



TRAINING MANUAL 4 Private Sector Participation

Module 4-5: Contract Preparation and Procurement Major Critical Contract Issues / Terms of Contract

Prepared by the International Consortium
GTZ-ERM-GKW



These Training Tools are part of the

Training Manual for ISWM: Private Sector Participation for Waste Management Services

This Training Manual has been prepared in support of capacity development of waste management service delivery through Private Sector Participation (PSP),

The Training Manual contains 4 categories of modules:

1. Category 1: Private Sector Participation - General Approach and Framework Requirements (one module)
2. Category 2: Private Sector Participation - Choice of the appropriate contract model (three modules)
3. Category 3: Private Sector Participation - Contract preparation and procurement (three modules)
4. Category 4: Private Sector Participation - Contract monitoring (one module)

This particular Module **4-5 “Major Critical Contract Issues / Terms of Contract”** is the first module of the third Category. This document includes a description and assessment of several critical issues in contracts for Private Sector Participation (PSP) in different ISWM activities. It should be considered after a general decision for PSP has been taken and the general type of contract (e.g. Service contract or DBO contract) has been identified (see the PSP training modules, Category 2: “Choice of the appropriate contract model”).

The subsequent modules of this third Category will focus on:

- procurement approach
- Case Study: Private Sector Participation Solid Waste Management in Alexandria - Governorate, Egypt

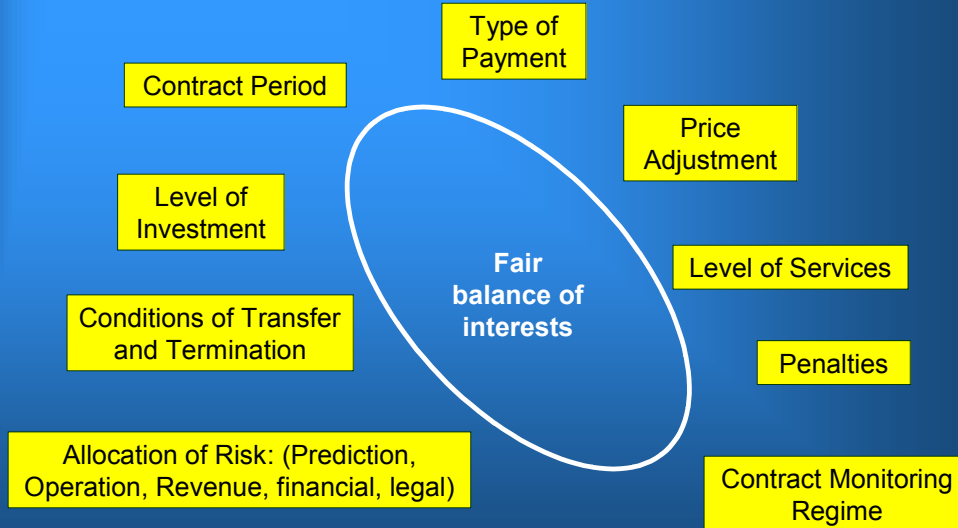


Content

- I. Overview
- II. Introduction
- III. Particular Contract Issues
 - A) Contract Period
 - B) Type of Payment
 - C) Price Adjustment
 - D) Change of Requested Services
 - E) Penalties
 - F) Incentives
 - G) Guarantees
 - H) Allocation of Key Risks
 - I) Settlement of Disputes
 - J) Contract Monitoring Regime
- IV. Additional Sources of Information
- V. Conclusion



Introduction



Introduction

This document includes a description and assessment of several critical issues in contracts for Private Sector Participation (PSP) in different ISWM activities. It should be considered after a general decision for PSP has been taken and the general type of contract (e.g. Service contract or DBO contract) has been identified (see TM 4-2).

The contractual clauses differ with regard to national legal framework, ownership, responsibility for investment, operation, share of risks and contract duration depending on the type of contract. However, several issues need to be addressed in most of the contract types. Emphasis has been given to the typical content of service contracts, as it is not possible to cover all items with regard to complex DBO or BOT contracts. Additional Sources of Information are provided.

As the approach for PSP for the provision of ISWM is a relatively new approach in the region, the national contractual frameworks are not yet fully developed. During the analysis of the current situation several contractual problems have been identified. There are various examples of contractual clauses addressing critical items which are not fulfilling the requirements of both contract partners. These items lead to ongoing conflicts and disputes and in many cases contracts have been terminated by one party due to an unacceptable situation.

Analysing these different aspects should lead to the development of an appropriate contract which ensures that the aim of the contract, the implementation and provision of services or works, is taking place successfully and in an effective, correct and fair manner.

A 1) Contract Period

The contract period depends on:

The depreciation time of investment

Investment for construction and equipment within the same contract have different depreciation time and different needs of reinvestment.

The conditions of Transfer

In case that the investment is transferred earlier than the depreciation time of the investment, the Contractor will need compensation. The shorter the time till transfer the higher compensation will be needed. (Or if no compensation is agreed in the contract clauses, the fee per unit will be higher)



Contract Period (1)

All contracts with the private sector should be of sufficient duration or sufficient compensation in case of transfer to make them bankable.

Due to this the contract clauses concerning the duration of the contract, the requested investment, the transfer and the termination and early termination should be drafted in well balanced relationship.

Appropriate contract periods increase the attractiveness of the work for the private sector participants and lower the costs considerably.

Mention: continuous investment could be necessary even short time before regular contract termination and possible transfer. Therefore equations and procedures for the remaining value at the regular termination (and transfer) date are needed. Also in case of "early termination" these equations and procedures are needed.

Example: In the METAP region (e.g. in Tunisia) due to legal restrictions, contracts are often awarded only for a period of 1-2 years, sometimes including an option for a step by step contract extension. Such limited contract period makes it unattractive for the contractor to invest in new and more cost effective equipment as he risks a termination of the contract before depreciation of equipment and repayment of his loans. Quite often this will lead to higher unit costs. In Tunisia therefore, it is intended to change the relevant laws in order to allow longer contract durations.

A counter example is the current tender procedure for the waste collection and street sweeping services for the city of Casablanca, Morocco which has a contract period of 10 years.



A 2) Typical Contract Periods

Service contract with low degree of technical equipment

1 – 3 years

Waste collection, waste transport and landfill operation

5 – 8 years

Construction and operation of facilities

See next slide



Typical Contract Periods

In case of contracts involving a lower degree of technical equipment such as (manual) street sweeping services a limited contract period of 1-3 years might be appropriate because no or only limited equipment with a longer depreciation period is required.

In the case that the compensation of termination should be low, appropriate contract periods for waste collection, waste transport or landfill operation should be in a range of 5 to 8 years.

With regard to construction and operation of waste management facilities as landfills, the depreciation times are considerably longer and vary between 15 and 25 years. The following slide, which is a repetition out of the training module PSP 4-2.1, shows modern contract types to cover such investment and depreciation times with different contract duration and different dates of transfer.

A 3) Contract Duration, Transfer and Termination of Contract Types for Investment in Facilities

	Duration				
	< 5 y	5 – 10 y	10 – 20 y	20 – 30 y	> 30 y
DBO	----- Termination				
BTO	----- Termination				
BOT	----- Termination				
BOO	-----				

DBO Design-Build-Operate **BTO** Build-Transfer-Operate
BOT Build-Operate-Transfer **BOO** Build-Own-Operate

Duration, Transfer and Termination of DBO / BTO / BOT and BOO Contracts

The figure demonstrates the differences of the duration, Transfer of the facility and the contract termination.

The contract duration can be different from that shown, but in general the structure of the different contract types will be as shown.

The DBO contract doesn't need any "transfer" because the investment construction is paid step by step during the completion of the construction.

The BTO contract defines early transfer and ongoing operation after transfer.

The BOT contract defines late transfer and in parallel termination.

The BOO contract does not define any transfer or termination.



A 4) Start of Operation / Transition Period (1)

The clauses on the start of operation and the clauses on transition period are connected:

If the private contractor should start more or less immediately (taking over the complete staff, equipment and facilities) a defined transition period is needed to enhance efficiency and provided services up to the level requested in the bidding documents.

If the private contractor is allowed to prepare his investment and to choose his own personnel (e.g. out of the existing staff) the transition period to reach compliance with the requested level of services could be shortened

After the contract signing procedure (or even a defined date before) the public authority should need the approval of the private contractor in any case of incurring debts and future liabilities (as staffing; contracts) which should be transferred to the private contractor.



Start of Operation

The start of operation must be clearly defined and has to take into account the complexity of the contract and the required preparation. The more complicated the contract, and the more time consuming the supply of equipment that is needed, the longer the period between signing the contract and the start of operation is required. All over the region contractors complain that they usually do not have enough time for preparation especially for supply of appropriate equipment. A defined transition period could be a possible way to start operation early after contract signing but the requested level of service could be reduced.

In general the contractor will do his best in order to start operation and be in compliance with the requested level of services as soon as possible, because start of operation is a pre-caution for his payment. However, there are several examples especially in the case of international supply of various equipment for large contracts in which a period of up to 6-12 months is required before start of operation is possible. In addition, the issue gets worse in the case that there is a delay e.g. with regard to custom clearance, obtaining required permits that can not be influenced by the contractor. In such cases a respective procedure for adjustment of the start of operation is required.

In case of complex contracts such as huge collection contracts covering several collection zones, a step by step approach might be required to start operation zone by zone. This might be easy if the public sector provides the services. If the current work is already executed by private Operators that are going to be replaced by a new contractor, a clear interface is required in order to have a defined taking over procedure.

Notes Continued on Next Slide



A 4) Start of Operation / Transition Period (2)

The clauses on the start of operation and the clauses on transition period are connected:

If the private contractor should start more or less immediately (taking over the complete staff, equipment and facilities) a defined transition period is needed to enhance efficiency and provided services up to the level requested in the bidding documents.

If the private contractor is allowed to prepare his investment and to choose his own personnel (e.g. out of the existing staff) the transition period to reach compliance with the requested level of services could be shortened

After the contract signing procedure (or even a defined date before) the public authority should need the approval of the private contractor in any case of incurring debts and future liabilities (as staffing; contracts) which should be transferred to the private contractor.



Example: The implementation of large collection contracts for major Egyptian cities such as Alexandria and Cairo was obstructed due to custom problems with regard to the import of collection equipment by the international contractors. In view of this, the start of operations were delayed considerably.

In some case it was observed, that the public authority incurs unfavourable debts like staffing of new employees after closing of the (concession) contract . The private contract than refuses such contracts after his start of operation and the first dispute arises. To avoid such disputes a clause is necessary to oblige the public authority to apply the contractor for approval of all future liabilities exceeding a certain level.

A 5) Extension of Contract

Numerous contracts in the region are extended or renewed on a year by year base (some of them are, because of particular national laws)

Effects of renewed contract on a year by year basis.

- Higher risk for the private contractor to recover investment
- Lower interest to maintain vehicles and facilities
- → service provided with lower efficiency

General Rule: Contracts including periodic extension are less appropriate than defined long term contracts with termination and hand over conditions.

Extension of Contract

All over the region there are numerous contracts which are renewed or extended on a year by year basis. Sometimes these short contract periods are caused by respective legal requirements in the national tendering laws which should be adjusted accordingly.

Such approach is creating less comfort and additional risk for the Contractor than a defined long term contract covering the whole depreciation period. Respectively they are less attractive and more costly than contracts with appropriate contract periods.

There is no reason to have an annual extension. If the contract performance is poor as well in case of a 5-8 year contract might be terminated after one year based on a respective procedure for early termination.

Anyway, after a certain period a new tendering procedure should be performed in order to test the market and avoid the development of monopolies. The previous service provider should be allowed to participate in the new procedure and might demonstrate that he is able to present the most economic proposal.

A 6) Termination of Contract

Reasons for early Termination of Contracts:

Contractors fault (without compensation):

- Insolvency or bankruptcy
- Failure in providing required permits
- Series of contract breaches
- Non remediation of notified defects

Early Termination requested by the public authority (with compensation):

- Fundamental change of the waste management concept

Termination of Contract

An early termination of contract should remain a rare exception and not periodically applied as it occurs in the Region. However, there might be some reasons for a contracting Authority to terminate the contract such as fundamental changes with regard to the waste management concept that do not fit at all with the current contracts.

In the case where a Contracting Authority is requesting a termination which is not caused by the Contractor's fault, a clear procedure should be defined and applied. This might include an obligation in order to compensate reasonable and justified losses of the Contractor including loss of profit.

However, there are default events which allow the Contracting Authority to terminate the agreement without compensation such as insolvency or bankruptcy, failure in providing required permits, series of breaches of the Contract and non remediation of notified defects.

The option for the Contractor to terminate the contract should be restricted to the failure of the Contracting Authority to pay the Contractor exceeding a defined sum. It should not be the choice of the Contractor to run away from the contract as soon as a more attractive opportunity occurs. However, these cases have been reported as often as cases in which the contracting authority did not pay although works and services have been provided in accordance with the contract.

Example: In Tunisia, up to 50% of all collection contracts that have been awarded in the recent years have been terminated early due to several reasons – this has been due to contractors not fulfilling their obligations but also, the contracting authority not being able to pay the contract price.

B 1) Type or Payment (Lump Sum – Unit Price)

Items as basis for unit price

Collection contract

per ton, per container, per capita

Waste Transfer
Contract

Per ton and distance (€/t*km)

Waste Disposal
Contract

Per ton, per capita

General Rule: Payment in all types of contracts should, if possible, be linked with some kind of measurement of work provided in combination with a defined unit.

11



Measurement and Payment (1): Lump Sum Versus Unit Price Payment

There are several options in order to define the method of measurement and payment within a contract. Most important methods are lump sum and unit price payment. Periodic lump sum payments do not take into account the actual workload within the period and are appropriate when the nature and quantity of work can be clearly defined and would not be expected to change during the life of the contract. Payments based on unit prices and measurement reflect the extent of work carried out.

Examples of items to be measured, include:

- collection contract: unit price for each tonne of waste collected and / or number of containers provided and served by the contractor
- waste transfer contract: unit price for each tonne of waste transferred between transfer station and landfill, or each container transfer (based on a certain defined distance)
- waste disposal contract (landfill operation, composting): unit price for each tonne disposed at the landfill / treated in the composting plant.

In case of such linkages between the service provided and payment, there is a simple mechanism to adjust payment when changes occur, such as an increase in waste quantities or number of containers etc. Such a mechanism ensures fairness and reduces risks for the contractor. Where there is an increase in waste generation, which for example might require supply of additional vehicles, the contractor will receive an adjusted payment. In view of this, the expected overall quantities to be collected should be clearly stated in the contract to provide a basis for assessing the change in scope of works and capital / operating costs relating to waste collection. The same approach should be considered where the scope of work in other areas change.

B 2) Avoid Misuse of Unit Price Payment

Weighbridge	Operated or supervised by the public Authority
Spot check	of the origin and the composition of the charged waste
Measures to avoid bribery and corruption	Rotation of personnel, unexpected evaluation / control of the personnel

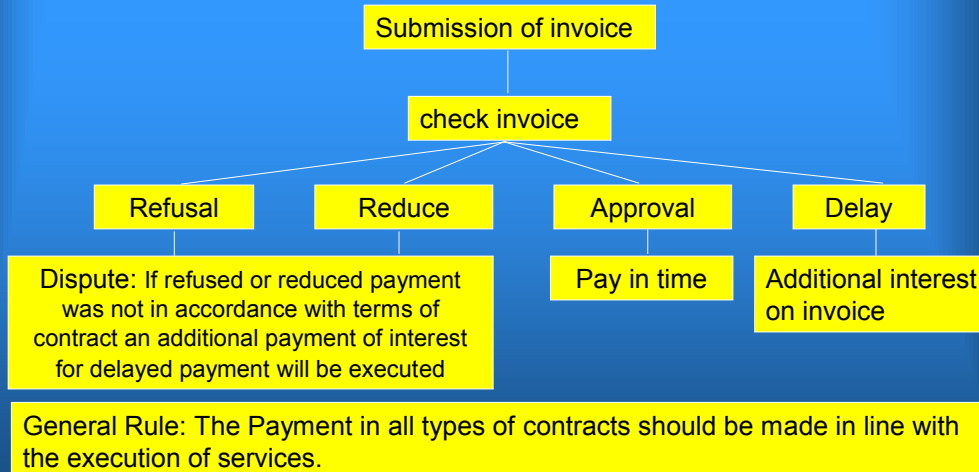
Avoid Misuse of Unit Price Payment

However, such measurement and payment requires a defined and verifiable measurement procedure. Such procedure should be based on a weighbridge that is operated or at least supervised by the employer. Otherwise there is a strong temptation for the contractor to manipulate the measurement in order to increase his payment. An assessment without a weighbridge e.g. based on the volume of the truck and an assumed density, often is not exact enough to form the basis for the reimbursement of the contractor. In addition during the design of the measurement and payment clauses a cross check should always be undertaken in order to identify potential options of misuse and fraud.

Example: For situations where payments were based on the waste quantity collected and delivered to the landfill: the contractor might try to also charge for commercial waste that they have collected under separate contracts with commercial waste producers and for which they have already charged the waste generator.

On the other hand weighbridges are often not yet installed so that no correct measurement is possible. Therefore often Contracts are based on a lump sum payment (fixed payment per year). This leads to a higher risk to be covered by the contractor in case that waste quantities increase and the contractor might therefore include a surcharge in their proposal. It might be considered to have at least an adjustment based on the number of inhabitants served or on other measurable items which determine the work.

B 3) Payment Schedule and Delay of Payment



Payment Schedule and Delay of Payment

In collection contracts payments are usually made on a monthly, bi-monthly or quarterly basis. Service contracts usually include no advance payment. The contractor will re-finance his initial investment e.g. for the supply of the equipment during the whole contract duration.

In construction or DBO Contracts the payment should be in line with the design, construction and operation progress. This includes a step by step payment beginning with an advanced payment and further down payments during design and construction stage to cover investment costs as well as periodic payments during operation period.

Delay between submission of invoice and payment should be reduced to the minimum that is required for the approval and administration procedure (e.g. 1-2 months).

In the same manner the Contractor is requested to execute the service according to the contract, each Contractor expects to receive his payment in time. In order to outline the willingness of the Contracting Authority to pay in time, a penal interest clause should be included: In case that there is a delay of payment exceeding one month after the defined date the contracting authority is obliged to pay an additional interest for the delayed period (e.g. inflation rate or defined national bank interest rate plus 3%).

Example: There are several examples all over the region in which the payment is delayed dramatically up to a period of 12 months. Although this might be attractive for the contracting authority, in the long run it will lead to a destabilisation of the private sector and to an increase in costs as the contractor has to include a surcharge for the interest during the delay period.

C) Price Adjustment: Example

$$PPU (y+1) = PPU (y) * (1 + (FCp*FCi + ECp*ECi + ECCp*ECCi + IFIp*IFLe + NBp*NBi + Ep*Ee))$$

PPU = Price Per Unit; (y+1) = for the next year (or period); (y) actual year

FC = Fuel Costs, EC = Employment Costs, IFI = Cost for IFI loans,
NB = Costs for National Bank loans, E = Costs for (foreign) Equity

p = portion on the total costs, sum of the portion should be less than 100% (e.g. 80%)

i = price index (change of prices), source (if available): National Statistic Institute (in national currency)

e = exchange index

General Rule: The longer the contract duration and the higher the (foreign) investment the more important is a fair price adjustment procedure.
Unprofessional combination of price adjustment due to inflation and exchange rate will lead to unreasonable price increase.

Price Adjustment

All contracts with a contract duration exceeding approximately 18 months (depending on the type of contract and expected price development in the specific country) should have a fair price adjustment procedure. Such price adjustment is required in order to cover the risk of drastic inflation or increase in other cost factors (e.g. fuel cost, personnel costs, taxes).

Unfortunately, most contracts for ISWM services do not include an appropriate price adjustment clause. In case that no price adjustment is foreseen the contractor has to include the expected price development in their proposal price and might include a surcharge to cover their risks. In addition, the contractor might run away from the contract after a certain period because due to the price development the contract is no longer profitable and creates losses.

Advanced price adjustment clauses as shown in the above as example are covering a large portion e.g. Upto 80% of the total costs and include a fair split of cost factors such as personal costs, equipment costs and fuel costs and investment costs (on loans and equity). For each of this cost factors the proportion of the total costs and the adequate index of the National Statistic Institute (or other Institution) has to be considered.

To enforce the Contractor to enhance efficiency a portion of the total Costs should not be adjusted (e.g. 20%) so that the risk is partly shared between the contractor and the contracting authority

The proportion (p) in the calculation in the slide above could be fixed during the contract duration or be adopted each year according to the change of index.

In countries where there is a considerable inflation, it may be necessary to implement a quarterly adjustment.

In case of contracts which require the use of foreign equity or loans in foreign currency a price adjustment with regard to the exchange rate is necessary. Otherwise it might be difficult to make a contract attractive for an international operator. But it is also necessary to define the percentage of the price carefully that is effected by the exchange rate to avoid so called windfalls due to combination of price adjustment due to inflation and price adjustment due to exchange rate. Adjustment procedures to adjust 100% of the price due to exchange rate will lead to non reasonable price increase.

However, the application of such clauses should consider a specific estimation of the real proportion of each cost factor and should be applicable during the whole contracting period. (In a three year collection contract with initial procurement of vehicles, there is no need to adjust the price according to the development for the vehicle costs).

D) Change of Requested Services

Changes of provided services could be caused by:

- New requests by the local authority
- Change of (legal) framework
- Proposals to enhance services by the private contractor

Changes of provided service should be linked with change of service fee

The contractor should be obliged to submit a supplementary bid for additional services.

The supplementary bid should be connected to the clauses of dispute resolution

Change of Requested Services

A major contractual problem is the request of additional services to be provided by the Contractor and the relevant payment.

Example: It has been reported all over the Region that contracts have failed due to disputes with regard to additional or changed services. Often the contracting authority obliges the contractor to provide services that have not been specified in the TOR without any reimbursement. A similar problem occurs in the case of a change in legal framework conditions such as new or revised laws, ordinances or regulations that are not under the control of the contractor.

A typical example is the change of the site of disposal facility in a collection contract which leads to extended transportation and transfer costs. A procedure in which the contractor has the right to make a claim to the Contracting Authority should be established. The contracting authority shall have the right, as a condition for its approval, to demand inspections by itself or by an independent auditor of pertinent records that demonstrate the need for an adjustment to the Bill of Quantities rates. Negotiations might be easier if at the tendering stage several unit prices for additional services are called up such as unit prices for additional transport, or unit prices for day works (e.g. daily prices vehicles, machines and workers). The more potential changes are anticipated and addressed in the TOR the easier an agreement can be identified during the contracting period. Therefore during the elaboration of the TOR an analysis should be undertaken in order to identify the potential changes.

E) Penalties

Penalties shall

- enforce the Contractor to provide services according to the contract.
- enable substitutive execution.
- shall be connected to the procedure for dispute resolution.
- be capped to 5 to 10% of the annual turnover

Penalties shall not be used

- to reduce the expenditure of the local authority for the services
- to fund the Contract Monitoring Unit or other duties of the local authority
- As an alternative approach for early termination (tease the contractor till he "runs away")

Penalties

All over the region the application of penalty clauses is a major contractual issue that leads to dispute even up to the early termination of contracts. On the one hand the contracting authority needs to have a mechanism to enforce the keeping of the contractual obligations.

But on the other hand it has been reported several times that all over the region there is a temptation for an excessive use of penalty clauses. Such application does not aim primarily at the correct provision of services but seems like an approach to reduce the payments to the contractor. A fair procedure needs to be defined in the contract documents to ensure that services are performed according to the contractual obligations but prevents excessive misuse by the contracting authority. In general penalties should be captured (e.g. 5 to 10% of the annual turnover) to avoid misuse. The penalty regime is not installed to cover all cases of bad performance. The clause on performance guarantee (or bond) and the clause on early termination have to cover the case of crucial insufficient performance.

The determination of a penalty for a certain failure should be based on the assumption "what would it cost if the contracting authority or a third party has to solve the problem" (substitutive execution by the public service). Typically penalties should be set at a level somewhat above the costs that would be incurred by the Contractor if the services were satisfactorily provided. In order to formalise the approach a system of default points might be established. In any case cooperation and a fair, co-operative and pro-active contract management and performance monitoring should be the aim and not cost minimisation for the contracting authority.



F) Incentives

Incentives may be used to encourage the contractor to increase his performance and motivate him especially if the solid waste management services are not fully developed and require continuous improvement.

Milestones / targets and connected incentives needs to be defined in specific terms of contract

Disadvantage: The public authority has to recover the cost of (unexpected) incentives



Incentives

The implementation of incentive clauses is a new approach to encourage private sector operators to increase their performance. Compared to the traditional approach of application of penalties, incentives have the advantage that they motivate the contractor to increase the service level. If services are already well developed there might be no need for such motivation. In areas for services which are not developed so far this approach might be suitable.

However, the application of incentives requires the definition of respective milestones/ targets and procedures for fair determination of results achieved. An incentive compensation programme needs to be tailored according to the specific situation and the operational goals of the individual project on a case by case basis.

To avoid possible unexpected payment of incentives which have to be recovered by the public authority the targets or milestone could / should reflect on targets / milestones which have effects on the same time cost saving for the public authority.

Example: a management contract has incentive clauses in case of reduced energy costs. An appropriate general example for such an incentive compensation programme and the respective fulfilment of the performance incentive obligations has been prepared by the World Bank and is presented in Appendix 7 of the "Draft Generic Documents for the Design, Build Operate Contract for a Solid Waste Facility, 05/2000" This draft is developed as part of a World Bank pilot project. While the legal consultant and many Bank professionals used their best skills and know-how in drafting some rather innovative provisions, it is important to keep in mind that these draft documents have so far, (i) not been field-tested, (ii) not been reviewed by bidders in an actual application and (iii) not been adopted by the Bank even as a trial edition.

G) Guarantees

The request for the submission of a performance bond should be assessed carefully depending on the risk assigned to both parties.

Mention: the costs of bonds will raise the service fee. Due to this the duration and value of performance bond has to be designed carefully to avoid an unreasonable high service fee.

Guarantees

In a typical service contract in which the contractor is obliged to provide and finance his equipment the request for the preparation of a performance bond should be assessed carefully.

On the one hand the contracting authority has an interest that the contractor performs his contract according to the specification and in case that the contractor runs away from the contract receives some kind of compensation.

On the other hand the contracting authority has to consider that the bank that issues the bond requests a certain payment that finally will be paid by the contracting authority. It might be considered to limit the validity period of the performance bond to e.g. the first year after the signing of contract which covers the start of the operation and critical implementation of services. A typical value of the performance bond is 10 % of the annual contract value, which needs to be adjusted to the risks to be overtaken by the Contractor.

The situation is completely different, in the case that equipment is provided by the contracting authority to the contractor. In such a case a performance bond is urgently required in order to assure that the contract will be fulfilled according to the specifications and to cover the respective risks of the contracting authority. The same situation occurs in DBO or construction contracts in which a work has to be performed.

H) Allocation of Key Risks (1)

Risk	Responsible Party
Waste Management Data and Predictions	Public Authority
Operation Risk	Private Contractor
Revenue Risk	Public Authority (specific regional conditions concerning waste management)
Financial Risk	shared
Legal Risk	Public Authority

General Rule: Risks should be assigned via a clear definition to the party who has the most control over resp. influence on the risk.

Allocation of Key Risks (1)

During the preparation of the contract documents a risk analysis should be performed. The more tasks that are given to the private sector and the longer the contract period, the more risks need to be assessed and assigned to the contract partners. Therefore complex and long term DBO or BOT contracts need a very careful assessment by experienced experts.

There are various examples all over the region where contracting authorities tend to assign all types of risks to the Contractor which leads to no submission of bids for the offered tender, increase of price and a high risk that poor performance leads to an early termination of contract.

The following table lists major contractual risks and outlines suggestions on who and how these risks should be covered.

Waste Management Data and Predictions:

Waste management data on quantity and quality need to be assessed, described and predicted carefully during the preparation of the bidding documents (population growth, increase of waste quantity). The Contracting Authority should be responsible for these data. Clauses for the adjustment of payment with regard to changed waste quantities should be included. (e.g. payment based on unit prices for each ton of waste collected and disposed or population growth.)

Operation Risks

In service contracts operation risks should be assigned to the Contractor. They are obliged to fulfil the contractual obligations and has to cover the related risks (especially cost overrun, exceeding of the pledged operation costs).

However, it has to be requested and assured that the Contractor and their subcontractors, have adequate liability insurance to cover these operational risks. Operational standards (traffic, health and safety environmental protection) and performance standards need to be well justified and defined. Penalties should be applied in case that they are violated or there is a shortfall of quality.

H) Allocation of Key Risks (2)

Risk	Responsible Party
Waste Management Data and Predictions	Public Authority
Operation Risk	Private Contractor
Revenue Risk	Public Authority (specific regional conditions concerning waste management)
Financial Risk	shared
Legal Risk	Public Authority

General Rule: Risks should be assigned via a clear definition to the party who has the most control over resp. influence on the risk.

Allocation of Key Risks (2)

Revenue Risk

In case of contracts in which the contracting authority pays the Contractor for the provision of services or works the revenue risk clearly has to be assigned to the contracting authority. Cost recovery has to be assured by the contracting authority and need to be assessed via cost estimations and secured via determination of required taxes during the project implementation. Tender services that are not affordable for the Contracting Authority and the customers should never be produced!

Where the contractor is responsible for the fee collection it will cause considerably higher costs per unit due to bad debt and late payment.

Financial Risks

The financial risk of unpredicted rises of interest rate and inflation should be shared by the Contracting Authority and the Contractor. Respective clauses for price adjustment should be included.

Legal Risks

Legal risks such as changes of national or communal legislation (higher standards, new or increased taxes) or jurisdiction which lead to considerable additional costs for the contractor should be assigned to the Contracting Authority as the private sector has no chance to influence them. A respective clause including the options for comprehensible claims and negotiations should be foreseen.

I) Settlement of Disputes (1)

Avoid disputes via clear and appropriate specifications of the level of services, the requested performance and the monitoring of the performance.

Define a reasonable service level and not the maximum desirable level.

Disputes and conflicts should be resolved in a step by step procedure to avoid time consuming and expensive arbitration procedures.

This step by step procedure should be defined in the terms of contract.

Settlement of Disputes

Implementation of private sector participation involves a potential for conflicts. Two common reasons are the difficult / unsuitable framework conditions and the lack of experience of the contract parties.

Conflicts might range from disputes related to the technical performance of the Contractor (such as fulfilment of performance targets, regular provision of services, commissioning of facilities in time etc.) as well as related financial issues (such as determination of the amount to be invoiced or punctual payment by the contracting authority). Several examples in the Region outline that in many cases these conflicts cannot be resolved in an appropriate logical manner and the contracts are ultimately terminated.

It has to be pointed out that the major strategy should be to avoid conflicts by defining clear and appropriate technical specifications and contract clauses.

An example would be to describe a step by step performance criteria for the start up phase in order not to provoke a serious breach of contract right from the beginning. Due to the same reason it seems to be advisable to define a reasonable service level and not the desirable maximum one (with 100 % performance). Furthermore the contract should include clauses in order to cover several potential changes (e.g. reimbursement in case of variation of disposal site with longer distance, extension of service area etc).

I) Settlement of Disputes (2)

If disputes occur:

1.) Mutual consultation of both contract parties

2.) If 1) fails: involve a pre-defined adjudicator

3) If 2) fails: formalise arbitration procedure according to national / international rules

Settlement of Disputes

However, even if technical specifications and contract clauses are as clear and reasonable as possible a staged approach for settlements of disputes is suggested:

- First step of settlement of disputes is mutual consultation of both contract parties (via responsible representatives).
- If the parties fail to resolve such a dispute or difference by mutual consultation, the next step would be to involve a pre-defined adjudicator. Involvement of an adjudicator should enhance the prompt resolution of conflicts by an impartial person without starting formal arbitration.
- Failing the above, the final step would be the conduction of a formal arbitration procedure according to national / international rules. However, this approach is time consuming, expensive and might lead to lasting disturbance of contractual relationship.

A detailed discussion and description of several international routes to implement procedures for the settlement of disputes is provided in Chapter 6 of the document "Legislative Guide on Privately Financed Infrastructure Projects", by United Nations Commission on International Trade Law (UNCITRAL), available (as well in French and Arabic) on: <http://www.uncitral.org/english/texts/procurem/pfip-index-e.htm>



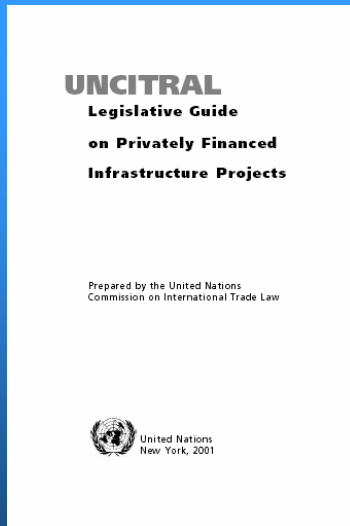
J) Contract Monitoring Regime

See separate Training Module PSP 4-4 on Contract Monitoring



Contract Monitoring Regime
see separate Training Module PSP 4-4 on Contract Monitoring

Additional Sources of Information



INDEX	
	Tab
Preparation Documents	I
Bidding Documents	II
Annex A to the Bidding Documents - The Draft Contract	A
Terms of Contract	Form of Contract
General Conditions	General Conditions
Special Conditions of Contract Appendix	Appendix 1
Terms and Conditions of Payment Appendix	Appendix 2
Technical Specifications Appendix	Appendix 3
Design-Build Services Appendix	Appendix 3A
Operations Services Appendix	Appendix 3B
Technical Standards Appendix	Appendix 3C
Site Appendix	Appendix 4
Service Area Appendix	Appendix 5
Contract Price Adjustment Appendix	Appendix 6
Insurance Compensation Appendix	Appendix 7
Legalized Damages Appendix	Appendix 8
Contract Staff Appendix	Appendix 9
Operator's Personnel Appendix	Appendix 10
Operator's HR Appendix	Appendix 11
Annex B to the Bidding Documents	B
1st Form	
Builder's Price Form and Price Schedules	
HR Security Form	
Performance Security Form	
Bank Guarantee Form - Advance Payment	
Form of Contract Vice	

24

Additional Sources of information:

United Nations Commission on International Trade Law: Legislative Guide on Privately Financed Infrastructure Projects, United Nations New York, 2001

Content:

Consolidated legislative recommendations

Introduction and background information on privately financed infrastructure projects*

I. General legislative and institutional framework

II. Project risks and government support

III. Selection of the concessionaire

IV. Construction and operation of infrastructure: legislative framework and project agreement

V. Duration, extension and termination of the project agreement

VII. Other relevant areas of law



Conclusion

- Consider the national legal framework
- Choose the type of contract (e.g. service Contract – Concession)
- Check proposals for the general conditions by WB and UNCITRAL
- Develop general and special conditions with fair allocation of risks
- Use international consulting know how for the development of the bidding documents and the conduction of procurement procedure



Conclusion:

- Consider the national legal framework
- Choose the type of contract (e.g. service Contract – Concession)
- Check proposals for the general conditions by WB and UNCITRAL
- Develop general and special conditions with fair allocation of risks
- Use international consulting know how for the development of the bidding documents and the conduction of procurement procedure