

# A Guide to the Statistical Treatment of PPPs

September 2016



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Eurostat and the European PPP Expertise Centre have worked together to produce this publication on the statistical treatment of public private partnerships (PPPs).<sup>1</sup>

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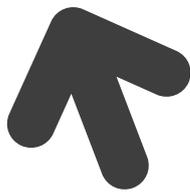
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## Foreword



Almost two years ago, the European Commission and the European Investment Bank Group launched the Investment Plan for Europe (IPE) to support economic recovery by stimulating additional investment in the real economy. The IPE is not only about investments using public money, but also aims to engage private capital and expertise.

This is why Public-Private Partnerships (PPPs) are expected to play an important role in getting Europe's investment in infrastructure back on track. Experience shows that, if used well, these structures can boost the 'value for money' of public investments and services. The European Commission and the EIB have supported the development of PPPs over the years. The EIB, for example, is the largest lender to PPPs in Europe and hosts the European PPP Expertise Centre (EPEC), one of its Advisory Services, created in 2008 to help the public sector to deliver sound PPPs.

PPPs are complex arrangements. They require institutional and legal frameworks that are clear and conducive to their implementation, as well as high-quality project preparation

by public authorities with adequate resources devoted. Clearly, PPPs should be undertaken on the basis of, amongst other things, value for money, an appropriate allocation of risks and operational efficiency, with a particular eye on affordability and long-term fiscal responsibility. Many challenges must be overcome to deliver robust public investment through PPPs.

The 'Eurostat rules' for the statistical treatment of PPPs can sometimes be seen as one of the obstacles to delivering PPPs and have therefore been the subject of much debate. Some stakeholders have argued that the rules make it difficult to understand how PPPs can affect the balance sheet of EU Member States and how they impact on the fiscal criteria set out in the Maastricht Treaty.

Although we caution against an excessive focus on the "off" balance sheet treatment of PPPs, the calls from stakeholders regarding the clarity of the rules, doubts on how they should be interpreted, and the frequency of changes to them should be addressed. In response to this, Eurostat has recently mobilised considerable resources to deal with the PPP topic and Eurostat and EPEC have worked together for the last nine months to produce clear guidance on the subject of the statistical treatment of PPPs.

On behalf of the European Commission and the EIB, we are now pleased to introduce this guide as a concrete action deriving from the IPE. We are sure it will help Member States and PPP stakeholders more generally better understand the impact of PPPs on government balance sheets and will assist public authorities in taking well-informed decisions when using PPP arrangements. Perhaps most importantly, it should allow them to plan ahead with greater confidence so that more investment involving the private sector will come forward using the opportunities offered by sound PPPs.



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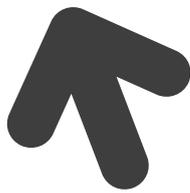
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# Table of Contents

6	Main Terms Used in the Guide
8	Introduction
14	Chapter 1 – Background to the Rules
18	Chapter 2 – The Features of a PPP
28	Chapter 3 – The PPP Contract
30	<b>Theme 1</b> – The project site
32	<b>Theme 2</b> – Design and construction of the asset
38	<b>Theme 3</b> – Operation and maintenance of the asset
44	<b>Theme 4</b> – The payment mechanism
64	<b>Theme 5</b> – Other payment arrangements
72	<b>Theme 6</b> – Compensation, relief and force majeure events
80	<b>Theme 7</b> – Changes to the PPP contract
84	<b>Theme 8</b> – Changes in law
86	<b>Theme 9</b> – Insurance
92	<b>Theme 10</b> – Warranties and indemnities
96	<b>Theme 11</b> – Early termination of the PPP contract
102	<b>Theme 12</b> – Compensation on early termination of the PPP contract
114	<b>Theme 13</b> – Expiry of the PPP contract
118	<b>Theme 14</b> – Financing arrangements
130	<b>Theme 15</b> – Government influence
136	<b>Theme 16</b> – Miscellaneous provisions
138	Chapter 4 – Concluding the Statistical Treatment Assessment
142	Annex: Table of Typical PPP Contract Provisions that Influence the Statistical Treatment



## Main Terms Used in the Guide

<b>Authority</b>	The public authority that enters into the PPP contract for itself and/or on behalf of other public authorities
<b>Construction Phase</b>	The period during which the asset is constructed
<b>ESA 2010</b>	The European system of accounts in force at the date of the Guide <sup>2</sup>
<b>Financial close</b>	The date that the financing agreements for a PPP transaction become unconditional and the financing becomes available
<b>Government</b>	The general government sector, as defined in the Rules <sup>3</sup>
<b>Guide</b>	This guide
<b>MGDD 2016</b>	The latest version of the Eurostat Manual on Government Deficit and Debt – Implementation of ESA 2010, published in March 2016, and its supporting Clarification Note on the Statistical Treatment of PPP Contracts <sup>4</sup>
<b>Operational Payments</b>	The routine payments made by the Authority to the Partner during the Operational Phase, linked to the availability of the asset and/or the demand for the asset and/or related services

2 Council Regulation (EC) 549/13 of 21 May 2013 on the European system of national and regional accounts in the European Union (OJ L 174/1, 26.06.2013, p.1). [ec.europa.eu/eurostat/en/web/products-manuals-and-guidelines/-/KS-02-13-269](http://ec.europa.eu/eurostat/en/web/products-manuals-and-guidelines/-/KS-02-13-269)

3 See ESA 2010, paragraphs 2.111 to 2.112 and 20.05 to 20.06.

4 See [ec.europa.eu/eurostat/en/web/products-manuals-and-guidelines/-/KS-GQ-16-001](http://ec.europa.eu/eurostat/en/web/products-manuals-and-guidelines/-/KS-GQ-16-001) and [ec.europa.eu/eurostat/documents/1015035/7204121/Clarification-note-Statistical-treatment-of-PPP-contracts-accompanying-2016-MGDD.pdf/ed12cf33-f8eb-4e7e-aa58-29a5fbc3f978](http://ec.europa.eu/eurostat/documents/1015035/7204121/Clarification-note-Statistical-treatment-of-PPP-contracts-accompanying-2016-MGDD.pdf/ed12cf33-f8eb-4e7e-aa58-29a5fbc3f978)

<b>Operational Phase</b>	The period during which the asset is maintained or maintained and operated by the Partner
<b>PPP</b>	Public private partnership
<b>PPP contract</b>	A contract for the design, construction, operation/ maintenance and financing of an asset under a PPP arrangement
<b>Partner</b>	The entity that enters into the PPP contract with the Authority
<b>Rules</b>	The rules used by Eurostat for assessing the statistical treatment of PPP arrangements
<b>SPV</b>	A special purpose vehicle
<b>Statistical treatment</b>	The recording of a PPP on or off the balance sheet of the relevant government according to ESA 2010
<b>Themes</b>	The main features of a typical PPP contract as set out in Chapter 3 of the Guide



# Introduction

The recording of public private partnerships (PPPs) on or off governments' balance sheets according to the European system of accounts (commonly referred to as the "statistical treatment of PPPs") is a subject that has attracted increased attention over the past few years.

Many public and private sector stakeholders have recently called for more clarity on the rules used by Eurostat for assessing the statistical treatment of PPP arrangements (the Rules). Their concerns largely relate to the perceived complexity of the Rules and difficulties in understanding how they apply to specific projects. These concerns have arisen in particular as new provisions and structures have been emerging on the European PPP market over the years, prompting Eurostat to update the Rules and fine-tune its interpretation of them. The public sector's decision to procure projects as PPPs is often influenced by expectations as to their statistical treatment (i.e. how those projects will impact on government debt and deficit figures). Uncertainty in how to assess the statistical treatment of PPPs can therefore create difficulties and delays in the various stages of project planning, preparation and implementation.

In response to PPP stakeholders' concerns, and with a desire to bring clarity, Eurostat and EPEC have worked together to produce this guide (the Guide).

## Aim of the Guide

The Guide is aimed mainly at public sector PPP stakeholders, and in particular PPP practitioners (i.e. authorities in charge of PPP policy, decision-making and the preparation and procurement of PPP projects). It is intended to improve their understanding of how the Rules should be applied to PPPs. It explains how the features of typical PPP contract provisions (i.e. those that reflect general market practice in the EU jurisdictions) are relevant to the application of the Rules, and therefore whether they influence the statistical

treatment of a PPP as on or off the balance sheet of government.

In contrast to existing Eurostat publications, which look at the statistical treatment of PPPs through a “statistical lens”, the Guide looks at it through a “PPP lens”. It is therefore expected to benefit PPP practitioners in a number of ways:

- **Practicability:** the Guide is organised according to the structure of a typical PPP contract with which PPP practitioners will be familiar;
- **Comprehensiveness:** the Guide explains the application of the Rules to a comprehensive set of PPP contract provisions commonly observed across the EU market;
- **Clarity:** the Guide has been prepared with a view to being as definitive and unambiguous as possible; and
- **Stability:** as the Guide is underpinned by a significant effort to be comprehensive in its coverage of PPP contract provisions across the EU PPP market, further substantive revision of the Rules is not expected in the near future unless it becomes necessary to address new practices that emerge in the market.

## Approach to producing the Guide

EPEC managed the development process of the Guide. Two main steps were taken:

- **A stock-take of PPP contract provisions across the EU:** PPP contracts differ significantly across the EU, so the first step involved identifying the various approaches adopted across the EU to deal with key contractual aspects of PPPs (including matters implied by relevant laws). This part of the work was led by EPEC and benefited from the support of Allen & Overy LLP, an international law firm with extensive PPP experience across the EU;<sup>5</sup> and
- **Applying the Rules to the typical PPP contract provisions:** the second step involved EPEC asking Eurostat to explain how it would apply the Rules to the PPP contract provisions considered to represent typical EU practice.

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<sup>5</sup> EPEC and Eurostat thank Allen & Overy for its contribution to the production of the Guide.

## Structure of the Guide and how to use it

The Guide is structured around four Chapters:

- Chapter 1 provides users with the background required for understanding the statistical treatment of PPPs. It gives a general overview of the development of the Rules and their key underlying principles. It also explains the stages at which the statistical treatment of a PPP should be assessed;
- Chapter 2 explains the general features of PPPs that, according to Eurostat, distinguish PPPs from other types of long-term arrangements used by public authorities for delivering public infrastructure. If a project is a PPP, as defined by Eurostat, the Rules (as explained in the later Chapters of the Guide) apply. If a project is not a PPP, as defined by Eurostat, the Rules do not apply and the statistical treatment of the project will be determined under separate Eurostat rules that are outside the scope of the Guide;
- Chapter 3, the main body of the Guide, deals with how the Rules apply to the specific features of PPPs. It does so by looking at 16 typical PPP contract themes (the Themes). Chapter 3 summarises the typical approaches taken in PPP contracts in the EU to deal with the main issues under each Theme and provides Eurostat's view on whether or not the approaches taken influence the statistical treatment. For ease of reference, Eurostat's comments are shown in *colours and italics*. Where an approach does influence the statistical treatment (meaning that it points to the PPP being on balance sheet for government), Chapter 3 indicates if the matter is of VERY HIGH, HIGH or MODERATE importance or is sufficient in itself to record the project ON BALANCE SHEET for government; and
- Chapter 4 explains the methodology that Eurostat uses in practice to reach a conclusion on the statistical treatment of a PPP where it has identified one or more issues that influence the statistical treatment. Users can refer to this Chapter to help them understand whether a single issue (or a combination of issues) that they may have identified through Chapter 3 is likely to lead Eurostat to an off or on government balance sheet decision.

## Scope and limitations of the Guide

When using the Guide, the following points should be borne in mind:

- The Guide is based on the Rules as set out in the European system of accounts in force at the date of the Guide (ESA 2010) and the most recent version of the *Manual*

on *Government Deficit and Debt – Implementation of ESA 2010* published in March 2016 with its supporting *Clarification Note on the Statistical Treatment of PPP Contracts* (the MGDD 2016). Although, as mentioned above, substantive revision of the Rules is not expected in the near future, when using the Guide it is important to ensure that ESA 2010 and the MGDD 2016 are still in force;

- The Guide is fully endorsed by Eurostat. It therefore constitutes official Eurostat guidance and applies to PPP contracts which reached financial close after the date of its publication. Eurostat is of the view that the Guide complements, interprets and clarifies its existing publications and published opinions (in particular the MGDD 2016). Although the Guide is consistent with the MGDD 2016, in the unlikely case that a view expressed in the Guide is perceived to conflict with the MGDD 2016, the view expressed in the Guide prevails as it reflects Eurostat’s latest thinking;
- The Guide deals only with PPPs (as defined by Eurostat, see Chapter 2) and therefore excludes “concessions” (as defined by Eurostat, see Chapter 2), and “institutionalised PPPs”.<sup>6</sup> It is important to stress that the statistical treatment of concessions is assessed under separate rules from those that apply to PPPs (see Chapter 2). If and when opportune, Eurostat and EPEC will consider working together to produce a similar guide on the statistical treatment of concessions;
- The Guide does not deal with “energy performance contracts”, even in these cases where such contracts have some features of PPPs;<sup>7</sup>
- As noted above, the Guide is based on PPP contract provisions commonly observed across national PPP markets in the EU. Although considerable efforts have been made to be as extensive as possible, the Guide does not claim to cover all possible PPP contract provisions that may have an impact on the statistical treatment, or any provisions that may appear on the EU PPP market in the future. The fact that a specific PPP contract or project contains features and/or provisions that are not covered by the Guide does not mean that those features or provisions should be disregarded in assessing the statistical treatment;

6 A description of institutionalised PPPs can be found in the following European Commission communication: [eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008XC0412\(02\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008XC0412(02)&from=EN)

7 Many features of energy performance contracts (e.g. savings-based remuneration) differ from those of typical PPPs. For Eurostat rules for energy performance contracts see: [ec.europa.eu/eurostat/documents/1015035/6934993/EUROSTAT-Guidance-Note-on-Energy-Performance-Contracts-August-2015.pdf/dc5255f7-a5b8-42e5-bc5d-887dbf9434c9](http://ec.europa.eu/eurostat/documents/1015035/6934993/EUROSTAT-Guidance-Note-on-Energy-Performance-Contracts-August-2015.pdf/dc5255f7-a5b8-42e5-bc5d-887dbf9434c9)

- In order to meet its intended purpose, the Guide is detailed and reflects a level of complexity that is typical of PPP transactions. It is assumed, therefore, that users of the Guide have a good working knowledge of the structure and principal terms of PPP transactions;
- In using the Guide and interpreting how it applies to a specific project, users must consider the commercial impact of the typical PPP contract provisions described and of the principles referred to in Eurostat's comments. It is important to be aware that the Rules are concerned with the economic substance and effect of the provisions that regulate PPP transactions. However detailed and practical the Guide may prove to be, PPP structures and contracts vary greatly and it is important to consider the statistical treatment of each PPP transaction on a case by case basis, taking account of all aspects of the transaction as a whole (including all provisions in all documents relating to the transaction). The form that the provisions take in individual projects may vary from those described in the Guide. Different projects use different terminology and drafting mechanisms, include provisions in different transaction documents, and can be affected by provisions that are contained in underlying laws rather than the PPP contract itself;
- The statistical treatment of a PPP involves assessing many features of the transaction, which are often interdependent. As a result, users need to consider the Guide as a whole and should refrain from looking at specific sections of it in isolation;
- The aim of the Guide is to provide assistance with the indicative statistical treatment of PPPs. As is the case with all statistical issues involving government, final decisions on the statistical treatment of PPPs remain with national statistical authorities and, ultimately, Eurostat. Early consultation with national statistical authorities is recommended if the statistical treatment of a project is likely to be a determining factor in the public sector's decision to procure or enter into a PPP contract or when certainty on the statistical treatment is required. This is particularly important if a project features new provisions or structures for which no specific Eurostat guidance exists;
- If there is doubt as to whether or how the Rules or the Guide apply to a specific contract, the national statistical authorities of EU Member States have the ability to ask Eurostat for its assessment. Such requests can be made for contracts that have already been signed or for contracts that are under preparation. However, it must be noted that Eurostat only gives opinions on projects that are already structured. It does not issue guidance on hypothetical cases or different variants

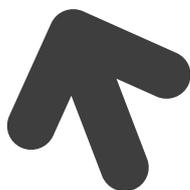
of the same projects and does not provide advice on how to structure projects in order to arrive at a particular conclusion on their statistical treatment;<sup>8</sup>

- The Guide does not deal with “value for money” and “bankability” issues that arise in PPPs. It must not be interpreted as providing an endorsement of, or advice on, the value for money and bankability of the PPP contract provisions that it describes. Likewise, it must not be interpreted as providing an endorsement of, or advice on, the value for money and bankability implications of using, structuring or amending any PPP contract provisions in order to arrive at an off government balance sheet treatment; and
- The comments on the statistical treatment expressed in the Guide are those of Eurostat<sup>9</sup> alone and do not reflect the views of EPEC or the views or interests of the EIB as a lender to PPP projects.

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8 Guidelines for Eurostat’s ex-ante advice on methodological issues is available at: [ec.europa.eu/eurostat/documents/1015035/2046549/Ex-ante-advice-final-2013-01-18.pdf/483cc8b1-d384-416f-b7ed-7a788f246517](https://ec.europa.eu/eurostat/documents/1015035/2046549/Ex-ante-advice-final-2013-01-18.pdf/483cc8b1-d384-416f-b7ed-7a788f246517)

9 The contributions from Luca Ascoli and Lourdes Prado-Ureña from Eurostat in producing the Guide are acknowledged.



# Chapter 1 – Background to the Rules

## Overview

This Chapter provides users with the background required for understanding the statistical treatment of PPPs. It gives a general overview of the development of the Rules and their key underlying principles. It also explains the stages at which the statistical treatment of a PPP should be assessed.

## Development of the Rules

The “Excessive Deficit Procedure”, defined by the Maastricht Treaty (Article 104), has been in force in the EU since 1994. The European Commission (through Eurostat) endeavours to guarantee the proper application of the European system of accounts, in order to gather reliable and comparable statistics on the debt and deficit position of Member States. As of September 2014, ESA 2010 is the reference framework for these data. Its use is legally binding for all EU countries.

ESA 2010 is aimed at producing economic statistics and seeks to record the economic substance of transactions (rather than their legal form). ESA 2010 contains rules for the statistical treatment of PPPs<sup>10</sup> that reflect, amongst other things, Eurostat’s work on this subject since 2004, as explained below.

Eurostat rules on PPPs were first published in February 2004 under the *New decision of Eurostat on deficit and debt – Treatment of public-private partnerships*.<sup>11</sup> This decision concerned the statistical treatment of long-term partnership contracts in which government is the main purchaser of the services provided by a partner. It specified the main principles for the statistical treatment of PPPs and their recording in government

<sup>10</sup> See ESA 2010 paragraphs 20.276 to 20.290, pages 453-456.

<sup>11</sup> The Eurostat Decision of 11 February 2004 is available at: [ec.europa.eu/eurostat/documents/1015035/2041337/Treatment+of+PPPs.pdf/af9e90e2-bf50-4c77-a1a0-e042a617c04e](http://ec.europa.eu/eurostat/documents/1015035/2041337/Treatment+of+PPPs.pdf/af9e90e2-bf50-4c77-a1a0-e042a617c04e)

deficits and debt data. This decision led to more descriptive guidance in the form of a chapter in the *Manual on Government Deficit and Debt*. The current version of the Manual, the MGDD 2016, is harmonised with ESA 2010 and is its indispensable complement. The Rules are therefore drawn from ESA 2010 and the MGDD 2016 as well as official opinions produced by Eurostat on specific PPP cases.

It is important to stress that ESA 2010 requires national accounts to use a “binary” reporting system. Accordingly, a PPP’s asset is to be recorded either as a wholly government asset or a wholly non-government asset (i.e. its economic ownership cannot be split between government and the partner).<sup>12</sup> As a result, when a PPP’s asset is found to be on balance sheet for government, the aggregate value of the project asset (and the related liabilities) must be recorded.

### Fiscal risks in PPPs

Although the statistical treatment of a PPP may be an important factor in the process of deciding to opt for a PPP arrangement, or to procure or sign a PPP contract, two important points should be borne in mind:

- It has been observed that an excessive focus on off government balance sheet recording can be at the expense of sound project preparation and value for money and may push public authorities to use PPPs where not appropriate; and
- PPPs can create an “affordability illusion” (mainly due to the deferral and spreading of public sector payments through time), which tends to be exacerbated when a project is found to be off balance sheet. The fiscal liabilities that arise from PPPs can have a detrimental effect on the relevant country’s fiscal sustainability and so they should be managed properly (e.g. through recognition of government contingent financial commitments, limits on volumes of PPP investment).

<sup>12</sup> Components of a project that are provided, but not maintained/operated, by the partner under a PPP contract are not considered by Eurostat to be part of the PPP’s asset. The statistical treatment of such components requires separate analysis. An example would be a hospital accommodation project where the PPP contract requires the partner to construct additional access roads but places no responsibility on the partner for the maintenance or operation of those access roads once they have been completed.

## Key principles for assessing the statistical treatment of PPPs

The purpose of the Rules is to allocate a PPP to the balance sheet of the economic owner of the asset, which is the party that bears most of the risks and has the right to most of the rewards<sup>13</sup> associated with the asset. If the assessment of risks and rewards is not conclusive, the Rules state that it is appropriate to assess the statistical treatment by looking at which party to the PPP contract has “control” of the asset, in particular control of its specification and the services to be delivered from it and control over it once the PPP contract expires.

Chapters 3 and 4 of the Guide explain how Eurostat applies the above key principles in practice.

## Timing of the assessment of the statistical treatment of PPPs

The statistical treatment of a PPP is assessed by examining the PPP arrangements as they stand at financial close against the Rules in force at financial close. In normal circumstances, the conclusion of the assessment made at that time will hold for the duration of the PPP contract.

However, if a PPP contract is changed, or the nature or control of one of the parties to the PPP contract changes,<sup>14</sup> it is necessary to consider whether the change affects the original conclusion on the statistical treatment. The change itself is assessed under the Rules as they stand at the time it is made. If, according to those Rules, the change itself directly alters the balance of risk and reward (or nature or control of the relevant party) in a way that would alter the statistical treatment, the original statistical treatment must be revised.

By way of illustration, a PPP that reached financial close and was recorded off balance sheet for government in April 2013 (when the MGDD 2013 applied) is amended in April 2016 (when the MGDD 2016 applies):

- If the original PPP contract includes no government right to refinancing gains and is amended to introduce a 60% government share of refinancing gains, the statistical treatment needs to be changed to record the PPP on balance sheet for

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13 The requirement to consider rewards (in addition to risks) in assessing the statistical treatment of PPPs was explicitly introduced into the Rules by ESA 2010.

14 Chapter 2 explains how the nature or control of the parties is relevant to the statistical treatment.

government. This is because the amendment has altered the balance of government reward in a relevant way;<sup>15</sup>

- If the original PPP contract includes a clause that specifies that government has a right to 60% of the gains from a refinancing and is only amended to allow for a physical alteration to the asset, there is no change to the off balance sheet recording for government. This is because the amendment has not altered the balance of risk and reward or control of either party;<sup>16</sup> or
- If the original PPP contract includes a clause specifying a 60% government share of refinancing gains and is only amended so that deductions under the payment mechanism are not applied for a reasonably short time period after the asset becomes operational, there is no need to change the recording of the PPP off balance sheet for government. Although the change affects the balance of risk and reward, it does not do so in a relevant way (as explained in Chapter 3, Theme 4.7.2).<sup>17</sup>

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15 Under MGDD 2016 (the Rules in force when the amendment is made and used to assess the amendment), a 60% government share of refinancing gains automatically leads to a PPP being recorded on balance sheet for government (see Chapter 3, Theme 14.6.2).

16 It is the amendment that is assessed under MGDD 2016. The fact that the contract gives government a 60% share of refinancing gains is not relevant because under MGDD 2013 (the Rules in force when the contract reached financial close) a 60% government share of refinancing gains was not relevant to the statistical treatment.

17 See footnote 16.



## Chapter 2 – The Features of a PPP

### Overview

The term “PPP” is typically used to describe a long-term contractual arrangement for the provision of a public asset and related services in exchange for performance-based payments linked to the asset’s availability and/or use and the delivery of the related services. This Chapter explains the particular features of a project that determine whether or not it falls within Eurostat’s own definition of a PPP and therefore whether or not the Rules (and the later Chapters of the Guide) apply. These features are:

- the “statistical sector classification”<sup>18</sup> of the public authority that enters into the PPP contract (the Authority);
- the “statistical sector classification” of the entity that enters into the PPP contract with the Authority (the Partner);
- the source of the Partner’s revenues (i.e. the distinction between PPPs and concessions);
- the type of asset to be provided by the Partner under the contract;
- the nature of the works (e.g. new built, refurbishment, renovation, upgrading) to be carried out by the Partner under the contract;
- the economic life of the asset and the duration of the contract;
- the scope of services to be provided by the Partner under the contract; and
- any revenues received by government from the project.

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<sup>18</sup> The entities involved in a PPP transaction will, for statistical purposes, be classified as either inside or outside the general government sector. This will be determined by the same general rules used to determine the statistical sector classification of all entities within a Member State. This is a technical and complex area of national accounts. While Chapter 2 considers the likely relevance of the general rules to typical PPP transactions, users are strongly advised to consult their national statistical authorities for any specific queries or concerns.

As already mentioned, the statistical treatment of projects that do not fall within Eurostat’s definition of PPPs is outside the scope of the Rules and the Guide.

### Statistical sector classification of the Authority

Eurostat’s definition of a PPP requires that the Authority is, for statistical purposes, classified inside the general government sector (e.g. a central government ministry or department, a regional or local government entity).<sup>19</sup>

If the Authority is, for statistical purposes, classified outside the general government sector (e.g. a company that is owned by government but, in statistical terms, considered a “market producer”), Eurostat does not consider the project to be a PPP and the Rules do not apply.<sup>20</sup>

### Statistical sector classification of the Partner

Eurostat’s definition of a PPP requires that the Partner is, for statistical purposes, an entity classified outside the general government sector. The tests applied to determine if an entity is classified inside or outside the general government sector depend on whether or not the entity is a special purpose vehicle (SPV). These tests are described below.

In the vast majority of PPP projects, the Partner is an SPV created for the sole purpose of entering into a PPP contract with an Authority. The relevant tests for determining the sector classification of the Partner will, therefore, usually be those that apply to SPVs.

<sup>19</sup> EDP Inventories Annex I: list of units classified in the general government sector by countries available at: [ec.europa.eu/eurostat/web/government-finance-statistics/excessive-deficit-procedure/edp-inventories](http://ec.europa.eu/eurostat/web/government-finance-statistics/excessive-deficit-procedure/edp-inventories).

<sup>20</sup> An example of this would be where a rail company (owned by government but classified as a market producer outside the general government sector) enters into a long-term arrangement with a partner for the construction and operation/maintenance of rail track infrastructure. It should be noted that any government involvement in such a project can have an impact on its statistical treatment through the application of other (i.e. non-PPP) Eurostat rules.

### Cases where the Partner is an SPV

If the SPV is controlled by private entities<sup>21</sup> it will, for statistical purposes, be classified outside the general government sector.<sup>22</sup> Assuming that the project has the other features of a PPP (as defined by Eurostat and explained in this Chapter), the project will be considered to be a PPP and its statistical treatment will be assessed using the Rules (see Chapters 3 and 4).

If however the SPV is controlled by government, the Partner will, for statistical purposes, be classified inside the general government sector. As a result, the project will not be considered to be a PPP (according to Eurostat's definition) and it will be on balance sheet for government.

For statistical classification purposes, government control of an SPV can be established in a number of ways including, for example, through ownership rights, contractual rights, financing arrangements, law, regulation or vetoes over the SPV's important decisions.<sup>23</sup>

Determining whether government controls<sup>24</sup> an SPV is often a matter of degree and it is important to assess each case on its own particular facts and circumstances.<sup>25</sup> The following is a non-exhaustive list of examples of government control, which are given for illustrative purposes only:

- If government has a 51% share in the ownership and voting rights of the SPV, the

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21 This includes where an SPV is controlled by one or more public entities classified outside the general government sector (such as national public banks or government companies that are, for statistical purposes, considered to be "market producers" – see footnote 26). However, an important exception to this is where those public entities are acting on an instruction of government (see the final paragraph of this section).

22 It is usually the case that an SPV enters into a single PPP contract to deliver a single PPP project. However, an SPV that is controlled by private entities could enter into multiple PPP contracts with one or more Authorities, without this affecting its classification outside the general government sector.

23 See ESA 2010 paragraphs 2.38, 20.309 and 20.316 to 20.318 and MGDD 2016 Chapters I.2.3 and I.6.2.

24 It is important to note that government control of an SPV can be established through the relationships that the SPV has with any government entity in the relevant Member State, and not only through its relationships with the Authority. For example, on a project where the Authority is a local government entity, a majority or controlling ownership share in the SPV that is held by another government entity (e.g. if central government invests in the SPV) would establish government control of the SPV.

25 The simple fact that government participation in the ownership of the SPV may be a condition imposed in the tender process for a PPP project is not in itself, in Eurostat's view, a relevant factor in determining whether the SPV is controlled by government.

SPV is deemed to be controlled by government through its majority share;

- If government has a 25% share in the ownership of the SPV which gives it rights to veto important decisions of the SPV (for example through shareholder agreements or through general company law), the SPV is deemed to be controlled by government through those rights. This is the case even if the veto rights mirror veto rights held by other owners of the SPV; and
- If government has no share in the ownership of the SPV but has rights to veto important decisions of the SPV through a financing agreement or a contract, the SPV is deemed to be controlled by government through those veto rights.

In all of the examples mentioned above, the SPV is classified inside the general government sector and the project will be on balance sheet for government.

It is important to stress that in looking at the issue of government control of an SPV, any relationship between the SPV and a public entity that is classified outside the general government sector will be deemed by Eurostat to be a relationship between the SPV and government if the public entity is acting on an express or implied instruction of government in the context of the specific project. For example, if a national public bank (even though classified outside the general government sector) is instructed by government to take an equity share in the SPV, that equity share is considered by Eurostat to be held by government. As a result, any rights attached to that equity share will be considered to be rights held by government and will be taken into account in assessing whether or not government has control of the SPV.

#### **Cases where the Partner is not an SPV**

In the unusual case that the Partner is not an SPV, the sector classification of the Partner is assessed in a slightly different way.

The first step is to determine whether the Partner is controlled by government (using the same tests that apply to SPVs, as described above).

If the Partner is not controlled by government, it is classified outside the general government sector. Assuming that the project has the other features of a PPP (as defined by Eurostat and explained in this Chapter), the project will be considered to be a PPP and its statistical treatment will be assessed using the Rules (see Chapters 3 and 4).

If the Partner is controlled by government, there is a second step, which is to determine whether the Partner is, in statistical terms, a “market producer”. This involves both a qualitative and a quantitative assessment:<sup>26</sup>

- If, on the basis of the qualitative and quantitative assessment the Partner is deemed to be a “market producer”, it will be classified outside the general government sector. Assuming that the project has the other features of a PPP as defined by Eurostat and explained in this Chapter, the project will be considered to be a PPP and its statistical treatment will be assessed under the Rules (see Chapters 3 and 4). This situation may arise where an Authority enters into a PPP contract with, for example, a rail infrastructure manager company which is a government-owned company considered to be a “market producer”; and
- If, on the basis of the qualitative and quantitative assessment, the Partner is not deemed to be a “market producer”, the Partner will be classified inside the general government sector. In that case, the project will not be a PPP (according to Eurostat’s definition) and it will be on balance sheet for government.

## PPP or concession

Eurostat’s definition of a PPP requires that a government entity is the direct source of the majority of the revenues that the Partner is entitled to receive under the contract. This is the case whether the demand for or use of the asset originates from the government entity itself (e.g. a hospital paid for by a government entity on an availability basis) or from users (e.g. a road, paid for by a government entity on a demand (shadow toll) basis).

If the majority of the Partner’s revenues is sourced directly from the users of the asset, Eurostat will consider the project to be a concession, and the statistical treatment will be assessed under separate rules (which are outside the scope of the Guide).

It is important to emphasise that Eurostat’s definitions of PPPs and concessions are relevant for statistical purposes only and may differ from definitions used by Member States or those that are commonly understood by the market. The fact that a contract is procured or contracted for in a particular way or under a particular domestic law (for example a public procurement law or a concession law) is not in itself relevant to determining whether the contract is a PPP or a concession for statistical purposes. As mentioned in the introduction, Eurostat and EPEC will consider, if and when opportune,

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<sup>26</sup> See ESA 2010 paragraphs 20.19 to 20.34 and MGDD 2016 Chapter I.2.4.

engaging in further joint work to produce guidance (similar to this Guide) on the statistical treatment of concessions.

## Type of asset

The Rules require that a PPP involves investment in a clearly identifiable and specifically-designed asset. Obvious examples include buildings, and structures such as roads, bridges and rail/tram/metro tracks. Eurostat’s definition of a PPP also covers situations where a PPP asset has interfaces with other infrastructure and some other less conventional projects<sup>27</sup> including, for example:

- an extension to an existing road or rail network;
- a new metro or tram line within an existing tram/metro system;
- a rail track that will pass through a tunnel procured by government under a separate conventional public works contract;
- a rail track that will be installed on infrastructure (e.g. a bridge) procured conventionally;
- locks and dams;
- broadband networks and information technology systems; and
- transport equipment (e.g. rolling stock).

Eurostat’s definition of a PPP assumes significant capital expenditure by the Partner in the construction of a new asset or in the renovation or refurbishment of an existing asset. Although the Rules refer to “significant” capital expenditure, Eurostat does not apply any minimum threshold of capital expenditure in its definition of a PPP. However, specific requirements relating to the amount of capital expenditure on projects involving the refurbishment, renovation or upgrade of assets are explained below.

## Refurbishment, renovation or upgrade of existing assets

For a project involving the refurbishment, renovation or upgrade of an existing asset to be considered a PPP, the amount of capital expenditure by the Partner under the contract

<sup>27</sup> Military equipment projects are outside the scope of the Guide. Specific rules on the statistical treatment of military equipment are contained in ESA 2010 paragraphs 20.190 to 20.192 and MGDD Part II.5.

must represent at least 50% of the value of the asset after completion of the works. The value of the asset after completion of the works can be calculated by combining:

- the capital expenditure incurred at the time in constructing the existing asset (in current prices and less depreciation);
- all capital expenditure on the existing asset up to the present time (in current prices and less depreciation); and
- all capital expenditure that will be incurred by the Partner under the contract (on the refurbishment, renovation or upgrade and on any new-build components) up to completion of the works.

If the Partner's capital expenditure does not meet the 50% threshold, the project is not considered to be a PPP and it will be on balance sheet for government.

### **Economic life of the asset / PPP contract duration**

The Rules refer to PPPs as "long-term" contracts. In practice, Eurostat is likely to question whether a contract with a total duration of less than 10 years should, for statistical purposes, be treated as a PPP. It will give careful consideration as to whether the substance of such a contract is more aligned with conventional government expenditure than with the features that it expects of a PPP.

Eurostat's definition of a PPP requires that, on the one hand, the asset has an economic life that is longer than the duration of the contract. A project that requires full replacement of the original asset during the contract period (e.g. a 20-year contract for information technology equipment that will be replaced every five years) will not normally be considered a PPP and other rules will be applied in assessing its statistical treatment.

On the other hand, Eurostat expects a PPP contract to cover a meaningful part of the asset's economic life. This means that Eurostat would normally expect the period during which the asset is maintained or maintained/operated by the Partner (the Operational Phase) to cover at least one cycle of major maintenance or replacement of significant components of the asset (e.g. road surfaces, boilers in a building). On this basis, a contract with an Operational Phase of 10 years or more for an asset that has an economic life of more than 10 years will normally (e.g. on most accommodation, road or rail projects) be considered by Eurostat to be a PPP.

It is worth stressing that, on projects that are considered by Eurostat to be PPPs, the relationship between the PPP contract duration and economic life of the asset will influence the statistical treatment only if the assessment of risks and rewards is inconclusive (see Chapter 4).

### Scope of services to be provided by the Partner

In order for a project to be considered a PPP by Eurostat, the Partner must, as a minimum, be obliged to maintain the asset for the duration of the contract with a view to making it available to the Authority or other end-users.

Projects on which the asset requires no or a negligible amount of maintenance or operation by the Partner need to be looked at carefully on a case by case basis, as Eurostat would normally consider these to be more aligned with conventional government expenditure.

There are services that Eurostat considers to be “secondary” to maintaining the asset, and the fact that the Partner’s obligations under a contract either include or exclude these services does not affect Eurostat’s view on whether or not the project is a PPP. Examples of services that Eurostat considers to be “secondary” include:

- On accommodation projects: catering, cleaning, portering, security, landscaping, decoration, waste management, laundry, pest control, parking management and services linked to the principal use of the asset (such as administrative, information technology and communications services, educational services in schools and universities, clinical services in hospitals, or custodial services in prisons);
- On roads projects: emergency/breakdown response, traffic signalling, signage, lighting management, landscaping, traffic monitoring and management, traffic incident monitoring and management, weather monitoring, snow clearance; and
- On other transport infrastructure projects (e.g. train or tram projects): management of the operation of the transport service including service planning (frequency and timing of journeys), traffic incident monitoring and management, security and supervision, ticketing.

### Revenues received by government from the project

Eurostat does not consider a project to be a PPP if, at financial close, the revenues that the Authority (and/or government more widely) is forecast to receive from users of the asset

will exceed 50% of the total value of payments that the Authority is forecast to make to the Partner over the life of the contract. Where this is the case the project should be recorded on balance sheet for government. If, on the other hand, the revenues that the Authority (and/or government) is forecast to receive are below the 50% threshold, the project is considered by Eurostat to be a PPP.<sup>28</sup> There are three points to be aware of when applying this 50% test:

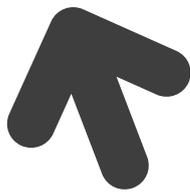
- Forecast revenues and forecast payments should be compared on a net present value basis (at financial close). Forecast revenues should be the best estimates the Authority can make at the time of financial close;
- Where a PPP asset will form part of a wider network (e.g. a PPP project for the construction and maintenance of a line of a tram or metro system), it may be that revenues that the Authority (and/or government more widely) will receive from users of the PPP asset will not, in practice, be readily distinguishable from the revenues that it receives from users of the rest of the network. For example, users may be able to buy a single ticket for a journey on any part of the network and it may not be possible to trace the part of the network on which the ticket is used. In such cases an assessment needs to be carried out to attribute forecast revenues to the PPP asset itself in order to apply the 50% test. If, for example, the annual network revenues are currently EUR 100 million and are forecast to increase to EUR 120 million on completion of the PPP asset, the revenues attributed to the PPP asset should be EUR 20 million; and
- The 50% test applies to the amount of revenues that the Authority (and/or wider government) is forecast to receive from the PPP asset and not to the amount of profit that the Authority (and/or wider government) is forecast to generate from these revenues.

It is important to note that if, during the PPP contract, there is a change in the forecast revenues that the Authority (and/or wider government) will receive from users of the assets over the life of the PPP contract, it is necessary to consider whether the change in forecast revenues affects the original conclusion on the statistical treatment (see comments in Chapter 1 on the timing of the assessment of the statistical treatment). This is the case even if the change in forecast revenues is not triggered by a formal change to the PPP contract.

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<sup>28</sup> Note that in this case the amount of forecast revenues will influence the statistical treatment (see Chapter 3, Theme 5.5).





## Chapter 3 – The PPP Contract

### Overview

The commercial structures and contract provisions used on PPP transactions, and the approaches and styles used in documenting them, vary widely across Member States, sectors and projects.

Rather than attempt to opine on individual contract clauses used on PPPs across the EU, this Chapter takes the key Themes of a typical PPP transaction, summarises the typical approaches taken in the EU to dealing with the main issues relating to each Theme, and provides Eurostat's view on the relevance of each approach to the statistical treatment. For ease of reference, Eurostat's comments are shown in *colours and italics*.

As already stated, the Guide does not claim to cover all possible PPP contract provisions that may appear on individual PPP transactions but does cover those most commonly observed across the EU.

It is also important to recall that, as stated in the introduction, the Rules are concerned with the substance rather than the form of a transaction. This means that:

- A view stated by Eurostat on a provision described in the Guide will apply equally to a provision that achieves the same commercial effect using a different drafting mechanism or different terminology; and
- Although the Guide may assume that a provision is contained in the PPP contract between the Authority and the Partner, the view stated by Eurostat will apply equally to a provision that achieves the same commercial effect but is contained in a different document or in the underlying law.

In addition, when assessing the statistical treatment of a PPP, it is important to look at the risks and rewards that are taken by all entities classified to the general government sector and not just those that are taken by the Authority that enters into the PPP contract. Theme 14 in this Chapter makes specific reference to this, as financing is an area where a

government entity other than the Authority itself is most likely to be involved in a PPP project. However, the same principle applies to all aspects of the PPP transaction. Examples include:

- Where a government entity is one of the Partner’s construction or maintenance sub-contractors on the project (i.e. the government entity takes risk); and
- Where a public entity (classified outside the general government sector) is a shareholder in the Partner and has a specific arrangement to transfer any profit it receives from the PPP contract to a government entity (i.e. the government entity takes reward).

This Chapter identifies whether a PPP contract provision influences the statistical treatment (meaning that it points towards the PPP being on balance sheet for government) or does not influence the statistical treatment (meaning that it is neutral to the statistical treatment). It is worth stressing that:

- In some cases, Eurostat’s comments state that a PPP contract provision does not influence the statistical treatment if it meets particular conditions or has certain features. The provision would therefore influence the statistical treatment if the particular conditions or features were not met; and
- In other cases, Eurostat’s comments state that a PPP contract provision does influence the statistical treatment if it has certain features. The provision without those features would therefore not influence the statistical treatment.

Eurostat’s comments contained in this Chapter also indicate whether a provision that influences the statistical treatment is an issue of MODERATE, HIGH or VERY HIGH importance to the statistical treatment or whether it is sufficient in itself to lead to the PPP being ON BALANCE SHEET for government. The process that Eurostat then follows to reach a conclusion on the statistical treatment of a PPP is explained in Chapter 4.



# Theme 1 – The project site

## 1.1 Identifying and obtaining the project site

On most PPP projects the Authority is responsible for identifying the site on which the asset will be built and operated. If the Authority does not own, or has not obtained access to, the site (or parts of it) by the time the PPP contract is signed, the PPP contract typically requires the Authority to obtain ownership of, or access to, the site (or parts of it) within a timescale that will allow the Partner to comply with its obligations to deliver the project.

In some PPP contracts, obtaining the site, or access to it, is a Partner responsibility (there are, for example, projects on which the Partner has taken responsibility for site expropriation) or is a joint Authority/Partner responsibility.

### **Eurostat's comments**

*Eurostat's view is that the fact that the Authority takes some or all responsibility and/or risk under the PPP contract for obtaining site ownership or access, necessary for the delivery of the project, **does not influence the statistical treatment.***

## 1.2 Site ownership and Partner rights to access the project site

Typically, ownership of the site and the asset remains with the Authority throughout the PPP contract (and after its expiry) and the Authority grants access rights over the site and the asset to the Partner. The legal form of those access rights varies from project to project, but the most common forms are:

- leases;
- permits (e.g. for a bridge to be constructed over a motorway); and
- contractual rights (e.g. in the PPP contract itself or a separate licence agreement).

The Partner is typically restricted to exercising its access rights over the site/asset to the extent necessary for it to perform its obligations and exercise its rights under the PPP contract.

In some rare cases, legal ownership of the site and the asset is transferred to the Partner. In these cases, the Authority sometimes has an option to buy back the site/asset on early termination or expiry of the PPP contract.

#### **Eurostat's comments**

*Eurostat's view is that:*

- *the retention of legal ownership of the site and asset by the Authority during the PPP contract;*
- *the legal form of access rights granted to the Partner; and*
- *the restriction of the Partner's access rights to those that are necessary for the performance of its rights and obligations under the PPP contract;*

**do not influence the statistical treatment.**

*Eurostat's comments in Theme 13.2 explain the relevance that provisions relating to the ownership of the asset following expiry of the PPP contract have on the statistical treatment.*



## Theme 2 – Design and construction of the asset

### 2.1 Responsibility for design

In most cases, the Partner takes responsibility under the PPP contract for designing the asset in order to meet the Authority's specification. The Authority's specification may include aspects of the asset's design, which means that, in practice, the amount of design work required of the Partner depends on the extent to which the design has been developed by the Authority.

In rarer cases, the majority of the design work is carried out by the Authority before the PPP contract is signed.

The PPP contract typically gives the Authority the right to review, comment on or approve the Partner's design work (or certain aspects of it) as and when it is developed. Any comment or approval given by the Authority does not typically remove or reduce the Partner's responsibility to ensure that the asset is built and made available to the standards set out in the PPP contract.

#### ***Eurostat's comments***

*Eurostat's view is that the extent to which the Authority develops, reviews or approves the design of the asset **does not influence the statistical treatment**. However, any risk that the Authority takes under the PPP contract for:*

- construction delays or deficiencies;*
- increased construction or maintenance/operating costs; and/or*
- operational failures;*

*that may arise as a consequence of the design **does influence the statistical treatment** and is an issue of HIGH importance.*

## 2.2 Responsibility for construction

The conventional PPP contractual approach to construction is that:

- The Partner is responsible for completing the construction of the asset by a fixed date. In some cases, the Partner is entitled to receive a bonus (in the form of a payment or through the Operational Payments starting earlier than expected) for early completion. In limited cases, the Partner is required to pay liquidated damages to the Authority if completion is delayed;
- The Partner takes responsibility for obtaining permits and authorisations as far as this is in its control (with the Authority taking responsibility for, and risk on, permits and authorisations that rely on actions of the Authority and/or that cannot be obtained by the Partner);
- The Partner takes responsibility for constructing the asset to the Authority's specification in accordance with relevant law, industry standards and good practice;
- The Partner takes responsibility for the performance of all parties in its construction supply chain (e.g. designers, construction sub-contractors). The PPP contract sometimes specifies conditions for appointing the supply chain (e.g. appointments must be made through an open tender process, appointments must contain fair payment terms);
- The Authority has rights to monitor the progress and quality of the construction work and to require the Partner to rectify issues of non-compliance;
- The completion of the asset is assessed by reference to objective criteria specified in the PPP contract (see Theme 2.3 below); and
- There are typically some limited specific circumstances in which the Partner can claim relief and/or compensation for delays and increased costs, lost revenues and/or changes in the project's risk profile caused by events (see Theme 6) that arise in the period during which the asset is constructed (the Construction Phase).

### **Eurostat's comments**

*Eurostat's view is that the conventional approach to responsibility for construction described above **does not influence the statistical treatment**. In particular, it is the case that:*

- *providing (or not providing) for payment of liquidated damages by the Partner to the Authority on late completion of the asset **does not influence the statistical treatment**;*

- *providing (or not providing) for the payment of a bonus (of a commensurate amount) by the Authority to the Partner on early completion of the asset **does not influence the statistical treatment**; and*
- *provisions for the Authority to take responsibility for, and risk on, permits and authorisations that rely on actions of the Authority and/or that cannot be obtained by the Partner (for reasons that are not connected with its failure) **do not influence the statistical treatment**.*

*However, when looking at the transfer of construction risk, it is important to note Eurostat's views on three related matters: Theme 2.3 on completion tests, Theme 5.1 on commencement of Operational Payments and Theme 6 on the circumstances in which the Partner can claim relief and/or compensation.*

## 2.3 Construction completion

PPP contracts set out objective criteria which are used for determining whether the construction of the asset is complete. Satisfaction of these criteria is what typically triggers the Partner's right to start receiving routine payments (the Operational Payments) from the Authority, linked to the availability of and/or demand for the asset and/or related services (see Theme 4). These criteria can be highly technical and vary significantly from project to project.

The process for determining whether the completion criteria have been satisfied also varies from project to project. On some, completion is certified by one of the parties (most typically the Authority) and any dispute is dealt with through the dispute resolution procedure set out in the PPP contract. On others, an independent third party is appointed to certify that the asset meets the completion criteria. Whatever process is used, confirmation under the PPP contract that the completion tests have been satisfied does not remove or reduce the risk taken by the Partner on the asset (as designed and constructed) satisfying the contractual standards for the Operational Phase.

On some projects, the PPP contract provides for the construction of the asset to be completed in phases. Where this is the case, the Partner starts to receive the Operational Payments when the first phase is deemed to have met the relevant completion criteria, and Operational Payments increase as and when the later phases are deemed to be complete.

**Eurostat's comments**

*Eurostat's view on the approach to construction completion described above is as follows:*

- *The process for determining whether the completion criteria have been satisfied (and in particular whether this is to be agreed or determined by the parties or by an independent third party) **does not influence the statistical treatment**;*
- *The specific criteria used for determining whether construction of the asset is complete **do not influence the statistical treatment if** they are (i) objective and clearly set out in the PPP contract (i.e. they are not left open to the discretion of either party or to negotiation between the parties) and (ii) robust (i.e. they require the asset to be in a condition that allows it to be used by the Authority or end-users). Where this is not the case, the issue is of HIGH importance to the statistical treatment; and*
- *Provisions for phased completion of the asset that triggers the phased commencement of Operational Payments **do not influence the statistical treatment if** (i) each phase is linked to a component of the asset that is genuinely capable of being used (by the Authority or end-users) independently and (ii) the proportion of the Operational Payments linked to each phase is not greater than the proportion of the phase's capital cost to the capital cost of the whole asset. Where this is not the case, the issue is of HIGH importance to the statistical treatment.*

*However, when looking at the transfer of construction risk, it is important to note Eurostat's views on two related matters in particular: Theme 5.1 on commencement of Operational Payments and Theme 6 on the circumstances in which the Partner can claim relief and/or compensation.*

## 2.4 Snagging works

PPP contracts often stipulate that the completion criteria can be deemed to have been satisfied in spite of the fact that minor aspects of the construction (typically referred to as “snagging works”) are incomplete.

Typically the Partner is obliged to complete any snagging works within a limited period of time.

#### **Eurostat's comments**

*Eurostat's view is that provisions that allow for minor snagging works to be excluded from the completion criteria tests **do not influence the statistical treatment** if the snagging works are limited to works that do not affect the availability of the asset. Where this is not the case, the issue is of HIGH importance to the statistical treatment.*

## 2.5 Partner reimbursement of Authority costs

On some projects, the PPP contract requires the Partner to pay the Authority an amount to cover costs incurred in connection with the preparation of the project in the period up to financial close (e.g. for site investigations or site preparation works).

#### **Eurostat's comments**

*Eurostat's view is that provisions for the Partner to make any such payment to the Authority **do not influence the statistical treatment** if the payment covers clearly identifiable costs incurred by the Authority in direct connection with the project. Where this is not the case, the issue is of HIGH importance to the statistical treatment.*

## 2.6 Partner performance guarantees

In some PPP contracts, the Partner is required to provide the Authority with a third party guarantee that covers the performance of the construction obligations placed on the Partner or its key sub-contractors. The guarantee may be issued by, for example, a bank or a company with an equity share in the Partner.

#### **Eurostat's comments**

*Eurostat's view is that the provision of performance guarantees to the Authority **does not influence the statistical treatment**.*





## Theme 3 – Operation and maintenance of the asset

### 3.1 Responsibility for operation and maintenance

There is wide variety of practice across sectors and projects when it comes to defining the scope of the maintenance and/or operational services to be delivered by the Partner.

The following examples illustrate this variety:

- On some roads projects, the Partner is required to provide a “first response” service for vehicle break-downs, whereas on others responsibility for the provision of that service is retained by the Authority (and perhaps sub-contracted by the Authority to a third party);
- On some accommodation projects (e.g. schools and hospitals), the Partner is required to provide catering, cleaning, security and/or laundry services (and even in some cases clinical services), whereas on others the Partner’s obligations are restricted to maintenance of the asset; and
- On some projects, the Authority takes responsibility for maintaining and/or replacing some components of the asset or equipment provided by the Partner with the asset (e.g. catering equipment in a school, medical equipment in a hospital).

#### ***Eurostat’s comments***

*As stated in Chapter 2, in order for a project to be considered a PPP for the purposes of the Rules, the Partner must, as a minimum, be obliged to maintain the condition of the asset for the duration of the contract with a view to making it available to the Authority or other end-users.*

*Where that is the case, the fact that the Partner’s obligations include or exclude services that are secondary to maintaining the asset **does not influence the***

**statistical treatment.** Examples of services that Eurostat considers to be “secondary” are mentioned in Chapter 2.

Eurostat’s view is that the fact that the Authority takes responsibility for maintaining and/or replacing any component of the asset **does influence the statistical treatment** and is an issue of HIGH importance to the statistical treatment.

The fact that the Authority takes responsibility for maintaining and/or replacing any equipment that is provided by the Partner, but is otherwise outside the scope of the Partner’s responsibilities and not linked to the availability of the asset, **does not influence the statistical treatment** of the PPP. However, the statistical treatment of the equipment itself or the arrangements for the financing of the equipment may require separate analysis (see comments in Chapter 1).

### 3.2 Operation and maintenance standards

PPP contracts define standards to which the Partner is required to operate and maintain the asset. The specific standards vary significantly from project to project, as do the consequences for the Partner of failing to meet those standards. However, failures that result in the asset being unavailable for use trigger reductions in the Operational Payments (see Theme 4).

PPP contracts typically set out processes for regular monitoring and reporting of the Partner’s performance against the relevant standards. Although the detailed processes (including frequency and methodology of monitoring and reporting) can vary significantly from contract to contract, most rely on self-reporting by the Partner, with the Authority having rights to dual-monitor and/or audit the Partner’s reports.

#### **Eurostat’s comments**

*Eurostat’s view is that:*

- *the standards to which the Partner is required to operate and maintain the asset must, as a minimum, establish conditions in which the asset is genuinely capable of being used; and*
- *the regime for monitoring and reporting on the Partner’s performance against those standards must allow the Authority to sanction the Partner for its non-performance (as explained in detail in Theme 4).*

*A PPP contract that does not meet either of these conditions **does influence the statistical treatment** and the PPP is automatically ON BALANCE SHEET for government.*

### 3.3 Maintenance plan

PPP contracts require the Partner to carry out both planned and reactive maintenance in order to ensure that the asset meets the required standards.

In most PPP contracts, planned maintenance must be carried out in accordance with an agreed plan or programme. The maintenance plan or programme is updated by the Partner on a regular basis and issued to the Authority for approval.

#### **Eurostat's comments**

*Eurostat's view is that provisions that give the Authority a right to approve the maintenance plans or programmes **do not influence the statistical treatment** if the following conditions are met:*

- The Authority's approval does not remove or reduce the Partner's liability for deficiencies in the asset or service delivery. Where this is not the case, the issue is of HIGH importance to the statistical treatment; and/or*
- The PPP contract does not oblige the Partner to incur the cost of maintenance at the scheduled time where it can demonstrate that deferring the maintenance will not have a negative impact on the condition of the asset, the services or the use of the asset by the Authority or end-users. Where this is not the case, the issue is of MODERATE importance to the statistical treatment.*

### 3.4 Maintenance funds

A minority of PPP contracts impose an obligation on the Partner to reserve cash to fund its future maintenance obligations. This obligation, enforceable by the Authority, is distinct from the maintenance cash reserve requirements imposed on the Partner by the finance providers.

In some PPP contracts, the Authority is entitled to share in any financial savings that the Partner generates through its effective management of maintenance risk. The Authority may, for example, be entitled to receive a share of the savings that arise if the actual costs incurred by the Partner in maintaining the asset to the required standards (assessed at intervals or at the end of the PPP contract) are lower than the costs that were forecast when the PPP contract was signed.

#### **Eurostat's comments**

*Eurostat's view is that provisions that require the Partner to create a maintenance fund **do influence the statistical treatment** if the PPP contract also envisages that the Authority:*

- takes risk in relation to the fund, for example by contributing to the fund to meet actual maintenance costs incurred (in which case the issue is of HIGH importance to the statistical treatment); or*
- takes reward in relation to the fund, for example by taking a share or all of the surplus in the fund if the Partner spends less than anticipated on maintaining the asset (in which case the PPP is automatically ON BALANCE SHEET for government).*

*Independently of specific provisions for maintenance funds, any other mechanism through which the Authority is entitled to any share in financial savings generated through the Partner's management of maintenance risk (e.g. by taking all or a share of savings where maintenance costs incurred by the Partner are lower than anticipated) **does influence the statistical treatment** and leads to the PPP being automatically ON BALANCE SHEET for government.*

### **3.5 Partner performance guarantees**

In some PPP contracts, the Partner is required to provide the Authority with a third party guarantee that covers the performance of the operation and maintenance obligations placed on the Partner or its key sub-contractors. The guarantee may be issued by, for example, a bank or a company with an equity share in the Partner.

**Eurostat's comments**

*Eurostat's view is that the provision of performance guarantees to the Authority **does not influence the statistical treatment.***

### 3.6 Staffing issues

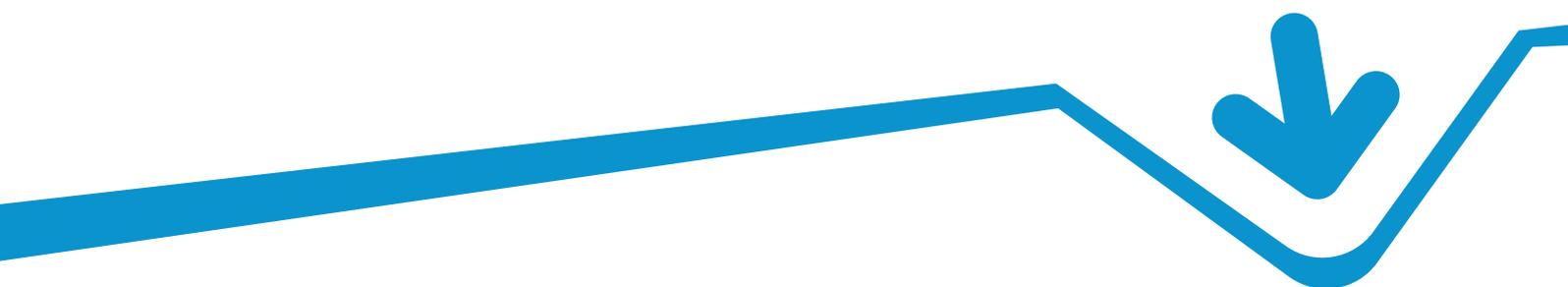
PPP contracts often contain provisions relating to the staff that will be involved in the Partner's delivery of the project. These provisions can cover a variety of issues including:

- rights and obligations of each party in connection with staff transfers under relevant law during and at the end of the PPP contract;
- rights and obligations of each party in connection with the protection of employment and pension rights for staff that transfer to the Partner and new staff employed;
- staff pension liabilities;
- requirements for certain qualifications and skills and eligibility for individuals involved in the delivery of the project; and
- provision of information relating to staff involved in the delivery of the project.

**Eurostat's comments**

*Eurostat's view is that provisions dealing with staffing issues connected to the delivery of the project **do not influence the statistical treatment.***





# Theme 4 – The Payment Mechanism

## A. PPP CONTRACTS WITH AVAILABILITY-BASED PAYMENTS

### 4.1 Structure of the Operational Payments

Availability-based payment mechanisms are typically approached in one of two ways. The first is to pre-determine the Operational Payments that represent 100% availability of the asset and 100% performance of the services and to adjust those amounts for:

- indexation (see Theme 5.4);
- pass-through costs (see Theme 5.9);
- deductions for unavailability of components of the asset (see Themes 4.2 to 4.8); and
- deductions for poor service performance (see Themes 4.2 to 4.8).

The second is to build up the Operational Payments on the basis of the number of components of the asset (e.g. rooms in a building, sections of a road) that are made available and then adjust those amounts for:

- indexation (see Theme 5.4);
- pass-through costs (Theme 5.9); and
- deductions for poor service performance (see Themes 4.2 to 4.8).

For ease of reading, the remainder of this Theme 4 assumes that the first approach is used, but the same principles should be applied to the second approach.

#### ***Eurostat's comments***

*Eurostat's view is that the choice of either of the two availability-based payment mechanism structures described above **does not influence the statistical treatment.***

## 4.2 Adjustments for unavailability and poor service performance

PPP contracts contain provisions that allow for the Operational Payments to be adjusted for unavailability of the asset and (in most cases) poor service performance by the Partner.

### **Eurostat's comments**

*Eurostat's view is that the mechanism set out in the PPP contract to allow for adjustments to the Operational Payments for unavailability and/or poor service performance **does not in itself influence the statistical treatment if the following conditions are met:***

- *The amount to be deducted for an instance of unavailability or poor service performance can be determined objectively by applying the terms of the PPP contract (i.e. the amount of the deduction is not left to the discretion of either party or left open for negotiation between the parties on a case by case basis); and*
- *If a deduction has been determined as due, it is capable of being applied without further negotiation between the parties.<sup>29</sup>*

*If either of these conditions is not met, the PPP is automatically recorded ON BALANCE SHEET for government.*

## 4.3 Defining availability / unavailability

The availability (or unavailability) of individual components of an asset is typically measured against availability standards set out in the PPP contract. The definitions of availability vary significantly from contract to contract – some can be very general (e.g. a road must be open to traffic and free from obstruction) and others can be very specific (e.g. a school classroom must have a temperature of between x and y, lighting levels must be comprised between x and y). Deductions are applied to the Operational Payments to reflect failures to meet these standards (i.e. unavailability).

<sup>29</sup> Eurostat recognises that most PPP contracts are likely to express the provisions for deductions as a right or entitlement (rather than an obligation) of the Authority to make deductions from the Operational Payments. Users should note that Eurostat expects the Authority in practice to apply the deductions when they fall due under the PPP contract.

Some PPP contracts contain provisions for:

- consequential unavailability, where, despite the fact that a component of the asset meets the availability standards, it is automatically deemed to be unavailable because of the unavailability of certain other components of the asset (e.g. the swimming pool is deemed unavailable if the swimming pool changing facilities are unavailable); and/or
- whole asset unavailability, where the entire asset is automatically deemed to be unavailable if certain components of the asset or a certain proportion of the asset is unavailable (e.g. an entire hospital is deemed unavailable if the operating theatres are unavailable, an entire school is deemed unavailable if  $x\%$  of the classrooms are unavailable).

#### **Eurostat's comments**

*Eurostat's view is that the contractual standards used to define and measure the availability of the asset must, as a minimum, establish conditions in which the asset is genuinely capable of being used. A PPP contract that does not have an availability regime that satisfies this test **does influence the statistical treatment** and the PPP is automatically recorded ON BALANCE SHEET for government.*

*Eurostat's view is that provisions for consequential unavailability and for whole asset unavailability, as described above, **do not influence the statistical treatment.***

## 4.4 Defining service performance

In addition to availability standards, most PPP contracts also specify standards for the quality of the performance of the services to be provided by the Partner and apply deductions to the Operational Payments for failures to meet some or all of those standards.

Some of these standards may be intrinsically linked to the Partner's obligations to make the asset available (e.g. an obligation to respond within a certain time period to issues requiring maintenance). Others may be more general in nature (e.g. submitting monthly reports to the Authority).

Some obligations must be met routinely, and are therefore measured routinely (e.g. an obligation to submit monthly reports to the Authority). Others are met and measured on an ad-hoc basis (e.g. responding to maintenance requests).

It is common for PPP contracts to base the Operational Payments on availability standards alone and to make no deductions for the poor performance of the services.

#### **Eurostat's comments**

*Eurostat's view is that the contractual standards used to define and measure the quality of the performance of the services (as opposed to the availability of the asset) **do not influence the statistical treatment** if the PPP contract contains an effective availability regime. Eurostat's view is that a PPP contract contains an effective availability regime if the availability standards, as a minimum, establish conditions in which the asset is genuinely capable of being used (as explained in Theme 4.3) and the deductions applied to the Operational Payments for unavailability sanction the Partner appropriately (as is explained in Themes 4.6 and 4.7).*

*Eurostat's view is that a contract that constructs Operational Payments entirely around availability, in accordance with the principles stated in this Guide, and does not contain additional provisions for measuring the performance of the services and/or for making deductions for poor service performance **does not influence the statistical treatment**.*

*As a result, users will note that many of the payment mechanism provisions referred to in Themes 4.6 and 4.7 **do not influence the statistical treatment** to the extent that they relate to the quality of the performance of the services (as opposed to the availability of the asset).*

## **4.5 Measuring availability and performance**

The PPP contract typically sets out a process for regular monitoring and reporting on the availability of the asset and performance of the services against the relevant standards. The details of the process (including frequency and methodology of measuring and reporting) can vary significantly from contract to contract, but most rely on self-reporting by the Partner and give the Authority rights to dual-monitor and/or audit the Partner's report.

#### **Eurostat's comments**

*Eurostat's view is that the contractual regime for monitoring and reporting on the availability of the asset and the performance of the services must allow the Authority to sanction the Partner for its non-performance.*

*If the payment mechanism relies on a monitoring and reporting regime that the Authority has the right to monitor or audit (and dispute), the specific process or methodology used for monitoring and reporting **does not influence the statistical treatment**. However, if the payment mechanism relies on self-reporting by the Partner and the Authority has no right to monitor or audit (and dispute) the Partner's reports, this **does influence the statistical treatment** and is an issue of HIGH importance.*

## 4.6 Quantifying availability and performance deductions

PPP contracts take different approaches and use different mechanisms for calculating the amount that is deducted for each instance of unavailability or poor service performance.

This Theme 4.6 describes some of the mechanisms that are commonly used (either alone or in combination) to calibrate the payment mechanism and determine the financial impact (and risk) for the Partner of non-performance of the PPP contract.

### 4.6.1 Unavailability deductions

Deductions for unavailability are usually determined according to the component or components of the asset that are affected. Weightings are often applied to individual components of the asset and to different time periods to reflect how important these are to the Authority and other end-users.

The amount deducted for an instance of unavailability is determined by the number of components that are unavailable, the period for which they are unavailable and the weightings attached to those components at various times over that period. Some areas and/or time periods may have a 0% weighting.

The incentive for the Partner to perform is sometimes strengthened by applying weightings to produce deductions that exceed (or are over-proportional to) the notional value of the Operational Payments (e.g. two weeks of unavailability leads to deductions equal to one month of Operational Payments). Where this is the case, a cap on deductions is often applied to ensure that the Partner's total liability for deductions does not exceed the notional Operational Payments (see Theme 4.7.4).

**Eurostat's comments**

*Eurostat's view is that the principle of proportionality is fundamental to availability-based payment mechanisms, meaning that the Operational Payments should be proportional to the degree to which the asset is available. As a result:*

- *at the extremes, 100% availability justifies the Partner receiving the full Operational Payments and 0% availability must result in the Partner receiving no Operational Payments (sometimes referred to as “zero availability, zero payment”); and*
- *between those two extremes, a principle of broad proportionality in all availability scenarios should be maintained.*

*Eurostat expects the proportionality principle to be realised over a meaningful period of time (e.g. one year). Failure to apply this principle over a meaningful period of time **does influence the statistical treatment** and automatically leads to the PPP being recorded ON BALANCE SHEET for government.*

*Eurostat's view is that the application of weightings to individual components of the asset and different periods of time is consistent with the principle of proportionality, and **does not influence the statistical treatment, if:***

- *the weightings reflect the use or functionality of the asset (and its constituent components);*
- *0% weightings (if used) are used exceptionally; and*
- *it can be evidenced that zero availability will result in zero payment as referred to above.*

*By way of illustration, low or 0% weightings do not influence the statistical treatment where they apply at times when the asset is not required (e.g. out of school hours in a schools PPP). Where weightings are not used appropriately, as described above, the issue is of HIGH importance to the statistical treatment.*

*Finally, Eurostat's view is that the use of weightings to produce deductions that exceed (or are over-proportional to) the notional value of the Operational Payments (such as in the example described above where two weeks of unavailability leads to deductions equal to one month of Operational Payments) **does not influence the statistical treatment.**<sup>30</sup>*

<sup>30</sup> See Theme 4.7.4 for Eurostat's views on caps on deductions (which are often used in combination with weightings to produce over-proportional deductions).

#### 4.6.2 Performance deductions or performance points

PPP contracts sometimes allocate a fixed monetary value to each service performance failure, and deduct that amount from the Operational Payments on the occurrence of each failure. An alternative approach is to have a system which allocates performance points to each service performance failure and a monetary value to the performance points and then deducts from the Operational Payments the amount corresponding to the number of performance points accrued. Both approaches can include weightings that reflect the significance of the failure in a particular area at a particular point in time.

Some PPP contracts contain provisions that are designed to avoid double-counting between unavailability deductions and performance deductions. For example:

- The performance regime is not applied (i.e. performance deductions are not made) during periods in which the asset is unavailable; and/or
- If a failure by the Partner could lead to both unavailability and performance deductions then only one deduction (usually the higher) is made.

#### **Eurostat's comments**

*Eurostat's view is that the approach taken to measuring, quantifying and applying performance deductions **does not influence the statistical treatment if the PPP contract contains an effective availability regime (as described in Eurostat's comments in Theme 4.4). Where this is the case, there is no influence on the statistical treatment if, for example:***

- *the performance deductions are applied to the service performance failures themselves or through a performance points system; or*
- *service performance failures are weighted, for example according to where or when they occur; or*
- *provision is made to avoid double-counting between performance deductions and unavailability deductions.*

#### 4.6.3 Rectification periods

PPP contracts typically specify time periods for the Partner to repair or rectify failures in availability or service performance, and apply deductions only if repairs or rectification are not carried out within those time periods. PPP contracts do not necessarily provide the Partner with an opportunity to repair or rectify all types of failure.

The time periods for repair or rectification are either stated precisely (e.g. four hours, two days) or defined more generally (e.g. as a reasonable period of time in the circumstances).

In some PPP contracts, the time periods are embedded in the way in which unavailability and poor service performance are defined technically (i.e. the asset is deemed to be unavailable, or the service deemed to be poorly performed, only if the failure to meet the standard is not repaired or rectified within the relevant time period).

An approach taken in other PPP contracts is to define the asset as unavailable or the service as poorly performed as soon as failure to meet the standard has occurred, but to provide that deductions will only be applied if the failure is not repaired or rectified within the relevant time period.

Finally, certain PPP contracts grant the Partner an initial time period to find a temporary solution to a failure and a further time period to implement a full repair or rectification (e.g. a broken window must be boarded up temporarily within two hours and a new window installed within two days).

#### **Eurostat's comments**

*Eurostat's view is that providing the Partner with an opportunity to repair or rectify failures in order to avoid the application of deductions (including the opportunity to carry out temporary repairs) **does not influence the statistical treatment** if the time periods given to the Partner (whether stated precisely in the PPP contract or not) are reasonable given the impact of the failure on the use of the asset and/or the circumstances of the project (e.g. geographical location). Providing unreasonably long repair or rectification periods is an issue of MODERATE importance to the statistical treatment.*

#### 4.6.4 Minimum deduction amounts

Some PPP contracts specify minimum amounts that must be deducted for unavailability and/or poor service performance. This has the effect of applying a higher deduction to a minor component of the asset or service than it would otherwise attract given its weighting relative to the rest of the asset or service.

#### **Eurostat's comments**

*Eurostat's view is that provisions for minimum deduction amounts, as described above, **do not influence the statistical treatment**.*

#### 4.6.5 Ratchets and multipliers

Some PPP contracts contain provisions (often referred to as “ratchets” or “multipliers”) that increase the deduction amounts for failures in availability and/or service performance that continue for a prolonged period of time. The deduction amounts are sometimes also increased for failures that occur repeatedly.

##### **Eurostat’s comments**

*Eurostat’s view is that provisions for ratchets and multipliers, as described above, **do not influence the statistical treatment.***

#### 4.6.6 Unavailable but used

Some PPP contracts apply “unavailable but used” provisions which typically reduce the amount of unavailability deductions by a percentage (e.g. 50%) if the Authority decides to use the asset (or component of the asset) despite it being unavailable according to the standards specified in the contract.

##### **Eurostat’s comments**

*Eurostat’s view is that “unavailable but used” provisions, as described above, **do not influence the statistical treatment.** However, “unavailable but used” provisions that reduce the availability deductions by more than 50% **do influence the statistical treatment** and are an issue of MODERATE importance.*

#### 4.6.7 Temporary alternative facilities

Some PPP contracts allow for the Partner to offer the Authority alternative facilities to use on a temporary basis while the asset is (or components of it are) unavailable. If the temporary alternative facilities are acceptable to the Authority, the relevant unavailability deductions are not applied.

##### **Eurostat’s comments**

*Eurostat’s view is that provisions for temporary alternative facilities, as described above, **do not influence the statistical treatment.***

## 4.7 Relief from deductions for availability and performance failures

PPP contracts usually give the Partner relief from deductions in certain situations, examples of which are described below.

### 4.7.1 Excusing causes

Most PPP contracts recognise some situations where the Partner is not the cause of the unavailability or poor service performance and where deductions are therefore not applied. There are a variety of ways in which the PPP contract can achieve this.

For example:

- The unavailability or poor service performance may be deemed not to have occurred;
- The unavailability or poor service performance is deemed to have occurred but is ignored for the purposes of calculating deductions; or
- The unavailability or poor service performance is deemed to have occurred and a deduction is made, but the Partner has the right to recover the deduction from the Authority through another route (e.g. a compensation event mechanism, as referred to in Theme 6).

Common examples of this relief from deductions are where failures are directly caused by:

- planned maintenance;
- failures in external energy supplies;
- compensation events (see Theme 6);
- force majeure events; or
- third party actions that are outside the Partner's control (e.g. unavailability of a motorway lane caused by a vehicle break-down if this is not treated as a compensation event under the PPP contract).

#### **Eurostat's comments**

*Eurostat's view is that provisions that give the Partner relief from deductions for unavailability or poor service performance that is directly caused by events of the nature of those described above **do not influence the statistical treatment.***

*However, provisions that excuse the Partner for unavailability or poor service performance for events that are within the control of the Partner or events that capture changes in macro-economic conditions **do influence the statistical treatment**. This is an issue of HIGH importance to the statistical treatment.*

#### 4.7.2 Grace periods

Many PPP contracts provide relief from deductions for certain periods of time during the Operational Phase (commonly referred to as “grace periods”). Different PPP contracts approach grace periods in different ways, as described below.

Some PPP contracts provide a grace period at the start of the Operational Phase, during which deductions are not applied (or are not applied in full). The purpose of this is to give the Partner some time to settle into the operation and maintenance of the asset. The time period and the services or deductions for which the relief from deductions is given vary considerably from contract to contract. For example:

- Relief may apply to all deductions or to performance failure deductions only;
- Relief may apply to all services or to selected services only; or
- The deductions may be set at zero or reduced by a certain percentage.

Other PPP contracts provide a grace period at the start of the Operational Phase, during which deductions are applied in full to the Operational Payments but are ignored for the purposes of triggering the early termination of the PPP contract.

Under either approach, the grace period provisions sometimes also apply when the Partner replaces a key sub-contractor and/or when lenders replace the Partner after having stepped in to the PPP contract (see Theme 14.8).

Some PPP contracts make no provision for grace periods.

#### **Eurostat’s comments**

*Eurostat’s view is that:*

- *“grace period” provisions that give relief from deductions for poor service performance only (i.e. unavailability deductions still apply) **do not influence the statistical treatment if the PPP contract contains an effective availability regime (as described in Eurostat’s comments in Theme 4.4);***

- “grace period” provisions that give relief from unavailability deductions **do not influence the statistical treatment** if the periods of time are reasonable given the nature of the asset, the duration of the PPP contract and other circumstances of the project. To illustrate this, Eurostat’s view is that grace periods that apply no availability deductions (or a reduced amount of availability deductions) for a period of up to a maximum of six months are reasonable on any project with an Operational Phase of 20 years or longer. Grace periods would need to be proportionally shorter on projects with shorter Operational Phases and longer grace periods may be considered reasonable on projects with longer Operational Phases. Where grace periods are not deemed reasonable, the issue is of MODERATE importance to the statistical treatment; and
- “grace period” provisions that only give relief from unavailability and/or performance deductions for the purposes of triggering the early termination of the PPP contract (i.e. the deductions are still applied to the Operational Payments) **do not influence the statistical treatment**.

*The views stated above refer to grace periods that apply at the start of the Operational Phase, those that apply when the Partner replaces a key sub-contractor and those that apply when lenders replace the Partner after having stepped in to the PPP contract.*

#### 4.7.3 Tolerances / de minimis exceptions for deductions

Some PPP contracts provide that no deductions are applied for a period if the number of failures or performance points in that period or the amount of deductions accrued in that period is below a specified threshold. For example:

- No performance deductions are applied if fewer than x performance failures have occurred in the month; or
- No deductions are applied if the total amount of deductions in the month is less than EUR x.

#### **Eurostat’s comments**

*Eurostat’s view is that provisions that create a tolerance or de minimis threshold for performance deductions alone **do not influence the statistical treatment** if the PPP contract contains an effective availability regime (as described in Eurostat’s comments in Theme 4.4).*

*Provisions that create a tolerance or de minimis threshold for unavailability deductions **do not influence the statistical treatment** if the tolerance or de minimis threshold has a negligible effect (i.e. the amount of deductions that is not applied is no greater than 1% of the Operational Payments). Where this is not the case (i.e. the effect of the tolerance or de minimis threshold is not negligible), the issue is of HIGH importance to the statistical treatment.*

#### 4.7.4 Caps on deductions

It is very common for PPP contracts to cap the Partner's exposure to deductions for unavailability and/or poor service performance. There are numerous approaches taken to this but common examples include:

- capping the Partner's exposure to unavailability deductions at 100% of the notional Operational Payments in a given period;
- capping the Partner's total exposure to unavailability and performance deductions at 100% of the notional Operational Payments in a given period;
- capping the Partner's total exposure to performance deductions for certain services (e.g. catering services) at the underlying cost of providing those services;
- deductions are applied only to a certain percentage of the total notional Operational Payments (examples range from 20% to 100%) but any deductions that have not been off-set in one period (because they exceed the specified percentage) can be off-set in future periods; and
- deductions are applied only to a certain percentage of the total notional Operational Payments (e.g. 20%) but if that threshold is breached the Authority has the right to terminate the PPP contract for Partner default.

#### **Eurostat's comments**

*Eurostat's view is that any cap on deductions that undermines the principle of proportionality (which, for example, should result in "zero availability, zero payment" over a meaningful period of time) **does influence the statistical treatment** and automatically leads to the PPP being recorded ON BALANCE SHEET for government.*

*Eurostat's view is that, in a PPP contract that contains an effective availability regime (as described in Eurostat's comments in Theme 4.4), the following mechanisms for capping deductions do not undermine the proportionality principle and therefore **do not influence the statistical treatment**:*

- *provisions that cap performance deductions (at any level); and*
- *provisions that cap unavailability deductions so that the Partner will not lose more than 100% of the notional Operational Payments (over a meaningful time period, most typically one year).*

*Provisions that cap unavailability deductions so that the Partner is guaranteed a minimum level of payment above 0% of the notional Operational Payments **do not influence the statistical treatment** if the principle of proportionality resulting in “zero availability, zero payment” over a meaningful period of time is achieved in another way. The principle of proportionality may, for example, be achieved through a roll-forward mechanism that allows accumulated deductions to be recovered over that period (most typically one year) and/or a right for the Authority to terminate the PPP contract early for Partner default at the end of that period.*

## 4.8 Adjustments for use

On some availability-based PPP contracts the Partner is entitled to an increase in the Operational Payments if use of the asset is higher than anticipated. The Authority may also be entitled to a reduction in the Operational Payments if use of the asset is lower than anticipated.

In most PPP contracts, no specific amount of use is estimated and the Partner is required to accept the consequences of any possible amount of use of the asset.

### **Eurostat's comments**

*Eurostat's view is that provisions that increase the Operational Payments to compensate the Partner for higher than anticipated use of the asset **do not influence the statistical treatment**. Equally, not providing for such an adjustment (i.e. requiring the Partner to take the risk on higher than anticipated use of the asset) **does not influence the statistical treatment**.*

*Eurostat's view is that provisions that reduce Operational Payments (that are 100% availability-based) to reflect a lower level of use of the asset than anticipated **do influence the statistical treatment** and this is an issue of HIGH importance.*

*Eurostat's view is that it is possible for a PPP contract to provide for Operational Payments that are linked to both availability and the actual level of use of the asset, without influencing the statistical treatment, by using a mixed availability/demand-based payment mechanism structure (see Theme 4.11).*

## B. PPP CONTRACTS WITH DEMAND-BASED PAYMENTS

### 4.9 Structure of the Operational Payments

Some PPP contracts feature demand-based payment mechanisms that calculate the Operational Payments due by the Authority according to the level of use of the asset (e.g. number of cars using a road, tonnes of waste treated). The Operational Payments are typically subject to indexation (see Theme 5.4).

Demand-based payment mechanisms do not typically apply deductions for poor performance of services, although the quality of service performance is taken into account for other purposes (e.g. financial penalties, triggers for early termination of the PPP contract for Partner default) in some PPP contracts.

### 4.10 Quantifying the Operational Payments

Various approaches are taken to calibrate the payment mechanism and determine the financial impact for the Partner in taking the risk of demand for the asset. This Theme 4.10 identifies some examples of approaches typically taken (although it is not an exhaustive list).

#### **Eurostat's comments**

*Eurostat considers that the principle of proportionality is fundamental in looking at the transfer of demand risk, meaning that the Operational Payments should be proportional to the level of demand for the asset. In the extreme case of no demand, the Partner should receive no Operational Payments.*

*Eurostat's views on how various calibration mechanisms affect the principle of proportionality, and therefore influence the statistical treatment, are set out below.*

#### 4.10.1 Type of use and time weightings

In most PPP contracts with demand-based Operational Payments, weightings are applied to the different types of use that are made of the asset (e.g. the type of vehicle making the journey on a road) and/or to the different times of use. As a result, the Operational Payments due for each instance of use depend on the type and time of that use. Some types and/or times of use may have a 0% weighting.

##### **Eurostat's comments**

*Eurostat's view is that the application of weightings (including 0% weightings) to types and times of use of the asset **does not influence the statistical treatment.***

#### 4.10.2 Banding

Demand-based payment mechanisms are often structured in “bands” where the amount paid by the Authority for a unit of use (e.g. a car journey on a road) varies according to the “band” in which the unit of use falls. For example, the payment per car is x EUR for the first 1,000 cars, y EUR for the next 1,000 cars, etc.

Typically, the unit price is higher in the low-use bands than it is in the high-use bands (e.g. the payment per car is higher when use is between 1 and 1,000 cars than it is when use is between 9,000 and 10,000 cars). In some cases, the unit price in the lowest-use band is set so that in practice a large share of the Partner's fixed costs is covered under a reasonable demand forecast. In some PPP contracts, the unit price in the highest-use band is set at zero.

##### **Eurostat's comments**

*Eurostat's view is that provisions that band the price per unit according to the level of use of the asset have the potential to undermine the key principle of proportionality and, in doing so, to influence the statistical treatment. The impact of banding provisions on the principle of proportionality and the statistical treatment must be considered in light of reasonable demand forecasts, revenue forecasts and the Partner's underlying costs. By way of example, Eurostat's view is*

*that the following banding provisions **do influence the statistical treatment**:*

- *The unit price for the highest-use band is set at zero or close to it (this automatically leads to the PPP being ON BALANCE SHEET for government);*
- *The unit price for the upper-use bands is set at a nominal level which, de facto, significantly limits the Partner's upside (an issue of HIGH importance to the statistical treatment);*
- *The unit price for the lower-use bands is such that the Partner will recover a significant proportion of its costs at a level of demand that is significantly below reasonable forecasts (an issue of HIGH importance to the statistical treatment analysis); and/or*
- *The unit price for the lower-use bands is, de facto, akin to a minimum use/revenue guarantee (this automatically leads to the PPP being ON BALANCE SHEET for government – see Theme 4.10.3).*

#### 4.10.3 Minimum use/revenue guarantees

In some demand-based PPP contracts, the Partner is guaranteed to receive a certain amount of revenues from the Authority during the Operational Phase, regardless of the actual level of use of the asset. The PPP contract mechanisms used to achieve this vary but examples are:

- a minimum amount of monthly Operational Payments;
- a warranty from the Authority as to the level of use of the asset; or
- a compensation event (see Theme 6) triggered if the level of use of the asset falls below a certain threshold.

#### **Eurostat's comments**

*Eurostat's view is that any form of minimum use or minimum revenue guarantee **does influence the statistical treatment** and automatically leads to the PPP being ON BALANCE SHEET for government.*

*Eurostat's view is that it is possible for a PPP contract to provide for the Partner to be entitled to some Operational Payments that are not linked to the demand for the asset, without influencing the statistical treatment, by using a mixed availability/demand-based payment mechanism structure (see Theme 4.11).*

## C. PPP CONTRACTS WITH MIXED AVAILABILITY/DEMAND-BASED PAYMENTS

### 4.11 Structure of the Operational Payments

Some PPP contracts feature mixed availability/demand payment mechanisms, which comprise Operational Payments with two components: one based on availability/performance (see section A above) and one based on demand (see section B above). In addition, adjustments are typically made for:

- indexation (see Theme 5.4); and
- deductions for poor service performance.

By way of example:

- A schools PPP contract provides for availability-based Operational Payments for the provision of the asset and volume (or demand) related payments for a catering service (based on the number of meals provided);
- A metro PPP contract provides for 80% of the forecast Operational Payments to be received through availability-based payments and 20% of the forecast Operational Payments to be received through demand-based payments; or
- A waste-treatment PPP contract provides for 20% of the forecast Operational Payments to be received through availability-based payments and 80% of the forecast Operational Payments to be received through demand-based payments.

#### **Eurostat's comments**

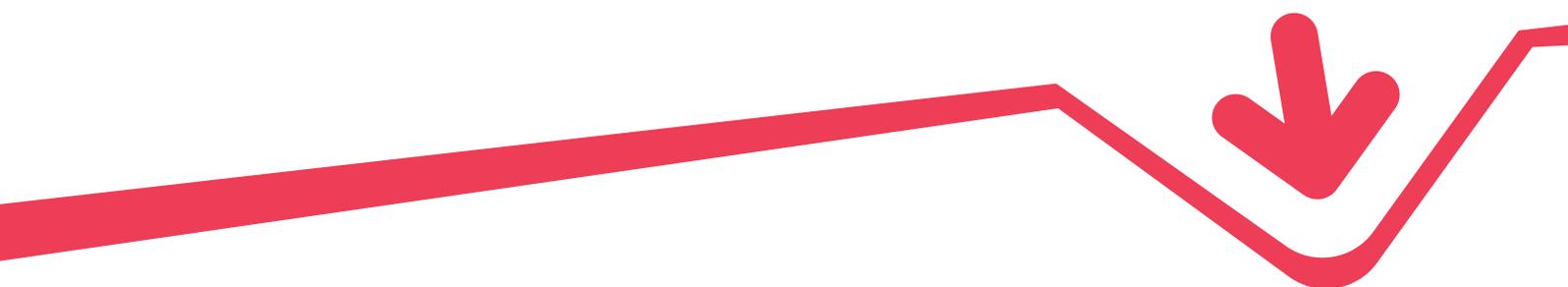
*Eurostat's view is that using a mixed availability/demand payment mechanism **does not in itself influence the statistical treatment.***

*However:*

- *Where the split between the availability and demand components of the Operational Payments distinguishes between (i) payments linked to the provision and maintenance of the asset and (ii) payments linked to the demand for services that are secondary to the maintenance of the asset, the statistical treatment of the asset will be determined solely by the payments linked to the provision and maintenance of the asset. In the example of the schools PPP contract described above, the statistical treatment will be determined by the risk transferred through the availability payments; and*

- *In other cases, the availability and demand components of the Operational Payments are assessed individually to determine whether each component transfers the relevant risk. Eurostat’s views in section A of this Theme 4 apply to the availability component and its views in section B of this Theme 4 apply to the demand component.*





## Theme 5 – Other payment arrangements

### 5.1 Commencement of Operational Payments

In most PPP contracts, the Partner's right to start receiving the Operational Payments is triggered on or after the date that construction of the asset is complete (see Theme 2.3). In a minority of PPP contracts, the Operational Payments start on a fixed date, whether or not the asset is complete.

On some projects, the Partner is required to provide some services in relation to separate existing assets during the Construction Phase, which the Authority pays for as and when they are provided (i.e. payments for these services are made during the Construction Phase). These services are usually subject to a different regime to the one that applies to the services that the Partner is required to provide for the asset once it is complete. As an example, the Authority may pay the Partner to provide routine or reactive maintenance services on a section of an existing road from the date the PPP contract is signed while the Partner builds another section of the road.

#### **Eurostat's comments**

*Eurostat's view is that the Partner should not be entitled to receive Operational Payments before the date on which construction of the asset is complete (see Theme 2.3). Therefore, an obligation on the Authority to start making Operational Payments in respect of the asset before the date on which it is complete **does influence the statistical treatment** and automatically leads to the PPP being ON BALANCE SHEET for government.<sup>31</sup>*

<sup>31</sup> Theme 2.3 refers to an exception to this, which is where the asset is constructed in phases.

*Eurostat's view is that provisions for payments to the Partner for services linked to separate existing assets during the Construction Phase, as described above, do not influence the statistical treatment.*

## 5.2 Benchmarking and market testing of services

Many PPP contracts provide for regular benchmarking and/or market testing of the Partner's costs for delivering particular services and adjust the Operational Payments to reflect increases and decreases in the prevailing market rates for the relevant services.

These provisions typically apply only to services that (as described in Chapter 2 and Theme 3) are secondary to maintaining the asset (e.g. catering or cleaning on an accommodation project, traffic management on a road project).

Benchmarking is a process by which the Authority and the Partner agree the prevailing market rate by reference to available data on the cost of providing comparable services (the Operational Payments are then adjusted accordingly).

Market testing, on the other hand, is a process by which the Partner re-procures the relevant services through a competitive tendering process. The Operational Payments are adjusted to reflect the winning tenderer's price (which is, *de facto*, the prevailing market rate).

The benchmarking and market-testing provisions are typically applied every five to seven years. The adjustment to the Operational Payments is forward-looking and fixed for the following five to seven-year period (i.e. the full risk and benefit of any cost increases and savings in relation to the relevant services between each benchmarking and market-testing exercise is taken by the Partner).

In some PPP contracts, an adjustment to the Operational Payments is only made if the prevailing market rate is higher or lower than a specified threshold.

### **Eurostat's comments**

*Eurostat's view is that provisions for the adjustment of the Operational Payments following the benchmarking and market testing of services, as described above, do not influence the statistical treatment if:*

- *they apply only to services that are secondary to the maintenance services required to make the asset available (see Chapter 2 and Theme 3). Where this*

- is not the case, the PPP is automatically ON BALANCE SHEET for government;*
- they apply no more frequently than every five years. Where this is not the case, the issue is of HIGH importance to the statistical treatment; and*
  - the risk and benefit of cost increases and savings between each benchmarking or market testing process is taken by the Partner. Where this is not the case, the issue is of HIGH importance to the statistical treatment.*

### 5.3 Utilities costs

Most PPP contracts contain mechanisms through which the risks that drive the cost of utilities (e.g. electricity, gas, water) consumed in the use or operation of the asset (during the Operational Phase only) are retained by the Authority or shared between the Authority and the Partner. The risks that drive the cost of utilities on a project are (i) the volume of the utilities consumed and (ii) the unit prices of the utilities.

Examples of typical utilities risk-sharing mechanisms include:

- a) The Authority takes responsibility for procuring the utilities and pays the utilities suppliers directly (volume and price risk retained by the Authority);
- b) The Partner takes responsibility for procuring the utilities and pays the utilities suppliers directly and is reimbursed by the Authority for the costs incurred (volume and price risk retained by the Authority);
- c) As in examples (a) or (b) above except that the Partner reimburses the Authority (or does not pass on the cost) for utilities consumed in excess of a specified threshold (volume risk shared, price risk retained by the Authority); and
- d) As in examples (a), (b) or (c) above, except that the parties share the risk/benefit of variations in the unit price of utilities (volume risk retained or shared, price risk shared).

In some cases, typically projects with relatively low reliance on utilities consumption, the Partner takes the full risk on the unit price and consumption of utilities for the duration of the PPP contract.

#### ***Eurostat's comments***

*Eurostat's view is that there is **no influence on the statistical treatment if the Authority retains or shares:***

- *the volume risk on projects where the Partner does not control the volume of utilities consumed in the use or operation of the asset (e.g. a school, a hospital); and/or*
- *the utilities price risk.*

*However, Eurostat's view is that there **is an influence on the statistical treatment** if the Authority retains or shares:*

- *the volume risk on projects where the Partner controls the volume of utilities consumed in the use or operation of the asset (e.g. a street lighting project on which the hours of operation of the street lights are specified in the PPP contract), in which case the issue is of MODERATE importance to the statistical treatment; and*
- *the price and/or volume risk on projects whose core objective is to deliver energy efficiency,<sup>32</sup> in which case the issue is of MODERATE importance to the statistical treatment.*

## 5.4 Indexation

Most PPP contracts provide for regular indexation of the Operational Payments. The indices used, the proportion of the Operational Payments that is indexed, and the frequency with which the indexation provisions are applied, varies widely from contract to contract.

Indexation is also typically applied to:

- other payments due by either party, for example liquidated damages due by the Partner (see Theme 2.2), lump sum payments due by the Authority (see Theme 14.4.1); and
- amounts specified for other purposes such as defining triggers for early termination of the PPP contract or defining minimum levels of insurance cover.

<sup>32</sup> This comment refers to projects where the Operational Payments are linked to the availability and/or demand of the asset, as opposed to energy performance contracts where payments are linked to efficiency savings (for which users should refer to footnote 7 of the Guide).

### **Eurostat's comments**

*Eurostat's view is that provisions for the indexation of the Operational Payments **do not influence the statistical treatment** if the provisions are based on an index or indices generally recognised in the relevant jurisdiction or sector. Where this is not the case, the issue is of MODERATE importance to the statistical treatment.*

*The application of different generally recognised indices for different elements of the Operational Payments **does not influence the statistical treatment**.*

*Provisions for the indexation of other payments and amounts (as mentioned above) **do not influence the statistical treatment**.*

## **5.5 Third party revenues from the asset**

Some PPPs envisage the asset being used to generate revenues from third parties by:

- charging for the primary use for which the asset is created (e.g. charging motorists tolls on a road project, charging passengers for use of a tram network); and/or
- charging for services or activities that are ancillary to the primary use of the asset (e.g. renting school facilities to third parties outside of school hours, renting retail space in a hospital, selling advertising space along a road, selling waste treatment services to third parties at a waste treatment plant intended primarily for treatment of the Authority's waste).

This is typically addressed in the PPP contract by providing that:

- the Partner may not generate any revenue in addition to the Operational Payments, in which case the Authority may have the right (either expressly stated in the PPP contract or implied) to choose to generate revenues from the asset itself; or
- the Partner may use the asset to generate revenues in addition to the Operational Payments, subject to certain restrictions (e.g. on times or types of use) and, in some cases, also subject to sharing with the Authority the revenues or profit that it generates.

**Eurostat's comments**

*Eurostat's view is that provisions that prohibit the Partner from generating third party revenues in addition to the Operational Payments, or that restrict the Partner's scope for generating such revenues (either by restricting the amount or the types and times of use), **do not influence the statistical treatment.***

*However, the amount of third party revenues that the Authority is forecast to receive over the life of the PPP contract whether through:*

- the Authority itself charging for the primary use of the asset;*
- the Authority itself charging for ancillary use of the asset; or*
- the Authority taking or sharing in revenues that the PPP contract allows the Partner to generate from ancillary use of the asset;*

**does influence the statistical treatment** as follows.

*If the third party revenues that the Authority is forecast to receive over the life of the contract equal or exceed 50% of the payments that the Authority is forecast to make to the Partner over the life of the contract, the project is not considered by Eurostat to be a PPP and is automatically recorded on balance sheet for government (see Chapter 2). In the case of a PPP, if the third party revenues that the Authority is forecast to receive over the life of the contract are:*

- below the threshold of 50% but equal or exceed 20% of the payments that the Authority is forecast to make to the Partner over the life of the PPP contract, the issue is of HIGH importance to the statistical treatment; or*
- below the threshold of 20% but equal or exceed 5% of the payments that the Authority is forecast to make to the Partner over the life of the PPP contract, the issue is of MODERATE importance to the statistical treatment.*

*If the third party revenues that are forecast to be received by the Authority fall below the threshold of 5% of the payments the Authority is forecast to make to the Partner over the life of the PPP contract, the issue **does not influence the statistical treatment.***

*As mentioned in Chapter 2, if the forecast of third party revenues that the Authority will receive over the life of the PPP contract changes at any time during the PPP contract, this will trigger a re-assessment of the statistical treatment.*

## 5.6 Timing for making Operational Payments

PPP contracts take different approaches to the timing of Operational Payments and the application of deductions to them. This is illustrated by the following examples:

- The notional Operational Payments for month  $n$ , adjusted for availability and performance deductions incurred in month  $n$ , are invoiced by the Partner at the end of month  $n$ ;
- The notional Operational Payments for month  $n$ , adjusted for availability and performance deductions incurred in month  $n-1$ , are invoiced by the Partner at the beginning of month  $n$ ; or
- The notional Operational Payments for month  $n$ , adjusted for availability deductions incurred in month  $n$  and for performance deductions incurred from months  $n-6$  to  $n$ , are invoiced at the end of month  $n$ .

### **Eurostat's comments**

*Eurostat's view is that provisions that purely deal with the timing and method of payment (including, for example, those described above) **do not influence the statistical treatment.***

## 5.7 Late payments

Late payment by the Authority will typically attract interest calculated from the due date for payment until payment is made in full. The interest rate applicable varies from contract to contract but typical examples include the rate prescribed by underlying law, or a percentage above underlying interest rates, or the default payment rate contained in the Partner's financing agreements.

### **Eurostat's comments**

*Eurostat's view is that provisions for interest on late payments (including the interest rate applied) **do not influence the statistical treatment.***

## 5.8 Disputed payments

The PPP contract typically allows either party to refer any disputes on amounts due by the Authority to the Partner to an independent dispute resolution procedure. In some PPP

contracts, pending resolution of a dispute, the Authority is required to pay the undisputed amount but is entitled to withhold the amount that is disputed.

#### **Eurostat's comments**

*Eurostat's view is that provisions on disputed payments, as described above, **do not influence the statistical treatment.***

## 5.9 Pass through costs

Costs that are properly attributable to the Authority as user/occupier of the asset (e.g. local property taxes, phone and internet charges) may, for practical reasons, be paid by the Partner on the Authority's behalf. These costs are typically added to the Operational Payments due by the Authority to the Partner.

#### **Eurostat's comments**

*Eurostat's view is that provisions for the Authority to reimburse the Partner for costs incurred by the Partner on behalf of the Authority as user/occupier of the asset (e.g. local property taxes, phone and internet charges) **do not influence the statistical treatment.***

## 5.10 Payment mechanism reviews

Some PPP contracts provide for joint reviews of the payment mechanism (or specific elements of the payment mechanism such as weightings and response/rectification times) on a regular basis. The purpose of these reviews is to determine whether the payment mechanism is in practice achieving what the parties intended. Any adjustment will usually be made with the agreement of both parties.

#### **Eurostat's comments**

*Eurostat's view is that provisions for reviews of the payment mechanism **do not influence the statistical treatment if the reviews are not designed to result in an adjustment to the risk and reward allocation under the PPP contract.***<sup>33</sup>

<sup>33</sup> If a payment mechanism review results in a change to the terms of the PPP contract, it is necessary to consider whether the change affects the original conclusion on the statistical treatment (see Chapter 1 for guidance on the timing of the statistical treatment assessment).



## Theme 6 – Compensation, relief and force majeure events

### 6.1 PPP contract mechanisms for compensation, relief and force majeure events

All PPP contracts contain mechanisms by which certain risks linked to the delivery of the asset and/or the services are either taken by the Authority or are shared between the Authority and the Partner. The mechanisms (and terminology used to describe them) vary from contract to contract but many jurisdictions have adopted a three-tier approach which the Guide categorises as “compensation events”, “relief events” and “force majeure events”.

#### 6.1.1 Compensation events

The following types of event are commonly treated as compensation events:

- Authority breach of the PPP contract;
- change in law;
- delays in the Authority giving site access to the Partner;
- delays in third party approvals or permitting processes;
- site conditions that are unforeseeable or for which the consequences are not estimable (e.g. archaeological discoveries, geological conditions, contamination, utilities relocations, latent defects in existing structures, endangered species);
- protester action against the project that affects the Partner’s performance; and
- vandalism to the asset.

The compensation event mechanism typically puts the full risk of an event on the Authority, meaning that the Partner is to be put in the same position as it would have been had the event not occurred.

The PPP contract typically achieves this by giving the Partner relief and/or financial compensation as follows:

- If the event causes delay to the construction, the Partner is given an extension of time for the construction milestones and/or required completion date and (if applicable) relief from paying any liquidated damages to the Authority;
- If the event causes unavailability or service failures or other PPP contract performance issues, the Partner is given relief from any deductions that would otherwise occur under the payment mechanism and relief from its failure to perform (e.g. relief from early termination of the PPP contract); and
- If the event causes an increase in the Partner's costs (construction or operational) or loss in the Partner's revenues, the Partner receives full financial compensation from the Authority.

### 6.1.2 Relief events

The following types of event are commonly treated as relief events where they affect the Partner's performance of the project and have not been caused by the Partner's actions or failures:

- fire;
- explosion;
- bursting or overflowing water tanks, apparatus or pipes;
- accidental loss or damage to the asset or other infrastructure on which the Partner relies for the performance of its obligations;
- failure or shortage of power, fuel or transport; and
- industry-wide labour disputes or strikes.

The relief event mechanism typically shares the risk of an event between the Authority and the Partner, meaning that the Partner is often expected to bear (fully or partly) the financial consequences of the event but is given relief from the other contractual consequences of the event.

Typically PPP contracts provide relief for the Partner as follows:

- If the event causes delay to the construction, the Partner is given an extension of time for the construction milestones and/or required completion date and (if applicable) relief from paying any liquidated damages to the Authority are granted;

- If the event causes unavailability or service failures, deductions are usually still applied to the Operational Payments (or, in some PPP contracts, deductions are partially applied) but the Partner is given relief from its failure to perform (e.g. relief from early termination if the PPP contract would otherwise give the Authority the right to terminate for the deductions or unavailability that has been caused by the relief event);
- Most PPP contracts leave the Partner to bear any increase in costs or loss in revenues caused by the event but some PPP contracts give the Partner the right to receive a limited amount of financial compensation (lower than for a compensation event). These PPP contracts may, for example, provide compensation once the event has continued for  $x$  days, provide compensation for costs exceeding EUR  $y$ , or provide compensation equivalent to  $z\%$  of the Operational Payments that would have been due had the relief event not occurred; and
- If the event continues for an extended period of time, some contracts allow either party to treat it as a force majeure event (see Theme 6.1.3).

### 6.1.3 Force majeure events

The following types of event are commonly treated as force majeure events where they affect either party's ability to perform its obligations under the PPP contract and have not been caused by the actions or failures of the party claiming relief:

- war, civil war, riot, armed conflict, revolution, terrorism, protests;
- nuclear explosions, ionising radiations or radioactive, chemical or biological contamination;
- pressure waves caused by airplanes travelling at supersonic speeds;
- plane crash; and
- natural disasters such as earthquakes, landslides, lightning, floods, storms, cyclones and other extreme climatic or environmental circumstances recognised as natural disasters by the authorities.

The force majeure event mechanism typically shares the risk of an event between the Authority and the Partner, meaning that the Partner is often expected to bear some or all of the financial consequences of the event but is given relief from the other contractual consequences of the event (e.g. relief from early termination of the PPP contract). What typically distinguishes the force majeure event mechanism from the other mechanisms is

that either party has the right to elect to terminate the PPP contract if the event continues for an extended period of time.

The force majeure event mechanism typically grants relief as follows:

- If the event causes delay to the construction, the Partner is given an extension of time for the construction milestones and/or the required completion date and (if applicable) relief from paying any liquidated damages to the Authority;
- If the event causes a breach of the PPP contract (e.g. unavailability or service failures), the relevant party's failure to perform is excused (although in some PPP contracts deductions for unavailability or service failures will still be applied);
- Some PPP contracts leave the Partner to bear any increase in costs or loss in revenues caused by the event. Other PPP contracts give the Partner the right to financial compensation from the Authority, with some giving the Partner full compensation and others giving partial compensation only (e.g. to cover debt servicing costs); and
- If the event continues for an extended period of time, either party has the right to terminate the PPP contract. The period of time is usually shorter in contracts where the Partner is not entitled to financial compensation in the intervening period.

In some jurisdictions the Partner has the right to claim relief from force majeure events through provisions in the underlying law (see Theme 6.2). In these cases, the events giving rise to relief, and the relief available, are determined by the underlying law.

#### **Eurostat's comments**

*Regarding Themes 6.1.1, 6.1.2 and 6.1.3, Eurostat's view is that provisions by which the Authority takes or shares the risk of events that affect the delivery of the project **do not influence the statistical treatment if all of the following conditions are met:***

- *There is a finite number of well-defined events (i.e. the Authority should not be exposed to an indefinite number of risks);*
- *The events do not capture changes in macro-economic conditions;*
- *The events are not attributable to the acts or omissions of the Partner;*
- *The events, or the consequences of the events, are not reasonably foreseeable or estimable. This is to be assessed by reference to a level of due diligence carried out before financial close that is reasonably appropriate given the*

*specific circumstances of the project (e.g. the ability of the parties to access the project site for investigations before the PPP contract is signed); and*

- *On projects with demand-based Operational Payments, a variation in the level of demand for the asset is not included as an event that leads to relief and/or compensation, unless it is a variation in demand that results directly from identifiable deliberate government action. Where government itself determines the level of demand under the PPP contract (e.g. a waste treatment facility that treats government waste) the deliberate government action would need to be un-related to the normal functioning of the PPP contract itself (e.g. a decision to build a competing facility but not a day-to-day decision on how much waste to send to the facility).*

*Eurostat's view is that the examples of compensation events, relief events and force majeure events listed in Themes 6.1.1, 6.1.2 and 6.1.3 satisfy the above conditions. Provisions that do not meet these conditions would be issues of HIGH importance to the statistical treatment.*

*The choice to treat any event that satisfies the above conditions as either a compensation event, a relief event or a force majeure event (according to the descriptions provided above) **does not influence the statistical treatment.** However, users should refer to Eurostat's comments in Theme 6.1.4 on quantifying the amount of compensation and/or relief that should be given to the Partner for these types of events.*

*In looking at the influence on the statistical treatment of the risks taken by the Authority, it is important to draw a distinction made by Eurostat between (i) the Authority accepting the consequences that a defined risk may have on the PPP project's cost or performance and (ii) the Authority accepting fundamental uncertainty regarding the project's cost and/or performance.*

*The distinction between defined risk and fundamental uncertainty can be illustrated by the case of a project involving tunnelling works, where the extent of unforeseeable geological conditions and the influence they have on the project's cost and timetable can be particularly significant. Eurostat's view is that PPP contract provisions that simply make the Authority responsible for the cost and/or time impact of whatever geological conditions are discovered would fail to transfer construction risk to the Partner and would influence the statistical treatment. On the other hand, PPP contract provisions that adjust the Authority*

*payments and the project timetable for defined risks that satisfy the conditions listed above (e.g. by providing for a range of pre-priced outcomes based on the type of geological conditions likely to be found in practice) would not influence the statistical treatment.*

#### 6.1.4 Quantifying compensation and/or relief

In most cases, the PPP contract provides that the Partner is only entitled to compensation and/or relief to the extent that the relevant event has caused its non-performance, costs or losses. The Partner is given relief and/or compensation to put it in a “no better, no worse” position than it was before the event occurred, meaning that it will continue to bear the consequences of any under-performance for which it was responsible before the event occurred.

In a minority of cases, however, the compensation and/or relief given to the Partner puts it in the position that it was forecast (at financial close) to be in at that point in time had the event not occurred. This means that the compensation and/or relief for the event effectively also compensates and/or relieves the Partner for any under-performance for which it was responsible before the event occurred.

Compensation for revenues lost on availability-based projects is usually quantified by reference to the scheduled Operational Payments. On demand-based projects, where revenues are determined by actual use of the asset, lost revenues can be more difficult to quantify objectively, but this is typically done by reference to the financial model which is updated regularly in accordance with the PPP contract on the basis of the latest available data on use/demand.

Where compensation is due by the Authority, it is typically net of amounts which the Partner should be able to recover through the required insurances.

#### **Eurostat's comments**

*Eurostat's view is that provisions for calculating compensation and/or relief for the Partner **do not influence the statistical treatment if:***

- *the provisions do not compensate or provide relief for anything other than the effects of the event in question (i.e. provisions that give compensation/relief for under-performance unrelated to the event **do influence the statistical treatment**);*

- *lost revenues on demand-based projects are calculated by reference to demand forecasts based on current data; and*
- *the provisions exclude from any compensation due by the Authority any amounts that the Partner should be able to recover under the required insurances (see Theme 9) or under the normal terms of insurance that is available on commercially viable terms.*

*Provisions that do not meet the conditions listed above are issues of HIGH importance to the statistical treatment.*

#### 6.1.5 Paying compensation

The PPP contract may provide for compensation to be paid by the Authority in a lump sum or through adjustments to the Operational Payments or a combination of both, usually depending on the nature and/or amount of costs and losses incurred by the Partner.

A minority of PPP contracts do not envisage a formal payment of compensation as such, but instead extend the duration of the contract to give the Partner the opportunity to generate additional revenues from the project (equivalent to the amount of compensation due).

#### **Eurostat's comments**

*Eurostat's view is that provisions relating to payment of compensation to the Partner (e.g. the timing of payment, whether payment is made in a lump sum or through adjustment to the Operational Payments or by extending the duration of the contract) **do not influence the statistical treatment.***

## 6.2 Public law doctrines on compensation, relief and force majeure events

In some jurisdictions, the Partner is entitled, as a matter of public law, to raise a court action seeking compensation from the Authority in situations where the performance or “economic balance” of the PPP contract is disrupted by certain types of event (e.g. an event that is unforeseeable or outside the Partner’s control).

In these jurisdictions, if the parties do not or cannot waive their rights under the public law doctrine, the PPP contract itself may contain:

- provisions to clarify or qualify the circumstances in which the parties would intend the underlying public law doctrine to apply;
- provisions that reflect or repeat the underlying public law doctrine; or
- no express provisions on the circumstances in which the compensation, relief or force majeure events may apply, the implication being that the parties will simply rely on the application of the underlying public law doctrine.

The detail of these public law doctrines, and their potential impact on PPP transactions, varies significantly from jurisdiction to jurisdiction. In practical terms, their existence often creates uncertainty as to both the events for which the Authority may be required to relieve and/or compensate the Partner and the amount of relief and/or compensation that would be due.

#### **Eurostat's comments**

*Eurostat's view is that the existence of public law doctrines of the nature described above **may influence the statistical treatment**. Analysis of the particular public law and jurisprudence would be required to ascertain whether it could result in the Authority taking or sharing the risk of events which, according to the Guide, would influence the statistical treatment. For example, a public law doctrine that would compensate the Partner for a reasonably foreseeable event would be an issue of HIGH importance (see Eurostat's comments in Theme 6.1).*



# Theme 7 – Changes to the PPP contract

## 7.1 Changes proposed by the Authority

All PPP contracts recognise a right for the Authority to propose changes to the terms of the contract (including the agreed terms of the asset's design, construction, operation and maintenance) and that the Partner is entitled to relief and/or compensation for the consequences of complying with those changes.

In some PPP contracts, the Authority's right to propose changes is restricted (e.g. to changes below a certain value, to changes of a certain type, by the Partner having grounds for objecting to the proposed change).

Most PPP contracts contain provisions that allow the Partner to claim:

- compensation from the Authority for any increase in costs or loss in revenues or change in the project's risk profile; and
- relief from any non-performance of the PPP contract;

that arise as a result of the change.

Similarly, most PPP contracts provide that the Authority benefits from any cost savings or increases in revenues that arise from Authority changes.

Some PPP contracts provide that the Authority can require the Partner to finance the change, although if the Partner is unable to obtain financing the Authority will finance the change itself.

In some cases, the financial adjustment for an Authority change is made by reference to an underlying principle of public law (see Theme 6.2).

**Eurostat's comments**

*Eurostat's view is that:*

- *provisions that give the Authority a right to propose changes to the PPP contract (either on a restricted or an unrestricted basis) **do not influence the statistical treatment**;*
- *provisions that give the Partner a right to claim compensation and/or relief for the consequences of complying with an Authority change, and the method for calculating and paying compensation, **do not influence the statistical treatment if** the compensation and/or relief are limited to addressing the effects of the Authority change (i.e. they do not indirectly compensate or relieve the Partner for its own poor performance or other Partner risks). Where this is not the case, the issue is of HIGH importance to the statistical treatment;*
- *provisions that pass on to the Authority any cost savings or increases in revenues that arise from an Authority change, and the method for calculating and passing those on to the Authority, **do not influence the statistical treatment**; and*
- *provisions that allow the Authority to require the Partner to finance an Authority change **do not influence the statistical treatment**.*

*As explained in Chapter 1, at the time of implementing any change to the PPP contract, it is important to consider the impact that the change may have on the statistical treatment.*

## 7.2 Changes proposed by the Partner

Some PPP contracts provide a right for the Partner to propose changes to the terms of the contract (including the agreed terms of the asset's design, construction, operation and maintenance), but this is usually qualified as follows:

- the Authority is not obliged to accept any such proposal (other than where the change is required in order to comply with law);
- the Authority is not obliged to compensate the Partner for any costs incurred or revenues lost; and
- the Authority is entitled to share in any cost savings or increases in revenues that arise for the Partner.

Other PPP contracts contain no formal right for the Partner to propose a change.

**Eurostat's comments**

*Eurostat's view is that:*

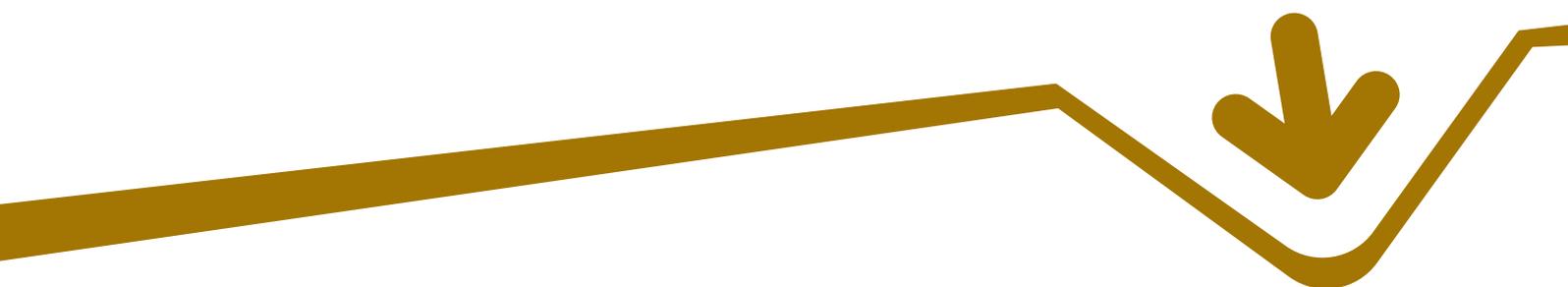
- *providing the Partner with a right to propose changes to the PPP contract, as described above; and*
- *providing the Authority with a right to share (to whatever degree) in any cost savings or increases in revenues that result from a Partner change;*

**do not influence the statistical treatment.**

*Equally, not providing the Partner with a right to propose changes to the PPP contract and not providing the Authority with a right to share in any cost savings or increases in revenues resulting from a Partner change, **does not influence the statistical treatment.***

*However, Eurostat's view is that an obligation on the Authority to bear the financial consequences of a Partner change proposal (other than one that is required in order to comply with law, as described in Theme 8) **does influence the statistical treatment** and is an issue of HIGH importance.*





## Theme 8 – Changes in law

Almost all PPP contracts contain specific provisions through which the Authority takes the risk of changes in law that affect the project, meaning that the Authority is required to compensate the Partner for costs incurred or revenues lost as a result of changes in law.

In many PPP contracts, the Partner's right to claim compensation is limited to changes in law that were unforeseeable at the time the contract was signed. The definition of "unforeseeable" varies from contract to contract, but encompasses changes in law that the Partner could not have been expected to reflect in its bid for the project.

Some PPP contracts limit the Partner's right to claim compensation further by providing, for example, that for changes in law that are general in nature (i.e. do not relate solely to the project or the Partner or to similar projects or businesses) the Partner:

- bears any increases in operating and maintenance costs; and/or
- shares any increases in capital costs.

In some jurisdictions the right of the Partner to claim some form of compensation for unforeseeable changes in law is enshrined in public law (which may also be referred to in the PPP contract).

### ***Eurostat's comments***

*Eurostat's view is that provisions that allocate change-in-law risk to the Authority **do influence the statistical treatment** if they include the Authority taking the risk of:*

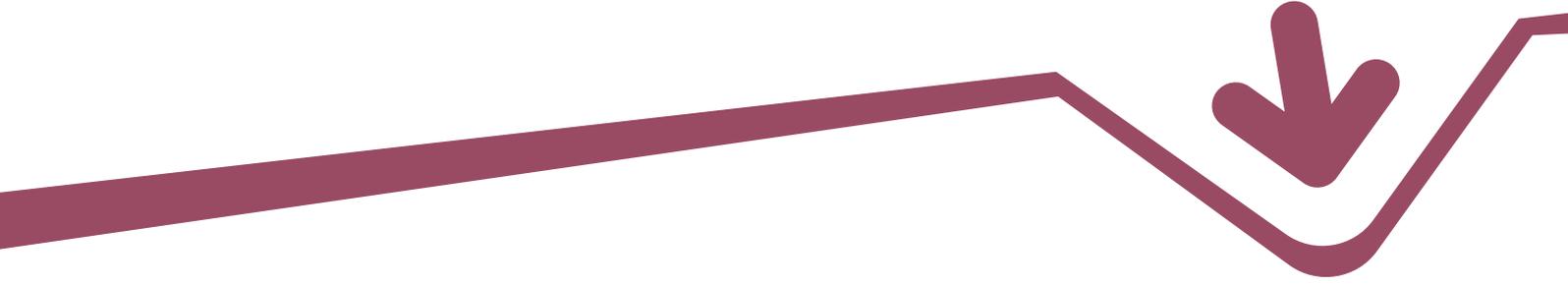
- *changes in law that are foreseeable at the date of signature of the contract; and/or*

- *changes in law that are general in nature (i.e. that do not relate solely to the project or to the Partner or to similar projects or businesses) and affect the general operating costs of businesses in the relevant jurisdiction (e.g. changes in rates of taxation,<sup>34</sup> changes in employment laws).*

*Where this is the case, the issue is of MODERATE importance to the statistical treatment.*

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<sup>34</sup> An exception is only made for cases where the Authority takes the risk of a general change to the value added tax regime.



## Theme 9 – Insurance

### 9.1 Insurance requirements

The PPP contract typically specifies insurances that the Partner is (as a minimum) required to have in place for the Construction Phase and the Operational Phase. The required insurances typically include:

- professional indemnity insurance (covering the Partner’s design liabilities);
- construction/property damage insurance (covering damage to the construction works/asset);
- public liability insurance (covering liabilities to third parties); and
- delay in start-up and business interruption insurance (covering the Partner’s exposure to loss of revenues).

The PPP contract also typically specifies key terms for each of the required insurances (e.g. the parties to be covered, the period of cover, the minimum amount of cover, the maximum deductible, specific inclusions and exclusions) as well as requirements for:

- the Authority to be a “named party” on the construction/property damage and public liability insurance;
- the Authority’s approval of the identity of the insurer;
- “non-vitiation” protection, to ensure that the Authority’s claims cannot be refused by the insurers as a result of actions by the Partner (e.g. the Partner’s non-disclosure or misrepresentation to the insurers); and
- “subrogation waiver”, to limit the insurers’ recourse to the Authority in connection with any claims on the insurances.

**Eurostat's comments**

*Eurostat's view is that provisions in the PPP contract requiring the Partner to have certain insurances in place, the scope of those insurances and the terms on which they must be put in place **do not influence the statistical treatment.***

**9.2 Reinstatement of the asset**

PPP contracts typically require the Partner to take out property damage insurances and use the proceeds of those insurances to reinstate the asset if it is damaged. They typically include a process by which the Authority and the Partner agree on the reinstatement proposals, plans and timetable.

Some PPP contracts (that are becoming increasingly rare) apply what is referred to as an “economic reinstatement test” in situations where there is complete or substantial loss of the asset. Before the Partner starts work to reinstate the asset, an assessment is made to determine if, after the asset is reinstated, the Partner will still be in a position to repay its senior debt. If the test is failed, the senior lenders can take any insurance proceeds that are available to repay their loans to the project. The Partner will remain under a contractual obligation to reinstate the asset. If it is unable to do so (which is likely to be the case if some or all of the insurance proceeds have been taken by the senior lenders), it will be in breach of contract and the Authority will be entitled to terminate the PPP contract for Partner default.

**Eurostat's comments**

*Eurostat's view is that provision in the PPP contract for the Authority and Partner to agree the proposals, plan and timetable for reinstatement of the asset **do not influence the statistical treatment.***

*Eurostat's view is that the inclusion of an “economic reinstatement test” as described above **does influence the statistical treatment** and is an issue of HIGH importance.*

**9.3 Insurance costs**

Most PPP contracts include provisions for adjusting the Operational Payments to reflect increases and decreases in the costs of the required insurances for the Operational Phase.

The specific provisions vary from project to project. For example:

- Many PPP contracts provide for adjustments to the Operational Payments on each insurance renewal but some provide for less frequent adjustments;
- On some projects, the Operational Payments contain baseline insurance cost assumptions (e.g. costs forecast at financial close, actual costs incurred in the first year of the Operational Phase) and the adjustment is made by comparing actual costs incurred against the assumed baseline costs. On other projects, the Operational Payments contain no baseline insurance cost assumptions and the adjustment is simply a “pass-through” of actual insurance costs (or a proportion of actual insurance costs) to the Authority as and when they are incurred;
- On many PPP contracts, the Partner takes the risk and benefit of fluctuations in insurance costs within specified limits, with the risk and benefit of fluctuations outside those limits being shared by the Authority and the Partner (e.g. an 80/20 sharing of cost fluctuations that are greater than 10%); and
- Some PPP contracts take account of the underlying reasons for the increases/decreases in insurance costs (e.g. distinguishing between changes caused by the Partner’s claims record and general changes in the insurance market).

There are some rare examples of PPP contracts in which the Partner takes the full risk and benefit of fluctuations in insurance costs throughout the contract.

#### ***Eurostat’s comments***

*Eurostat’s view is that the fact that the Partner retains the risk/benefit of changes in insurance costs for the duration of the PPP contract **does not influence the statistical treatment.***

*Eurostat’s views on provisions for the Authority to take or share the risk/benefit of changes in insurance costs in situations of uninsurability are provided in Theme 9.4.*

*Eurostat’s view is that provisions for the Authority to take or share the risk/benefit of changes in insurance costs in situations other than uninsurability (as described in Theme 9.4) **do not influence the statistical treatment if all of the following conditions are met:***

- *The Authority takes or shares the risk that insurance costs increase above a specified ceiling and/or takes or shares the benefit if insurance costs fall below a specified floor;*

- *The ceiling (if applicable) is set no lower than twice the amount of the insurance costs forecast at financial close;*
- *The floor (if applicable) is set no higher than half the amount of the insurance costs forecast at financial close;*
- *If insurance costs increase above the ceiling, the Authority is only liable for the difference between the actual costs and the ceiling;*
- *If insurance costs fall below the floor, the Authority only takes or shares the benefit of the difference between the actual costs and the floor; and*
- *The provisions do not allow the Authority to take the risk and/or benefit of changes in insurance costs that are attributable to the actions of the Partner.*

*Provisions for the Authority to take or share the risk/benefit of changes in insurance costs (other than in situations of uninsurability as described in Theme 9.4) that do not meet all of the conditions described above **do influence the statistical treatment** and the issue is of HIGH importance.*

*The following example illustrates the way that Eurostat expects the conditions described above to apply (i.e. so that the provisions would not influence the statistical treatment). The example assumes a PPP contract with forecast annual insurance costs of EUR 1 million, a cost increase ceiling set at twice this amount (i.e. EUR 2 million) and a cost decrease floor set at half this amount (i.e. EUR 0.5 million). The example assumes that the Authority takes (rather than shares) the full risk and benefit of cost increases above the ceiling and decreases below the floor. In this example:*

- *If annual insurance costs increase to EUR 2.5 million, the Partner is liable for EUR 2 million and the Authority is liable for EUR 0.5 million (i.e. the difference between actual costs and the ceiling); and*
- *If annual insurance costs fall to EUR 0.4 million, the Partner keeps the benefit of the cost saving of EUR 0.5 million and the Authority takes the benefit of a saving of EUR 0.1 million (i.e. the difference between actual costs and the floor).*

## 9.4 Uninsurability

Most PPP contracts include “uninsurability” provisions that deal with the situation where a required insurance for the project ceases to be available in the insurance market or is only available at excessive cost.

Typically, if a situation of uninsurability arises, either party can elect to terminate the PPP contract and compensation is paid to the Partner (see Theme 12.5). In some situations, the Authority may have the right to elect for the PPP contract to continue, on the basis that it will act as insurer of last resort if and when the uninsurable risk occurs.

The provisions typically do not apply if the uninsurability has been caused by the Partner’s acts or omissions, and deal only with the prevailing conditions in the wider insurance market. As such, they typically cover two scenarios:

- Where insurance for a risk is simply not provided by reputable insurers in the market; and
- Where insurance for a risk is provided by the market but only on terms that are commercially unviable. This is sometimes assessed by reference to the deductible or premium being above a specified threshold and sometimes assessed more generally by looking at whether other entities similar to the Partner have stopped insuring the risk.

### **Eurostat’s comments**

*Eurostat’s view is that provisions that treat the unavailability of insurance in the way described above **do not influence the statistical treatment** if they apply only in situations of disruption in the insurance market and not in situations where the insurance is unavailable because of the Partner’s acts or omissions. Disruption in the insurance market is assumed to exist where:*

- *the insurance is not provided by reputable insurers in the market; or*
- *the terms on which the insurance is available are commercially unviable such that entities similar to the Partner are generally not taking out the insurance.*

*Provisions that assess the commercial viability of insurance by reference to any other test (e.g. an increase in insurance costs above a specified level) **do influence the statistical treatment** if they are likely to apply in a scenario other than disruption in the insurance market. Where this is the case, the issue is of HIGH importance to the statistical treatment.*

## 9.5 Unavailability of required insurance terms

Some PPP contracts provide for the situation where insurance is available on the market on commercially viable terms (i.e. the risk is not “uninsurable”) but it is not available on the terms specified in the contract (e.g. the level of deductible available in the insurance market is higher than the level specified in the contract).

In this situation, the Partner is relieved of its obligation to take out the insurance on the required terms (i.e. it will not be considered to be in breach of the PPP contract) but is expected to bear the additional risk as a result of not being able to insure on the required terms (e.g. it will bear the financial impact of the level of deductible being higher than stated in the contract).

### ***Eurostat’s comments***

*Eurostat’s view is that provisions that deal with the unavailability of a term or condition of insurance specified in the PPP contract (as described above) **do not influence the statistical treatment.***



# Theme 10 – Warranties and indemnities

## 10.1 Warranties

In most PPP contracts, the Authority and Partner will each provide the types of warranties that are typical to commercial deals, warranting for example:

- their legal status and capacity to enter into the contract;
- that they have followed due process in entering into the contract; and
- their compliance with law.

These types of typical commercial warranties tend to be focussed on the parties' own corporate status, actions and behaviour.

In some PPP contracts, however, warranties are also used as a mechanism to allocate risks/rewards associated more directly with the delivery or performance of the project. For example:

- a warranty from the Authority relating to unforeseeable geological conditions;
- a warranty from the Authority relating to the level of use/demand of the asset; or
- a warranty from the Partner that it will not refinance the project in any circumstances.

Using contractual warranties for this purpose is quite rare. In most cases the parties prefer to use specific contract mechanisms to deal with project risks and rewards (e.g. compensation events relating to the condition of the site, minimum payments in a demand-based payment mechanism) rather than rely on general remedies available for a claim for breach of warranty.

**Eurostat's comments**

*Eurostat's view is that the provision of "typical" commercial warranties of the nature described above **does not influence the statistical treatment.***

*However, users should be aware that warranties may influence the statistical treatment if, in substance, they allocate risks and rewards in a way that influences the statistical treatment as described in other provisions of the Guide. For example, a warranty from the Authority on minimum traffic levels on a roads project with demand-based Operational Payments might, in substance, be a minimum revenue guarantee and would be assessed accordingly (see Theme 4.10.3).*

## 10.2 Indemnities given by the Partner

Most PPP contracts contain provisions which require the Partner to indemnify the Authority for any losses or liabilities that the Authority incurs as a result of the Partner's performance or non-performance of the PPP contract.

The indemnities typically cover matters for which the Partner would otherwise have legal liability. In some cases the indemnities cover additional matters, for which the Partner would not necessarily have legal liability, but which the Authority has identified are capable of arising as a result of the Partner's delivery of the project.

The categories of losses and claims covered by the Partner indemnities typically include:

- death or personal injury;
- loss or damage to property;
- breach of the Authority's statutory duties; and
- third party claims brought against the Authority.

The indemnities granted by the Partner are often limited in the following ways:

- through excluding specific losses or claims (e.g. those that arise from the Authority's own breach or negligence, those related to matters which are Authority risks under the PPP contract such as site contamination, those for damage to the asset itself); and
- through financial caps on the Partner's liability for specific losses or claims.

The limitations on the indemnities are often designed to protect the Partner from exposure to losses or claims which would not be recoverable through the insurances required under the PPP contract.

### **Eurostat's comments**

*Eurostat's view is that the scope of indemnities granted by the Partner (including provisions that limit or exclude the Partner's liability) **does not influence the statistical treatment** if the limits or exclusions apply only to the Partner's liabilities for events:*

- that are unforeseeable and are not covered under the normal terms of insurance that is available for the asset and service delivery on commercially viable terms;*
- that arise from matters that are within the scope of the Authority's management or control; or*
- for which the Authority has another remedy against the Partner either under the PPP contract or at law (e.g. by enforcing the Partner's contractual obligation to maintain the asset and/or making deductions from the Operational Payments).*

*Limits or exclusions on the Partner's indemnities that do not meet the conditions listed above are of HIGH importance to the statistical treatment.*

## **10.3 Indemnities given by the Authority**

A minority of PPP contracts contain indemnities from the Authority in favour of the Partner, typically limited to losses and claims for:

- death or personal injury; or
- damage to property;

caused by the Authority or parties that the Authority controls or manages.

The indemnities granted by the Authority typically exclude losses and claims that are caused by the Partner and losses and claims which the Partner should be able to recover from the insurances required under the PPP contract.

### **Eurostat's comments**

*Eurostat's view is that the provision of indemnities from the Authority to the Partner, in the nature and manner described above, **does not influence the statistical treatment.***

*However, Eurostat's view is that the provision of an indemnity from the Authority to the Partner for any risk other than:*

- the Authority's own acts or omissions;*
- acts or omissions of any third party that the Authority manages or controls;*
- risks that the Guide states can be taken by the Authority without influencing the statistical treatment (e.g. the risk of unforeseeable ground conditions as described in Theme 6);*

**does influence the statistical treatment** and is an issue of HIGH importance.



## Theme 11 – Early termination of the PPP contract

Early termination of PPP contracts can typically be triggered by the following events:

- default by the Partner;
- default by the Authority;
- unilateral (or voluntary) decision by the Authority;
- extended and continuing force majeure event; or
- uninsurability or the occurrence of an uninsurable risk.

### 11.1 Partner default termination

Most PPP contracts contain an itemised list of Partner defaults that give the Authority a right (although not an obligation) to terminate. The list usually contains the following events:

- insolvency/bankruptcy of the Partner;
- failure by the Partner to reach certain construction milestones;
- failure by the Partner to deliver services to the agreed standards;
- failure by the Partner to take out the required project insurances;
- breach by the Partner of restrictions on changes in ownership or transfers of the contract;
- material breach of the PPP contract by the Partner;
- fraudulent or corrupt behaviour by the Partner; and
- in rare cases, major default of the Partner under the senior loan agreement.

Some PPP contracts rely on a broad or general definition of Partner default, rather than an itemised list of events. Where this is the case, the definition often contains a “materiality test” so that early termination can be triggered only by defaults that are of a serious nature or have a significant impact.

The PPP contract may give the Partner a limited period of time in which to remedy the default or the circumstances that have given rise to the default, and thereby avoid termination by the Authority. This usually depends on the severity or nature of the default (e.g. whether it is capable of remedy).

The Authority’s right to terminate the PPP contract for Partner default is normally subject to the right of senior lenders to step in to the PPP contract in an attempt to remedy the default and avoid termination (see Theme 14.8).

#### **Eurostat’s comments**

*Eurostat’s view is that the provisions that define the circumstances and process by which the Authority may terminate the PPP contract for Partner default, including:*

- *the definition of the termination triggers themselves (and whether they are itemised in a list or defined more broadly); and*
- *the circumstances in which the Partner may or may not have an opportunity to remedy the default and, where that opportunity exists, the length of the remedy periods;*

**do not influence the statistical treatment.** *However, separate consideration must be given to provisions for compensation that may be payable by the Authority on early termination of the PPP contract for Partner default (see Theme 12.1).*

## **11.2 Authority default termination**

The PPP contract usually contains an itemised list of Authority defaults that give the Partner a right (although not an obligation) to terminate. The list will usually contain the following events:

- non-payment of amounts owed by the Authority to the Partner;
- breach of contract by the Authority that prevents the Partner’s performance;
- expropriation or confiscation of the asset or the Partner’s business;

- breach by the Authority of restrictions on its right to transfer the contract; and
- sometimes, a change in the Authority’s credit-worthiness or legal status.

Some PPP contracts rely on a broad definition of Authority default, often based on a “materiality test” so that termination can be triggered only by defaults that are of a serious nature or that have a significant impact.

In a limited number of jurisdictions where there is no express contractual right for the Partner to terminate for Authority default, the Partner can usually rely on provisions of underlying law to the same effect.

The PPP contract may give the Authority a period of time in which to remedy a default (where this would be possible) in order to avoid termination by the Partner.

#### **Eurostat’s comments**

*Eurostat’s view is that the provisions that define the circumstances and process by which the Partner may terminate the contract for Authority default, including:*

- *the definition of the termination triggers themselves (and whether they are itemised in a list or defined more broadly); and*
- *the circumstances in which the Authority may or may not have an opportunity to remedy the default and, where that opportunity does exist, the length of the remedy periods;*

#### **do not influence the statistical treatment.**

*However, it should be noted that if the triggers for early termination for Authority default result in the Authority taking risks that, as stated elsewhere in the Guide, **do influence the statistical treatment** (e.g. the Authority taking the risk of the Partner’s own performance or general macro-economic risks, as referred to in Theme 6), this is an issue of HIGH importance to the statistical treatment.*

*In addition, separate consideration must be given to provisions for compensation that may be payable by the Authority on early termination of the PPP contract for Authority default (see Theme 12.2).*

### 11.3 Authority voluntary termination

The Authority usually has an express right (in the PPP contract or in underlying law) to terminate the PPP contract at will (regardless of either party's performance of the contract). Sometimes this right is limited to situations where the Authority is motivated by particular circumstances (e.g. overriding public interest).

#### **Eurostat's comments**

*Eurostat's view is that the provision (or non-provision) of a right by the Authority to terminate the PPP contract at will, on unlimited or limited grounds, **does not influence the statistical treatment**. However, separate consideration must be given to provisions for compensation that may be payable by the Authority on the Authority's voluntary early termination of the PPP contract (see Theme 12.3).*

### 11.4 Force majeure termination

PPP contracts often recognise the right for either party to terminate the contract in circumstances where a force majeure event has subsisted for an extended period of time, which is typically six to 12 months.

#### **Eurostat's comments**

*Eurostat's view is that the provision of an early termination trigger for force majeure risks, and the period of time after which a force majeure event can trigger termination, **do not influence the statistical treatment**. Equally, not providing an early termination trigger for force majeure risks **does not influence the statistical treatment**. However, the definition of force majeure itself may influence the statistical treatment (see Theme 6) as may provisions for compensation payable by the Authority on early termination of the PPP contract for force majeure (see Theme 12.4).*

### 11.5 Termination linked to uninsurability

Many PPP contracts treat the unavailability of key project insurances as a shared risk or an Authority risk. Typically this is achieved by way of the Authority deciding, when a risk becomes uninsurable, to:

- terminate the contract immediately; or
- “self-insure” and to pay the Partner an amount equivalent to insurance proceeds if the risk later occurs.

If the Authority chooses to “self-insure” and the uninsurable risk does later occur, the Authority usually has the option to terminate the PPP contract as an alternative to paying the Partner an equivalent of the insurance proceeds. Some PPP contracts contain an explicit right for the Authority to terminate in this particular situation, but otherwise the Authority may opt to use its general unilateral right to terminate at any time.

#### **Eurostat’s comments**

*Eurostat’s view is that the provision or non-provision of a right of termination linked to uninsurability or the occurrence of an uninsurable risk **does not influence the statistical treatment**. However, the underlying uninsurability provisions themselves may influence the statistical treatment (see Theme 9.4) as may provisions for compensation payable by the Authority on early termination of the PPP contract for uninsurability (see Theme 12.5).*





## Theme 12 – Compensation on early termination of the PPP contract

The vast majority of PPP contracts provide for the payment of compensation by the Authority to the Partner on early termination of the PPP contract. The amount of compensation payable varies depending on the circumstances giving rise to termination, as explained below. Responsibility for the asset itself will usually revert to the Authority or, if the PPP contract is re-tendered by the Authority, to a third party.

### ***Eurostat's comments***

*Eurostat's view, which applies to all early termination scenarios, is that the payment of compensation should not cancel any liabilities of the Partner to the Authority that pre-date termination (e.g. an indemnity claim that the Authority has against the Partner). PPP contract provisions that do not preserve pre-termination liabilities **do influence the statistical treatment** and are issues of HIGH importance.*

### 12.1 Partner default termination compensation

#### 12.1.1 Approach 1 - No compensation payable

Some early deals in what are now more established PPP markets contain an express provision that the Partner is entitled to no compensation on termination triggered by its own default.

### ***Eurostat's comments***

*Eurostat's view is that this approach **does not influence the statistical treatment**.*

### 12.1.2 Approach 2 - No provision in the PPP contract for compensation

Some PPP contracts are silent about how much compensation is payable in the event of termination for Partner default. Where this is the case, the Partner will usually be entitled to claim compensation in accordance with the underlying law in the relevant jurisdiction.

#### **Eurostat's comments**

*Eurostat's view is that the absence of express provision in the PPP contract as to the amount of compensation due on Partner default creates uncertainty which **may influence the statistical treatment**. Further analysis (e.g. of the underlying law and jurisprudence in the relevant jurisdiction) would be required to determine the amount of compensation to which the Partner may be entitled and how this would align with Eurostat's views on compensation on early termination for Partner default that are stated in this Theme 12.1.*

### 12.1.3 Approach 3 - Market value of the contract

This is the most common approach, where the Partner receives compensation based on the market value of the PPP contract, determined either:

- by the market itself through a process of re-tendering the PPP contract; or
- by estimating how the market would value the PPP contract.

Typically, the PPP contract gives the Authority the right to choose which approach to take (i.e. whether re-tendering or estimated market value). The right to choose re-tendering is usually subject to a condition that, at the point of termination, a “liquid market” for the relevant type of PPP contract in the relevant jurisdiction exists. The PPP contract usually provides that where there is no liquid market, the market value of the contract is to be estimated. Usually the PPP contract will allow the Authority (but not the Partner) to change its choice from re-tendering to estimated value at any time before bids are received.

Some PPP contracts require the Authority to make ongoing payments to the Partner during the re-tendering process and these are then deducted from the final compensation payment. Some PPP contracts also impose a time limit (e.g. two years from the termination date) on the Authority to complete the tendering process and pay the re-tendering market value of the contract to the Partner.

Some PPP contracts do not include a re-tendering option but instead only provide for compensation on the basis of an estimated market value of the contract. There are some rarer examples of PPP contracts that provide only for a re-tendering process.

Where the market value of the contract is to be estimated, this is usually done on the basis of a detailed methodology specified in the PPP contract. This methodology usually envisages a calculation (on a net present value basis) of the aggregate of payments forecast to be made by the Authority over the remaining term of the PPP contract, net of all costs (including any remediation costs resulting from the Partner's under-performance) forecast to be incurred over the remaining term of the PPP contract.

Some PPP contracts provide for the estimated market value of the contract to be agreed between the parties, based on a methodology set out in the contract (as described above), failing which it is determined through the contractual dispute resolution procedure. More rarely, other PPP contracts provide for referral to an independent expert to determine the market value, again based on the methodology set out in the contract, and in some cases either party can refer the independent expert's determination to the contractual dispute resolution procedure.

#### ***Eurostat's comments***

*Eurostat's view is that the market value of the PPP contract can be considered as a proxy for the market value of the underlying assets (as referred to in the Rules) during both the Construction Phase and the Operational Phase.*

*Eurostat's view is that the Approach 3 described above **does not influence the statistical treatment if** all of the following conditions are met:*

- Under the conditions of the re-tendering process set out in the PPP contract, the bidders for the PPP contract are required to take into account any remediation costs resulting from the Partner's under-performance (i.e. costs to complete/rectify the asset as well as additional operation, maintenance and financing costs);*
- The methodology for estimating the market value of the contract (where the re-tendering process is not followed) is designed to reflect the approach that the market would take in valuing the PPP contract and not to ensure the recovery of the Partner's incurred costs or outstanding debt. The methodology needs to take into account any remediation costs resulting from the Partner's under-performance (i.e. the forecast cashflows should take into account costs*

*to complete/rectify the asset as well as additional operation, maintenance and financing costs);*

- Where the PPP contract provides for a choice between re-tendering and an estimated market value, that choice lies with the Authority and not the Partner;*
- The Authority is only obliged to opt for an estimated market value in situations in which there is no liquid market;*
- The definition of liquid market ensures that (as at the time the choice is made) there are a sufficient number of capable and willing parties in the market for the relevant type of PPP or similar contracts to allow for a market price to be determined;*
- Any decision to switch to an estimated market value of the PPP contract instead of a re-tendered market value after the decision to follow a re-tendering process has been taken, but before bids are received, is solely at the discretion of the Authority and cannot be initiated or influenced by the Partner;*
- Under the conditions of the re-tendering process set out in the PPP contract, the validity of the re-tendering process is not conditional on a minimum number of bids being received or a minimum contract value being offered (i.e. the results of the re-tendering process are held to be valid even if no bids are received or if bids have a lower value than expected);*
- Under the conditions of the re-tendering process set out in the PPP contract, if the re-tendering process is followed and the number of bids received is below a certain number (or lower than expected) or the prices offered are below a certain value (or lower than expected), the price offered is deemed to be the market value and the contract does not provide for some other amount (e.g. an estimated market value) to be used to determine the market value;*
- Under the conditions of the re-tendering process set out in the PPP contract, if the re-tendering process is followed and no bids are received then the market value of the contract is deemed to be zero (i.e. the contract does not provide for some other amount, such as an estimated market value, to be used as an alternative basis for the compensation payment);*

- *Under the conditions of the re-tendering process set out in the PPP contract, if the re-tendering process establishes a market value that is less than zero, the contract provides for the possibility of a negative compensation payment (i.e. a payment that would be due by the Partner to the Authority);*
- *Any interim payments made by the Authority to the Partner between the termination date and the date that compensation is paid are deducted from the compensation payment;*
- *If the conditions of the re-tendering process impose a time limit on the Authority to complete the re-tendering process and pay the market value of the contract to the Partner, that time limit is no less than six months from the termination date;*
- *If the re-tendering process is not followed, the estimated market value of the PPP contract is calculated (using the methodology provided in the contract) either by an expert or jointly by the parties. Where the contract provides for an expert to be used, the expert should be independent of both the Authority and the Partner (and the Authority and the Partner can agree the precise tests for independence and expertise). Where the contract provides for the calculation to be agreed by the parties, both parties must have the right to refer any disagreement to an independent expert or to a dispute resolution procedure set out in the PPP contract; and*
- *If the methodology for calculating the estimated fair value of the contract establishes a value that is less than zero, the contract provides for the possibility of a negative compensation payment (i.e. a payment that would be due by the Partner to the Authority).*

*Where either of the first two conditions listed above is not met, the PPP is automatically ON BALANCE SHEET for government. Each of the remaining conditions listed above is of HIGH importance to the statistical treatment.*

#### 12.1.4 Approach 4 - Book value of the asset

Some PPP contracts provide that the compensation payable to the Partner is based on the book value of the asset at the date of termination. The book value tends to be determined either by reference to:

- the amount of capital (debt and equity) invested in the asset; or
- the costs expended by the Partner in building the asset.

The main difference between these approaches is that the first takes account of financing costs whereas the second does not.

This approach does not in itself take into account the cost to the Authority (if any) of remedying any poor performance issues associated with the project (e.g. rectifying construction defects). In some jurisdictions, the compensation paid to the Partner will therefore be the book value of the asset minus remediation costs.

#### **Eurostat's comments**

*Eurostat's view is that provisions that calculate the compensation payable on Partner default on the basis of the book value of the asset but do not take into account the Authority's remediation costs **do influence the statistical treatment** and automatically lead to the PPP being ON BALANCE SHEET for government.*

*In contrast, provisions that calculate the compensation payable on Partner default on the basis of the book value of the asset and take into account the Authority's remediation costs (both the costs to complete/rectify the asset and additional operating/maintenance costs) **do not influence the statistical treatment**.*

*If only some remediation costs are deducted from the book value of the asset calculation (e.g. additional maintenance/operating costs are not deducted), the provisions **do influence the statistical treatment** and are an issue of HIGH importance.*

#### **12.1.5 Approach 5 - Senior debt compensation**

Some PPP contracts provide that the compensation payable to the Partner is based on the amount (or a percentage of the amount) of senior debt outstanding at the date of termination.

In some cases deductions will be made from the senior debt outstanding to take account of the Authority's costs (e.g. re-tendering, remediation).

In some jurisdictions, a senior debt outstanding calculation is used for all Partner defaults. In other jurisdictions it is used only for a limited range of Partner defaults (typically breach of refinancing provisions and/or Partner fraud or corruption).

### **Eurostat's comments**

*Eurostat's view is that PPP contract provisions that base the compensation payable on Partner default on the senior debt outstanding (or a percentage of it) are akin to a financing guarantee (see Theme 14.4) **and do influence the statistical treatment**. Accordingly, the influence of such compensation provisions on the statistical treatment needs to be assessed (in combination with other government financing provisions) according to the principles stated in Theme 14.4.*

## **12.2 Authority default termination compensation**

### **12.2.1 Approach 1 - Compensation for costs and losses**

In most PPP contracts, the compensation due by the Authority to the Partner on termination for Authority default is designed to ensure that the Partner and its lenders are left no worse off as a result of the Authority default than they would have been if the PPP contract had continued as expected. Typically the compensation will cover the following key components:

- senior debt;
- sponsors' equity and subordinated debt (including loss of return); and
- payments due to third parties.

The first component, compensating senior debt providers, usually includes the debt outstanding at the date of termination, any accrued interest and costs associated with early breakage of the financing agreements (including hedging breakage costs) in addition to interest that will accrue on the compensation payment from the date of termination up until the date that the compensation is actually paid.

The second component typically compensates equity and subordinated debt investors for their initial investment and future loss of return. There are various ways in which this is calculated, the three most commonly used are:

- An "original return" approach, which ensures that investors receive an overall return equal to what was forecast at financial close (regardless of how the project has performed);

- A “market value” approach, which provides investors with an amount for which their investment could have been sold to a willing buyer at the date of termination; and
- A “future return” approach, which ensures that investors receive the return they were forecast to receive at financial close from the termination date until the date that the PPP contract would have expired.

In some cases, equity and subordinated debt investors are compensated with a pre-determined arbitrary amount (e.g. a certain percentage of the unexpired value of the contract).

The third component will typically include amounts due by the Partner to third parties such as sub-contractor breakage costs and redundancy payments.

#### ***Eurostat's comments***

*Eurostat's view is that the calculation of compensation due by the Authority to the Partner on termination for Authority default as described in Approach 1 above **does not influence the statistical treatment.***

#### 12.2.2 Approach 2 - Book value of the asset

Although less common than Approach 1 described above, in some PPP contracts the amount of compensation payable by the Authority to the Partner is the book value of the asset which is:

- in the case of termination during the Construction Phase, the amount invested at the date of termination; and
- in the case of termination during the Operational Phase, the amount invested during construction, subject to depreciation.

#### ***Eurostat's comments***

*Eurostat's view is that the calculation of compensation due by the Authority to the Partner on termination for Authority default as described in Approach 2 above **does not influence the statistical treatment.***

### 12.3 Authority voluntary termination compensation

The compensation due by the Authority on its voluntary termination of the PPP contract is typically the same as that due on termination for Authority default (see Theme 12.2).

#### ***Eurostat's comments***

*Eurostat's view is that the calculation of compensation due on voluntary termination made on the basis of Theme 12.2 **does not influence the statistical treatment**. In the absence of contractual provision for compensation on Authority voluntary termination, further analysis (e.g. of the underlying law and jurisprudence in the relevant jurisdiction) would be required to determine the amount of compensation to which the Partner may be entitled and how this would align with the Rules and Eurostat's views stated elsewhere in the Guide.*

### 12.4 Force majeure termination compensation

The compensation payable by the Authority to the Partner following termination of the PPP contract for force majeure will typically recognise the fact that termination has occurred through circumstances outside either party's control. As such, the most common approach is to compensate the Partner with an amount that covers:

- the amount of senior debt outstanding at the date of termination (including accrued interest and breakage costs);
- the amount of equity and subordinated debt actually contributed by investors (but not loss of future return and usually net of amounts of return already received by the investors); and
- payments due to third parties (such as sub-contractor breakage costs and redundancy payments).

It is the lack of compensation for investors' loss of return that typically distinguishes this from compensation due on Authority default and Authority voluntary termination (reflecting the "no-fault" nature of force majeure events).

A minority of PPP contracts, however, assimilate force majeure events with other events for which the risk lies with the Authority (e.g. Authority default).

### **Eurostat's comments**

*Eurostat's view is that the "no-fault" approach to calculating compensation on termination for force majeure described above **does not influence the statistical treatment**. The definition of force majeure itself may, however, influence the statistical treatment (see Theme 6).*

*An approach that calculates compensation on termination for force majeure on the same basis as compensation on termination for Authority default or Authority voluntary termination **does influence the statistical treatment** and is an issue of MODERATE importance.*

## **12.5 Uninsurability termination compensation**

Compensation payable where the Authority has elected to terminate the PPP contract due to a risk becoming uninsurable is typically calculated on the same basis as compensation on termination for force majeure.

In some PPP contracts, this is also the basis for calculating the amount payable if the Authority later terminates the contract on the occurrence of the uninsurable risk.

### **Eurostat's comments**

*Eurostat's view is that the approaches described above **do not influence the statistical treatment**. However, the underlying uninsurability provisions themselves may influence the statistical treatment (see Theme 9.4).*

## **12.6 Payment of compensation**

Compensation will usually be payable by the Authority in a lump sum within a specified period after the termination date.

In some PPP contracts the Authority has the right to opt to pay some or all of the compensation in instalments. Usually any right to pay in instalments will not exist on voluntary termination by the Authority or on termination for Authority default.

### **Eurostat's comments**

*Eurostat's view is that the mechanism and timing for payment of compensation on early termination **does not influence the statistical treatment.***

## **12.7 Partner obligations on termination**

The PPP contract typically contains provisions that require the Partner to co-operate with the Authority to ensure a smooth transition in the hand-over of the construction, operation and maintenance of the asset back to the Authority (or to a third party). These provisions typically include obligations on the Partner to:

- provide information relating to the design, construction and operation of the asset;
- provide information relating to staff and comply with obligations under relevant law;
- vacate the asset (or the site, if during construction) and leave it in an orderly state; and
- transfer the benefit of third party warranties and guarantees relevant to the design, construction and operation of the asset (e.g. third party equipment provider guarantees).

### **Eurostat's comments**

*Eurostat's view is that provisions that impose obligations on the Partner that are of a nature similar to those described above (i.e. are intended to facilitate the transfer of the construction, operation and maintenance of the asset to the Authority or a third party at the end of the PPP contract) **do not influence the statistical treatment.***





# Theme 13 – Expiry of the PPP contract

## 13.1 Expiry date

PPP contracts typically take one of two approaches to defining the date on which the contract expires:

- Some expire on a date that is a fixed period of time from the date of financial close (i.e. the overall duration of the PPP contract is fixed); and
- Others expire on a date that is a fixed period from the date on which the asset becomes operational (i.e. the Operational Phase is fixed).

### ***Eurostat's comments***

*Eurostat's view is that the approaches to defining a PPP contract's expiry date described above **do not influence the statistical treatment.***

## 13.2 Allocation of the asset on expiry

On the majority of PPP projects, the Authority takes responsibility for the asset on expiry of the PPP contract and no payment for the asset is due by the Authority to the Partner. This position may be stated expressly in the PPP contract, although it is more typically implied by the simple fact that the Partner's rights and obligations in relation to the asset come to an end when the contract expires.

In rare cases, the Authority takes responsibility for the asset on expiry of the PPP contract and makes a payment for the asset to the Partner. The circumstances in which this is most likely to occur are where the Partner's investment and lifecycle costs are not forecast to be recoverable through the revenues it is entitled to receive during the period of the PPP contract.

In other rare cases, legal ownership of the site and the asset is transferred to the Partner and retained by it when the PPP contract expires. In these cases, the Authority may have the right to extend the PPP contract and/or purchase the asset. However, in the absence of those rights being exercised, the relationship between the Authority and the Partner comes to an end on expiry of the contract and the Authority has no further rights or control in relation to the asset.

#### **Eurostat's comments**

*Eurostat's view is that provisions (express or implied) that allocate the asset to the Authority on expiry (with or without payment for the asset being due by the Authority to the Partner) **do not influence the statistical treatment if:***

- *there is evidence that the Partner's forecast investment and lifecycle costs will be recovered through the revenues it will receive throughout the period of the PPP contract; and*
- *the Operational Phase is 10 years or longer.*

*If these conditions are not met, the allocation of the asset to the Authority on expiry without payment **does influence the statistical treatment** and is an issue of MODERATE importance.*

### **13.3 Condition of the asset on expiry**

The PPP contract typically contains provisions by which the Partner takes the risk that, on expiry of the contract, the physical condition of the asset meets a minimum specified standard that is consistent with it having been maintained in accordance with the contract.

The mechanisms by which this is achieved (e.g. the condition required of the asset, the method for assessing its condition, and the consequences of deficiencies in the asset's condition) vary from project to project but, typically:

- The PPP contract requires an independent assessment of the condition of the asset to be carried out several years (usually two to five) before the expiry date;
- From the independent assessment, the parties agree the work needed to bring the asset into the condition required on expiry and an estimate of the cost of that work;

- The Partner is required to carry out the agreed scope of work before the expiry date;
- The Partner may be required to establish a fund or provide a bond or guarantee to cover the estimated cost of the work, which the Authority is entitled to access if the Partner fails to carry out the work by the expiry date; and
- No payment or compensation is due by the Authority to the Partner if the physical condition of the asset exceeds the specified standard.

These provisions do not appear in the rarer PPP contracts which leave responsibility for the asset with the Partner on expiry.

#### **Eurostat's comments**

*Eurostat's view is that, where responsibility for the asset will revert to the Authority on expiry of the PPP contract, the Partner must take the risk that the physical condition of the asset on expiry of the PPP contract meets a standard that is consistent with it having been maintained in accordance with the contract. Failure to transfer this risk to the Partner under the PPP contract **does influence the statistical treatment** and is an issue of HIGH importance.*

*However, the specific mechanism used to allocate this risk to the Partner (e.g. through detailed provisions that align with the typical approach described above, through more general provisions and reliance on breach of contract remedies) **does not influence the statistical treatment**.*

*The fact that a PPP contract makes no provision to compensate the Partner if the condition of the asset on expiry is better than the specified standard **does not influence the statistical treatment**.*

### **13.4 Partner obligations on expiry**

The PPP contract typically contains provisions that require the Partner to co-operate with the Authority to ensure a smooth transition in the hand-over of the operation and maintenance of the asset back to the Authority (or to a third party). These provisions typically include obligations on the Partner to:

- provide information relating to the design, construction and operation of the asset;

- provide information relating to staff and comply with obligations under relevant law; and
- transfer the benefit of third party warranties and guarantees relevant to the design, construction and operation of the asset (e.g. third party equipment provider guarantees).

**Eurostat's comments**

*Eurostat's view is that provisions that impose obligations on the Partner that are of a nature similar to those described above (i.e. are intended to facilitate the transfer of the asset to the Authority or a third party at the end of the PPP contract) **do not influence the statistical treatment.***



## Theme 14 – Financing arrangements

### 14.1 Timing of financial close

On projects where contract signature and financial close occur simultaneously, the PPP contract makes no provision for adjustment to the Operational Payments to reflect the Partner's actual financing costs.

On projects where the PPP contract is signed before financial close, it is common practice for the contract to contain a mechanism that adjusts and fixes the Operational Payments to reflect the underlying financing costs (usually the only variable being the base interest rate) achieved at financial close.

On projects where the PPP contract is signed before financial close and does not contain explicit provision for the impact of financial close, it is often unclear if either party has a right to seek adjustment of the Operational Payments to reflect the underlying financing costs achieved at financial close.

#### ***Eurostat's comments***

*As mentioned in Chapter 1, Eurostat's position is that the statistical treatment is capable of being confirmed only at the point that financial close is achieved. As a result, making provision (or not) in the PPP contract to adjust the Operational Payments to reflect the impact of financial close **does not influence the statistical treatment.***

### 14.2 Interest rate adjustments

The Partner's exposure to movements in interest rates is typically hedged through a long-term interest rate hedging arrangement. In most cases, the hedging arrangement is put in place simultaneously with financial close. However, in some cases, it is not put in place until an early point in the Construction Phase (e.g. once key permits have been awarded).

If contract signature, financial close and hedging do not happen simultaneously, the PPP contract provides for an adjustment to the Operational Payments to reflect the interest rate set through the initial hedging arrangement.

There are some rare examples of projects where the Partner’s exposure to movements in interest rates is not hedged (or is not fully hedged) and the contract provides for the Operational Payments to be adjusted (or partially adjusted) in line with underlying interest rates on a regular basis during the PPP contract.

#### **Eurostat’s comments**

*Eurostat’s view is that provisions for adjusting the Operational Payments to reflect the interest rate set through the initial hedging process (whether at financial close or at a later key milestone during the Construction Phase) **do not influence the statistical treatment**. Provisions for adjusting the Operational Payments to reflect fluctuations in interest rates in any other scenarios however (e.g. where only partial hedging arrangements are in place) **do influence the statistical treatment** and are an issue of HIGH importance.*

### 14.3 Availability of financing

On PPPs, the Partner is responsible for raising the finance required for the project and typically takes the risk of the availability and cost of financing after financial close. There are very rare examples of projects where the Authority has taken or shared this risk (e.g. through provisions for an upward/downward adjustment to the Operational Payments to reflect a change in financing costs following the refinancing of short-term debt arrangements put in place at financial close).

#### **Eurostat’s comments**

*Eurostat’s view is that provisions by which the Authority takes risk on the availability and/or cost of financing after financial close through, for example:*

- *a commitment to provide financing itself; and/or*
- *increases in the Operational Payments to reflect changes in financing conditions or costs put in place at financial close;*

*are to be treated as financing guarantees. Theme 14.4.4 explains how the provision of financing guarantees **does influence the statistical treatment**.*

*In addition, Eurostat's view is that provisions for a decrease in the Operational Payments to reflect a change in financing conditions or costs following the refinancing of short-term debt arrangements put in place at financial close represent an entitlement for the Authority to share in refinancing gains (see Theme 14.6.2 explaining how sharing refinancing gains may influence the statistical treatment).<sup>35</sup>*

#### 14.4 Authority/government participation in financing

The reasons for an Authority to participate in the financing of a project vary from project to project, as do the ways in which it may choose to do so. The most common examples are:

- milestone payments (non-refundable) made to the Partner during or at the end of the Construction Phase (see Theme 14.4.1);
- loans (see Theme 14.4.2);
- equity (see Theme 14.4.3);
- financing guarantees (see Theme 14.4.4); and
- exemptions from liabilities (e.g. corporate tax, value added tax) that the Partner would otherwise incur (see Theme 14.4.5).

Alternatively, or in addition, financing or guarantees in these forms are in some cases provided by government entities other than the Authority or by public entities that are classified for statistical purposes outside the general government sector (see Chapter 2).

##### ***Eurostat's comments***

*Eurostat's view is that a government commitment to the financing of a project in any form and any amount (i.e. taking into account all commitments, such as those described above, provided by the Authority or other government entities) **does influence the statistical treatment** as follows:*

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<sup>35</sup> MGDD 2016 Chapter VI.4.3.3 paragraph 60 refers to exceptional situations where, in the context of market disruption (e.g. credit crunch), government commitments to the majority of a PPP's financing could be made without an impact on the statistical treatment. Eurostat's view is that these exceptional situations should not put the Authority at risk in respect of the cost or conditions of any financing put in place after the market conditions return to normal (i.e. this risk should be taken by the Partner). Given the approach that is typically taken to financing PPPs, it is therefore unlikely that these exceptions will be relevant in practice.

- *If a government commitment of financing or any other support amounts to 50% or more of the capital expenditure to be incurred for the construction of the asset, the PPP is automatically recorded ON BALANCE SHEET for government;*
- *A government commitment of financing or any other support that amounts to less than 50% but more than one third of the capital expenditure to be incurred for the construction of the asset is an issue of VERY HIGH importance to the statistical treatment;*
- *A government commitment of financing or any other support that amounts to one third or less but more than 10% of the capital expenditure to be incurred for the construction of the asset is an issue of HIGH importance to the statistical treatment; and*
- *A government commitment of financing or any other support that amounts to 10% or less of the capital expenditure to be incurred for the construction of the asset is an issue of MODERATE importance to the statistical treatment.*

*In considering the influence of government financing on the statistical treatment the following points must be noted:*

- *Financing or funding from international entities resulting from inter-governmental agreements, such as EU funds, is excluded from the analysis of financing contributions (irrespective of whether it is the Partner or a government entity that is the beneficiary of such financing or funding);*
- *Financing from the EIB is considered to be financing from the private sector;*
- *Financing by a public entity classified outside the general government sector (e.g. a national public bank classified as a public corporation) is considered to be government financing if the public entity is considered by Eurostat to be acting on behalf of or on an express or implied instruction of government in connection with the project (see comments on the statistical sector classification of the Partner in Chapter 2);*
- *Government's total financing commitment must be considered by looking in aggregate at all forms of commitments it has made across the project (see Themes 14.4.1 to 14.4.4 and 14.5); and*
- *An adjustment must be made to the amount of any loan provided by government to reflect the risk profile of the loan. In the case of debt that is fully subordinated (i.e. the highest risk debt) the amount of debt must be*

*adjusted by a multiplier of 2.5. In the case of debt that is on a par with senior debt (i.e. the lowest risk debt) no adjustment is necessary. In the case of debt that falls between subordinated and senior debt, a reasoned analysis must be applied in determining a multiplier between 1 and 2.5 that reflects the risk it carries relative to the other forms of debt.*

#### 14.4.1 Milestone or other lump-sum payments

The Authority (or other government entities) may be required to make the following types of payment to the Partner:

- a significant payment shortly after the PPP contract is signed, the purpose of that payment being to meet the Partner’s bidding and initial mobilisation costs;
- a single or series of payments during or at the end of the Construction Phase (usually linked to the achievement of defined milestones in the construction of the asset); or
- a single or series of payments during the Operational Phase that do not align with the general principle of payments by the Authority to the Partner under the PPP contract being proportional to the availability or use of the asset (e.g. payments to cover significant lifecycle maintenance costs at the time they are incurred).

The purpose of milestone payments is typically to reduce the amount of financing that the Partner needs to raise for the project or to enable the Partner to make early repayment of some of its financing.

#### **Eurostat’s comments**

*Eurostat’s view is that the amount of milestone payments (of the types described above) that government is committed to make **does influence the statistical treatment** (as referred to in Theme 14.4). However, the profile and timing of any such payments **do not influence the statistical treatment**.*

#### 14.4.2 Loans

There is no “typical” approach as to the amount, terms and conditions on which the Authority (or other government entities) provides loans to the Partner.

**Eurostat's comments**

*Eurostat's view is that the amount of any loans committed by government **does influence the statistical treatment** (as referred to in Theme 14.4). Any rights of control that the Authority (or government) has over the Partner through the terms and conditions of loans may be relevant in determining the sector classification of the Partner and therefore whether the project falls within Eurostat's definition of a PPP (see comments in Chapter 2).*

**14.4.3 Equity**

In some PPP projects, the Authority (or other government entities) holds an equity stake in the Partner. The equity is typically provided through a combination of pure equity (i.e. share capital) and shareholder loans (i.e. subordinated debt). The pure equity is typically a negligible amount in the overall financing structure (e.g. 2%). The pure equity and subordinated debt are typically held by the same parties.

**Eurostat's comments**

*Eurostat's view is that, in the scenario described above, the amount of any equity provided by government constitutes government financing and therefore **does influence the statistical treatment** (as referred to in Theme 14.4). Equity carries the same weighting as subordinated debt for the purposes of the statistical treatment.*

*In addition, any rights that the Authority (or government) has to a share in the profits of the Partner **do influence the statistical treatment** (see Theme 15.1).*

*Any rights of control that the Authority (or government) has over the Partner through its share in the equity are relevant in determining the sector classification of the Partner and therefore whether the project falls within Eurostat's definition of a PPP (see comments in Chapter 2).*

**14.4.4 Financing Guarantees**

On some projects, government guarantees are given to third party debt or equity providers in order for the project to attract financing or benefit from a lower cost of financing.

The terms of such guarantees (which may or may not be separate legal documents from the PPP contracts themselves) vary significantly from project to project. Typically the

Partner will be required to indemnify government for any payments that government makes under the guarantee.

#### **Eurostat's comments**

*Eurostat's view is that any amount of the Partner's debt that is guaranteed by government **does influence the statistical treatment** (see Theme 14.4).*

*The amount of the guarantee must be adjusted to reflect the risk profile of the underlying debt/guarantee instrument (e.g. the multiplier applied to the underlying debt must also be applied to the guarantee, as mentioned above).*

### **14.5 Other forms of Authority/government support**

Other forms of financial support provided by the Authority (or any other government entity) can include minimum revenue guarantees or, on projects with demand-based payment mechanisms, minimum demand guarantees. These types of support are sometimes included in the payment mechanism itself (see Theme 4).

A guarantee of the performance of some or all of the Authority's obligations under the PPP contract is sometimes given by another entity of government on projects where there is concern about the Authority's ability to perform throughout the contract (e.g. a guarantee of its payment obligations is sometimes given where there are concerns about the Authority's credit-worthiness).

#### **Eurostat's comments**

*As already mentioned in Theme 4.10.3, Eurostat's view is that government support in the form of minimum revenue guarantees or minimum demand guarantees (whether as a specific undertaking or in the payment mechanism) **does influence the statistical treatment** and automatically leads to the PPP being ON BALANCE SHEET for government.*

*Eurostat's view is that government support in the form of a guarantee that is limited to the performance of the Authority's own contractual obligations **does not influence the statistical treatment**.*

## 14.6 Refinancing

The PPP contract usually contains provisions dealing with the situation where the Partner wishes to refinance the original financing package that it put in place at financial close. These provisions typically:

- define the Partner’s right to proceed with a refinancing with or without the approval of the Authority (see Theme 14.6.1); and
- set out the Authority’s right to share in any financial gains that result from a refinancing (see Theme 14.6.2).

### 14.6.1 Authority approval to refinance

The PPP contract typically takes one of the following approaches to Authority approval of a proposed refinancing:

- the Authority can withhold its approval on any grounds;
- the Authority cannot unreasonably withhold or delay its approval;
- the Authority can withhold its approval only if the proposed refinancing would have an adverse effect on the performance of the PPP contract or would increase the Authority’s liabilities on termination of the PPP contract;
- the Authority’s approval is not required but the Authority has the right to audit the refinancing in order to determine its share of any refinancing gain (where applicable); and
- the Authority’s approval is not required.

In PPP contracts where the Authority’s approval to proceed with a refinancing is not required, it is likely that new financing terms put in place on a refinancing will not be reflected automatically in the termination compensation provisions. This means that, in practice, the Partner will not proceed without approval from the Authority and confirmation that the new financing terms will be used as the basis for calculating compensation on early termination.

In some PPP contracts, the Authority has the right to require the Partner to investigate opportunities for and/or to proceed with a refinancing.

### **Eurostat's comments**

*Eurostat's views on the approaches described above are as follows:*

- *A right for the Authority to withhold its approval to a proposed refinancing **does not influence the statistical treatment if** its approval cannot be withheld or delayed unreasonably or if the grounds on which it can withhold its approval are limited to circumstances where the refinancing would have an adverse impact on the Authority (e.g. an increase in the Authority's potential liabilities on early termination) or on the performance of the project. Where this is not the case, the issue is of HIGH importance to the statistical treatment;*
- *A right for the Partner to proceed with any refinancing without the Authority's approval **does influence the statistical treatment if** the effect of this is that the Authority's liabilities under the PPP contract could increase without its prior consent. Where this is the case, the issue is of HIGH importance to the statistical treatment;*
- *A right for the Authority to require the Partner to investigate opportunities for refinancing during the PPP contract **does influence the statistical treatment if** the Authority has a right to require the Partner to proceed with a refinancing (see below); and*
- *A right for the Authority to require the Partner to proceed with a refinancing **does influence the statistical treatment** and automatically leads to the PPP being ON BALANCE SHEET for government.*

#### 14.6.2 Refinancing gains

Refinancing gains arise through improvements in the terms of finance available for the project, and most PPP contracts provide that the Authority is entitled to share in such gains.

The Authority's share is usually specified as a fixed percentage or fixed percentages of the gain (with the Authority's percentage share varying according to the size of the gain).

In some PPP contracts, the refinancing gain is calculated on the assumption that the project is performing as forecast at financial close.

Typically the Authority will be entitled to receive its share of the gain in the form of a lump-sum payment, an adjustment to the Operational Payments or a combination of both (depending on the nature and the timing of the gain).

**Eurostat's comments**

Eurostat's view is that there are two different approaches to refinancing gain sharing that **do not influence the statistical treatment**:

- The first approach is where the PPP contract states that the Authority is entitled to the share of any refinancing gain that results from identifiable actions of government. This approach is intended to allow the Authority to share in a refinancing gain to the extent that an action of government has led to improved terms of finance becoming available for the project. An example would be Authority (or government) action that improves the Authority's credit rating, causing the financing market to reconsider the project's risk profile and offer more favourable finance terms. The Authority simply giving its approval to the Partner proceeding with a refinancing (e.g. where the Authority's approval is required because the refinancing gain would increase its termination liabilities) is not, in Eurostat's view, a specific action of government that would entitle the Authority to a share of the refinancing gain; and
- The second approach is where the PPP contract states that the Authority is entitled to a specified share (no greater than one third) of any refinancing gain. Under this approach, no assessment is made of whether the refinancing gain results from the actions of the Authority or the Partner or other factors. Under this approach, specifying that the Authority is entitled to a share of more than one third of any refinancing gains automatically leads to the PPP being ON BALANCE SHEET for government.

Eurostat's view is that the PPP contract may adopt either one of the two approaches described above. Any provisions that attempt to combine the two approaches or that adopt any alternative approach to refinancing gain sharing automatically lead to the PPP being ON BALANCE SHEET for government.

In addition, Eurostat's view is that:

- The Authority having no right to share in refinancing gains **does not influence the statistical treatment**;
- Calculating the refinancing gain on the assumption that the Partner's performance is as forecast at financial close **does not influence the statistical treatment**; and

- *The mechanism by which the Authority receives its share of a refinancing gain **does not influence the statistical treatment.***

## 14.7 Foreign exchange rate risk

On projects where all or part of the financing raised by the Partner is in a different currency from the national currency, the Authority will often take the risk of fluctuations in the relevant exchange rate. This is usually achieved through:

- the Operational Payments being denominated in the national currency, with a periodic adjustment to a proportion of the Operational Payments to reflect the impact of exchange rate fluctuations; or
- a proportion of the Operational Payments being denominated in the currency of the financing.

The proportion of Operational Payments that is either adjusted or denominated in the foreign currency reflects the proportion of the Partner's costs that is incurred in the foreign currency.

### **Eurostat's comments**

*Eurostat's view is that provisions through which the Authority takes the risk of exchange rate fluctuations (as described above) **do not influence the statistical treatment.***

## 14.8 Lenders' step-in rights

PPPs typically include an agreement between the Authority and the lenders that the lenders have a right to step in and attempt to rectify Partner defaults that would otherwise trigger the Authority's right to terminate the PPP contract early.

On stepping-in the lenders are usually permitted to exercise the rights of the Partner under the PPP contract but are also required to take on the Partner's liabilities under the PPP contract.

Related to this:

- Some PPP contracts make provision for the Authority and lenders to agree the extent of the Partner's liabilities that have accrued before step-in, and in so doing crystallise the lenders' liabilities to the Authority; and

- Some PPP contracts give non-financial relief for the consequences of breaches committed before step-in (e.g. deductions for unavailability before step-in are applied to the Operational Payments but the deductions do not count for the purposes of triggering early termination of the contract).

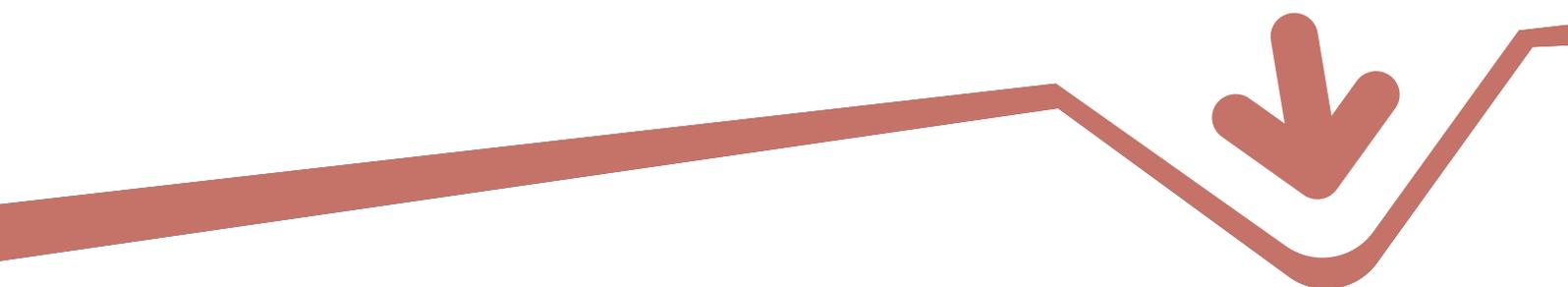
The lenders' step-in rights usually include the right to appoint other entities as temporary or permanent substitutes for the defaulting Partner, subject to the Authority's approval.

In some jurisdictions, lenders' step-in rights exist under law. In all jurisdictions, even if step-in rights are provided for in the contract or law, the lenders typically have the ability to take over the Partner's business by enforcing "security rights" that they have over the Partner's shares.

#### **Eurostat's comments**

*Eurostat's view is that provisions for lenders' step-in rights (in a contract between the Authority and the lenders, or in law, or in lenders' security arrangements over the Partner's shares) **do influence the statistical treatment** if the exercise of those lenders' rights changes the Authorities' rights or liabilities under the PPP contract before, during or after step-in. Where this is the case, the issue is of MODERATE importance to the statistical treatment. Provisions that allow the Authority and lenders to agree and fix the pre-step-in liabilities **do not influence the statistical treatment**.*

*Provisions that disregard, for the purpose of applying early termination triggers, the performance of the Partner before step-in but still preserve its financial liabilities **do not influence the statistical treatment**.*



# Theme 15 – Government influence

## 15.1 Authority share in the ownership of the Partner

On a minority of projects, the Authority (and/or other government entities) has a share in the ownership of the Partner. Across these projects, the Authority ownership arrangements vary (e.g. including the size of ownership share and the rights that attach to that share). However, some common features include:

- The Authority (or government) takes a minority share (ranging from 10% to 30%);
- The Authority (or government) has a right to appoint a director to the Partner's board;
- The Authority (or government) has rights to vote/veto certain decisions of the Partner, either through specific rights in the shareholders' agreement and/or through general company law; and
- The Authority's (or government's) shares carry a right to receive dividends.

### **Eurostat's comments**

*If the Authority's (or government's) share in the ownership of the Partner leads to a statistical classification of the Partner to the general government sector, the project is not considered to be a PPP by Eurostat and is on balance sheet for government (see Chapter 2).*

*Even where it is not sufficient to lead to the statistical classification of the Partner to the general government sector, an Authority's (or government's) share in the ownership of the Partner **does influence the statistical treatment** in two ways described below.*

*Firstly, the amount invested by the Authority in the shares of the Partner is considered to be government financing (see Theme 14.4).*

Secondly, any entitlement to the Partner's profits is considered to be Authority (or government) reward from the asset (see Chapter 1) and **does influence the statistical treatment** as follows:

- An entitlement to a share of 50% or more of the Partner's profit automatically leads to the PPP being ON BALANCE SHEET for government;
- An entitlement to a share of less than 50% but more than one third of the Partner's profit is of VERY HIGH importance to the statistical treatment;
- An entitlement to a share one third or less but more than 20% of the Partner's profit is of HIGH importance to the statistical treatment; and
- An entitlement to a share of 20% or less but more than 10% of the Partner's profit is of MODERATE importance to the statistical treatment.

An entitlement to a share of 10% or less of the Partner's profit **does not influence the statistical treatment**.

As stated in Chapter 2, if a public entity classified outside general government, acting on behalf of or on an express or implied instruction of government, takes a share in the ownership of the Partner, its share will be considered to be held by government. Likewise, as stated in the introduction to this Chapter, if a public entity classified outside general government has a share in the ownership of the Partner and has a specific arrangement to transfer any profit it makes from that share to a government entity, that profit will be considered to be government reward from the project.

## 15.2 Authority rights of approval

Most PPP contracts specify various actions that the Partner cannot take without the Authority's approval. These actions typically include:

- changing its name, corporate constitution or tax domicile;
- carrying out any business that is not related to the project;
- changing key personnel involved in delivering the project;
- changing, terminating or entering into new key sub-contracts;
- granting the lenders "security rights" over its assets;
- refinancing (see Theme 14.6);

- changing the terms and conditions of staff transferring from the Authority to the Partner; and
- selecting an insurer for the insurances required under the PPP contract.

Most PPP contracts also require the Partner to obtain the Authority's approval if it wishes to make any changes to its owners/shareholders. The strength of the Authority's approval rights varies from project to project, but it is common for them to be stronger in the early years of the PPP contract. For example, the Authority's approval may be required for any proposed change in ownership during the Construction Phase and for a period of between two to five years after construction is complete, and thereafter only for:

- transfers of ownership from those that have another role on the project in addition to being owners/shareholders (e.g. as construction contractor or service provider); and/or
- transfers to third parties involved in businesses that raise public policy concerns (e.g. the tobacco industry).

In a minority of PPP contracts, the Authority's approval is required for each and every change in ownership during the period of the contract.

#### **Eurostat's comments**

*Eurostat's view is that the Authority rights of approval described above **do not influence the statistical treatment**. However, for refinancing approvals, see Theme 14.6.*

### **15.3 Authority step-in rights**

The PPP contract will typically include provisions that allow the Authority to step in and take over the delivery of the project from the Partner on a temporary basis in circumstances where:

- it is in the public interest for the Authority to do so (e.g. because of health and safety concerns, issues of national security, or other reasons connected to the Authority's public duties); and/or
- the Partner is in default of its obligations under the PPP contract.

The Authority's rights are usually limited both in terms of the action it can take and the period for which it can take it. In other words, it has the right to do what is needed, for the time period that is needed, to address the underlying reason for the step-in and continue

the performance of the PPP contract. The Authority has to give the Partner (and sometimes also the lenders) prior notice of its intention to step in.

Some PPP contracts require the Authority to continue to pay the Partner the full Operational Payments during the period of step-in, but allow the Authority to deduct any step-in costs that it incurs if it has stepped-in because of the Partner's poor performance.

In some jurisdictions (or in some specific sectors within jurisdictions) the Authority's right to intervene in the delivery of the PPP contract exists as a matter of law. The law will usually also address any claim that the Partner has for costs and/or losses that it incurs as a result of such intervention.

#### **Eurostat's comments**

*Eurostat's view is that provisions that allow the Authority to step in and take over delivery of the project from the Partner (either on specific grounds specified in the contract or general grounds specified in law) **do not influence the statistical treatment.***

*An obligation on the Authority to continue to pay the Operational Payments in full during the period of step-in **does not influence the statistical treatment if:***

- deductions for unavailability and/or poor service performance up to the date that the Authority steps in and after the date that the Authority steps out are applied to the Operational Payments as envisaged for the normal operation of the contract; and*
- the Authority is entitled to recover its step-in costs from the Partner if the Authority has stepped in because of the Partner's poor performance.*

*Where either of these conditions is not met, the issue is of MODERATE importance to the statistical treatment.*

## **15.4 Caps on Partner profit or revenues**

Some PPP contracts contain provisions that cap the amount of profit that the Partner can make from the PPP. The cap can be expressed, for example, as a monetary value or a return on equity. Usually these provisions require the Partner to pay the Authority (or wider government) the amount of any profit that exceeds the cap.

Some PPP contracts with demand-based Operational Payments indirectly cap the Partner's profit by imposing caps on the revenues that the Partner can generate. These PPP contracts do not necessarily envisage any excess being paid to the Authority (or wider government). An example is where demand-based Operational Payments are "banded" and the unit price for the top band is set at zero (see Theme 4.10.2).

**Eurostat's comments**

*Eurostat's view is that any provision that imposes a cap on the Partner's profit **does influence the statistical treatment** and automatically leads to the PPP being ON BALANCE SHEET for government.*

*Similarly, any cap on revenues in a contract with demand-based Operational Payments **does influence the statistical treatment** and automatically leads to the PPP being ON BALANCE SHEET for government (see Theme 4.10.2).*

*Eurostat considers provisions that link the PPP contract's expiry to the Partner having generated a specific amount of revenue or profit to be akin to a cap on Partner revenue or profit, which **does influence the statistical treatment** and would automatically lead to the PPP being ON BALANCE SHEET for government.*





# Theme 16 – Miscellaneous provisions

## 16.1 Dispute resolution procedure

The approach taken to resolution of disputes between the Authority and the Partner varies from contract to contract, depending on the processes available in the relevant jurisdiction and the Authority's broader policies on public contracts. Typically, final determination of disputes will be referred to local and/or national courts or to arbitration.

Most PPP contracts provide the opportunity for some form of alternative dispute resolution process (e.g. mediation) to be followed before resorting to a court or arbitration process.

### ***Eurostat's comments***

*Eurostat's view is that the procedure for resolution of disputes between the parties **does not influence the statistical treatment.***

## 16.2 Information and confidentiality

Most PPP contracts contain provisions that deal with:

- information relating to the project that the parties are required to share with each other;
- information relating to the project that the parties are entitled to share with third parties; and
- information relating to the project that must be kept confidential.

### ***Eurostat's comments***

*Eurostat's view is that provisions in the PPP contract that deal with obligations relating to information and confidentiality **do not influence the statistical treatment.***

### 16.3 Compliance with law

Most PPP contracts impose an express obligation on each party to perform the contract in accordance with relevant laws, good industry practice, etc.

#### ***Eurostat's comments***

*Eurostat's view is that general provisions in the PPP contract that require the parties to comply with law, good industry practice, etc. **do not influence the statistical treatment.***

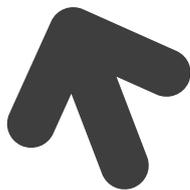
### 16.4 Restrictions on assignment (transfer) of the PPP contract

Most PPP contracts impose an absolute prohibition on the Partner assigning or transferring the contract to any third party without the Authority's prior agreement.

Some PPP contracts mirror this prohibition in the case of assignation or transfer of the PPP contract by the Authority (i.e. the Authority must obtain the Partner's prior agreement), but many PPP contracts give the Authority more flexibility (e.g. in the case of assignations or transfers to the Authority's successors or other public authorities in a re-structuring or reorganisation).

#### ***Eurostat's comments***

*Eurostat's view is that provisions that restrict (either absolutely or conditionally) the parties' rights to assign or transfer the PPP contract to third parties **do not influence the statistical treatment.***



# Chapter 4 – Concluding the Statistical Treatment Assessment

## Overview

Chapter 4 summarises the methodology that Eurostat uses in practice to reach a conclusion on the statistical treatment of a PPP, assuming that the PPP contract uses the typical provisions described in Chapter 3.<sup>36</sup>

It is important that Chapter 4 is not used on its own as a tool for concluding the statistical treatment assessment of a specific PPP project. As Chapter 4 is based on the typical provisions described in Chapter 3, users must bear in mind the limitations and qualifications stated in the introduction to the Guide and at the beginning of Chapter 3.

Eurostat's methodology for the assessment of the statistical treatment of a PPP is based on three main steps:

- identifying the issues that typically influence the statistical treatment;
- analysing the significance of the issues that influence the statistical treatment; and
- concluding the statistical treatment assessment.

## Step 1: identifying the issues that typically influence the statistical treatment

The first step is to identify all the provisions of the relevant PPP contract (and related documents and underlying law) that influence the statistical treatment and to list these according to their category of importance (i.e. ON BALANCE SHEET, VERY HIGH, HIGH or

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<sup>36</sup> Chapter 4 applies only if the project falls within Eurostat's own definition of a PPP (see Chapter 2).

MODERATE). For easy reference, the typical PPP contract provisions identified in Chapter 3 that influence the statistical treatment are listed and categorised in the table in the Annex to the Guide.

If this step identifies no provisions that influence the statistical treatment, it is reasonable to assume that the PPP is off balance sheet for government. In this case, steps 2 and 3 below do not apply.

If this step identifies one or more automatic ON BALANCE SHEET provisions, the PPP is on balance sheet for government and steps 2 and 3 below do not apply.

If this step identifies no automatic ON BALANCE SHEET provisions but one or more issues of VERY HIGH, HIGH, or MODERATE importance, steps 2 and 3 below apply.

## **Step 2: analysing the significance of the issues that influence the statistical treatment**

The second step is to analyse the degree to which each of the influential provisions identified at step 1 has an impact on the economic substance of the project.

The aim of this analysis is to “sense check” whether the categorisation of issues identified at step 1 is appropriate or whether an adjustment to the categorisation should be made given the facts and circumstances of the relevant project. The analysis needs to be done in the spirit of the views expressed by Eurostat in Chapter 3. In some cases, a quantitative assessment of the actual or potential impact of a provision may be possible and may be considered by Eurostat to be relevant to this analysis. The outcome of this analysis might, for example, be to re-categorise a HIGH importance provision identified under step 1 as a MODERATE importance provision.

It is important to note that, under step 2:

- Eurostat will not re-categorise a VERY HIGH importance provision as HIGH or MODERATE or re-categorise a HIGH or MODERATE importance provision as VERY HIGH;

- Eurostat will not re-categorise a provision where its importance to the statistical treatment (as stated in Chapter 3) is based on a specified proportion or percentage;<sup>37</sup> and
- In extreme cases, Eurostat may re-categorise a HIGH<sup>38</sup> importance provision as ON BALANCE SHEET for government.

The following examples illustrate how step 2 may be applied by Eurostat in practice:

- Chapter 3 states that a grace period for deductions that exceeds six months is categorised as an issue of MODERATE importance (see Theme 4.7.2). The economic impact of a grace period of eight months is, of course, very different from the impact of a grace period of two years. While, when applying step 2, it would likely be appropriate to maintain a MODERATE categorisation for an eight-month grace period, it is likely that a two-year grace period would be re-categorised as HIGH; and
- Chapter 3 states that compensation event provisions that do not meet the conditions stated in Theme 6.1 are categorised as an issue of HIGH importance. It is possible that, on a specific project, provisions that do not meet these conditions could be re-categorised as MODERATE (e.g. in the case of compensation for an event that is foreseeable but that has a very low likelihood of occurrence and a very low likely economic impact). It is also possible that, on a specific project, provisions would not meet these conditions to such a significant degree that the issue would be re-categorised as leading to an ON BALANCE SHEET treatment. This could for example be the case of a compensation event that covers macro-economic conditions or is foreseeable or controllable by the Partner, to such extent that the Partner cannot be considered to be taking risk on the price/quality/timetable of the construction of the asset.

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37 Examples include: government equity with a right to a share of more than **one third** of the Partner's profit is of VERY HIGH importance; a forecast that government will receive third party revenues of **5% or more but less than 20%** of payments under the PPP contract is of MODERATE importance.

38 Chapter 3 identifies only two VERY HIGH importance provisions (see Themes 14.4 and 15.1). Given that these are both based on specified proportions neither would be re-categorised as ON BALANCE SHEET for government.

### Step 3: concluding the statistical treatment assessment

Once all influential provisions have been identified (step 1) and their importance (i.e. VERY HIGH, HIGH, MODERATE) has been analysed (step 2), a conclusion on the statistical treatment of the relevant PPP can be reached.

Given that the individual facts and circumstances of PPP projects vary widely, it would be inappropriate to use a purely quantitative/scoring approach to conclude the statistical treatment assessment. However, Eurostat is of the view that the following guidelines should help in reaching a conclusion.

According to Eurostat, there would be a strong presumption that the PPP is off balance sheet for government if, after step 2, it has:

- no more than one VERY HIGH importance provision, no HIGH importance provisions and no more than two MODERATE importance provisions; or
- no VERY HIGH importance provisions, no more than two HIGH importance provisions and no more than one MODERATE importance provision; or
- no VERY HIGH importance provisions, no more than one HIGH importance provision and no more than four MODERATE importance provisions; or
- no VERY HIGH importance provisions, no HIGH importance provisions and no more than seven MODERATE importance provisions.

If a PPP has a combination of VERY HIGH, HIGH and/or MODERATE provisions that does not fall within one of the thresholds listed above, there is a strong likelihood that Eurostat will conclude that the project is on balance sheet for government.

In cases where the thresholds listed above are not met but only by a small margin, Eurostat may consider the analysis to be “inconclusive” and, in order to reach a conclusion on the statistical treatment, will assess the degree of control that the Authority has over the asset during its economic life. The assessment of control will include (but will not be limited to) consideration of:

- the extent to which the Authority determines the design and quality of the asset and its maintenance and operation; and
- if the asset has a residual economic life after the date that the PPP contract expires, the extent to which the Authority will enjoy the benefit of the asset after that date.

## **Annex:** Table of Typical PPP Contract Provisions that Influence the Statistical Treatment

The table below lists the typical PPP provisions that, as stated in Chapter 3, do influence the statistical treatment. It also identifies whether a provision is one that automatically leads to the PPP being ON BALANCE SHEET for government or whether it is of VERY HIGH, HIGH or MODERATE importance to the statistical treatment. It can be used as a reference point for step 1 in the methodology for reaching a conclusion on the statistical treatment (see Chapter 4). However, it is important to note that applying step 2 of the methodology (see Chapter 4) may result in provisions being re-categorised from those specified in the table below.

This table should not be used on its own as a tool for determining the statistical treatment of a PPP. It must be read in conjunction with the text in Chapter 3 which explains the particular features of the typical PPP contract provisions that influence the statistical treatment. At the same time, it is important that users recognise the limitations inherent in Chapter 3 itself (i.e. that while Chapter 3 contains an overview of a comprehensive set of provisions in typical PPP contracts it cannot, by its nature, take into account all of the facts, circumstances and provisions of individual PPPs).

Annex: Table of Typical PPP Contract Provisions that Influence the Statistical Treatment

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
<b>Theme 2: Design and construction of the asset</b>					
Responsibility for design: issues with Authority taking risk as described in Theme 2.1	2.1			✓	
Construction completion: issues with completion criteria as described in Theme 2.3	2.3			✓	
Construction completion: issues with phased completion and phased Operational Payments as described in Theme 2.3	2.3			✓	
Snagging works: issues described in Theme 2.4	2.4			✓	
Reimbursement of Authority costs: issues described in Theme 2.5	2.5			✓	
<b>Theme 3: Operation and maintenance of the asset</b>					
Responsibility for operation and maintenance: issues with Authority responsibility for maintenance as described in Theme 3.1	3.1			✓	
Operation and maintenance standards: issues described in Theme 3.2	3.2	✓			
Maintenance plan: issues with Authority approval reducing Partner risk as described in Theme 3.3	3.3			✓	
Maintenance plan: issues with requiring Partner to incur costs as described in Theme 3.3	3.3				✓

Annex: Table of Typical PPP Contract Provisions that Influence the Statistical Treatment

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
Maintenance funds: issues with the Authority taking risk on a maintenance fund as described in Theme 3.4	3.4			✓	
Maintenance fund: issues with the Authority taking reward on a maintenance fund as described in Theme 3.4	3.4	✓			
Maintenance: issues with the Authority taking benefit of maintenance cost savings as described in Theme 3.4	3.4	✓			
<b>Theme 4: The Payment Mechanism</b>					
Adjustments for unavailability and poor service performance: issues described in Theme 4.2	4.2	✓			
Defining availability / unavailability: provisions that fail to define availability / unavailability as described in Theme 4.3	4.3	✓			
Measuring availability and performance: issue described in Theme 4.5	4.5			✓	
Unavailability deductions: failure to apply the principle of proportionality as described in Theme 4.6.1	4.6.1	✓			
Unavailability deductions: inappropriate use of area and time weightings as described in Theme 4.6.1	4.6.1			✓	
Rectification periods: provision for unreasonably long repair or rectification periods as described in Theme 4.6.3	4.6.3				✓

Annex: Table of Typical PPP Contract Provisions that Influence the Statistical Treatment

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
Unavailable but used: provisions that reduce deductions by more than 50% as described in Theme 4.6.6	4.6.6				✓
Excusing causes: issues with provisions for excusing causes as described in Theme 4.7.1	4.7.1			✓	
Grace periods: provision for unreasonably long grace periods as described in Theme 4.7.2	4.7.2				✓
Tolerances / de minimis exceptions: provision for tolerances with a non-negligible impact as described in Theme 4.7.3	4.7.3			✓	
Caps on deductions: provisions that undermine the proportionality principle as described in Theme 4.7.4	4.7.4	✓			
Adjustments for use: provision for downward adjustment of Operational Payments as described in Theme 4.8	4.8			✓	
Banding of demand-based Operational Payments: highest-use band unit price set at zero or close to it as described in Theme 4.10.2	4.10.2	✓			
Banding of demand-based Operational Payments: issues with upper-use and lower-use bands as described in Theme 4.10.2	4.10.2			✓	
Minimum use or minimum revenue guarantees as described in Themes 4.10.2 and 4.10.3	4.10.2 and 4.10.3	✓			

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
<b>Theme 5: Other payment arrangements</b>					
Commencement of Operational Payments: provision for payments to commence before completion of the asset as described in Theme 5.1	5.1	✓			
Benchmarking and market testing: provisions that apply to maintenance services as described in Theme 5.2	5.2	✓			
Benchmarking and market testing: provisions that do not meet the second and third conditions described in Theme 5.2	5.2			✓	
Utilities costs: issues with provisions for risk sharing as described in Theme 5.3	5.3				✓
Indexation: issues described in Theme 5.4	5.4				✓
Third party revenues: Authority revenues equal or exceed the 20% threshold as described in Theme 5.5	5.5			✓	
Third party revenues: Authority revenues equal or exceed the 5% threshold as described in Theme 5.5	5.5				✓
Payment mechanism reviews designed to change the risk and reward allocation under the PPP contract	5.10	<b>Specific analysis required</b>			

Annex: Table of Typical PPP Contract Provisions that Influence the Statistical Treatment

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
<b>Theme 6: Compensation, relief and force majeure events</b>					
Scope and nature of events: provisions that do not meet the conditions described in Theme 6.1	6.1			✓	
Quantifying compensation/relief: provisions that do not meet the conditions described in Theme 6.1.4	6.1.4			✓	
Compensation, relief and force majeure events that are dealt with through public law provisions as described in Theme 6.2	6.2	<b>Specific analysis required</b>			
<b>Theme 7: Changes to the PPP contract</b>					
Authority changes: issues with Partner compensation/relief as described in Theme 7.1	7.1			✓	
Partner changes: obligation on the Authority to accept changes as described in Theme 7.2	7.2			✓	
<b>Theme 8: Changes in law</b>					
Change in law: issues with Authority taking change in law risk as described in Theme 8	8				✓

Annex: Table of Typical PPP Contract Provisions that Influence the Statistical Treatment

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
<b>Theme 9: Insurance</b>					
Reinstatement of the asset: provision for an economic reinstatement test as described in Theme 9.2	9.2			✓	
Insurance costs: provisions for the Authority to take/share risk/benefit of insurance cost changes that do not meet the conditions described in Theme 9.3	9.3			✓	
Uninsurability: issues identified in Theme 9.4	9.4			✓	
<b>Theme 10: Warranties and indemnities</b>					
Warranties: warranties that relate to risks and rewards as described in Theme 10.1	10.1	Specific analysis required			
Indemnities given by the Partner: limits or exclusions on indemnities that do not meet the conditions described in Theme 10.2	10.2			✓	
Indemnities given by the Authority: indemnities for risks other than those described in Theme 10.3	10.3			✓	
<b>Theme 11: Early termination of the PPP contract</b>					
Authority default termination: issues with Authority default termination triggers as described in Theme 11.2	11.2			✓	

Annex: Table of Typical PPP Contract Provisions that Influence the Statistical Treatment

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
<b>Theme 12: Compensation on early termination</b>					
Provisions that do not preserve pre-termination liabilities as described in Theme 12	12			✓	
Partner default termination compensation: issues with no contract provision as described in Approach 2 of Theme 12.1	12.1	<b>Specific analysis required</b>			
Partner default termination compensation: re-tendering provisions that do not take into account the Partner's performance of the project as described in Approach 3 in Theme 12.1 (first condition listed)	12.1	✓			
Partner default termination compensation: issues with the methodology for estimating the market value of the contract not meeting the conditions described in Approach 3 in Theme 12.1 (second condition listed)	12.1	✓			
Partner default compensation: provisions that do not meet the remaining conditions listed in Approach 3 in Theme 12.1	12.1			✓	
Partner default termination compensation: provisions that do not take into account the Partner's performance of the project as described in Approach 4 in Theme 12.1	12.1	✓			

Annex: Table of Typical PPP Contract Provisions that Influence the Statistical Treatment

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
Partner default termination compensation: provisions that only partially take into account the Partner's performance of the project as described in Approach 4 in Theme 12.1	12.1			✓	
Force majeure termination compensation: issue of compensation calculation as described in Theme 12.4	12.4				✓
<b>Theme 13: Expiry of the PPP contract</b>					
Allocation of the asset on expiry: allocation of the asset to the Authority (with or without payment) where the conditions described in Theme 13.2 are not met	13.2				✓
Condition of the asset on expiry: issue described in Theme 13.3	13.3			✓	
<b>Theme 14: Financing arrangements</b>					
Interest rate adjustments: issues described in Theme 14.2	14.2			✓	
Authority/government financing at or above the 50% threshold as described in Theme 14.4	14.4	✓			
Authority/government financing above the one third threshold as described in Theme 14.4	14.4		✓		
Authority/government financing above the 10% threshold as described in Theme 14.4	14.4			✓	

Annex: Table of Typical PPP Contract Provisions that Influence the Statistical Treatment

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
Authority/government financing up to (and including) the 10% threshold as described in Theme 14.4	14.4				✓
Provision of minimum revenue/minimum use guarantees as described in Theme 14.5	14.5	✓			
Refinancing: Authority's right to withhold approval for proposed refinancing on unlimited grounds as described in Theme 14.6.1	14.6.1			✓	
Refinancing: provisions that allow a refinancing to increase the Authority's liabilities under the PPP contract without its consent as described in Theme 14.6.1	14.6.1			✓	
Refinancing: a right for the Authority to require the Partner to proceed with a refinancing as described in Theme 14.6.1	14.6.1	✓			
Refinancing: gain-sharing provisions that do not align with either approach as described in Theme 14.6.2	14.6.2	✓			
Lenders' step-in rights: issues with liabilities as described in Theme 14.8	14.8				✓

Annex: Table of Typical PPP Contract Provisions that Influence the Statistical Treatment

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
<b>Theme 15: Government influence</b>					
Authority/government entitlement to a share of profit at or above the 50% threshold as described in Theme 15.1	15.1	✓			
Authority/government entitlement to a share of profit above the one third threshold as described in Theme 15.1	15.1		✓		
Authority/government entitlement to a share of profit above the 20% threshold (up to and including a one third share) as described in Theme 15.1	15.1			✓	
Authority/government entitlement to a share of profit above the 10% threshold (up to and including 20%) as described in Theme 15.1	15.1				✓
Authority step-in rights: issues described in Theme 15.3	15.3				✓
Caps on Partner profit or revenue: provisions that cap Partner profit or revenue as described in Theme 15.4	15.4	✓			





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