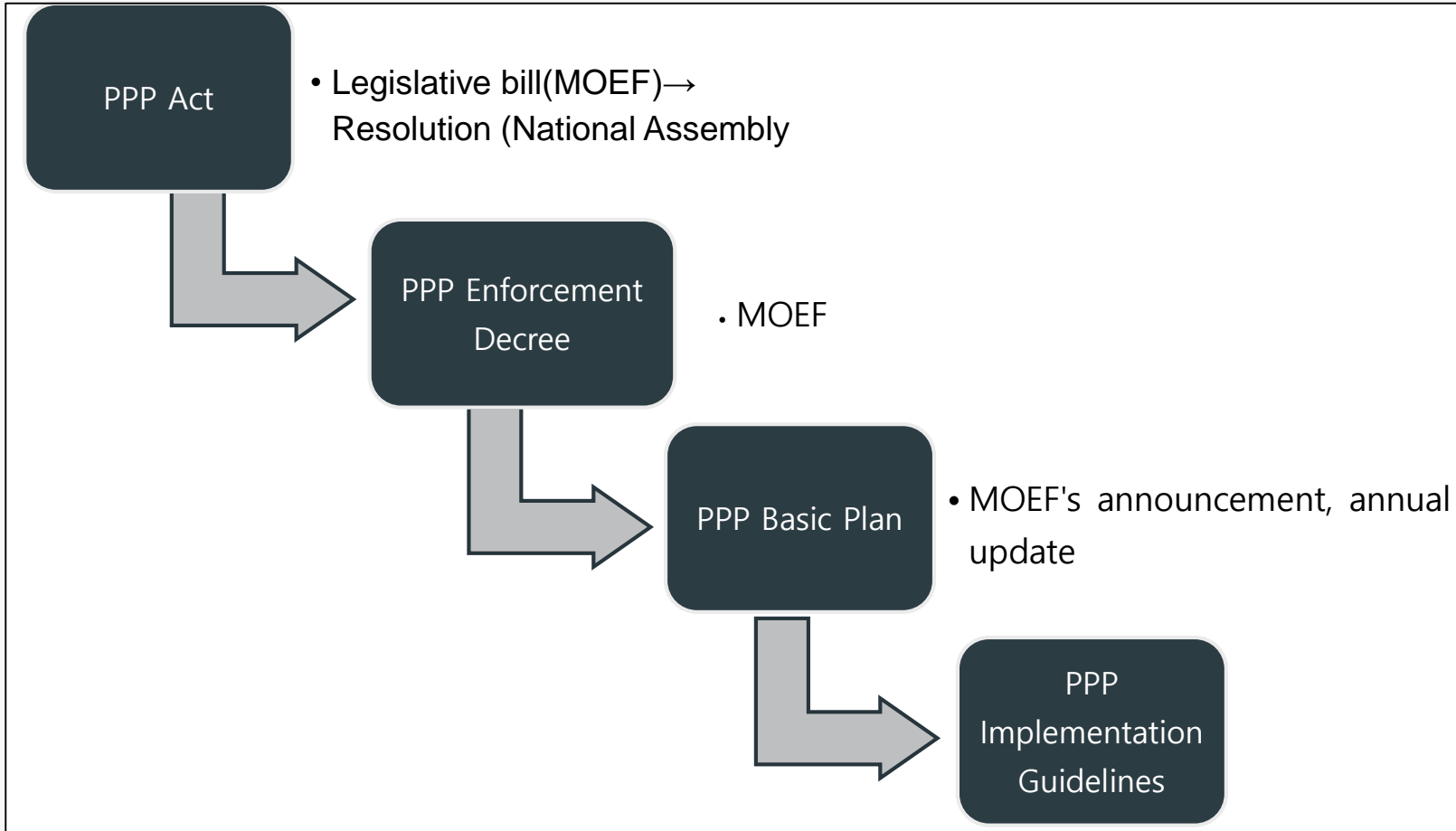
❖ A core of the PPP regulatory framework is the extent to which a **PPP contract** is privileged and protected through the legal and administrative arrangements.

- Strong protection for the PPP contract is required especially under the civil law system.
 - ✓ PPP-specific legislation and related regulatory measures
 - ✓ Standardization of PPP contract
- **Risk allocation agreement** is an essential security for both public sector and private investors
 - ✓ Universal risk allocation guideline lessens public sector's burden in negotiating
 - ✓ Security for long-term investors

❖ How to standardize

- ✓ Model contract clauses
- ✓ User-pays type and Government-pays type respectively
- ✓ By sector (Road user-pays/ Environmental facilities user-pays/Government-pays)
- ✓ Updated in accordance with legislation, PPP Basic Plan, MOEF's policy statement ➡ Key risk allocation principle should be affirmed by PPP Basic Plan

❖ Hierarchy of PPP Framework and Standard PPP contract



❖ **Who** is in charge of standardization?

- ✓ KDI PIMAC, Statutory independent PPP Unit
- ✓ Authorized to enact and update the Standard PPP Contract by PPP Act
- ✓ Staffs with expertise (legal, finance, technical)

❖ **Who uses** the standardized PPP Contract?

- ✓ Negotiating parties (Authority & Potential concessionaire)
- ✓ Practical guideline for negotiation parties

❖ **Advantages** of standardization

- ✓ Standard risk allocation could facilitate the negotiation process
- ✓ Can save the time and effort
- ✓ Specific project's agreement can be reviewed against standardized PPP contract.

Justification for standardization

❖ From an authority's view

- Contract should be binding for a long-term contract period in enforcing the private party's obligation.
- ✓ The authority should enforce the concessionaire to complete a construction
- ✓ The authority should enforce the concessionaire's maintenance and operation service requirement
- ✓ If any breach or default from concessionaire, the authority should enforce the contractual obligation to concessionaire.
- ✓ Equally applied risk allocation principle would enhance the universality of administration

Justification for standardization

❖ From a concessionaire's view

- Contract should be binding for a long-term period in setting the secured measures in the following situations ;
- ✓ The concessionaire is entitled to be paid from users or government for an agreed period.
- ✓ The concessionaire should be compensated in an early termination due to authority's default or force majeure.
- ✓ If any deduction of concessionaire's remuneration, the rule for the deduction should be clearly agreed between parties.
- ✓ The contractual arrangement should be secured for the purpose of providing a security to lenders
- ✓ Standard risk allocation principle would avoid the uncertainty

❖ Risk allocation 1) Land acquisition

✓ Article 55 (Provision of Land for Project Site)

(2) The competent authority shall provide the Concessionaire with the land for this project as necessary for the Concessionaire's construction and operation of facilities under this project immediately upon completion of relevant procedures for the section for which compensation is not required and immediately upon completion of the compensation procedure for the section for which compensation is required.

In providing the land for this project, the competent authority shall allow the Concessionaire to exercise the right to occupy and use the land, the right to use the land without consideration, and other rights recognized necessary for the Concessionaire to carry out this project under this Agreement during the project period without incurring any burden of tax, public charge, or security right

03 Key provisions of Standardized Contract **Risk allocation- Construction completion**

❖ Risk allocation 2) Construction completion

- Completion risk is borne by concessionaire; The concessionaire should be responsible for completing the construction in an agreed project cost within an agreed completion date.
- Total project cost is not variable unless otherwise agreed in the concession agreement.
- ✓ Article 12 (Total Project Cost and Total Private Project Cost)
 - The total project cost shall be KRW [] at constant price as at (Date) as set out in Table OO (Total Project Cost) and the total private project cost shall be KRW [], excluding construction subsidies of KRW [] from the total project cost. The total project cost shall not be variable, except as otherwise stipulated in this Agreement

Risk allocation- Construction completion (cont.)

✓ Article 13 (Amendment of Total Project Cost)

(1) If deemed necessary to adjust the total project cost fixed in this Agreement because any of the following events has occurred, the total project cost may be amended by a mutual agreement between the parties;

1. If there is a change in construction cost, significantly **higher or lower than price fluctuation rates** during the construction period;
2. If the total project cost increases or decreases due to the competent authority's fault or a force majeure event;
3. If the total project cost increases or decreases due to the enactment or amendment of an Act or subordinate statute, or specifications that may directly affect construction cost, the design standards established by the Government, or design rules or guidelines (including design standards of the Korea Highway Corporation);
4. If the total project cost is increased or decreased with the competent authority's authorization in response to an environmental or traffic impact assessment, a request by an authorizing or permitting authority, consultation with a local government, or any civil petition;
5. If the total project cost is increased or decreased in response to the competent authority's demand.

❖ Risk allocation 3) Demand risk

- ✓ Article 58-3 (Management of Demand Risk) of Road BTO contract

If there is a difference between the demand actually generated from the use of the main facilities and the estimated demand for the main facilities specified in this Agreement, the liability therefor and risks therein shall be taken by the Concessionaire, except as otherwise stipulated in this Agreement

- ❖ Demand risk sharing measures are devised by PPP Basic Plan, if then, standard contract reflects these measures. Other than the these PPP Basic Plan, in user-pays PPP, the concessionaire bears a demand risk

Early Termination

- ❖ Risk allocation 4) Early Termination
- ◆ Standardization of termination compensation : since 2001, the PPP Basic Plan has provided the specific calculation criteria for the early termination payment.
 - Standard calculation criteria for termination payments could provide a consistent approach in regard to issues related to contingent fiscal liabilities.
 - Also, this standard criteria may provide the investors with great certainty to the extent that might decrease the transactional costs.
- ◆ The termination payment is determined depending on who is defaulting party.
 - Termination by concessionaire's default : private investment cost(equity and subordinated loans are excluded)
 - Termination by authority's default during operation period : future cash flow would be reflected in compensation

Force Majeure

- ❖ Risk allocation 5) Force Majeure
 - ◆ Political force majeure → 90% of costs actually incurred shall be borne by the competent authority;
 - ◆ Non-political force majeure → 80% of costs actually incurred shall be borne by the competent authority;
 - ◆ Compensation when contract is terminated due to force majeure

Dispute Resolution

❖ Dispute Resolution

➤ Article 77 (Arbitration,)

(1) The parties to the Agreement may agree to resolve all disputes arising from or in connection with this Agreement by arbitration of the Korean Commercial Arbitration Board in accordance with the Arbitration Act and the Arbitration Rules.

(2) The language used in arbitration shall be Korean language, and the formation of the arbitration panel, the appointment of arbitrators, and arbitration procedures shall be governed by Acts, subordinate statutes, and regulations of the Republic of Korea regarding commercial arbitration.

(3) The parties shall be finally and conclusively bound by an arbitration award without resorting to any special means for appeal. The parties hereby relinquish a right to appeal and a right to claim repayment in whatsoever form to a court or any other judicial authority having jurisdiction and waive their rights to do so.

04 Conclusion Implication from Korean Experience

- ◆ Legal and administrative measures to provide the enabling environment in favor of PPP contract
 - Solid protection for PPP Contract through PPP Act
 - Standard risk allocation affirmed by PPP Basic Plan
 - Key risk allocation (Land acquisition, Compensation event(Termination, Force majeure etc.) should be clearly affirmed by standardized PPP contract
- ◆ Standardized PPP Contract could be a good signal to investors
 - Key risk allocation is affirmed by policy and standardization
 - Security to lenders