

■ **What are the top three advantages of KDI's standardized contract model?**

*I would like to place first advantage on the effect of facilitating the negotiation process by relieving the responsibility of public officials.*

The public officials' discretion or power in deciding the principal risk allocation methods may vary depending on each country's PPP framework. The more discretion the public officials have in negotiating, the more political or post-audit responsibility the officials might take. Even though the public officials might enjoy the infinite discretion in an exceptional circumstance, in most cases they tend to be afraid of such responsibility and thus unable to negotiate positively.

The PPP contract incurs a fiscal liability to the government side as a result of risk sharing measures, for example, construction subsidy, compensation events and early termination. This fiscal liability tends to be subject of political debate or audit. If the public officials don't have a reliable resource on the risk allocation or compensation criteria for projects, they would hesitate in making a decision which should incur the government's fiscal liability.

The standardized PPP contract provides the standard risk allocation model, i.e. when the government should compensate, how much early termination payment is paid, how the government should mitigate the revenue risk of private sector. The standard financial model is also published to reflect all the financial terms and conditions. By citing this standardized model, the negotiating officials in the line ministries are able to reduce their discretion in deciding the contract terms and risk allocation principles.

If the standard contract is approved by influential ministry within the government, the reliability and trust from line ministries could be highly enhanced. Even though the standardized PPP contract is prepared by KDI PIMAC which is the statutory independent PPP unit, the Ministry of Economy and Finance ("MOEF") in Korea approves the standardized risk allocation principles and the standard PPP contract. The MOEF has the powerful influence on line ministries in that the MOEF is responsible for budget and finance.

The MOEF plays a key role in approving the standardized PPP contract. MOEF's statutory policy statement, PPP Basic Plan has been announced and updated annually. This PPP Basic Plan comprehensively encompasses annual investment goal, guidelines which governs the PPP projects. In this PPP Basic Plan, the MOEF has announced special measures to mitigate private partner's revenue risk for the user-pays PPP model.

Throughout the 25years of PPP history in Korea, several risk sharing measures in revenue risk have been announced or transformed by MOEF, and then these measures have been incorporated into the Standard PPP Contract by KDI PIMAC. The public officials in line ministries would have no reason to hesitate in negotiating and signing the individual PPP contracts which exactly follow the standardized contract. The negotiating officials in the line

ministries would have faced the political responsibility if the decisions for risk sharing measures had made solely within individual ministries. The negotiating officials have complied with the risk allocation measures confirmed and declared by the budget ministry's policy, which can lessen the responsibility of the individual officials.

*Secondly, standard contract helps to induce the private party's trust.*

The private partners in PPP place the top priority in making an investment decision on whether return of the investment is sustained in a stable manner. Also, they first consider the safeguards in place to protect their investment even if unforeseen circumstances arise. All major risk allocation measures pre-announced through standard contract can elicit the trust from the private party.

Private partners encompass contractors for construction and operation as well as financial investors. The private party can identify the risk allocation principles in advance because the standardized contract provides all provisions relating to construction, operation, force majeure and termination confirmed within the legal framework and policy direction.

To the contractors for construction, the provisions of the standard contract that may relieve concerns on risks of land acquisition, construction, *force majeure*, or early termination are meaningful. From the perspective of the contractors for operation and financial investors, confidence in securing stable revenues during the operation period and recouping investment in the case of early termination is of great importance. Therefore, the measures to mitigate demand risk and the *force majeure* or early termination of a project should be a primary consideration. From the lenders' point of view, the security or collaterals which the private party may set without contracting authority's interference is a main concern. The standard contract provides that contracting authority consents to concessionaire's provision of collateral to lenders.

The full contract clauses which encompass the PPP risk allocation measures during the PPP project cycle could be a gesture of welcome to private investors.

*Thirdly, I would like to place third advantage on the time- saving effect in negotiation.*

There is also time-saving effect in negotiation. It takes quite a while for all the project conditions to be negotiated between the parties. The calculation of costs and its verification, the estimates of future demand and resulting revenue and financial terms are all the target of negotiation.

The negotiating parties check the details of unit price and quantity in calculating the project (construction and operation) cost and then verify this calculation of the cost. Also, the negotiating parties agree the estimates of the future demand. In addition to these cost and demand factors, the financial terms should be agreed to fix the project terms and conditions.

Under the Korea's negotiation practice where unsolicited projects have been actively implemented, the negotiation phase is final stage for government to set the project conditions. From the private party's point of view, the negotiation results are enforceable and fixed during the entire project period. All contractual terms which are finally negotiated are fixed, and there is little likelihood of renegotiation. Because of this inflexibility of contractual terms, the negotiation parties continue to have a difficult tug-of-war over the negotiation conditions. The contracting authority may seek lower fiscal burden or lower user-fee while the private party may pursue high return of the project. The authorized guideline could be a good solution to these unyielding situation.

The negotiation team consists of the working-level and principal members from both the contracting authority and the preferred negotiation party as well as the outside experts as an aide to the respective party. The working-level meetings focus on project condition details and are held periodically on the specific terms, i.e. demand, cost, project IRR, user-fee, contract period.

After the working-level meeting finishes, the principals from the both side meet and sign based on the results from the working-level discussion. Due to this time-consuming process, in most cases it tends to take a year or longer in signing the PPP contract. The parties save this time by making use of the standard contract in finalizing their own contract.

The standardized contract provides the basic allocation of risks and sets out the wording of the whole paragraph of the contract. If the negotiated outcome and the financial model are finalized, the time to sign the agreement itself is shortened since the entire contract clauses just follow the standardized contract.

- **What would be two recommendations that you would give to the countries in LAC to promote the standardization of its contracts.**

*My first recommendation is that legal and policy framework need to be firmly established so that these frameworks strengthens the standardized PPP contract.*

The core of the standardized PPP contract is the risk allocation agreement. If the risk allocation principle complies with the legal and policy framework, the contracting parties would readily adopt the standardized contract.

Some risk allocation principles need to be handled with great care as to whether they are acceptable within the legal environment. Some risk allocation principles need to be confirmed and declared by the influential ministry within the government.

Let me give some examples of Korea.

- 1) The firm legal basis for the land acquisition is a good example.

Land acquisition risk is a key risk which private partners encounter in economic infrastructure (Toll road and railway). Also, even in social infrastructure which is built in the designated area, normally within the publicly-owned land, the land acquisition cost could be a barrier to private partner. If the public authority doesn't take this risk, the private partner is not able to handle due to their weak taking power.

The legal framework has been established so as to allow the public authority to provide the publicly-owned property for free to the private partner for PPP projects where the ownership is transferred to the public authority. Also, the private party is entitled to take the privately-owned land under the PPP Act. If the private partner wants to entrust its taking power to the public authority, the public authority may take the privately-owned land for the sake of the private partner as a trustee. The authority's risk taking in land acquisition under the legal framework is not a target of negotiation. The standardized contract need not to articulate a different scheme.

- 2) Let me give a good example of role of policy framework for standardized contract.

The risk allocation in demand or revenue risk is an example of powerful policy framework for the standardized contract.

Demand risk is a key risk in user-pays PPP (concession) model. The private partners are keen to make sure the revenue is guaranteed up to their investment and expected rate of return. On

the other hand, the public authorities' concern is that the guarantee of the future revenue could lead to government's fiscal burden or could result in a higher user-fee.

Strong policy direction for mitigation of demand risk is required so as to both parties can rely on. The MOEF in Korea plays the role of coming up a compromise for both contracting authority and private partner. Through the announcement of PPP Basic Plan, MOEF has declared some major risk sharing methods for user-pays PPP. Historically, in the year of 1999, 2009 and 2015, the MOEF announced the direction to guarantee a portion of the income or a portion of the investment cost as a risk sharing in demand for user-pays PPP.

Once these risk-sharing devices are established in a policy direction, the risk sharing method is reflected in the PPP contracts. Without this policy direction, it is very difficult to devise a unique demand risk sharing in the standardized contract. Also, it is highly unlikely that the parties would accept the unapproved risk allocation principles.

Another example of strong policy framework can be found in articulating the early termination compensation criteria. The PPP Basic Plan provides the early termination payment calculation method. Because the MOEF has a budget allocation and financing power, these criteria could be binding to contracting authority. The standardized contract also follow the same approach as the PPP Basic Plan. In an individual negotiation, there is no much room for different scheme.

*My second recommendation is that the establishment of PPP unit could promote the standardization of PPP contracts.*

Standardized PPP contract encompasses a various aspects of PPP projects. Construction, operation, financing issues as well as legal aspects all are incorporated into the contract. Professionals from technology, financing and legal field can play a key role in producing a standardized contract and financial model. Also, PPP contracts continue to be managed for a long-term period. New issues are steadily raised through contract management and the standardized contract need to incorporate these issues and be updated. The standardization of PPP contract is not a one-off work, it needs constant updates and management.

On the other hand, the public officials, in line ministry or budge ministry is subject to personnel transfers which means they are not fully specialized in the PPP contracts.

This is why the independent PPP unit which comprises experts from these various sectors play a key role in establishing and managing the standardized contract. The professionals in PPP unit tend to have a deep understanding of the PPP market. If these experts work well with policy makers, the outcome will be a satisfying outcome for both the government and investors

■ Can you give us a specific PPP case in Korea benefited from the standardized PPP contract model?

❖ Case study of Seobu Naeryuk [West Inland] highway

- Project Type : User pays(BTO) type
- Scope : total length of 138.3km
- Competent authority : The Minister of Land, Infrastructure, and Transport
- Total Cost : 2.1 trillion KRW (1.9 billion USD)
- Operation period : Stage 1: 40 years, Stage 2: 30 years
- Negotiation period : 16 months(A total of 28 rounds of working-level meetings)
- Contract agreement date : 2017.2

“SC” means the Standardized Contract.

Demand Risk	Same as the SC	Borne by the concessionaire
Land Purchase and acquisition risk	Same as the SC)	Borne by the competent authority
Early Termination	Identical to those of the SC & PPP Basic Plan	Compensation depending on the defaulting party <ul style="list-style-type: none"> <li>• Concessionaire’s default</li> <li>• Authority’s default</li> <li>• Force majeure</li> </ul>
Force Majeure	Identical to those of the SC	The Concessionaires are entitled to be compensated 80% or 90% of additionally incurred costs
Cost overrun risk	Identical to those of the SC	SC clause is adopted with adding some details. <ul style="list-style-type: none"> <li>• When the competent authority requests for construction or alteration of an interchange (IC) or junction (JCT)</li> </ul>

		<ul style="list-style-type: none"> <li>When taxes and the public utilities' charge increase/decrease due to a reason not imputable to the concessionaire</li> </ul>
Refinancing Gain Sharing	Identical to those of the SC	Refinancing gain sharing by 50:50
User fees, others	Identical to those of the SC	