



World Bank Seminar on Port Reform

PORT TERMINAL CONCESSION DESIGN

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Introduction

Terminal Concessions

- ✓ Concluding a concession agreement for a greenfield or an existing terminal is only one step in a long process.
- ✓ From start to finish this process can easily take one year.
- ✓ The process requires a professional negotiation team to prepare, negotiate and conclude a concession agreement.

Character

Basics

- ✓ A Concession is a long term agreement between a Grantor (Port Authority) and a professional terminal operator (and/or an strategic investor) setting out the rights and obligations with respect to the development, operation, management and maintenance of a terminal during an agreed period and the hand back of that terminal to the Grantor after termination or expiry of the agreement.

The Process

From Start to Finish

- ✓ Issuing Tender Documentation.
 - Information Memorandum
 - Project description & traffic forecasts
 - Construction issues and estimated investments (if applicable)
 - Institutional and legal issues (incl. main terms of concession)
 - Indication of Royalties
 - Instructions to Bidders (incl. qualification criteria)
 - Selection criteria and evaluation procedures
 - Submission requirements
- ✓ Bidders must have sufficient info for financial model.

The Process

Selection of Preferred Bidder

- ✓ Questions of Bidders and Replies by Grantor
- ✓ Data Room with all background information
- ✓ Selection of Preferred Bidder on the basis of transparent and previously announced selection procedures and criteria.

Note: the entire process must be legally “guarded” by the Grantor’s legal counsel, one mistake and everyone ends up in court with long delays for the project execution.

Concession Preparation

Necessary Data

- ✓ Prior to drafting a concession, the Port Authority should have available:
 - A master plan for the terminal development;
 - Basic design and cost estimates for the construction works (if required);
 - Financial calculations on the project including a financial model (OPEX and CAPEX);
 - Labour Plan in case of an existing terminal.

Drafting the Concession

General

- ✓ A professional fully authorised negotiation team should be in place, consisting at a minimum of:
 - Member of PA Board (Chairman)
 - Economist/Financial expert
 - Technical officer
 - Operations expert
 - Legal counsel
- ✓ Start with clear targets to be achieved, define dealbreakers and keep the team as small as possible!!

Type of Concession

Most common variants

- ✓ BOT – Build, Operate, Transfer. Ownership of port land (existing or reclaimed) remains with Grantor.
- ✓ BTO – Built, Transfer, Operate. Land is acquired by Concessionaire but ownership is transferred to Grantor after completion of construction (Greenfield terminal).
- ✓ BOOT – Build, Own, Operate, Transfer. Ownership remains during term of concession with Concessionaire and is transferred to the Grantor at expiry or termination.
- ✓ Wraparound BOT: An existing terminal is extended. The new part is built and operated under a BOT while the existing part is operated under a management agreement.

Signatories

Join the Club...

- ✓ The Grantor (Ports Authority).
- ✓ The Government (depends on ownership of port land or to provide certain guaranties).
- ✓ The Special Purpose Vehicle (SPV), to be established by the Sponsor(s).
- ✓ The Sponsor(s) of the project (Selected Bidder) to provide certain guaranties.

Special Purpose Vehicle

Local Company as SPV

- ✓ Sponsors establish a limited liability company under national law to finance and construct or refurbish the terminal (SPV). The SPV might also be the operator of the terminal.
- ✓ If not, the terminal will be operated and managed by a specialised operator under a management agreement which will be part of the concession.
- ✓ Grantor should in principle not participate in share capital of SPV to avoid conflicts of interest.

Conditions Precedent

Transition Period

- ✓ There is always a transition period between signing the concession and the date the concession becomes effective (*Effective Date*). During that period the concessionaire has to fulfil a number of important conditions.
- ✓ In the event that the conditions precedent cannot be fulfilled, the parties may terminate the concession without any compensation to either one of them.

Conditions Precedent

Typical Conditions

- ✓ Approvals by the Boards of Directors of the signatories.
- ✓ Applicable permits for the operation of the terminal.
- ✓ Development Bond submitted by the Concessionaire (5-10% of construction costs).
- ✓ Hiring of personnel or transfer to the Concessionaire of (part of) the personnel already employed at an existing terminal.

Term of Concession

Varying Terms

- ✓ The Term (duration) of the Concession is mainly dependent on the investments by the Concessionaire.
- ✓ No major investments: 15 - 20 years is sufficient.
- ✓ BOT type of concessions: 25 – 35 years.
- ✓ Concessions may be extended in case of:
 - Investments during later part of the term, or
 - In case of Force Majeure or Change in Law.

Construction Works

Control, yes ...but not too much!

- ✓ Grantor must always be represented by a Construction Observer at the construction site who guards the Grantor's interests.
- ✓ Basic design and construction standards to be agreed as part of the concession.
- ✓ Detailed design and design data are the responsibility of the Concessionaire. Grantor should avoid liability for faults and mistakes.

Royalty and Lease Rent

The Crux of the Matter.

- ✓ Types of Royalties:
 - TEU fee or tonne tariff. The amount may vary with the quantities, or
 - Percentage of Gross Revenue (total annual benefits of the terminal prior to deduction of any costs, expenses and taxes).
- ✓ Apply a Minimum Guaranteed Throughput based on agreed traffic forecast to diminish risks.
- ✓ Royalties to be annually adjusted for inflation.

Royalties and Lease Rent

What Money?

- ✓ Every Grantor should consider which currency to use for Royalties. Until recently the US \$ was the preferred currency.
- ✓ It might be clever to introduce a basket of Euro and US \$ for Royalty payments.
- ✓ Lease Rent is usually paid in local currency.

Funding Issues

Who Pays for All of This?

- ✓ The SPV is responsible for financing the Construction Works. The investments will be financed with:
 - share capital invested in the SPV; and
 - bank loans.
- ✓ The SPV will not be able to offer a mortgage on the terminal since it has no ownership title on the land and (often) on the superstructure under a BOT.
- ✓ The SPV must therefore rely on limited recourse financing.

Limited Recourse Financing

What is this?!

- ✓ The Senior Lenders (mostly commercial banks) have to rely on the future income from the concession as collateral for their loan to the SPV.
- ✓ Movable assets such as cranes may be used as security by the SPV.
- ✓ The Senior Lenders often require a Lenders Direct Agreement setting out their so called step-in rights in case of early termination of the concession. This agreement is signed by the Grantor (sometimes the Government), the SPV and the Senior Lenders

Tariff Adjustment

Tariff Regulation

- ✓ In many countries specific terminals (containers, oil, chemical, etc.) have a monopoly position.
- ✓ Some form of tariff regulation may be necessary and justified.
- ✓ Tariff Regulation may be effected either:
 - by an independent regulator on the basis of a law (Competition Law), or
 - by the concession itself (by contract).

Tariff Adjustment

Regulation by Contract

- ✓ Adjustment always requires approval by the Grantor.
- ✓ The Concession may have special provisions (Schedule) for the adjustment of tariffs by the Concessionaire, in case of the occurrence of specific circumstances
- ✓ In case such circumstances occur, the tariffs will be adjusted (increased) to compensate for the Concessionaire's loss of income.
- ✓ Annual adjustment for inflation may be allowed, sometimes an efficiency factor is applied.

Force Majeure

Act of God

- ✓ Force Majeure event: tsunami, war, terrorist attack, national strike. Exact meaning of Force Majeure to be defined in Concession.
- ✓ During a situation of Force Majeure the parties are both relieved from their obligations.
- ✓ Concessionaires often want financial compensation from Grantor. Grantor should allow for tariff increase and/or extension of the term.
- ✓ After a continued Force Majeure of more than 180 days party may terminate the Concession.

Breaches of the Concession

Prepare for the Worst!

- ✓ Usually, there are two types of breaches of the concession:
 - minor breaches which have to be cured within a certain period; and
 - major breaches which may result in termination by one of the parties.
- ✓ Direct termination is rare, only when the Grantor or the Concessionaire goes bankrupt.
- ✓ Most breaches which cannot be resolved, end up in an arbitration court.

Termination Compensation

Difficult, difficult....

- ✓ At early termination or expiry the Grantor always pays compensation to the Concessionaire, whatever the reason.
- ✓ The amount of compensation varies, depending on:
 - who was in breach;
 - what was the reason for the termination;
 - when was the concession terminated.
- ✓ Concessionaires always try to negotiate compensation on the basis of Fair Value (market value plus lost profits). This should be allowed only in case of nationalisation (termination in the national interest).

Termination Compensation

Hotly Debated Issue!

- ✓ The Grantor should offer termination compensation only on the basis of net book value of investments, outstanding debt and existing assets, owned by the Concessionaire.
- ✓ 80%-100%-120% rule may be agreed between the parties in relation to who is in breach.
- ✓ In practice, the outcome of negotiations on this issue depends of the relative strength of each party.

Dispute Resolution

Arbitration

- ✓ International Concessionaires & sponsors always favour arbitration instead of proceedings in a local court.
- ✓ Many concessions opt for ICC arbitration which is basically a set of procedural rules.
- ✓ A panel of three Arbiters selected in accordance with ICC rules will judge the issue
- ✓ ICC arbitration can be conducted under Brazilian law in Brazil.

These were the main issues.
Thank you for your attention

