

1. NATURE OF BOT PROJECTS

In Australia, there have been a number of major construction projects in the last five years. In the 1980's public infrastructure construction was performed, predominantly, in the traditional tendering style. In the last five years, however, the private sector has been substantially involved in the construction and funding of public infrastructure work.

BOT (Build/Own/Transfer) projects are public infrastructure projects which employ a particular form of structured financing.

The involvement of the private sector in the development of infrastructure in Australia by way of BOT projects, alternatively called BOO (build-own-operate) or BOT (build-own-operate-transfer) is proving to be a challenging exercise. The lead time of a project is very long, and associated up-front costs are significant. Further, there are a number of complex issues which have yet to be resolved by any of the infrastructure projects settled to date.

Such projects are complex by virtue of the number of parties involved and the corresponding number of contracts, which must all interlock. Furthermore, each party is dependent upon the performance of not only its counterpart, but also the performance of all parties to the project.

BOT projects are generally structured on a project basis requiring all parties to share the risks of the project. Project risk sharing is necessary because the sponsor, a joint venture of one sort or another, will have a limited worth being substantially less than the aggregate net worth of the equity parties.

Structure of BOT Projects

The attached diagram (Fig. 1) shows a typical BOT structure.

In a BOT arrangement, the private sector designs and builds the infrastructure, finances its construction and owns, operates and maintains it over a period, often as long as 20 or 30 years. This period is sometimes referred to as the "concession" period.

Traditionally, such projects provide for the infrastructure to be transferred to the government at the end of the concession period. (in Australia, primarily for reasons related to the borrowing powers of states, the transfer obligation is omitted).

BOT is a type of project financing. The hallmarks of project financing are:

- (i) The lenders to the project look primarily at the earnings of the project as the source from which loan repayments will be made. Their credit assessment is based on the project, not on the credit worthiness of the borrowing entity.
- (ii) The security taken by the lenders is largely confined to the project assets. As such, project financing is often referred to as "limited recourse" financing because lenders are given only a limited recourse against the borrower.

Most project finance structures are complex. The risks in the project are spread between the various parties; each risk is usually assumed by the party which can most efficiently and cost-effectively control or handle it.

Once the project's risks are identified, the likelihood of their occurrence assessed and their impact on the project determined, the sponsor must allocate those risks. Briefly, its options are to absorb the risk, lay off the risk with third parties, such as insurers, or allocate the risk among contractors and lenders. The sponsor will be acting, more often than not, on behalf of an sponsor at a time when the equity participants are unknown. Nevertheless, each of the participants in the project must be satisfied with the risk

allocation, the creditworthiness of the risk taker and the reward that flows to the party taking the risk. In this respect, each party takes a quasi equity risk in the project.

A listing of privately funded infrastructure projects completed and proposed in Australia over the last few years is attached at the end of this paper.

2. PARTIES TO BOT PROJECTS

There are a number of major parties to any BOT project, all of whom have particular reasons to be involved in the project. The contractual arrangements between those parties, and the allocation of risks, can be complex.

The major parties to a BOT project will usually include:

1. Government Agency

A government department or statutory authority is a pivotal party. It will:

- grant to the sponsor the "concession", that is the right to build, own and operate the facility,
- grant a long term lease of or sell the site to the sponsor, and
- often acquire most or all of the service provided by the facility.

The government's co-operation is critical in large projects. It may be required to assist in obtaining the necessary approvals, authorisations and consents for the construction and operation of the project. It may also be required to provide comfort that the agency acquiring services from the facility will be in a position to honour its financial obligations.

The government agency is normally the primary party.

It will initiate the project, conduct the tendering process and evaluation of tenderers, and will grant the sponsor the concession, and where necessary, the offtake agreement. The power of a government agency to enter into the documentation associated with an infrastructure project and perform its obligations thereunder, and the capacity in which that body enters the documents (agent of the Crown or otherwise) is a critical issue. This is examined in detail below.

The doctrine of ultra vires is largely irrelevant to companies, as the Corporations Law provides that they have the powers of a natural person, subject to any express exclusion in a company's constituent documents. However, this is not so for statutory authorities.

It is settled law that a statutory authority constituted under legislation has only the powers for which its constituent legislation provides. Therefore, its statutory powers and functions must, without doubt, be wide enough to empower it to enter into each of the project documents to which it is a party and perform its obligations thereunder. If the authority does not have the requisite powers, its actions are ultra vires and thereby void.

To determine whether a government agency's actions are intra vires or ultra vires, one must closely examine the legislation under which the authority is constituted.

Examples of the powers required by the authority in a typical BOO(T) project are:

- to contract with another person for that person to carry out one or more of the authority's functions (eg, the construction and operation of the relevant infrastructure);
- to make payments to that person in consideration of the services provided;
- to resume land and then make that land "available" to that person;
- to lease or sell land to that person together with providing easements and rights of way for access; and
- to provide undertakings, indemnities or guarantees to financiers and others in relation to its or other persons' liabilities.

2. Sponsor

The sponsor is the party, usually a consortium of interested groups (typically including a construction group, an operator, a financing institution, and other various groups) which, in response to the invitation by the Government Department, prepares the proposal to construct, operate, and finance, the particular project.

The sponsor may take the form of a company, a partnership, a limited partnership, a unit trust or an unincorporated joint venture. The investors in the sponsor are often referred to as the "equity investors" or the "equity providers". It is not unusual for equity investment to be approximately 20% of the cost of the project. Equity funds are, however, expensive compared to the cost of debt. An equity investor may require a return of 20% to 25% in today's market to compensate it for assuming the major risks inherent in an infrastructure project. As a result it may be cost-efficient for equity to be much less than 20% of the project cost.

The sponsor may be a company, partnership, a limited partnership, a unit trust, an unincorporated joint venture or a combination of one or more.

3. Construction Contractor

The construction company may also be one of the sponsors. It will take construction and completion risks, that is, the risk of completing the project on time, within budget and to specifications. These can be sizeable risks and the lenders will wish to see a construction company with a balance sheet of sufficient size and strength with access to capital that gives real substance to its completion guarantee.

Often the general design of the infrastructure is dictated by the experienced utility. The construction risk is then taken by the construction company. Further, depending upon the nature of the infrastructure, the commissioning risk is often allocated to the construction company. The sponsor will aim to require the construction company to enter into a fixed price fixed time construction contract. However, this is rarely fully achieved, as there are normally some cost or timing issues which are not taken by the construction company which can lead to variations in price or timing.

4. Operation and Maintenance Contractor

The operator will be expected to sign a long term contract with the sponsor for the operation and maintenance of the facility. Again the operator may also inject equity into the project.

There has not been a shortage of operators, mainly from offshore, for proposed infrastructure projects. This probably has a lot to do with the fact that operators tend to accept little risk in the form of up-front capital or expenditure. An operator simply anticipates making a profit from operating the infrastructure more efficiently than an equivalent government run project.

5. Financiers

In a large project there is likely to be a syndicate of banks providing the debt funds to the sponsor. The banks will require a first security over the infrastructure created. The same or different banks will often provide a stand-by loan facility for any cost overruns not covered by the construction contract.

As the financing of BOO(T) structure projects is a form of project finance, debt financiers will undertake a review of all core project documents to assess the allocation of risks and how that allocation impacts upon their credit approval. There has been some difficulty in attracting debt financiers to infrastructure projects, mainly because of the long term nature of the repayment of the bank debt, which may have a repayment term of up to 20 years, and the large number of infrastructure projects currently in the market place. Debt financiers have traditionally seen themselves as short term financiers, as evidenced by the fact that there is little long term debt in Australia. Accordingly, debt financiers are only comfortable financing the construction phase of an infrastructure project, provided they have a take out for the long term repayment phase of 15 years or more. The size of the debt required for many infrastructure projects may also limit the number of willing financiers. Furthermore, tax exempt infrastructure bonds are only available to limited types of infrastructure. For example, infrastructure bonds are not available to water and health projects but are available to land transport, seaport and electricity generation.

6. Equity Investors

It is always necessary to ensure that proposed investors in an infrastructure project have sufficient powers to enter into the relevant contracts and perform their obligations under those contracts. Two examples where powers must be carefully reviewed are life insurance companies and trustees of superannuation funds.

7. Other Parties

Other parties such as insurers, equipment suppliers and engineering and design consultants will also be involved. Most of the parties too will involve their lawyers and financial and tax advisers.

Other parties are involved in an infrastructure project. These include equity providers, insurers, equipment suppliers, fuel suppliers and, of course, consultants.

3. THE AGREEMENTS

3.1 Offtake Agreement

The offtake agreement is normally the key document in an infrastructure project. It is the agreement between the government agency and sponsor under which the government agency agrees to purchase the output of the infrastructure (be it water, health services or electricity etc) at agreed prices and volume.

3.1.1 Performance Standards

The critical element of the offtake agreement from the government agency's perspective is the performance warranties to be given by the sponsor. The performance warranties should deal with both the quantity and quality of output from the project together with the timing within which that output is required by the government agency.

The government agency will also require the offtake agreement to detail the consequences of a failure to meet the performance standards, such as liquidated damages and/or the right to call an event of default.

3.1.2 Revenue Stream/Tariff

The viability of the project and in particular its "bankability" will depend upon the reliability of the cashflow under the offtake agreement, and the government agency and sponsor performing their respective obligations.

(i) Tariff Structure

The aim of the sponsor in negotiating the offtake arrangement with the government agency will be to minimise its market risk. This may, to a certain extent, be achieved by structuring the cashflow in two parts, namely, an availability fee and a usage fee.

The availability fee is a fee payable by the government agency to the sponsor in consideration of the sponsor making the infrastructure available, irrespective of actual throughput. The usage fee regulates the price per unit that the government agency will pay for the actual amount of product supplied to it. The sponsor will want the availability fee to cover all or at least a substantial part of its fixed costs. The usage fee will cover the balance of fixed costs (if any) and the variable costs.

While the sponsor will push for a high availability fee to minimise its market risk, it must be careful in so doing because if all market risk is shifted to the government agency this may undermine the ability of the private sector to obtain taxation deductions and also of the Government to obtain a ruling from Loan Council that the project falls outside global limits.

(ii) Effect of Default on Tariff

The government agency will want to structure the transaction so that the sponsor has the maximum incentive to attain the pre-agreed performance standards. To do this, it will want the ability to reduce the tariff payable or impose liquidated damages if the performance standards are not achieved.

Financiers, on the other hand, will want to restrict the ability of the government agency to interrupt the cashflow under the offtake agreement (especially if this could affect the sponsor's ability to meet repayments on the bank debt). The financiers will firstly argue that non-performance related defaults should not have any impact on the tariff, as the government agency would in such circumstances still be receiving what it bargained for, namely, a high quality product. They will also argue that provided any default is being promptly rectified, the cashflow should not be interrupted, and other remedies, such as liquidated damages, may be more appropriate.

The obvious consequence of an interruption of cashflow is that the financiers will not have a source of revenue through which to repay their debt. However, as stated above, the government agency's ability to reduce tariff is its principal weapon to ensure the sponsor strives to achieve the performance standards.

(iii) Escalation of Tariff

The offtake agreement must also provide for part of the tariff stream to escalate during the probable long term life of the agreement. The base tariff is normally negotiated prior to the start of construction. The

base tariff must be regularly indexed in accordance with CPI or some other agreed formula to ensure that the tariff stays in line with the probably movement in costs over the life of the project.

Furthermore, there must be provisions enabling the tariff to be adjusted in the event of unforeseen circumstances occurring. For example, the sponsor will require the ability to increase the tariff in the event of its costs increasing due to a new law or regulation being introduced which affects the costs of operating the infrastructure. The government agency will also want the tariff to be decreased if costs decrease due to an unforeseen event occurring.

The formula regulating the indexing of the tariff, and the events entitling either party to seek an adjustment to the tariff, will be heavily negotiated. For example, the government agency is unlikely to accept an increase to the tariff if a tax change affects the sponsor's return on its investment.

A further issue which will impact upon the escalation of the tariff is the cost of funds. The finance arrangements may provide a right to the financier to increase the costs it charges the borrower if certain events occur, for example, change of law, changes in capital adequacy, etc. The financiers would like these increases to be matched by an increase in the tariff payable under the offtake agreement. The government agency will obviously resist this.

3.2 Construction Contract

The Construction Agreement is, typically, a turnkey design and construct fixed price contract, intended to reflect the back to back arrangements necessary to match up with the interdependent offtake agreement, operation and maintenance agreement, and other agreements comprising the BOT project.

There are a number of construction contract considerations peculiar to BOT projects:

3.2.1 Force Majeure

BOT projects, typically, to date, have involved substantial construction over a long period of time. The costs of delay under such construction contracts are always significant.

Traditionally, in non-BOT projects, the risk of delay has been allocated as follows:

- Delays caused by sponsor: Contractor receives extension of time and more money (delay costs).
- Delays by Contractor: Contractor receives neither an extension of time nor more money.
- Force Majeure delays: Parties negotiate Contract Sum dependent on whether Contractor is to receive extension of time and more money or both. (This regime differs project to project. A guiding principle, for principals, might be to always give the contractor an extension of time for no-fault delays, but to never give the contractor more money. The reverse principle might be true for contractors.)

There are strategic reasons for this regime beyond the scope of this discussion.

In relation to BOT structures, however, if it is accepted that the sponsor has no assets and no ability to bear risk, this regime may not be possible.

It may be that the Government would be prepared to accept a negotiated date for delivery of the project. It is extremely unlikely, however, that the Government would accept any potential obligation to pay extra costs arising out of those delays. The Government's obligation, in relation to construction of the Facility, is to buy the product on completion (not to pay the Construction cost).

The Sponsor would not, typically, be in a position to make extra payment.

The Financiers will not usually (ever?) accept that risk.

For these reasons, therefore, the Force Majeure risk will nearly always be borne as follows:

- Extension of Time: borne by Government;
- Delay Costs: borne by Contractor.

This may vary with negotiation. For example, the Contractor may be willing (and this may assist the negotiation of the BOT structure generally) to bear the extension of time risk. This will, traditionally, increase the tender sum.

So long as this increased cost of construction is reflected in the sponsor's agreement with the Government, this would in fact be more convenient. (It begs the question, however, of delays caused by the sponsor.)

The risk of additional cost and/or time where the sponsor causes delay to the construction contractor is more complex.

If, for the sake of this discussion, the sponsor is a special purpose vehicle with no assets and no ability to deal with claims for more time or more money from the Contractor, and if, for the reasons set out above, the Government will not usually be willing to accept the risk of claims for additional time and/or money where the sponsor is in default under the Construction Contract, the Contractor may be left without a remedy in the event of sponsor default under that agreement. (The obvious way of dealing with this difficulty is to completely back-to-back the obligations of the sponsor under the construction agreement with the take-or-pay agreement. We simply comment that this will usually be easier said than done, and it does not take into account the overriding interest of the Financiers.)

A possible finesse (but not an ultimate solution) to this difficulty might be to equip the sponsor with the capacity to deal with claims up to a certain limit (in effect, a contingency capacity) and leave the contractor exposed beyond that limit.

3.2.2 Underperformance

Underperformance in this context means a failure to deliver the product as specified (for example, a power generating plant which is not generating the specified output, or is not available to the specified extent).

This is not a major problem in a traditional construction contract. The owner, in that circumstance, would simply be entitled to damages from the contractor to compensate it for the level of underperformance.

In a BOT structure, however, underperformance has substantial consequences for the Government and the Financiers. The Government might have structured its capital expenditure program on the successful completion of the project (for example, it would usually have structured the State's electricity needs on the basis of the power project). Although it might have relief under its take-or-pay contract (in fact, those circumstances will usually be identified in the agreement and a regime of damages agreed) this may still be a serious concern.

The Financiers will usually be relying, for their security, on the product which is to be sold to the Government. In the event of underperformance, that security will (at best) be diminished.

Further, the Operation and Maintenance Contractor may have to operate and maintain an underperforming plant for a substantial period thereby diminishing its hoped-for output-based return over that period.

Accordingly:

- (i) underperformance will usually be expressly catered for;
- (ii) bare minimum performance requirements will usually be spelt out;
- (iii) the consequences are serious.

Underperformance, where caused by the Contractor, is easily allocated under the BOT structure. The risk will continue to lie with the Contractor. It may be, however, that the total loss is too vast to be borne by the Contractor alone. In that case, the risk might (on the premise that the sponsor is an asset-limited entity) ultimately end up with the Government and/or the Financiers. There is little doubt that those parties never intend, as a rule, to bear that risk (at least beyond certain limits).

A more difficult scenario is where the underperformance, for some reason, is the fault of the sponsor under the Construction Contract (for example, where the sponsor is responsible for providing fuel and the fuel is below the specified quality).

The critical conclusion is that the sponsor must back-to-back its obligations to the Contractor under the Construction Contract with its obligations (and remedies) under the offtake agreement.

Again, the risk would, therefore, ultimately end up in the hands of the Government and/or the Financiers (again, not a position which they set out to achieve).

3.2.3 Limitation of Liability

The need to limit a Contractor's liability is not special to BOT structure projects. The amounts involved, however, are so large as to deserve special attention.

A Contractor under a traditional Construction Contract, will typically need to limit its exposure. (For example, where an excavation contractor is doing a \$1M excavation on a \$200M project, any delay which he causes will delay the entire \$200M project. For this reason, his liability, if not expressly limited, might exceed several times over the value of his contract.)

For the same reason, the Construction Contractor in a BOT project is potentially exposed to damages for beyond the value of the Construction Contract.

In particular, the Construction Contractor has potential liabilities for:

- (i) damages to the sponsor for underperformance of the project;
- (ii) damages to the sponsor for lateness in delivering the project;
- (iii) damages to the sponsor in rectifying defects;
- (iv) damages to the sponsor for consequential losses incurred by the sponsor under the offtake agreement, or under the Operation and Maintenance Agreement, or under the Finance Agreements.

Under the agreements referred to in paragraph (iv) above, the sponsor itself will need to limit its liability or contract that risk away. To the extent that it retains such liability, those limits will need to reflect the funding under the Finance Agreements.

This may cause insoluble problems in allocating risk.

If the sponsor is an asset-less vehicle, and **if** the Contractor simply does not have the financial capacity to bear the unlimited risk, then the inescapable conclusion is that the risk is, in fact, being borne (irrespective of the contractual position) by either the Government or the Financiers or both. Again, neither the Government nor the Financiers would have intended this, in coming to the project.

3.2.4 Termination/Step In

In a BOT structure project, the Government and the Financiers **must** have the ability, in the event that the sponsor is in default to the point where the take-or-pay Agreement and/or the Finance Agreements are terminated, to "step in" and take over the obligations of the sponsor under the Construction Contract **and** the Operation and Maintenance Contract.

The agreements with the Construction Contractor and the Operation and Maintenance Contractor, therefore, must include provisions obliging the Construction Contractor and the Operation and Maintenance Contractor to comply with that regime.

In fact, that outcome (the stepping-in) would usually be in the interest of both the Construction Contractor and the Operation and Maintenance Contractor. The rights to assume the sponsor's position under those agreements would always be dependent on curing any contractual defects (for example, non-payment) existing under those agreements. (Otherwise, contractually, the Contractors could terminate their respective contracts, irrespective of the identity of the sponsor for the time being.)

For this reason, the Construction Contractor and the Operation and Maintenance Contractor should have no concerns in relation to these provisions. As a matter of practice, however, they do have peripheral concerns. Accordingly, they would prefer to have approval rights over the step-in process. This is not possible.

It is a critical feature of BOT projects that the right to terminate or step in, in appropriate circumstances, exists at all times for the Financiers and the Government. It is strategically impossible for the Construction Contractor and/or the Operation and Maintenance Contractor to have a right of approval over such step-in or termination.

3.2.5 Changes/Variations/Scope Changes

In BOT structures (which will usually involve design and construction contracts) the usual principles will apply to variations (also referred to from time to time as "Changes", or "Scope Changes"), but with some additional qualifications.

Under a BOT structure project, the risks arising out of such variations are slightly more complex than traditional construction contracts because:

- (i) the sponsor needs (again, on the premise that it is an asset-less vehicle) to pass such costs up to the Government;
- (ii) the Government is only paying for the **product** (as opposed to the **construction cost**) under the offtake agreement; and
- (iii) the Financiers would not be expecting (usually) to fund such variations.

The real difference between a BOT structure project and a traditional construction contract, in this regard therefore, is that there are other parties involved.

Traditionally, a contractor obliges itself, at the time of executing a construction contract, to perform extra work, at the whim of the sponsor, **within limits**. The sponsor, under such a traditional contract, agrees that it will pay the cost of that extra work at a price to be determined by an agreed mechanism.

Under a BOT structure project, however, the sponsor will usually have no fascination, itself, for the product to be delivered and no personal involvement in the decision to require variations. This will, necessarily, be a right (with its incumbent limitations) of the Government under the offtake agreement, which is necessarily given effect under the Construction Contract.

For this reason, the critical limitations will occur not only in the Construction Contract, but also in the offtake agreement.

As a further complication, the limitations imposed on the sponsor's/Government's right to demand variations will include limits arising necessarily out of the existence of the Finance Agreements. One could envisage, as a matter of contract **but not in practice**, variations being financed directly by the Government where the finance caused problems.

The contract regime for variations in a BOT structure, therefore, will extend beyond the Construction Contract, and will require an extended set of limitations on this right.

3.3 Operating & Maintenance Agreement

The Operation and Maintenance Agreement is a long term contract. Many of the contractual considerations which are set out below need to be considered in context of the matters set out above.

3.3.1 Terms of Operating and Maintenance Agreements

Typically, the following types of terms may be expected in this type of Agreement:

(i) Pre-Operational Phase

The Operator will have a contractual role on the project even before the hand over of the Facility by the sponsor.

In particular, the sponsor will typically require the Operator to advise, prior to acceptance testing of the Facility as to the necessary staffing levels, work programs, organisational matters, and other administrative functions necessary to be put into place upon acceptance and hand over of the Facility by the sponsor to the Operator.

The Agreement would also, typically, set out the hand over procedures, particularly having regard to the transfer of responsibility from the Construction Contractor to the Operator upon acceptance. An issue likely to arise in the negotiation of the agreements will be the degree to which the Operator will be responsible during the period when the Operator's staff are in control of the Facility under the supervision of the Construction Contractor, during the acceptance testing phase but prior to hand over. As a matter of principle, the Construction Contractor is still responsible for the Facility. The acceptance testing procedures will, however, usually take, depending on the project, a substantial operating time during which the Facility is, in fact, in the possession of and being managed by the Operator.

(ii) Operation of the Facility

The substantive contractual obligation of the Operator is to operate and maintain the Facility for the period of the Operation and Maintenance Agreement.

The responsibilities of the Operator during this period will need to be set out in detail in the Agreement. The Agreement will need to cover matters such as operating procedures, maintenance of the Facility (including major overhauls and outages), performance levels, reporting requirements to the sponsor and to the Government agency, maintenance of the continuing contractual relationship with the Government agency and with utility suppliers on behalf of the sponsor, and compliance with operational requirements imposed under the documentary regime (for example, compliance with environmental controls imposed on the project).

The description of the Operator's obligations can be complex. This may be treated contractually by attempting to describe the general requirements on the Operator and relating the obligations of the Operator to the performance results required to be achieved out of the operation of the Facility, including all matters necessary and incidental to that performance. This may be difficult to draft and/or negotiate during the documentation phase. This is further complicated by the long term nature of such contracts. Finally, having regard to the long term nature of such agreements, there is a real likelihood of a substantial change of circumstances during the period of the Operation and Maintenance Agreement (for example, where political change occurs, legislative regimes are expanded/alterd, or the original contract regime otherwise altered).

(iii) **Sponsor Obligations**

The obligations on the sponsor during the period of the Operation and Maintenance Agreement will relate principally to the payment to the Operator out of the proceeds of the offtake agreement.

There will, typically, be other major continuing obligations, for example, the supply of utility fuel, water and other consumables. In addition, the Agreement may provide for certain specific obligations (for example, there may be an obligation on the sponsor to provide an initial spare parts inventory). Further, there will usually be an obligation on the sponsor under the offtake agreement to maintain records in relation to the Operator's compliance with particular matters (for example, use of fuel, waste disposal) which may affect the sponsor's payment obligations under the Operation and Maintenance Agreement. The Agreement will usually provide for payment mechanisms (for example, mechanisms to cater for Consumer Price Index rises, payment in respect of major overhaul expenses, payment in respect of costs arising for work performed by the Operator beyond the scope of services described in the agreement, changed in law and other potential factors which give rise to necessary adjustments to the payment provisions).

(iv) **Performance Obligations**

The Operation and Maintenance Agreement will need to specify the performance obligations of the Operator during the period of the Operation and Maintenance Agreement.

Such performance criteria will, typically embrace matters such as availability, outages, production levels, and other technical performance criteria depending on the nature of the Facility. The Agreement will also, typically, specify the performance levels which might give rise to rights to damages and/or termination under the Operation and Maintenance Agreement where performance falls below certain levels (in some cases, there may also be provisions as to bonuses where performance exceeds particular levels).

The substantive terms of the Operation and Maintenance Agreement, therefore, relate to the detailed technical requirements on the Operator, and the payment obligations of the sponsor. By definition, therefore, the negotiation process will involve substantial technical review in addition to the legal negotiations.

3.3.2 Force Majeure

The consequences of a force majeure event during the construction period are severe but probably manageable in that the force majeure event, even if prolonged, will simply increase the cost of construction. This risk can be allocated between the parties to the BOT project prior to commencement of the project and taken into consideration in determining the economics of the BOT project.

The consequences of a prolonged force majeure event during the period of the Operation and Maintenance Agreement, however, may lead to an insoluble difficulty. In this event, the Operator may not be able (even if it was prepared to increase its financial commitment which, typically, it is not) to perform its obligations to the performance standard set out in the Agreement. This will have a direct effect on the offtake agreement, affecting (possibly beyond repair) the ability of the project to repay the Financiers.

In these circumstances, the **solvent** parties will ultimately bear the loss. (Typically, the Government agency may prove to be the only participant capable of bearing the losses caused by a prolonged force majeure event during the Operation and Maintenance Agreement.)

Most losses caused by force majeure events can be insured against.

The contractual obligations, typically, in the Operation and Maintenance Agreement will impose the obligation on the party affected by the force majeure event to take such steps as are possible to overcome the force majeure event, including reasonable expenditure of funds. The failure to perform contractual obligations **because of** the force majeure event, however, will, typically, prevent such a party from being in default.

If, however, a prolonged force majeure event causes a loss beyond the available insurance to the point where the project cannot repay the Financiers, the loss will fall on those parties to the BOT project who **happen** to be sufficiently solvent to meet that loss (typically, the Financiers will never, in any circumstances, accept this risk in the negotiation of the documentation, however their ultimate exposure could conceivably depend on a future government's attitude to support of the project). One would expect the Government agency always to be a participant in such a loss. On occasion, the project sponsor may, itself, be a consortium of substance and, therefore, able to and contractually oblige the participant in that loss.

3.3.3 Underperformance

The Operation and Maintenance Agreement will, typically, make detailed provisions for the consequences of default by the Operator in its performance obligations.

In particular cases (for example on a power project) the Agreement will specify the performance levels below which the Operator is in default under the Agreement and the remedy options available to the sponsor in the various circumstances arising out of the different levels of that default.

Typically (again, for example on a power project) such performance requirements will specify matters such as output, availability, outages, and other specific performance-related events.

Further, the Agreement will, typically, specify a damages, usually **liquidated** damages, regime to be imposed on the Operator where the Operator fails to perform to the specified levels.

The agreement on liquidated damages has a dual contractual effect. It conveniently enables the sponsor to calculate and recover money damages for underperformance by the Operator during the period of Operation and Maintenance Agreement. At the same time, it **limits** the potential losses (subject to other more serious remedies discussed below) caused to the Operator by reason of its failure to perform to the specified levels.

This is a critical contractual protection for the Operator.

The agreement on a liquidated damages mechanism under the Operation and Maintenance Agreement is, necessarily, linked to a limitation of liability clause which, effectively, caps the Operator's potential losses in respect of any underperformance by the Operator. Typically, liability for consequential losses (particular losses caused to one of the parties because of the particular economic situation of that party) are expressly excluded. Such consequential losses will usually expressly include loss of revenue, profit and/or other economic consequences of underperformance by the Operator.

3.3.4 Changes/Variations During Operation/Maintenance Period

The Operation and Maintenance Agreement will, typically, make provision for adjustments to the payment to be made to the Operator where, within limits, the obligations of the Operator under that Agreement are extended or reduced during the period of that Agreement.

For example, the Operation and Maintenance Agreement will, typically, make allowance for an adjustment in the payment to the Operator where the quality of fuel or other consumables falls below the technical criteria specified in the Operation and Maintenance Agreement.

Similarly, the agreement will typically provide for an adjustment in the payment entitlements of the Operator where there is a change in law which results in the Operator being required to perform obligations beyond those obligations described in the Operation and Maintenance Agreement at the time of execution of the Agreement (for example, increased environmental regulations leading to a more detailed treatment of wastes being required).

The treatment of the payment regime, in such circumstances, typically follows the following format. To the extent that particular changes can be and are anticipated in the Agreement at the time of execution (for example, inadequate quantities of or low grade fuels), the payment adjustment provisions can be specified in the Agreement at the time of execution. To the extent that such changes cannot be anticipated (for example, changes in law) or, at the option of the parties, though potentially able to be anticipated, for convenience the parties elect not to do so at the time of execution of the Agreement (for example the effects of inclement weather), the Agreement will need to provide a **mechanism** (rather than a dollar amount) to determine the consequential price adjustment.

This will, typically, be a reference of the issue to an agreed dispute resolution mechanism.

In the absence of any such contractual mechanism, the Operator will, in fact, have a contractual right to resist the imposition by the sponsor of the obligation to perform the Operator's changed duties. It is a critical prerequisite of the Agreement, therefore, that the sponsor have a suitable contractual mechanism to cater for such changed circumstances.

3.3.5 Termination/Step-in

Where, during the construction phase, it becomes necessary and/or advisable for the sponsor to either step-in or terminate the Construction Contract, the sponsor and the Financier (and to an extent the Government agency) will wish the sponsor to have the construction completed by others (so too, where the sponsor is in default, the Financiers would **usually** wish to take over the project to ensure the completion of construction of the Facility.)

Where, however, during the period of the Operation and Maintenance Agreement, the sponsor becomes in default to the point where the Operator seeks to terminate the Agreement, or the Operator becomes in default to the point where the sponsor seeks to determine the Agreement, the Financiers will be critically interested in creating a suitable regime to ensure the continued operation of the Facility and, in turn, to ensure the ability to repay the Financiers from the proceeds of the offtake agreement.

For this reason, the provisions of the Operation and Maintenance Agreement will, as in the case of the Construction Contract, in addition to the normal contractual terms setting out the grounds for and procedures to be employed in relation to termination of the Agreement, contain additional provisions to give, first, temporary step-in rights and, then, if necessary, assignment rights, to the Financiers.

3.4 Finance Facility

Financiers are concerned about the level and allocation of risk, as they are lending large amounts of money prior to the project being completed.

Financiers to the project will examine every aspect of risk allocation and the offtake agreement. The major issues a financier will examine are:

- the dates for completion of the infrastructure must be in accordance with those in the construction contract and be readily achievable;
- the commissioning procedures must be realistic;
- the warranted performance obligations of the sponsor must be reasonable;
- tariff calculations must be understood and financiers comfortable that the tariff is sufficient to repay the bank debt and to provide the equity providers with sufficient return on their investment;
- the tariff should not be capable of being offset against liquidated or unliquidated claims by the government agency against the sponsor; and
- the effect force majeure and default will have on the debt servicing.

3.5 Other Documents

There are many other documents, depending on the particular project, which will be required to make up the BOT project documents. Those documents must be compatible. Those documents might include any or all of the following:-

Shareholders Agreement (between the Investors)

Site Lease (between the government and the sponsor)

Design Agreement (between the sponsor and the design consultants)

Equipment Supply agreements

Fuel/Water Supply agreements

4. BOT CONTRACT ISSUES

4.1 Interdependency of Contracts

Infrastructure projects normally require many contracts. Each contract evidences an internal allocation of the underlying risks between the parties to the agreement. There are a large number of issues that will

arise when negotiating the contracts for an infrastructure project. Most of the issues which will arise occur in the offtake agreement. Many of the issues will also arise in the other project documents.

4.1.1 Interdependency

Many of the project documents evidencing an infrastructure project are closely interdependent. A default under one contract is likely to trigger cross defaults in other documents.

The financiers will want to examine all of the core contracts. They will want to be satisfied that each party's obligations under the relevant documents are reasonable and that defaults throughout each document are consistent. The financiers' interest in core contracts extends through until the repayment of the bank debt.

The construction company's interest in the project documents is much shorter in duration. Principally, it will want to ensure that the sponsor will be in sufficient funds to meet progress payments under the construction contract. To achieve this, the construction company will want to review the sponsor's ability to drawdown under the facility agreement and ensure that that ability matches the sponsor's potential liability to the construction company under the construction contract.

The government agency will normally only be a party to the offtake agreement with the sponsor. The sponsor then contracts for other parties to perform its design and construction, operating and other obligations. The government agency will want to review those documents to ensure that the obligations of the sponsor's co-contracting parties are consistent with the obligations under the offtake agreement.

The operator will be interested in the offtake agreement to ensure that it provides the sponsor with sufficient funds to meet payments that it will be entitled to claim under the operating and maintenance contract.

4.1.2 Mismatching of Risks

Each project documents will contain an allocation of risks to the contracting parties.

Each document must clearly define each party's obligations and their commencement and end. For example, if the construction company's obligations are simply to design and construct the infrastructure, with the commissioning obligation lying with the operator, agreement will need to be reached between the construction company and operator as to when each party's liabilities commence and finish. If the operator will be liable for liquidated damages for delays in commissioning, it will want to ensure that its commissioning period does not commence until such time as it is satisfied that the construction company has satisfied all of its obligations under the construction contract.

Therefore, it is critical that all parties carry out a review of all documents and the risk allocation inherent in them. Mismatching of risks will then need to be corrected. To identify any mismatching of risks, matrices of the risks inherent in each project document should be prepared and any mismatching of risks corrected.

4.2 Force Majeure

All the core contracts of an infrastructure project will have a force majeure provision, and in a perfect world these provisions would match and be consistent.

Typically, a force majeure clause will provide that in the event of a party being unable to perform its obligations due to the occurrence of a force majeure event, then that party's obligations shall be suspended for the duration of the force majeure event. The clause may go on to provide that for extended force majeure parties may have rights of termination.

4.2.1 What should be a Force Majeure Event?

Force majeure events typically include those events which are outside the control of the parties, examples are war, earthquake, flood, fire, storm, tempest and the like. What will or will not constitute a force majeure event will need to be tailored to meet the needs of the specific project.

4.2.2 Time Extension - Effect on Cost

The first issue that requires examination is whether a party should be afforded an extension of time for a delay caused by a force majeure event occurring during the construction period.

The occurrence of a force majeure event may allow the construction company to extend its time to complete the project and increase its costs, depending upon the terms of the construction contract.

To the extent that the force majeure risk is taken by the construction company, it is likely its price will increase to take that risk into account.

Independent of the terms of the construction contract, a force majeure event will increase the sponsor's end cost to complete the infrastructure because the extended term of construction will increase interest costs of the project borrowings. Furthermore, if interest is capitalised for the project borrowings, it may have a dramatic effect on the economics of the project, because these costs are compounded.

Other contractors will be committed to complete their works within a particular time frame which is geared to the timing of completion of construction under the construction contract. If the construction period is extended under the construction contract, the contractors will either have the ability to defer the date they complete their works or will be required to complete their works at the same time as was the link date with completion under the construction contract. In any event, the delay in construction may result in the contractor not being able to earn its projected income until a later date, which may result in it incurring additional finance costs.

4.2.3 Mismatching of Force Majeure

A delay in construction due to force majeure will have an impact on other related project documents other than simply costs. For example, if the sponsor of the infrastructure has entered into a contract for the acquisition of raw materials needed to operate the infrastructure, that contract may have a date by which the sponsor is required to commence purchasing the materials from the supplier. Therefore, it is necessary to ensure that the force majeure provisions of all project documents match and are consistent.

4.2.4 Insurance

If possible, the costs of delays during construction due to force majeure should be covered by insurance. To the extent that they cannot, the risk is generally borne by the construction company or the sponsor.

A more difficult issue is how force majeure events during the operating phase which cannot commercially be insured should be dealt with. An example of this may be a protracted national strike.

4.2.5 Termination

Putting aside the cost impact of force majeure, a further issue is whether a party should be entitled to terminate contracts due to a prolonged force majeure. During the construction period, if the contracts are terminated due to the occurrence of a force majeure event, the risk lies with the sponsor (and hence the financiers).

sponsors and financiers will want to restrict the right to terminate due to an extended force majeure, as they would be left with say a half built and potentially valueless asset, and therefore, with no means of repaying the project debt.

During the operating phase, if a force majeure event occurs which affects the operation of the plant and last for more than an agreed period, the parties may want the ability to terminate the offtake agreement. If this is permitted, the sponsor's source of repayment of its project debt ceases.

4.3 Sharing of Security

The interests of the government agency and the financiers may conflict in circumstances of default. For example, the government agency may want the right to terminate agreements for prolonged default while the financiers will want the ability to remedy defaults once the sponsor has failed to do so. To regulate such conflicts, it may be desirable for these parties to enter into what is known as a security sharing deed or enforcement arrangement deed.

The issues which one would look to see addressed in this document are:

- if the government agency requires second securities, it will want the consent of the financiers to it taking these securities together with an agreement with the financiers regarding the order of enforcement of securities and relevant priorities. The financiers will in all likelihood want first priority for all their debt and the first right to enforce securities;
- the financiers and the government agency may each want the other to be obliged to discuss defaults and appropriate remedies as a consequence thereof;
- the government agency may require the financiers to provide it with an agreed notice period prior to the financiers accelerating repayment of the project debt; and
- the rights of the government agency to terminate the offtake agreement will be regulated, eg., additional cure rights afforded to the financiers including replacing the sponsor with a party acceptable to the government agency.

4.3.1 Sponsor

Of pivotal importance to the viability of an infrastructure project is the ability of the sponsor to perform its financial and contractual obligations. This must be assessed taking into account the fact that due to the high capital cost of infrastructure projects the sponsor will be highly leveraged through its project financing and the sponsors (and if appropriate other equity providers) will limit their financial injection into and liability for the project.

There are many parties which will rely on the credit of the sponsor. The construction company is in its hands for progress payments under the construction contract. The operator is reliant upon it for payments during the operating phase. Further, if the sponsor fails to make payments, this is likely to affect the output available for purchase by the government agency.

The credit of the sponsor is further complicated by the fact that the financiers to the project will require first ranking security over the assets and undertakings of the sponsor. Other contracting parties (and in certain cases the government agency) may also want security over the sponsor to protect their investment. Multiple securities may firstly be resisted by the financiers as they could limit their rights as a first security holder, and, in any event, if such security is provided it will rank behind the financiers' security and for at least the initial phases of the project be close to worthless.

Any equity in the sponsor will be utilised to assist in the funding of the construction of the infrastructure. If costs are greater than anticipated, will the equity participants be required to make further equity contributions? The financiers in particular will be concerned to ensure that such further equity contributions are made.

4.3.2 Government agency

The ability of the government agency to perform its obligations and in particular, make payments to the sponsor, is central to any project.

If the financiers are not satisfied with the creditworthiness of the government agency, they will not finance the project unless other forms of security, such as government guarantee, are available.

4.4 Long Term Contracts

4.4.1 General

Each of the core documents evidencing an infrastructure project are of a long term nature, normally in the vicinity of 20-30 years. Examples of the contracts which will be of such a duration are the offtake agreement, the operating and maintenance agreement and fuel supply agreement.

It is possible to identify the risks present at the time of negotiation and entry into the contracts. However, it is impossible to foresee the events which will occur during the term of these agreements which may have an impact on each party's respective rights and obligations. Therefore, you will never have a contract that is appropriate for 30 years, nor would you want to be bound by a fixed 30 year contract.

The long term success of these projects will therefore very much depend upon the relationship built up between all contracting parties, and each party's monitoring of the situations affecting the contracts.

Parties to long term contracts have tended to rely upon the Australian legal principles of force majeure, frustration, implied terms and fundamental breach to handle these issues if the parties were unable to negotiate an acceptable middle ground at the time they arose.

This approach, however, is not acceptable in long term contracts, and in particular, infrastructure projects. A consequence of the parties not attempting to deal with these issues in the contract is that an event may arise which entitles either party at law to contend that the contract is frustrated, and therefore at an end, or to invoke a force majeure clause suspending their obligations and ultimately entitling them to terminate the contract. It goes without saying that such a result is totally unacceptable to the parties.

Further, Courts and the legislature have not adequately addressed these issues to date and, accordingly, they should be addressed to the extent possible by the parties to the contract so as to avoid the uncertain applications of these legal principles to their contract.

4.4.2 Unforeseen Circumstances

Given that it is impossible to estimate or anticipate a range of events which may occur, it seems the best that can be done is to insert into long term contracts a provision which requires the parties to discuss in good faith the impact of the unforeseen event with a view to solving any hardships or difficulties caused in the spirit of mutual understanding and collaboration. Such an approach does not attempt to allocate the risk, but merely bring the parties together in good faith to discuss.

To add further weight to the good faith negotiation provision, it may be advisable that a dispute committee containing an equal number of senior representatives of each party be formed to meet and attempt to resolve an unforeseen event if the parties' respective contract managers fail to agree. Other remedies such as expert determination or arbitration may also be considered.

4.4.3 Changes in Circumstances

It is also likely that the circumstances surrounding the project will change during its life. For example, the demand for the output of the infrastructure is likely to increase over the life of the project and laws regulating the standard of output may change. We examine these 2 possibilities below.

(i) Increased Demand

It appears that there are 2 alternative means by which the offtake agreement can regulate the obligation of the sponsor to upgrade or expand the facility in the event that future demand necessitates it.

Firstly, the government agency and sponsor may agree up-front on the timing and cost of the amplification of the infrastructure during the term of the agreement. In this case, the document would detail the obligations of the sponsor to upgrade at given times and for an agreed price. However, it is unlikely that the timing and cost of carrying out future upgrades can be predicted.

Alternatively, if (as is likely) the parties are unable to agree on the timing and cost of amplification, possibly the only avenue open to them is to insert into the contract a provision requiring the sponsor to, at the request of the government agency, upgrade the plant. This obligation to upgrade would be subject to 2 principal issues being resolved at the time of the proposed upgrade, namely the sponsor's ability to obtain finance for such upgrade and the impact of the upgrade on the tariff. Given that these 2 variables which cannot be predetermined are the most critical in the transaction, there is the clear risk of the parties being unable to agree on the cost of upgrades. This is a risk that government authorities run in that they may lose the ability to dictate their future infrastructure requirements.

(ii) Performance Standards

The performance standards contained in the offtake agreement will be tied to the laws and conditions prevalent at the time the document is entered into. These conditions may change. For example, a new law may require water to be treated to a higher standard or change the means by which electricity is to be produced.

The offtake agreement must provide that the sponsor is required to comply with future laws. This, however, will have a cost component which cannot be pre-agreed. Therefore, if performance standards change due to a new law or directive, the parties should be required to negotiate in good faith to attempt to agree on the cost impact of the change. Such a clause would be similar to the unforeseen circumstances clause referred to above.

4.5 Default/Remedies/Termination

4.5.1 Default

Default by any party to the project documents will have a significant impact on the project. In fact, it is likely that default under one project document (for example, the design and construction contract) will trigger default under the other documents (for example, the offtake agreement).

Invariably, the government agency is not obliged to commence making payments to the sponsor until the infrastructure is completed and commissioned. Therefore, during the design and construction phase, the real risk of loss due to default lies with the financiers because they have advanced funds for the construction prior to the revenue stream under the offtake agreement commencing. The financiers are required to rely upon the credit of the sponsor and the construction company under the design and construction contract.

Management of the construction risk is a well known tool; completion guarantees, performance bonds and/or liquidated damages may be payable if milestones are not achieved or construction is not completed by an agreed end date. However, if the construction cost of infrastructure is large then it is unlikely that these amounts could recover sufficient moneys to repay the debt outstanding at the time default occurs. Clearly the later into the construction phase that the default (and termination) occurs the greater the financiers' risk.

To mitigate their risks, the financiers will want the offtake agreement to remain on foot if there is a construction default so that they may seek a replacement construction company to complete the project.

During the operating phase, default may occur under the operating and maintenance contract, any equipment supply contract and of course the offtake agreement. Default under the operating or supply contracts may not be fatal to the project. The sponsor may have agreed periods within which it must find replacement operators/suppliers acceptable to the government agency. However, default under, and thereafter termination of, the offtake agreement is obviously critical, as when this document is terminated so too is the cashflow.

Defaults are generally categorised into 4 groups:

- performance default;
- failure to pay liquidated damages for non-performance;
- insolvency; and
- breach of miscellaneous contractual obligations.

4.5.2 Non-termination Remedies

(i) Step In

If a default is not rectified within the agreed cure period, the government agency may require a novel remedy known as "step in". Step in is a right afforded to the government agency by the sponsor (and acknowledged by the operator and financiers) whereby the government agency is entitled to step in and operate the facility to ensure a continuous supply of the product to its customers.

The government agency when exercising its step in right is not normally an agent of the sponsor. It is simply given limited rights pursuant to the contract to assume management of the facility. Therefore, while exercising its rights of step in, it should not have the right to terminate the project documents or take action which may prejudice the sponsor's rights. The government agency also would not be obliged to assume the obligations of the sponsor under the project documents.

There are risks to the government agency involved when exercising a step in. One of the most apparent is potential liability to third parties if the government agency is negligent. Further, officers of the government agency may be seen to be involved in the management of the sponsor, with the potential exposure to liability under the Corporations Law as de facto directors where the sponsor is insolvent.

(iii) Liquidated Damages

To protect itself against financial loss, the government agency may require liquidated damages to be paid in the event of default (and in particular performance default). It is unlikely that liquidated damages will fully compensate the government agency for continued underperformance.

Liquidated damages will be payable by the construction company to the sponsor if completion of construction is delayed due to default by the construction company. The question is then who should benefit from the payment of such liquidated damages, especially if they are insufficient to meet all claims on the sponsor by its co-contracting parties?

The answer comes down to deciding whether the liquidated damages should be paid to the government agency to ensure the offtake agreement is not terminated, thereby keeping the project on foot, or be paid to the financiers to repay the debt. The first course may be the most beneficial in the long term if a default under the offtake agreement can be avoided.

A. The Government agency's Claim

Delay in completion of the facility will affect the government agency. It will need to find alternative sources from which it can acquire the relevant product, and that product may be more costly than that contracted for with the sponsor. The government agency may also have incurred costs if it was required to construct infrastructure supporting the sponsor's facility to be built.

B. The Sponsor's Claim

Delay in construction will obviously affect the sponsor. Its liability to the financiers will increase due to interest capitalising beyond its committed repayment schedule. It is also likely that it will be liable for liquidated damages for the delay caused by the construction company.

Sharing of Liquidated Damages

It is unlikely that the liquidated damages payable by the construction company will be sufficient to meet all of the above costs. The question is then who should benefit and in what priority for the liquidated damages? Should one party have a right to liquidated damages paid by the construction company in priority to others or should the damages be under the control of and distributed by the sponsor?

This pre-completion risk will require commercial resolution via negotiations between all parties. Similar considerations apply in relation to operation phase liquidated damages, for example, liquidated damages payable by the operator to the sponsor under the operation and maintenance contract.

(iv) Options/Take-outs

Liquidated damages and/or a right of termination may not be satisfactory to the government agency. Further, the right to step in generally is intended only to be a short term remedy,

In these circumstances, the government agency may require an option to purchase the sponsor and/or the infrastructure.

The financiers may want the government agency to either assume the sponsor's obligations or purchase the facility at a price sufficient to repay the debt. A government agency will resist this, as it is an indirect guarantee that the debt will be repaid.

4.5.3 Termination

Once the infrastructure is commissioned, the sponsor (and its financiers) will argue that there should be long cure periods to remedy any defaults prior to the government agency being entitled to terminate the offtake agreement. They will also argue that during such cure period, the government agency should be obliged to continue paying both the availability fee and usage fee (on the basis of performance at that time) without setoff, to ensure the continued viability of the project.

While government authorities recognise the need for cure periods prior to being entitled to terminate, the hard issue is how long such cure periods should last. Ideally, lenders would like there to be no fixed cure periods. Rather, they will argue that provided best endeavours are being used to remedy the default then the payments should continue to be made and the authority should not be entitled to terminate.

The government agency, on the other hand, will be seeking to minimise the length of cure periods afforded to the sponsor (and financiers) prior to it being entitled to terminate.

5. LAND LAW ISSUES

The land law issues associated with infrastructure projects are not simple. There are many complex issues, and the following are examples of some of the issues which may arise:

5.1 Long Term Leases

Many infrastructure projects involve a long term (up to 30 years) lease of the land upon which the infrastructure is to be built. This can give greater control over the site to the government body. It also ensures that the redevelopment potential of the site is not transferred to the sponsors.

Financiers and other interested parties are becoming more aware of the issues involved in long term leases. For example, long term leases should be equivalent to freehold, they should only be terminable in the most extreme circumstances. They are very different to a 5 year CBD or factory lease. There is, however, a lack of Australian case law on long term leases.

Recently, this form of "ownership" has given rise to lawyers revisiting the question of ownership of fixtures.

5.2 Subdivision

Land leased to the sponsor by way of long term lease which is only part of the land in a title deed, may be deemed to effect a subdivision of the site under the Local Government Act, with the consequent need for relevant approvals if the government agency is bound by that legislation. This will involve Local Councils who may have an agenda different to the State or Federal Government, or their agencies.

If the private sector is obliged to obtain subdivision approval additional timing and costs must be allowed for in timetables.

5.3 Easements/Rights of Way

In addition to the lease of the main site, the following interests in land may be required:

- easements over privately owned or other Government land through which pipelines and other works associated with the main infrastructure are to be constructed; and
- rights of way/licences over private land or other Government land through which the sponsor must pass to obtain access to the main site and/or land subject to an easement.

These property interests may result in different income tax treatments for plant or other improvements located on these parts of the site. Further, there is the question of whether the government agency will get involved in the obtaining of the required easements/rights of way.

5.4 Resumption

The sponsor will not have the power to resume land. Therefore, any land or interest in land required for the project will probably be acquired by the government agency by either private agreement or resumption.

5.5 Power

The power of a government agency to deal with land is normally strictly regulated in its constituent documents. For example, some government authorities do not have the power to grant long term leases. Therefore, like all other aspects of infrastructure projects, one must closely review the relevant powers of the government agency.

5.6 State Taxes

Certain aspects of infrastructure projects are not envisaged by the stamp duty legislation of the relevant jurisdiction. This has resulted in attempts to fit complex structured finance transactions into existing stamp duty principles, with unusual results. Two examples are set out below:

5.7 Duty on Site Lease

Stamp duty is normally payable on the rent payable or, if higher, the market rent of the property, which may be greater than the more usual peppercorn rent. However, in infrastructure projects site leases (or the collateral offtake agreement) contain an obligation on the lessee to build the infrastructure. This obligation could lead to stamp duty being payable on the significantly higher value of the property to be constructed. It is also possible that the sale of the output of the infrastructure will be treated as "rent".

5.8 Transfer of Partnership Interests

As the law presently stands, the transfer of an interest in a partnership may be liable to ad valorem duty calculated on the higher of the purchase price and the unencumbered value of the interest being transferred. This treatment of a transfer of an interest in a limited partnership compares unfavourably with the transfer of "marketable securities". Therefore, if a viable market is to be created for the transfer of interests in a limited partnership, the stamp duty legislation must be amended so that interest in a limited partnership are treated on the same footing as shares in a company.

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BOT PROJECTS