The Latest in Delivery Methods in Canada
Design Build, Public-Private Partnerships and More…

Donald G. Pierce, Q.C.
Ira J. Berg
Cristina Alaimo

Goodmans LLP
THE LATEST ON DELIVERY METHODS IN CANADA
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The New Wave of P3s in Canada ~ The Experience to Date

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The New Wave of P3s in Canada ~ The Experience to Date

1. INTRODUCTION

Traditionally, the public-private partnership (P3) contractual model has been considered and used by the government public sector in seeking to provide basic services essential to the functioning of the economy. Through contract models in which the private sector invests in the design, construction, financing and operation of infrastructure facilities, the private partner consortium takes on many of the project risks and roles historically assumed by governments. Combining the strengths of the private sector with contributions from the public sector is meant to produce cost-effective facilities that lack funding from traditional sources, such as taxation. Private sector financial investment is usually needed to obtain the benefits of the project, given that the government will not likely be able to pay a return on the investment until the project succeeds in providing anticipated benefits.

The purpose behind P3s is to achieve better “value for money” for taxpayers. Proponents must demonstrate the most efficient use of resources to meet or exceed service delivery goals, while protecting the public interest. Value arises from the reality that the private sector is often more efficient in performing all aspects of the design, building, operation and maintenance of an asset. As such, while fiscal and debt management concerns are important reasons for partnering with the private sector, the biggest benefits of P3s in the long-term will likely arise from increased efficiencies (value for money), accelerated development of new infrastructure, and the acquisition of expertise that can be exported to other jurisdictions. Also, if the private sector has any involvement in a related industry, there is potential for economies of scale.

Further, the public-private relationship is mutually beneficial: since the private partner shoulders a large proportion of the project risk in exchange for a return, the government is guaranteed a commitment to economic efficiency, while fulfilling it’s mandate to serve the public interest.

2 Ibid. at 6.
3 Ibid. at 2.
II. THE EXPERIENCE WITH P3S TO DATE

The Canadian experience is moving from the historical privatization of government-owned entities toward increasing private sector involvement at a much earlier stage in the development of projects for the public benefit. The trend is not unwarranted: Canadian governments are up against increasing demands to ensure the availability of high quality services to support a growing population, and are expected to provide them in a timely and cost-effective manner. At the same time, they are facing pressure to reduce debt, lower taxes, and allocate resources to key areas of government responsibility that cannot be handled by the private sector.\(^4\)

The use of P3s in Canada is now well established at the federal level and in several provinces, notably Ontario, British Columbia, New Brunswick, and Nova Scotia. Currently, P3s are playing a bigger role in building and capital projects across all areas of government, such as transportation, communications, power generation, energy delivery, water and wastewater facilities, waste disposal, education and health facilities, and public service buildings. Recently, its popularity has led to P3s being used more frequently in smaller-scale developments across Canada, such as schools, courthouses, and hospitals.\(^5\)

However, despite their advantages, Canada still boasts relatively few P3s compared to other jurisdictions, notably the UK, Australia, New Zealand and the US. Canadians have been, for the most part, unfamiliar with the idea of essential services being provided by the private sector. In many cases, that lack of familiarity creates a certain degree of discomfort and suspicion. There is concern from the general population that this is just the beginning of privatization of essential services. Opposition from labour unions, particularly the Canadian Union of Public Employees, is a force to contend with. By way of example, in the hospital arena, public sector unions are concerned that the “for-profit” hospitals result in increased costs, user fees, bed and staffing cuts. The profit motive is perceived to create an irrevocably ‘divergent interest’ to long-term value for the public sector. As well, there is a concern that people who were traditionally covered by collective bargaining agreements will be replaced by cheaper, non-union labour. These concerns, however, can be addressed through concession agreements whereby the deals are structured to guarantee the terms of existing collective agreements. As evidenced by the protest marches


\(^5\) Ibid.
against the proposed hospital P3s at William Osler Health Centre and the Royal Ottawa Hospital, there is a need for leadership from political and public service leaders and private proponents to communicate the benefits, and clarify the misconceptions, relating to the P3 approach.

Further, if one is to successfully bring about change in traditional government procurement practices, legislation and regulations at all levels need to be reviewed so as to enable, not prohibit, the P3 approach when it produces ‘value for money.’\(^6\) In fact, in the UK, the government has ordered that all new infrastructure spending must take the P3 route unless a compelling case can be made against it.

### 2.1 Examples of P3 Initiatives in Canada

Governments at all levels in Canada lag behind other OECD countries in adopting the P3 model and its fundamentally new financing philosophy. Although Canadian firms participate in international consortia, there is not enough domestic P3 activity to allow them to build export credibility. That said, there have been a number of projects in Canada which have been completed or awarded on the P3 model, including the 407ETR toll highway in Toronto, the Confederation Bridge linking PEI to New Brunswick, Cobequid Pass and Highway 104 in Nova Scotia, water projects in Dartmouth, Winnipeg, Moncton, and in the Regional Municipality of York, the Hamilton-Wentworth airport, and the TeraNet land registry system in Ontario.\(^7\) The most recent wave includes plans for a privately owned full-service hospital in Brampton.

There are indications that Canada is ready to forge ahead with the P3 model. Through the SuperBuild initiative, Ontario has committed $10 billion over five years to meet the province’s infrastructure challenges.

**William Osler Health Centres (Ontario)**

The William Osler Health Centre group\(^8\) is comprised of three hospital sites, namely, Brampton, Etobicoke and Georgetown. In November, 2001, it was announced that the Centre would undertake the first pilot project for a public-private partnership to design, build and finance hospital expansion projects

\(^6\) *Ibid.*

\(^7\) *Ibid.*

\(^8\) For more information and updates regarding the William Osler Health Centre, visit the Redevelopment section on the following website: <http://www.williamoslerhc.on.ca/Redevelopment/news_main.htm>.
at a total cost of $73.7 million ($65 million for construction and renovations, and $8.7 million for new equipment and furnishings at all three locations).

The government also entertained a proposal for a new hospital at the Brampton site, and on May 29, 2002, issued a Request for Qualifications (RFQ) to design, build, finance, own, operate, property manage and maintain the new 608 bed hospital that will serve the Brampton community, and become Canada’s first privately owned full-service acute care hospital. The $350 million hospital will be financed, built, owned and maintained by a private-sector company, which will then lease most of the space back to the William Osler Health Centre group in Brampton. The new hospital will continue to be a public hospital governed by the Canada Health Act and Public Hospitals’ Act.

The hospital P3 models currently relate to the building only, so that the hospital Board of Directors continue to be accountable to the public for health care management, and the delivery of patient care services continues to be the responsibility of the William Osler Health Centres. In order to ensure the project outcomes are of the highest quality, the specifications and performance standards were designed in consultation with the Ministry of Health, SuperBuild Corporation, physicians, nurses, and staff. Cost savings will be realized by incorporating the most sophisticated materials and processes into the design of the new Brampton hospital, creating a more functional and operational environment upon completion (scheduled for Spring 2005).

**Royal Ottawa Hospital (Ottawa, Ontario)**

The Royal Ottawa Hospital is scheduled for re-development in Summer 2003. The hospital, a century-old psychiatric teaching hospital of the University of Ottawa, will be replaced by a new state-of-the-art, $100 million mental health facility, which will be designed, constructed and owned by a private sector partner. It will be the first teaching hospital in Canada to be privately built and operated. The qualifying consortia, comprising of a number of corporations, will be responsible for either the design, construction, financing, operation or maintenance aspects of the project, and will be required to submit an innovative proposal on who they intend to provide for and manage new facilities under a long term partnership with the Royal Ottawa Health Care Group.

Approval for the new psychiatric hospital was received on December 7, 2001, after two years of discussion with government on new programs and funding formulas to meet the new mandate of the hospital and its desperate need for new facilities. It will be the second public-private hospital partnership announced in the province of Ontario.
Although the new facility will be privately developed and owned, funding of the core activity for the hospital - the delivery of mental health services - will remain the responsibility of the Ministry of Health, the hospital Board and Administration. This means that all health services will still be provided within the provisions of the publicly-funded health system. The re-development is a joint project of the Ontario SuperBuild Corporation and the Ministry of Health and Long Term Care. Completion of the project is anticipated for Fall 2004.

The Academic Ambulatory Care Centre (Vancouver, British Columbia)

On October 19, 2002, the Vancouver Coastal Health Authority issued a press release stating that it will enter into a public-private partnership to build the province's first P3 project involving the construction and management of a large, integrated health care facility. The innovative care centre will provide integrated health services, and enhance medical training for medical students. The new facility will coordinate ambulatory patient care services, along with medical education, physician practice offices, research and related commercial/retail activities. It will also accommodate teaching functions, with lecture and seminar rooms, a library and clinical teaching rooms integrated with specialized hospital clinics and private specialist offices.

It is anticipated that the successful private-sector partner will assume responsibility for the financing, design, construction and operation of the building, while the health authority and the University of British Columbia faculty of medicine will ensure that the services within the centre provide appropriate teaching and clinical services. The project is expected to be completed in the spring of 2005, at a cost of $90 million.

Fraser Valley Health Centre and Eastern Fraser Valley Cancer Centre (Abbotsford, British Columbia)

The Fraser Health Authority ("FHA") and the BC Cancer Agency ("BCCA") submitted a proposal to the Ministry of Health Services in June 2000 to jointly develop a new health care facility on lands owned by the then Regional Hospital District in Abbotsford, BC, 50 kilometres east of Vancouver. The first part of the facility is planned as a 300-bed acute-care hospital, intended as a replacement for the

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10 More information relating to this project can be found at the Fraser Health Authority website under the ‘Initiatives’ link: <http://www.fraserhealth.ca/INITIATIVES/AHCC/Default.htm>.
Matsqui-Sumas-Abbotsford Hospital located in Abbotsford. The second part is planned as a new cancer treatment facility that will form part of the provincial network operated by the B.C. Cancer Agency. The new facility, to be named the Abbotsford Hospital and Cancer Centre, will provide services to the local health area as well as specialized programs to the residents of the entire Fraser Valley Health Region.\textsuperscript{11}

In late June 2000, the FHA and BCCA received approval and planning funds from the Ministry of Health Services to proceed with planning for these facilities. It is being presented as the first major project to be developed under the BC government’s new P3 capital program, Partnerships BC. Construction is scheduled to commence in 2004 and the doors to the new Abbotsford Hospital and Cancer Centre are scheduled to open in 2007.

**Vancouver Convention Centre (Vancouver, British Columbia)**

On June 19, 2002, the Government of British Columbia announced the selected private partner proponent to negotiate a P3 to expand the Vancouver Convention & Exhibition Centre.\textsuperscript{12} Expansion is estimated to generate over $1.5 billion in economic benefits to industry and all levels of government, as well as over 6,700 person-years of employment during construction. The Vancouver Convention Centre Expansion Project Ltd., a provincially owned corporation, is responsible for delivering the completed expansion in 2008.\textsuperscript{13}

**Downtown Commercial-Law Court Project (Chilliwack, British Columbia)**

The Downtown Commercial Law Court Project has led to a new complex which includes three distinct developments: the *Provincial Courthouse*, a 32,000 square foot facility which houses five court rooms; *Chilliwack Five Corners Office Building Complex*, a new 18,000 square foot, three-story commercial/retail building; and a city-owned millennium clock tower and law courts plaza.\textsuperscript{14} The project

\textsuperscript{11} Health Services Group, Business Case, “The Fraser Valley Health Centre and The Eastern Fraser Valley Cancer Centre” (8 February 2001), online: Health Services Group <http://www.healthservices.gov.bc.ca/cpa/publications/fvhr_bcase.pdf>.


\textsuperscript{13} Vancouver Convention & Exhibition Centre, "What's New: New Developments" (17 February 2003), online: <http://www.vanconex.com/whats_new/new_dev.html>.

was initiated by the City of Chilliwack who approached the Province of British Columbia to pursue avenues for joint funding and possible building partnerships. The City and the Province together decided to lease 15,000 square feet of the commercial/retail space with the remaining 3,000 square feet being offered to local businesses at fair market value. The project was expected to cost in excess of $10 million. The courts opened officially on May 31, 2002.

**NAV CANADA**

In 1996, the Canadian Government entered into an agreement with NAV CANADA, a private non-share capital corporation, to own and operate Canada’s civil air navigation system. This made Canada the first country in the world to have a privately owned, operated, and financed civil air navigation system.\(^{15}\) The federal Government is the regulator. NAV CANADA’s Board includes representatives of the aviation industry, the federal government and the unions as well as the company itself, ensuring broad input into how the system is run and what fees are charged. Operating one of the safest and most efficient air navigation systems in the world, NAV CANADA is an example of a P3 at it’s best.

**Highway 407 Express Toll Route (Toronto, Ontario)**

The Highway 407 Express Toll Route (407ETR), the world’s first electronic toll road, is a 69-kilometre highway north of Toronto that involved sequential public-private partnerships. It was financed and built by the Canadian Highways International Corporation (CHIC), a consortium of four construction companies, in partnership with the government of Ontario. The 407ETR is an example of a P3 that no longer relies on funding from the government. In 1999, the Province of Ontario sold the toll road to a consortium called 407 International Inc. for $3 billion. The consortium has a 99-year lease on the land and owns the road and all related structures. When the lease expires, these assets will be transferred back to the government.

The Highway 407 Project is a prime example of the synergies that can be produced when Government and the private sector work together in providing public services. Together with NAV CANADA, both projects have produced safety records comparable with any in the world.

2.2 The Future of Public-Private Initiatives in Canada

There are great opportunities to continue and expand public-private initiatives in Canada in order to maximize the efficiencies of public services. All that is required is a constant cash flow that can be securitized to finance the project, as well as heightened political support. To date, the approach to P3 has been fragmented. However, the pressure to provide for the continued well-being of the public is opening the door for governments to seek alternative ways of making ends meet.

Notably, Ontario has established itself as the leader in the P3 arena, largely by its creation of the Ontario SuperBuild Corporation, a Provincial government organization that works with the Ministries to develop capital projects through public-private partnerships. No doubt, fiscal pressures are the driving factor. In British Columbia, the creation of Partnerships BC has signalled an invitation to private companies to participate in the design, construction and operation of new capital projects. The reason is obvious – “BC government … is embracing public-private partnerships as a method of making the math work.” While revenues have been falling, debt has been rising and the demand for public projects has been growing at a rapid rate.

The following are some areas where much action is anticipated to take place in the way of major public-private initiatives. In general, the forms of public-private initiatives are unlimited and can work under any situation where there is a secure, constant income stream flowing from the project. The income stream may have to be supplemented by the government either by a front-end top-up or by a subsidy, but the general deal can be easily worked out. The possibilities are only limited by the creativity of the politicians, lawyers, accountants and/or businesses involved in formulating them.

Health Care

This continues to be a highly controversial area for public-private partnerships, but one where the public debate is generating a clearer understanding of the options and benefits. Overall, the level of partnership initiatives in the hospital arena has increased significantly in Canada over the past few years, due in large part to submissions that the health care system in its current form is economically unsustainable. As mentioned above, it was recently announced that two major health care projects in Ontario would shift from the traditional procurement format to a form of P3, and there is every indication that the exploration and application of P3 by the Government in this area is going to continue.
**Water/Sewage Treatment Plants**

There are two such public-private initiatives already in the Province of Ontario, in the York and Halton regions, and it is anticipated that many more will emerge. Water and wastewater systems are almost exclusively delivered in Canada by the municipal sector through public utility commissions or through their own operations.

In May 2000, Walkerton, Ontario, was victim to the single largest water-related crisis in Canada as a result of e-coli entering the water system. Seven residents of Walkerton died, and hundreds were ill. The impact of that crisis is the subject of the Walkerton Inquiry, set up to examine the contamination of the water supply in Walkerton, Ontario. The event, along with a similar event in North Battleford, British Columbia, have given rise to discussions centred around two issues: the under-funding of infrastructure related to Water and to a lesser extent the treatment of water; and the Public-Private debate over who can deliver these services more effectively.17

Canada’s first major drinking water public-private partnership between the City of Moncton and USF Canada and the Hardman Group continues to run well and continues to set high quality standards for other private and public systems. This is an example of a smaller-scale project which was designed, financed, built, operated and maintained through a P3 initiative. The facility was built in just 18 months, and is designed to meet or exceed all Canadian drinking water quality criteria. Most importantly, the partnership enabled the City of Moncton to assume ownership of the facility without having to make any up-front capital investment, and significant savings were passed directly to the City through the use of USF’s Trident water filtration process that reduced the facility’s required size by 40 percent.18

**Schools**

Currently, school boards are under great financial strain. The easiest form of initiative to alleviate the strain, and one that frees up capital quickly, is a sale leaseback arrangement for existing schools. There are various opportunities for new schools to be developed through public-private


17 Supra note 15 at 11.

initiatives. The developer can either build the school and lease it to the school board, school boards can sell the land to the developer who will build and lease back the building to the school board, or the school boards can simply enter into concession agreements and have private management companies manage the schools.

Through SuperBuild, partnerships with the private and public sectors have produced a $2.6 billion investment in campuses across the province of Ontario.\(^{19}\) Examples include:

- **University of Western Ontario** – the 45,000-square-foot London Biotechnology Incubator (LBI) is being built at the university’s research park, due in part to a SuperBuild investment of $5 million. The total partnership value for this project adds up to $11.5 million.\(^{20}\) Further, the University will receive another $16 million in SuperBuild funding for its Biomedical Sciences Building Upgrade Project.\(^{21}\)

- **Sheridan College** – the College’s Centre for Animation and Emerging Technologies is adding 400 more students, 15 classrooms and 33 laboratories. SuperBuild is investing $7.2 million as part of the overall $33.2 million project. Partnership contributions from the private sector and the college total $26 million.\(^{22}\)

- **Queen’s University** – a SuperBuild investment of almost $40 million enabled Queen’s University in Kingston to build the new Chernoff Hall chemistry building (completed Fall of 2002) and to renovate and expand the teaching space for the school of business. Supplemeting the SuperBuild investment, Queen’s raised $39 million in private investment.


contributions from industry and other partners. Queen’s contributed $11.2 million to the project.  

- York University – A SuperBuild investment of almost $31 million will enable York University to construct a new building for its Schulich School of Business and to renovate its existing business school to accommodate the Faculty of Education. The project will also permit the business school to implement a new International Bachelor of Business Administration (IBBA) program. Partnership contributions from the private sector and the University total approximately $28 million.

Public Housing

Public Housing is another prime opportunity for a sale leaseback type of situation or perhaps outright sales with restrictions as to tenant mixes and/or subsidies.

### III. BENEFITS AND PITFALLS OF P3S

The value of the P3 approach derives in part from the design-build-operate opportunity, with cost and schedule savings due to efficiency in having a single team contracted for design and construction. Further, the knowledge that one is expected to operate the service it has built, means that there is pressure to build it right, which should naturally lead to reduced operating and maintenance costs.

Public-private initiatives are delivered through one of the various alternate delivery methods, such as design-build, design-build-operate, or design-build-operate-finance among them. The features of these delivery systems, along with the advantages and disadvantages that are unique to each, are chronicled in the latter part of this paper. It is worth noting that the benefits and pitfalls of P3s also tend to be reflected by the delivery method chosen to carry out the P3 initiative. As such, the following section can be supplemented by reference to the advantages and disadvantages of the various project delivery methods.

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3.1 Benefits of P3s

- P3s deliver on time and on budget. More infrastructure can be created sooner (i.e. by a margin of 20 to 25 years), through private finance, and with greater cost effectiveness. Traditional public sector procurement still suffers from delay, cost overrun and compromise on initially planned requirements.\(^{25}\) Partnerships facilitate the co-ordination of efforts and systems and typically provide a broader base of expertise. There is more intense scrutiny of costs, benefits, relevance and payback, which leads to the selection of the best proponents for the job. Importantly, partners who are free from bureaucratic “red tape” and not subject to political intervention may be able to operate more flexibly and effectively than a government department or agency.\(^{26}\)

- Public-private partnerships typically involve the formal identification, quantification, and allocation among the partners of the risks associated with the partnership project.\(^{27}\) Efficiency is served by allocating specific risks, such as construction risks and financing risks, to the party best able to manage them. Where private sector partners assume the risk, there will be incentives for better performance, especially if payment is to commence only with the initiation of the actual provision of service, or is conditional on the quality of the service provided. The private party can also be held accountable if they fail to meet their contractual obligations. Further, there is a focus on maintaining high standards if the private party hopes to do future projects.

- A bigger private sector role in fields traditionally dominated by government can pave the way for stronger economic growth, and may provide access for economies of scale or scope.

- Governments borrow at a lower cost than the private sector. However, properly structured, a P3 can be less expensive than the government-run alternative when the total costs (including financing, operating and capital costs) over the life of the project are considered.

- A private-sector partner in a P3 may have incentives to attract secondary users, thereby stimulating more usage of the partnership capital assets. Multiple users may mean multiple income streams.


\(^{27}\) Ibid. at 13.
therefore, greater profitability to a private-sector partner or lower lease costs (if that is the arrangement in place) to the public-sector partner. Also, if the sale of Highway 407 to a private sector purchaser is any indication of future trends, P3s can create an asset which is capable of being sold by the government at a considerable profit.

- In terms of using P3s for hospital infrastructure, patients benefit from these partnerships since the partnership model sets a framework for funding the capital needed for the new infrastructure, without the government giving up responsibility for the clinical provision of services. The private-sector responsibility for building, financing and property management of hospitals means that physicians can focus on quality care, and still get a new facility much sooner than through the traditional procurement methods. If things progress as planned, state-of-the-art facilities will set a gold standard for health care, and help the hospitals retain the best and attract the brightest clinicians and researchers.

### 3.2 Pitfalls of P3s

- It is inevitable that when dealing with governments, often there will be a political agenda. While there have been some great successes with respect to P3 development in Canada, the experience is mixed because government can change its mind once the process has started. The experience with the Pearson International Airport in Ontario, is one such example. The Pearson airport deal was a very large public-private initiative entered into with a private consortium by one government and subsequently reneged on by a later government. Not only was the contract cancelled, but the new government proceeded to pass legislation limiting the claim that the private consortium could make for compensation against it. In short, this amounted to expropriation without compensation, and caused complicated legal proceedings. This fear of subsequent governments cancelling contracts is a very real concern to the private sector, and may act to deter future investors from engaging in P3 activity.

- It may be important to plan projects within a government’s term in office. An example of the vulnerability of P3s is Halifax’s City Council, which undertook the construction of four wastewater treatment plants in 1998. Before the project was completed, the city held an election in which the mayor lost to a council member who pledged to terminate the project. Also, the province of Nova

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Scotia abandoned a P3 project involving the construction of 33 schools. When the Liberal government was defeated in 1999, the new government decided to forgo the $350 million project.  

IV. KEY PROCESS AND LEGAL ISSUES

This section presents selected legal and process issues related to P3s. The division of issues into legal and process issues is for organizational purposes only, and does not imply that legal issues do not have process implications or vice versa.

4.1 Process Issues

Great amounts of thought and planning must go into developing the process that will govern the public-private partnership project. First of all, it is crucial to recognize that there are two distinct worlds that must be addressed when dealing with projects such as these: the business world and the political world.

Creation of a Government Team

The first step and probably the most important is for the government to create a team of experts to run the government side of the project (the “Government Team”). The Government Team’s task is to set up, monitor, and implement the various steps of the process throughout the entire project. The Government Team’s job is to create a process that once established, facilitates the development of a fair business deal while at the same time is, and appears to be, beyond reproach to the outside scrutiny of the public. It is essential that not only must the business deal be fair, it must appear fair to the public who is often very sceptical. Fairness and the appearance of fairness are crucial for the ultimate long-term success of the project, and can only be achieved by the establishment of a fair process.


Who are the players on the Government Team? The team of experts will likely consist of four main groups of consultants: (1) Process Consultants; (2) Legal Consultants; (3) Technical Consultants; and (4) Financial Consultants.

1. The Process Consultant

This role is generally filled by a large accounting/consulting firm and it is their job is to coordinate and steer the Government Team so that all the issues are addressed in a comprehensive and efficient manner. They are essentially the quarterback of the process. They assist in setting the rules, the evaluation criteria, the review process, and the selection process.

2. Legal Consultants

The lawyer on the team is responsible for providing legal advice both on the business transaction and on the process. As such, the lawyer must be experienced in all aspects of the business deal, fully understand the process, and ensure that the process can withstand the most intense public scrutiny. In developing a full understanding of the process, it is then the lawyers job to communicate this process to ensure that all members fully understand the potential pitfalls of certain actions. The lawyer wants to be constantly anticipating future events and constantly encouraging the other members to do so as well. Importantly, the lawyer must also endeavour to draft the documents in an even-handed manner to ensure lender participation, and an easy, quick closing.

3. Technical Consultants

The technical consultants are generally comprised of engineers or other technically trained people whose job it is to review the technical proposals and technical issues that arise in the planning stages, and throughout the process.

4. Financial Consultants

The financial consultant's specific job is to determine the real costs of the various proposals breaking them down into net present values, so that proper analyses can take place.

These four team members must start working together immediately and each member must fully understand the whole process. One of the most consistent themes is that the better the consultants work as a team from the outset and throughout the project, the greater the chance that the project will operate smoothly.
A Well-Defined Process Framework

A properly prepared **Process Framework** is key to ensuring that all the players proceed with the same view to a defined result. The process framework is the internal document that defines the procurement and evaluation process for a particular project. It provides detailed evaluation methodologies and criteria, as well as the forms to be used by evaluation teams in the conduct of their evaluations. It incorporates the RFQ (if any), the RFP, and the project agreement(s) by reference. It is designed to document to unsuccessful prospective proponents and third parties, that the process followed was fair and rationally related to its objectives. Typical contents of a Process Framework include:

- An overview of the entire procurement process for the project;
- Detail on the RFQ process (if it is distinct from the RFP process), including the roles and inter-relationships of the various teams made up of government staff and advisors;
- Detail on the RFP process, including the roles and inter-relationships of the various teams made up of government staff and advisors;
- Detailed RFQ evaluation methodologies and criteria used by the evaluation teams that are based on and consistent with the summary evaluation criteria included in the RFQ, and that therefore do not need to be issued to prospective proponents;
- Detailed RFP evaluation methodologies and criteria used by the evaluation teams that are based on and consistent with summary evaluation criteria included in the RFP, and that therefore do not need to be issued to prospective proponents;
- Provisions relating to confidentiality and conflict of interest.

It is important to understand that the framework developed from the outset can either serve to guide the project to fruition with minimal conflict, or through lack of forward thinking and communication, bog down the process at every turn.

**Development and Application of Evaluation Methodology and Criteria**

The development and application of evaluation methodologies and criteria helps to ensure that the selection of the successful proponent is unbiased and rational. It is generally recommended that government develop detailed evaluation methodologies and criteria in parallel with the development of the Request for Qualification (if any) and the Request for Proposals for the project.
Once the cohesive Government Team is established, they generally work within a framework which incorporates the following four major steps (1) the Request For Qualifications - the RFQ; (2) the Request For Proposals – RFP; (3) the analysis of proposals; and (4) the selection process.

1. The RFQ - The Request for Qualifications

An RFQ is used in a two-stage evaluation process to solicit statements of qualifications from prospective proponents in order to generate a short list of eligible proponents. Typical contents of an RFQ include:

- A detailed description of the opportunity, couched in commercial, rather than legalistic language, as the opportunity should be marketed to prospective proponents in order to generate greater interest and thereby enhance project value;

- A summary disclosure of information related to the opportunity, with references to sources of more detailed information not contained directly within the RFQ, to allow prospective proponents to decide whether the opportunity is suitable to pursue, and if so, with whom they should partner;

- The procurement schedule, including submission deadlines, especially with respect to the RFQ stage if not also with respect to the RFP stage;

- Evaluation criteria and submission requirements in enough detail to provide prospective proponents a reasonable opportunity to prepare a formally and substantially viable and compliant statement of qualifications;

- Legal disclaimers with respect to government’s liability for any inaccuracies in information provided to prospective proponents, with respect to government’s right to amend the RFQ, and with respect to government’s right to reject the statement of qualifications of any or all prospective proponents.

In projects the size of the Highway 407, for example, the Government Team may desire to somehow control the number and quality of companies entitled to bid on the project. From the government’s perspective, they have to determine from the outset exactly what type of private companies they are looking for and, within that type, which ones might be most qualified for the particular jobs. From the private sector's point of view, the issue is: how does your company get on this qualifying list?
From experience, there are two dominant criteria that the government uses to determine who is qualified: (a) experience; and (b) financial capability and stability. There are also some ancillary criteria that vary in weight depending on the type of project and the political/economic climate.

**Experience:** The government is looking to the private sector to provide a certain expertise in developing the project. They want to be assured that only highly qualified, highly experienced companies apply for the jobs. These types of projects are not a great opportunity for a local company with little experience to gain experience at the expense of the government. The government wants to be comfortable that the companies bidding are capable of doing the jobs correctly, and the best assurance is to require experience.

**Financial Capability and Stability:** The financial capability of the private corporations is also very significant due to the relatively large size of the proposed projects. Obviously, the Government wants to retain companies whose balance sheets are proportionate to their responsibilities under the project, including the provision of performance bonds. Once again, this is not a place for start-up companies to hope to make their mark with a huge contract that is disproportionate to their past dealings. Thus, the Government, in striving to minimize problems from the outset, wants assurance that all the potential bidders are experienced and have financial capability to carry out the job.

2. **RFP – Request for Proposals**

An RFP is used to solicit proposals from proponents who have been pre-qualified in an RFQ process, or if there is no RFQ process, it will also include the requirement to provide a statement of qualifications. The RFP is the key document in the process, and outlines what the government wants the private sector to bid on. Typical contents of an RFP include:

- A detailed description of the opportunity, couched in commercial, rather than legalistic language, as the opportunity should still be marketed to proponents in order to generate greater interest and thereby enhance project value, and (for two-stage evaluation) in order to ensure continued interest among prospective proponents so that they do in fact proceed to become proponents;

- A summary disclosure of information related to the opportunity, with references to more detailed sources of information not contained directly within the RFP. The disclosure of information, both within and outside the RFP, is ordinarily more detailed than in an RFQ;

- The procurement schedule, including submission deadlines;
- Evaluation criteria and submission requirements in enough detail to provide proponents a reasonable opportunity to prepare a formally and substantively viable and compliant proposal;

- Legal disclaimers with respect to the government’s liability for any inaccuracies in information provided to proponents, with respect to government’s right to amend the RFP and with respect to government’s right to reject the proposal of any or all proponents.

**Risk Allocation**

Risks should be allocated (item by item) according to the specific circumstances of each project, taking into account the following important considerations:

- It should be allocated to the party best able to manage risk, either through insurance or self-insurance, or through financial or operational risk mitigation strategies;

- It should be clearly allocated prior to the submission of proposals, since vagueness will force proponents to build sizable contingencies into their bid amounts that would not otherwise be incorporated given clear allocation;

- It should be drafted by a team with cross-functional representation. Members of the team should expressly take on the advocacy of the various project stakeholders – one government, another the private partner, and another the private partner’s lenders (if applicable). Other stakeholders, such as affected local governments or affected labour groups, where of sufficient importance to the project, may also have an advocate, but even if not, should be taken into account.

**Changes to Consortia Membership and to Contractors and Sub-contractors**

Government might require restrictions on proponents to ensure that capability requirements are not by-passed through making changes to consortia membership after the capability of the original membership has been assessed to be satisfactory.

It should be noted that the requirement for managerial capability means that restrictions may be imposed on changes to individual people within project organizations holding certain key positions. This helps ensure that highly qualified personnel put forward initially in order to attract selection are not later substituted with less qualified personnel that the government would deem unsatisfactory.
Restrictions may also extend to time-limited restrictions on transfer of equity or other interests in consortia members or in entities consortia members establish for the purposes of certain projects, to the extent that such further restrictions are necessary to achieve the objectives that the restrictions are intended to achieve.

Confidentiality of Information

Confidentiality of information in the procurement process deals with who is to keep what confidential from whom, and in what manner. While there are important reasons to maintain the confidentiality of certain information related to public policy and the protection of proprietary information and intellectual property, these reasons must be counter-balanced against the reasons for disclosing material information related to the infrastructure being procured.

Freedom of information legislation helps define what information the government may keep confidential and what, after defined periods of time, it may not. In order to keep information that it receives from proponents confidential from the public at large, it may be necessary to destroy or return that information at the conclusion of the procurement process so that it cannot at some later date be required to be made available by the government under freedom of information legislation.

Disclosure of Information

Disclosure of information related to the infrastructure being procured, prior to submission of statements of qualifications and proposals, has a bearing on fairness in the procurement process and on project value. However, it must be weighed against competing requirements for confidentiality:

- Fairness in the procurement process, both as between government and proponents, and as between proponents themselves, is served by timely disclosure of identical information to all proponents. By disclosing as much information material to the proposed project as possible, information asymmetries cannot be exploited either by government or by proponents who may have special access to information (perhaps through extensive experience in the region). Moreover, failure to disclose material information may open government to legal liability.

- Project value can be enhanced by detailed disclosure of information, as such disclosure of the structure of the deal renders more definite the assignment of risk and responsibility between government and the private partner, and helps to better quantify the exposure and cost that the allocated risk and responsibility bring. Contingencies incorporated into bid amounts, due to
unclear allocation of risk and responsibility and due to sub-optimal information for the quantification of exposure and cost, can be reduced through increased disclosure.

**Integration of Legal Agreements into Procurement Process**

Legal agreements are the documents which define the deal structure of the project. The manner in which they are incorporated into the procurement process is a key element of procurement management. Five methods are available to integrate legal agreements into the process, listed in order of increasing negotiability of contract terms: forms of agreement issued; forms of agreement issued based on comments from proponents; forms of agreement issued with invitation to comment; forms of agreement issued as basis for negotiation; and no agreements issued.

The two key objectives which can be influenced by the method by which the legal agreements are integrated into the process are value (in particular, the maximization of bid amounts), and fairness (in particular, the establishment of a level playing field across proponents). Value and fairness are achieved by issuing all relevant information to all prospective proponents (at the RFQ stage) and to all proponents (at the RFP stage) in a timely manner, and in a way that does not discriminate between proponents.

Another concern is timely closing. Timely closing is achieved by drafting the legal agreements for a project in an even-handed fashion that takes into account the interests of government, the private partner, and the private partner’s lenders, and by attaching them to the RFP documentation so that bidders and their lenders know exactly what is expected of them. Selection of proponents is usually the first step in what could potentially be a very difficult process. If the government first selects a winner in the process, and then attempts to negotiate the legal agreements, the government has lost its advantage and must work at negotiation in order to ensure that the winner agrees to comply with important legal conditions and requirements. At this point, all other bidders are long gone, and the process has surely been prolonged. The key to attaching all the documents at this early stage is that there is little room for future negotiation. The most that the government may choose to offer in terms of compromise is to put out a draft, invite comments from the proponents, reissue a revised draft incorporation such of those comments as the Government decides in their discretion should form part of the document, and then reissue the document as amended. Once the proponent bids, they are bound to sign those amended forms of agreement.
Restrictions on Competition

To enhance the financial viability and value of a project, cash flow to the project in the form of revenue from operations may be protected through restrictions on competition. What restrictions are available, and their relative impact on project value should be considered. For example: a time limited undertaking on the part of government not to construct, enhance, or expand an infrastructure that competes for the same user population, and not to allow such infrastructure to be constructed, enhanced, or expanded by others.

However, the very fact that government is proceeding by way of a public-private partnership tends to indicate that public sector financing for competing infrastructure is not readily available, and what risk of competition remains tends not to concern either proponents or their lenders. It should also be noted that aside from restrictions on competition, cash flow to a project can be enhanced by providing for ancillary revenue, including revenue from development of real estate adjacent to project land.

Economic Benefits Requirements

Economic benefits requirements, motivated by an intention to promote economic development, are often sought to be, and often are, incorporated into the Request for Qualifications (if any) and Request for Proposals for a project. However, the efficacy of such requirements has been challenged to the point where it may be best for government to make its policy decisions in advance, based on its own analysis, rather than impose this requirement on the bidders.

Economic benefits requirements may include: local employment requirements and employee training requirements; local procurement requirements and supplier development requirements; local management requirements, such as the maintenance of local design and construction management offices and of local operations management offices; domestic ownership requirements; technology transfer requirements, in order to develop export capability; and requirements not directly related to the project, as for example, funding of capital or social projects not related to the subject of the project.

An important option, not to be discounted, is not to impose economic benefits requirements at all, either because the free market is taken to ensure socially optimal outcomes more effectively, or because economic benefits requirements tend not to succeed in securing economic benefits. Any benefits that had been sought to be secured through economic benefits requirements could then be secured, if optimal in context, through win-win arrangements with the successful proponent or other parties outside of the procurement process altogether, or through general programs applicable across the jurisdiction.
4.2 Legal Issues

In order to fully appreciate the legal issues involved in any P3 arrangement, those responsible for making decisions need to fully understand the nature and extent of the asset/business which is the subject of the proposed P3, and the nature of the project option chosen by the government to implement the P3 (i.e. Design-Build etc.). One must ask: have all required planning and other approvals been obtained? Does the government body have all the necessary statutory authority needed to implement the proposed P3? Is the government’s authority flexible enough to accommodate inevitable changes to the proposed deal? Has the Government decided on performance standards, hand back standards, post transaction regulations and controls, and the need for commercial and technical interoperability?

Once the above preliminary matters have been reviewed, certain process issues will need to be considered from a legal perspective. Specifically, one must consider whether the proposed process complies with certain vital requirements, such as: the government’s need for a transparent process; caselaw on the law of tender; International Trade Agreements which apply to the Province (NAFTA and WTO); and Inter-Provincial Trade Agreements which bind the Province (Agreement on Internal Trade (AIT)).

The following is a summary of select legal issues relating to P3s.

Appropriate Legal Structure Including Tax Issues

At the outset of any project the government must decide upon a legal structure that not only best implements its short and long-term interests, but the short and long-term needs of the private sector partner and its lenders. There are a wide range of options that can only be developed once the government decides upon its fundamental requirements for the project in question.

For example, if the project includes a land component, the government will need to make a fundamental decision as to whether it will agree to transfer an outright interest in the lands or whether the government requires that title to the land remain with the government, in which event, the structure of the transaction will need to include a ground lease arrangement. If the government is prepared to sell the land outright, the government will need to control and regulate the building and operation of the project by way of a concession agreement and perhaps by regulation. The private partner will have a significant interest in the legal structure to ensure that it can operate the project properly and at the same time raise the necessary financing.
Also, the government may require that the legal structure provide a tax neutral result, whereas the private sector may desire a structure that avoids or minimizes taxes to the greatest extent possible. GST, Capital Tax, Large Corporations Tax, and Income Tax ramifications need to be considered.

**Form of Ownership**

Public-private initiatives can take numerous possible forms of ownership. The government can do a sale leaseback with the private sector operating the project on a long-term lease basis, the public sector can sell the project outright to private ownership with or without a right of reversion, or the government can enter into some sort of concession agreement where they retain ownership and the private sector simply manages the project. The form chosen raises many issues some of which are similar to those found in the private sector while others are unique to public-private initiatives. Some of the issues that are similar to those in the private sector, and which will not be discussed here, are: capital tax, liability as owner as compared to manager, and appropriation of risk.

Some issues that are particular to public-private initiatives are as follows:

a) Often, government statutes and regulations dictate that the government must own the particular project. This often constrains the types of arrangements that can be created between public and private sectors. However, one must remember that it is usually the same government that made the statutes and regulations and if proper thought is given to the matter well in advance, the Government can change these statutes and/or regulations to allow for the desired form of arrangement. It is great to be King!

b) Capital Cost Allowance - provincial governments do not pay Federal Corporate Tax, but private-sector corporations do. Obviously, it is of great advantage to a private-sector corporation to be able to take capital cost allowance on projects as large as the Highway 407 Project. However, capital cost allowance directly affects the amount of Federal Tax paid by the private sector. As such, the federal government is often very concerned when a provincial public-private initiative works to reduce revenues flowing to the federal government. This issue had to be dealt with in the Highway 407 Project, and the eventual form chosen resulted in a tax neutral situation vis à vis the Federal Tax Payable.

**Independent Agent**

Government must determine if the quality and safety functions exercised in the design, construction, maintenance, rehabilitation and operation phases of the infrastructure development will be
carried out by its own workforce, or by an independent agent. The range of quality and safety functions that can be exercised extend from full design approval at one end, to monitoring work as it is conducted, to inspecting work when it is done, to auditing the project-specific quality and safety processes of the design-builder (and operator, if any) according to ISO or other quality standards.

One possibility is to set up teams that include both government and independent agent representatives. Whatever the respective roles of government and the independent agent are, the nature of the reporting obligations of the independent agent to government, and within government itself, and the identity of the entity that pays for the services of the independent agent (either the private partner or the government), need to be determined. However, an important consideration is that to the extent that roles are assigned exclusively to the agent, the potential for blaming government for quality and safety problems are minimized. Moreover, there is a party other than the government which can be held liable (and for which reason financial capability of candidate agents to satisfy claims should be assessed). The level of detail which the independent agent is required to report to the government can vary. While the government may be used to detailed reporting, the more detail that is reported, the more government can be held responsible for its action or inaction, both politically and legally.

**Extent and Term of Warranties**

If design/construction warranties are to be provided, the requirement for security of the warranty will have to be determined, as well as the particular limitations and qualifications to which the warranty will be subject (e.g., defects covered, duration, and the quantum of recourse that will be available under the warranty). The risk or contingent liability to a developer/constructor of being called under a warranty will almost invariably be included in its pricing for the relevant work. As such, this is a cost-benefit analysis, in that it will be important to balance this cost with the benefit the security or assurance is likely to provide.

If in the design-build-operate or design-build-operate-finance models, the operator has contracted to perform the operation and maintenance of the facility in accordance with prescribed standards on a fixed price basis for a significant term on the basis of the facility as designed and constructed, it is arguable whether warranties for design/construction defects are necessary, as in effect the risk of such defects has been transferred from the designer/contractor to the operator/maintainer.

With respect to whether or not and the extent to which security or other assurances should be provided to “back up” or support the warranty obligations, the relative “net worth” of the developer/contractor giving the warranty should be considered, and an assessment of the risk of defects
arising and the cost to rectify them should be undertaken. Security or assurances could take the form of letters of credit, performance bonds, other surety bonds, parental guarantees, professional errors and omissions insurance and/or a withholding of payments under the expiry of the warranty period and the completion of the warranty work.

**Extent and Type of Surety Bonds (Performance Bonds and Labour and Material Bonds)**

Government must determine if surety bonds will have to be posted by the constructor and/or operator as security for the performance of contractual and payment obligations, and if so, the type of bonds to be provided and their quantum amount. It should be noted that there is a cost to the constructor/operator in providing a surety bond, both as to the fees to be paid, and the security and corporate guarantees that are often required by the sureties.

If the constructor, operator, or guarantor have significant financial worth, so that there is little or no concern as to ultimate redress for a default, the provision of surety bonds may be dispensed with. However, it is generally the case that some form of performance bond and/or labour and material payment bond is provided in large scale infrastructure projects. Since the quantum of the bonds and the financial qualifications of the sureties providing the bonds varies with the circumstances of each project, it is strongly recommended that appropriate expert consultants be retained by government to provide advice as to the required amount of the bonds and the required qualifications of the sureties in the context of the particular circumstances of the project.

**Need for Parental Guarantees**

If the project company is not well capitalized, it is advisable that government require that the obligations of the project company be guaranteed by the members of the consortium, or the parents of such members, who can provide an effective guarantee. In order for government to make a proper decision in selecting the successful proponent and to determine whether or not parental guarantees are necessary, the procurement process should include a process whereby financial information necessary to establish the financial capability and willingness to provide such guarantees, will be available and required as part of the selection process.

**Dispute Resolution Process**

To expeditiously and effectively address disputes between the parties without resort to the courts and time-consuming, expensive litigation, it is advisable that an alternative dispute resolution (ADR)
process be established in contractual agreements. Given that disputes will almost certainly arise in the
course of any project, some form of resolution mechanism in the contract is suggested, although it is very
difficult, if not impossible, to recommend one form of dispute resolution process generally. Often, larger
design-build contracts contain elements of various dispute resolution processes which can be ‘staged’
such that one can outline what happens in the first instance, and then failing that, what next step is to be
taken. Consideration should be given as to how many layers or stages a dispute must go through before it
is referred to binding arbitration or to court.

Important considerations in creating a dispute resolution process in infrastructure contracts
further include: a determination of the experience of the parties with ADR processes (since unless there
is a “buy in” by all parties, there is little likelihood that the process will lead to a successful resolution of
issues); consideration as to the type of disputes that will be subject to ADR; and the qualifications,
expertise, and independence of mediators and arbitrators.

Ownership and Use of Intellectual Property

If new intellectual property is developed or existing intellectual property owned by the successful
proponent is used for a project, government must decide if it or the selected proponent will own the
intellectual property. If the intellectual property is owned by a third party, the most that government can
require is a license agreement for the use of such intellectual property on agreeable terms and conditions.

Since most owners of intellectual property guard their rights very zealously, as part of the
procurement process, sufficient time should be permitted for negotiations for license agreements to be
completed. Also, if the government is paying the developer/contractor/operator for the development of
intellectual property, the best course of action is for the government to own such intellectual property for
which it has paid.

Operating Standards During Term and Handback Standards at End of Term

Government should determine what specific standards should be in place, both during the
operating period and at the end of the term. In some cases, maintenance and rehabilitation frequencies
may (perhaps conveniently on the part of the operator) be such that substantial maintenance and
rehabilitation is required relatively shortly after the transfer of the infrastructure back to the government.
To the extent that they are reasonable, financial analysis of bids should take into account the consequent
cash obligations of the government, especially as they may differ between proponents, in determining the
optimal bid amount across proponents.
Changes to Legal Requirements

Agreement provisions should address cost allocations between government and the private partner resulting from changed legal requirements, should these arise. Only certain types of changes in legal requirements are relevant to this issue. Changes to legal requirements that are related specifically to the type or business of the infrastructure in question are relevant; changes to legal requirements of more general application are not.

For changes to legal requirements which are relevant to this issue, the party that bears the burden of the associated costs needs to be defined. Since the externalization of costs (i.e. passing on costs to users of infrastructure) by government is politically and financially easier under innovative financing and procurement, rather than under conventional financing and procurement, there may be a tendency for government to generate changes to legal requirements with greater impact than it would if it could not externalize the costs. For this reason, it may be optimal to re-internalize those costs to government by allocating them to government under the legal agreements for a project.

To the extent that costs associated with changes to legal requirements are imposed on the operator, then bid amounts will tend to incorporate a risk premium to compensate for the uncertainty as to the extent of those costs. In practice, the risk premium that is incorporated will substantially exceed the benefit that government hopes to receive by allocating those costs away from itself. Therefore, in practice, governments should allocate the burden of the costs associated with changes to legal requirements to itself.

Termination for Convenience or For Cause

To protect the interests of all parties, the original contract agreement should stipulate the quantum of compensation that the government will be required to pay if a contract is terminated for convenience or for cause by government. Given examples at the federal and provincial levels of government of policy shifts leading to changes to or termination of procurement contents, there is a very real concern on the part of the private sector that the government of the day or subsequent governments will re-examine contractual arrangements and exercise contractual termination rights or introduce legislation providing for termination. There is tension between protecting the integrity of the contract, and the asset it represents to the develop/operator and its lender, and the legitimate need of the government to be able to terminate the contract in the event of a material breach (and perhaps without cause) so as to give effect to changing policies and public priorities.
Important considerations with respect to the right to terminate for cause on default

- Is there a significant or upfront or other payment or investment by the private sector for or in connection with the contract? If so, in an effort to maximize “return” to the government and the amount being paid, the right to terminate even for cause should be limited to what would be perceived as the most material default and failure to perform, with longer than usual notice and cure periods. As well, consideration should be given to affording lenders additional notice and cure periods so as to facilitate the financing of the venture by the private sector and to maximize the return to the government.

- Given the legitimate concerns of the private sector and its lenders, what defaults or failure to perform should lead to a drastic consequence of termination? Whether other remedies could be utilized so as to police the agreement without resort to termination should also be considered.

Important considerations with respect to the right to terminate for convenience:

- Insertion of the right to terminate for convenience will cause significant concern to the private sector and its lenders which may have a negative impact on the return to government and/or the pricing of the project by the private sector. This concern can be alleviated, but not entirely eliminated, by providing that on exercise of the right, full compensation will be paid by government to the private sector party and its lenders.

- The political sensitivity of the project and an assessment of whether there is a real likelihood that the government of the day or subsequent governments will change policies so as to adopt a fundamentally different approach to the project should be taken into account. This is a two-edged sword, as the more politically sensitive the project, the more concern the private sector and its lenders will have with the termination for convenience clause; on the other hand, the more politically sensitive the project, the more persuasive the argument for government to have the termination right in order to preserve policy flexibility.

Government Responsibility for Decreased Return Events

Government should expect that the private partner and its lenders will require contractual protection against legislative and regulatory action or inaction that has a material adverse affect on the project, and might be required to indemnify and save harmless the selected proponent and its lenders from any claims or damages. If such an indemnity is not forthcoming, the government can expect that the cost
to raise financing will be significantly higher, thereby increasing the private partners’ costs in bidding on the project.

The Pearson Factor

By way of example, the Pearson Airport deal created great controversy and continues to generate fear in the private sector with respect to large public-private projects. The Pearson airport deal was a very large public-private initiative entered into with a private consortium by one government and subsequently reneged on by a later government. As mentioned previously in this paper, not only was the contract cancelled, but the new government proceeded to pass legislation limiting the claim that the private consortium could make for compensation against the government, which led to a lengthy legal proceeding in order to obtain compensation. This fear of subsequent governments cancelling contracts is a very real concern to the private sector. Arguably, the only way to try to prevent this from happening is to always strive for the following goals with projects such as these:

- **The Appearance of Fairness**

  The project should always be analyzed on a “what would the public think” basis. The test must be that the project is actually fair on its face and the public must perceive it as being fair. At a minimum, the private sector must continually provide full disclosure of all discussions, contracts, and agreements to the public from the outset. Also, there must be an independent decision-making body that is perceived to be independent. There is no use in having an independent decision making-body if the public thinks otherwise. Again, in this political world, perception may not be reality but it is often much more important.

- **The Project Must be Advantageous to the Government and Ultimately the Public**

  The public must be made constantly aware that the project is of great benefit to the public, both in the short-term and long-run. The benefits can be as easily quantified as dollars saved either in the cost of constructing the project and/or in the operation of the project, or demonstrated by improved service to the public, and quicker start-up and completion times. This great benefit must be continually demonstrated and marketed throughout the life of the project. To use the 407 Project as an example, the highway cost less to construct under this public/private initiative than if the public had done it itself. The quality of service is significantly better, and the project took three to five years to construct, whereas a twenty year time frame would be more reasonable if the government were to...
construct. Thus, with results such as these, one would think it would be very difficult for a subsequent government to garner support to cancel the deal.

Again, there does not exist a definitive solution to the Pearson factor, but the risk can be minimized by ensuring that the private party obtains a clear government covenant to pay fair compensation if the contract is not to be continued.

**Rate of Return and Toll Rate Regulations**

In deciding on whether or not to impose rate of return or toll rate regulation on the private partner, government must assess public opinion on the existence and level of toll rates and project financial viability under different regulatory regimes. Whatever form of regulation is put in place, a rigorous financial analysis of the proposed project should be performed prior to procurement so as to confirm that the deal has been structured in a financially viable, and financially optimal, fashion.

**Terms and Requirement of Tri-party Agreement with Lenders**

Lenders to private partners in design-build-operate-finance projects will usually require agreements with the public partner to create rights and protection for the lender, to which government will usually require that the lender assume or cause its assignee to assume all of the obligations of the developer or operator under the project agreements, and may stipulate other appropriate terms and conditions.

On the other side of the coin, in an effort to maximize the value received by government from the private partner and to facilitate financing of the project, the government will have to be prepared to enter into agreements with the lender giving significant additional rights of notice and cure to the lender, as well as monetary protections in the event of relevant action or inaction on the part of the government. However, these agreements must also recognize that a lender may have to accept a certain degree of risk that is present in any private business, and that government may from time to time impose regulations or take action that may adversely affect that business and the revenues to be derived therefrom.

**Drafting of Project Agreements in an Even-handed Fashion to Facilitate Financing and Early Closing**

Project agreements should be drafted by advisors experienced and knowledgeable in the needs and requirements of the private sector and its lenders. It may be advisable to include in the procurement process an opportunity for proponents and their lenders to comment on proposed draft legal agreements.
Experience has also shown that an early closing can be accommodated and met if all of the project agreements, including the schedules attached thereto, are attached to and form part of the RFP process documents.

4.3 General Issues When Dealing With Public-Private Initiatives

There are some general issues, outside of the process, which a lawyer and the clients they act for must be aware of when dealing with public-private initiatives. While some of these issues appear rather obvious, they are not always adequately addressed by the parties concerned.

The Government is a Bureaucracy

For a public-private initiative to work, both sides will have to understand each other’s constraints and make an effort to meet somewhere in the middle. From the government's perspective, they must realize that the private sector often has outside pressures from bankers, shareholders, etc., to which the corporations are accountable to, and unjustified delays by government bureaucracy can cause great stress and financial strain on a corporation. A lawyer representing the government must constantly be educating and encouraging the government to streamline their decision-making processes to get the maximum benefit out of the partnership. At the same time, the private sector must realize that Governments are used to doing things their way and often are very fearful of being rushed through their normal decision-making process. Private corporations working with the Government will enjoy a much healthier relationship with Government if from the outset they understand and plan for this inherent slowness.

Multiple Players

Huge projects usually result in a large number of interested parties having to work very closely together for long periods of time. The private consortium needs to establish a cohesive group of leaders so that decisions can be made by all parties quickly and effectively. The entire group benefits when the private corporations have their most experienced leaders and negotiators at the table when tough issues are being hammered out. It is in everybody's best interest for the companies to ensure that they put their best people in leadership positions at the negotiating table. It is just as crucial that these leaders realize they must form a team with the consortium and work together rather than to branch out according to their individual interests. The private consortium does not want to get bogged down at the internal decision-making stage. When this happens, timelines are generally dragged out and tension increases. The common interest of getting the job done quickly and effectively should be the goal of the leaders and flowing from this, the individual interests of their particular company will likely be looked after as well.
Life in a Fishbowl

From the outset, the private sector has to understand that pursuant to the *Freedom of Information Act*, everybody knows substantially everything about the project. The private sector has to enter negotiations and make all their deals in the context of being continually scrutinized by the public and special interest groups. Experience has shown that the private sector is best served by clearly documenting and preparing summaries of all major decisions made, and discussions that took place in making those decisions. The more open they can be, and the more pro-active disclosure that they can make, the less likely the chance of controversy in the future. A lawyer can be very useful to his clients by continually reminding them to approach negotiations in this light and to document everything. This is one area where the private sector is generally not used to being so open to scrutiny and it is suggested that they develop their patterns and habits early.

Financing

Financing these mega projects is an area that can be very complicated and an area where a lawyer can be of great value to his client by educating whatever party he may be representing as to the needs and desires of the other party in terms of financing.

Government Debt

In first dealing with the needs and desires of the government with respect to financing, it is important for the private sector to understand what type of structure the government prefers. The private sector must realize that just because government is their partner does not mean they have access to a money tree. Currently, governments are under great pressure to improve their credit ratings and are conversely very reluctant to throw money around like they used to. Their credit rating is determined by the major U.S. rating agencies and it is imperative for a lawyer to understand how the rating agencies rate government debt so as to better understand the government's position and ultimately work to a solution that satisfies both parties.

The buzz words when dealing with government is “off-book” or “off-credit” financing.

Off-book financing occurs when ownership of the asset, and the financing therefor, is transferred to the private sector without the requirement of any ongoing government covenant. Usually this is carried out by a transfer of title or long-term lease arrangement. Off-credit financings are financings which will not be included by the rating agencies in the total debt numbers for the government for credit rating
purposes. The test in determining whether or not certain debt will be off-credit or not is generally whether it is highly unlikely that the government covenant will ever be called upon, i.e. whether or not it can be said that the project is self sustaining as a stand alone project. A government loan or a government covenant for a loan on a project that produces a steady secure income stream that adequately services all debt payments will generally not be viewed as government debt for rating agency purposes. This is the kind of debt that governments do not mind incurring.

Thus, private companies must address and understand this concept very early on in the process, and if they are relying on a government covenant for a significant portion of the debt then the deal should be structured to maximize off-book or off-credit financing. Now, it is obvious that many public-private projects are not self sustaining and often will require additional funds either throughout the term as operating supplements or front-end money to offset future debt service. Practically speaking, the debt required is split into senior and junior debt. The senior debt is that part of the debt that can be sustained by the project cash flows and is the off-credit financing for the project. The junior debt if provided by the government is the remainder of the debt and it will be counted in the Government numbers.

**Private Sector Financing**

While, the private sector is often surprised as to the government's needs and desires when deciding what form of financing will be used, it is equally true that the government is often unaware of the private sector's financial requirements. One of the great sticking points for the government is that the private sector's cost of debt, even with a government covenant is greater than if the government borrowed the monies themselves. The government will often question why they would use private corporations to raise funds when they can raise it themselves at a cheaper cost. This argument has some merit on its face, but is often a fallacy.

Similar arguments regarding the expense of private sector partners can be heard by governments when the private sector negotiates putting equity into a project. Private corporations usually demand a return on capital in excess of 15% before taxes. In fact, world data indicates private corporations demand an average rate of return of between 17% to 23% before taxes. At first glance, governments view this rate as excessive, especially when they feel they can raise funds at provincial bond levels.

A lawyer can help the negotiations along by continuing to have the government focus on the big picture. While it is true the cost of funds at first glance appear higher, it is often the case that the principal amount, for initial design and construction and ongoing operation and maintenance, required in a public-private initiative is much less than what would be required for a straight public initiative. Thus, the real
cost of funds for the entire project is much less even though the cost of the funds on a per unit basis is greater. In cases where the principal amounts required would be the same whether governments formed a partnership with the private sector or not, it is often the case that operating expenses over the life of the project are significantly less under a public-private initiative, once again causing the cost of the total project to be much less over the life of the project than if government did not have a private sector partner.

As a lawyer representing the private sector it is his/her responsibility to make the private sector aware of the off-book and off-credit financing issues and to constantly reinforce, from very early on, that the government is no longer the proverbial big pocket. A lawyer’s job, when representing the government, is to continue to highlight to the government the big picture and overall long-term cost of the project. It is also important to educate the government as to what the accepted rates of return are in the private sector for various risk levels. Once again, communication between the private sector and government and between the Government Team and the government is crucial in making projects successful.
Pros and Cons of Old and New Project Delivery Methods

I. INTRODUCTION

The term ‘project delivery’ refers to the contractual relationships chosen for bringing together an Owner needing something built and the tradespersons who can perform the tasks required to carry out the project construction.

Project delivery can take many forms, ranging from the long-standing design-bid-build, to the newer “alternative” project delivery (APD) methods that are especially popular for large-scale construction projects, or for projects requiring the provision of a public service in which the government partners with private sector entities to deliver the project means. The hallmark of APDs is an innovative approach to procurement of the project’s design and construction, as well as more direct management of the project’s construction risks. ADPs range from single-firm responsibility for both design and construction, to public-private partnerships with a mix of design, build, financing, and operating responsibilities.

The role of design and construction providers changes with each different method of procurement and delivery, as does the role and expectations of the Owner. Importantly, the changes in roles signals changes in the overall distribution of the risks associated with the project. In determining which project delivery system is most appropriate to satisfy the Owner’s expectations, there are a number of questions which will have to be considered, such as:

- How much input does the Owner wish to have in the design of the project?
- How much experience does the Owner have in the design and construction of a project?
- How risk averse is the Owner?
- Is determination of cost early in the project development critical?
- How is the project being financed?
- Is the completion date of the project critical?
- Is there any equipment that has a long lead time for delivery?
- Are there performance guarantees that are critical to the Owner?
II. TRADITIONAL APPROACH

Main Features

A prominent feature of the traditional construction contract is the involvement of three distinct parties. This contract typically entails an arrangement between an Owner, a design professional (engineer or architect) and a contractor. The Owner contracts with the design professional to design the structure, and then the Owner hires the contractor to complete the project in accordance with the designer’s plans and specifications. Each of the parties might subcontract work to other parties, but they remain contractually responsible for all the obligations undertaken in design and construction, respectively.

Risk

In this setting, the Owner certifies/warrants to the contractor the sufficiency of the designer’s plans, and assumes any liability for defects in the plans and specifications. The contractor may look to the Owner for “extras” to remedy any inadequacies in the plans, the result of which usually gives rise to increased costs.

The contractor is responsible only for those defects that occur in relation to the construction of the structure (i.e. it is limited to its compliance with the dictates of the specifications and drawings), and assumes the liability of its subcontractors, the cost of the work, indemnification for casualties, and the responsibility for the coordination of the work.

The design professional is responsible for the design but does not assume any liability for defective construction other than that which should have been obvious to him/her in the course of his field services during the construction.

Advantages

- Owner has control over design and construction

The traditional approach minimizes many of the risks associated with more complicated project delivery structures because the Owner has more direct control over the construction project. The Owner exercises full control over the design, selection of materials, and documentation, before committing to a construction contract. As procurement methods become more exotic, the control that the Owner exercises over the outcome of a project delivery method diminishes, and co-ordination and communication risks among all the project players are increased.
The less sophisticated or less experienced Owner who prefers to keep his/her involvement limited can retain a consultant to remain fully immersed in the processes of the project on his/her behalf.

- **Single-point responsibility of designer, consultant, and contractor**

  Rather than the Owner entering into what may be a multiplicity of contractual arrangements, each of the major players may subcontract to other parties and bear any risks of non-performance of the sub-contracts.

- **Design is complete before construction begins**

  Since the design is typically complete at the time that the Owner goes out to tender for the construction, it is easier to get a fixed price tender from the contractor.

- **Established law and precedents**

  Established law and precedents exist; established risk management mechanisms exist (errors and omissions insurance, bid, performance and labour and materials bonding); and established standard contracts for both design and construction exist, with which the entire design and construction community are generally familiar.

**Disadvantages**

The disadvantages of the traditional approach translate into the advantages of other project delivery methods that have evolved more recently. Most of the shortcomings relate to budget overruns, delays and disputes. Some examples are the following:

- **Not conducive to fast-tracking of the construction**

  Fast-tracking refers to the commencement of construction before the project design is complete. In the traditional approach, the Owner must wait until the design is complete before seeking a contractor through the tendering process. A disadvantage of this system is not having input from the contractor during the design phase, which may be useful with respect to issues of constructability.

- **Cost is unknown early in the process**

  Until the fixed price is received from contractors pursuant to the tendering process, the construction costs are generally unpredictable. There is a high probability of project overruns, and
depending on the economy (boom/bust cycle), there may be a need to compress project delivery or deal with issues relating to the availability of materials and skilled labour.

- **Multi-source responsibility**

  On every project, someone has to take responsibility for the design (typically the designer) and someone has to take responsibility for the cost and the schedule (typically the contractor). If the project fails to perform in accordance with the Owner’s expectations, it is necessary to assess responsibilities between the designer and the contractor, each of whom may attempt to attribute blame to the other. This is a result of individual/independent goals between the project players.

## III. CONSTRUCTION MANAGEMENT

The term construction manager (CM) simply refers to the firm that is responsible for managing the entire construction process. Over the last three decades, construction management has developed into a preferred project delivery system. During this period, the scope of the CM’s legal responsibilities has tended to expand as designers have attempted to avoid liability by deleting responsibility for inspection and supervision from their contracts. Employed at the same time as the design consultants, the CM works alongside the designers as a team member, sharing his/her construction experience as the design evolves. Additional duties of the CM include taking responsibility for the project budget and project schedule, both during the design and documentation phases (normally the designer’s responsibility), and during the bidding and construction phases (normally the Owner’s and general contractor’s responsibility). These include detailed budgeting, cost estimating, scheduling, constructability reviews and value engineering studies.

There are typically **two commonly used approaches to construction management**: (1) A “pure” Construction Manager (CM “Not-at-Risk” or CM-as-Agent) and (2) Construction Manager at Risk (CM “At-Risk”). All other variations are just slight modifications of the responsibilities and expectations of the CM and do not change this fundamental division into two categories. For example, a CM/General Contractor is essentially the same as a CM “At Risk”. The courts have analogized at-risk CMs to general contractors, and agent CMs to design professionals. In both instances, liability to third parties is based on the CMs’ superior knowledge, or superior control.
3.1 CM-as-Agent (Not-at-Risk):

Main Features

In CM-as-Agent, the CM acts as an independent advisor to the Owner, and assists the Owner in making informed decisions throughout the construction process. Like any professional advisor, the CM is responsible for making the owner’s interests paramount. The CM is typically an agent of the Owner when contracting, and the Owner, not the CM, enters into the various trade contracts necessary to complete the building project. Each trade contractor is employed in a separate contract by the Owner, either by negotiation, or by a limited sequential bidding process managed by the CM. The effect of this is that the Owner is typically viewed as the ‘general contractor,’ holding the various trade contracts. The Owner may also opt to enter into one contract with a general contractor, who in turn becomes liable for those entities it subcontracts. The distinguishing feature of this contract structure is that the CM does not actually perform the construction work; rather, it is the CM’s role to administer the contracts and oversee payments on behalf of the Owner.

It is important to note that this is not a project delivery method. It is a project management method ~ a method of managing (versus delivering) design and construction services. Therefore, a CM-as-Agent could be used in conjunction with any project delivery method including design-bid-build, Design-Build, or even CM-at-Risk. The extent of the CM’s duties and responsibilities are a matter of negotiation for each project. Typically, the CM Not-at-Risk may help the Owner:

(a) hire an architect AND a CM at Risk  (Note: once again, CM Not-at-Risk deals with how you manage the project, and CM at risk addresses how you deliver the design and construction services)

(b) hire an architect, complete the design, and bid it to General Contractors

(c) hire an architect, complete the design, utilize a multiple prime (trade) contractor bid process, and hire multiple contractors (this generally turns the Owner into the General Contractor, using his CM Not-at-Risk as his ‘contracted’ employees to manage/coordinate the multiple prime trade contracts).

31 A CM who undertakes any of the actual construction tasks may give an air of bias.
Risk

In short, the Owner must ultimately carry the risk of the construction project, despite the fact that the CM is responsible for the scheduling and controlling of the project’s cost. This is in addition to remaining responsible for all of the actions of the CM. If the schedule or costs are negatively impacted through some fault of the trade contractors, or the trade contractors fail to perform the work, the risk lies with the Owner, if the Owner has opted for a structure where he/she performs as the general contractor. Nonetheless, the CM has a duty to use reasonable care in the performance of its services, whatever they may be. From an Owner’s perspective, the CM contract should address the CM’s liability for cost overruns and trade contractors’ claims resulting from the CM’s failure to carry out its work competently, in particular its duty to co-ordinate and schedule the work of the trade contractors.

The risks associated with this type of project structure also include the risks of the Owner becoming a “constructor” under Occupational Health and Safety legislation. The Owner, as “constructor”, will be responsible for the relevant provisions of health and safety legislation once it enters into more than one construction contract.

3.2 CM-at-Risk

Main Features

The CM-at-Risk model is a hybrid between the Traditional and the Construction Management project structures, so that it is often called “Contractor/Construction Manager Project Structure”. The CM in this project typically takes on construction management responsibilities together with the direct responsibility for the work that is normally taken on by a general contractor. The CM holds the trade contracts, and is at risk for performance deficiencies, construction delays, and cost overruns. The CM may provide some services or facilities normally included in the general contractor’s overhead such as a site office, facilities and site security.

The CM is brought on during the design phase of the project to be part of the design team, and to work with the architect (or engineer) in developing drawings that will minimize the final construction cost. Towards the end of the design development phase, the CM assumes the obligation to construct the project for a stipulated sum or a guaranteed maximum price (GMP).
Risk

In this form, unlike the “CM Agency,” the CM-at-Risk is the company that builds the project, holds the subcontracts and is responsible for guaranteeing the work, its cost and completion date.

3.3 Advantages and Disadvantages of Construction Management

Advantages

The Construction Management structure offers some advantages to that of the Traditional construction contract model:

- **Management assistance and expertise**

  CM Agencies can be very valuable to a project team. It is common for an Owner – who may have a great number of projects at one time – to hire a CM-as-Agent to help manage a construction project. The CM-as-Agent would then be responsible for overseeing the design, assisting the Owner in solidifying the various trade contractors, providing quality assurance during construction, and most importantly, assisting the Owner in making the necessary decisions that are required to support the entire process. Since the CM is both a consultant and an agent, the Owner has ready access to construction expertise at all times during the design and construction.

  CM deliverables include detailed updates of breakdowns of both budget and schedules. Presentation of materials is structured in a way that allows early identification of trends, allowing the Owner an opportunity to make timely and strategic decisions. Additional construction expertise during the design phase enhances the selection of materials, products and systems.

- **Budget control**

  The CM takes charge of the budget from the beginning of the preliminary design phase right through until the date of completion of the construction work. An experienced CM quickly reconciles initial budget problems and maintains constant vigilance as the design evolves, thereby ensuring predictable final construction costs with much greater precision. Since the CM would typically be retained at the same time as the designer, the CM is able to provide advice on construction costs and technology during the design phase. This helps to keep the project within budget and to reduce design error.
Schedule control

Since both design and construction overlap, total project delivery time can be effectively compressed, resulting in faster delivery. For example, fast-tracking allows the designer to prepare foundation drawings and provide those to the CM to tender the work and arrange for construction to begin at the same time as the design is proceeding.

Constructability input, value enhancement & quality control

By employing the CM at the same time as the design consultant, the constructability aspects of the design are enriched by having an experienced contractor available as part of the design team.

Construction management does not necessarily yield overall lower costs for any given project, but because both design and construction expertise are present during the design phase of the work (and these personnel work together as a team at the time), greater value is built into the project for the equivalent cost.

Quality assurance and control aspects can be built into the CM’s services to enhance and supplement the procedures normally conducted by design professionals.

All of the advantages listed above are common to both CM-as-Agency and CM-at-Risk. Further advantages particular to the CM-at-Risk model include:

- **Single-source responsibility**

  CM-at-Risk serves as a single point of responsibility contracting directly with the subcontractors during construction.

- **Guaranteed Maximum Price**

  Under this arrangement, the Owner is able to obtain a bonded GMP, producing a more manageable, predictable project. However, the CM should minimize risk to all the parties involved by taking many or all trade bids prior to providing the GMP.
Traditional risk protection coverage

CMs can obtain standard bonding coverage (identical to that of general contractors). Coupled with the usual Errors and Omissions coverage offered to the design professions, risk protection coverage is almost identical to that offered in the more traditional relationships.

Disadvantages

Multi-source responsibility in CM-as-Agent

In light of the liability that detaches in regards to the CM-as-Agent, careful consideration should be given to any decision to adopt a structure that uses a CM Agency rather than one that operates with a general contractor. Owners are exposed to the need to coordinate between designers, the CM, each trade contractor and each supplier. Opportunities abound for claims and hostile relationship problems. Also, since the Owner holds the contracts, many feel the need to duplicate some of the CM’s supervision with a few representatives of their own. This often increases the Owner’s cost, and weakens the CM’s role in the eyes of the prime trade contractors.

No early confirmation of price

The final cost of the project to be undertaken by the Owner will not be fully established until all components of the work are tendered for construction (which may be at the end of the construction phase after the final trade contract has been bid and awarded). As such, although the budget is strictly and competently managed, the Owner seldom has an early confirmation of price.

Also, since the work is sequentially bid, separate trade bidding and construction documents have to be prepared throughout the procurement period. It is not unusual to have ten to twenty bid packages bid sequentially.

Limited law and precedent

Very little established law exists with regard to the role and interrelationship between CM and the more traditional players.
IV. DESIGN-BUILD

Main Features

Design-Build is a project delivery system whereby the Owner, whether a public or private person or entity, hires a single entity or team for the design and construction of the project. The majority of the project risks are passed on to the Design-Builder (usually the general contractor) who obligates itself to provide a completed development to the Owner. This obligation usually entails the land assembly, design, construction, supervision of construction, and commissioning of a fully operative facility.

Risk

The single contract approach to the building of a structure establishes a legal relationship that departs from traditional three-party arrangements. In this case, the contractor is ultimately responsible for any defects or deficiencies in the building of the structure, as well as any defects or deficiencies in the design. The contractor must also absorb any additional cost that occurs as a result of design or construction. The Owner has literally no legal responsibility for the project until the building is completed, and title is transferred to the Owner.

However, the Owner is the party with the most at stake when it knows very little to nothing about design and construction. The Owner must live with, operate, and maintain the finished facility. Because of this, the Owner has to take extra precaution and more of an active role in ensuring that it is receiving the benefit of the bargain and true value.

Advantages

The easiest way to see the benefits of the Design-Build delivery method is by example of what it improves upon, namely, the Traditional approach. Design-Build combines the price guarantees of lump sum tendering with the speed and flexibility of Construction Management.

- Single source responsibility

When an Owner engages a designer and, separately, a constructor, there is a potential risk that each will blame the other for schedule or performance problems. Disputes between any of the players can give rise to claims for delay, acceleration or extra work. Typically, the contractor blames the problem on “design” error or omission and the architect blames it on defective construction work.
The Design-Build approach offers single source responsibility to the Owner. There is only one firm responsible for meeting the performance specifications in all regards so that any issues that may arise are internal to the Design-Build team, and the Owner can call one party (and failing that, that party’s bonding company, to fix any problems). Ideally, the performance is already spelled out so that the energy of the design-construction team is channelled into meeting the requirements, rather than battling with each other.

**Designer:**

Under any of the other formats, designers have two primary relationships (even if they have only one contractual relationship), leaving them potentially exposed in the uncomfortable middle between client and contractor. The Design-Build format leaves them only one primary relationship to worry about—the contractor—and this relationship is much more cooperative and flexible than under the Traditional approach.

**Contractor:**

In theory, the contractor’s exposure is broadly increased under the Design-Build format. However, it also gives the contractor the ability to manage their exposure. The single-point responsibility, which is characteristic of this delivery method, puts the contractor in a better position to guarantee the performance of the project. For example, where an Owner wants to develop a hydroelectric facility which is to have certain required output, it may be beneficial to have one party responsible for both design and construction.

The contractor has a fairly powerful motivation to be balanced because she/he has to get the design completed and the building erected, and there must be a satisfied client at the end of it.

- **Cost savings, efficiency and time compression**

There are greater costs and schedule savings in having a single contract team for design, engineering, and construction, since it facilitates fast-tracking without the loss of cost control. The obvious benefit is that the project may be completed in a shorter time.

In terms of cost savings through innovation, Design-Build offers the chance for the designer and constructor to work together to actually develop the design to meet certain performance parameters, prior to review by the Owner. “Constructability” issues, for example, can affect design. The designer and
contractor have an incentive to cooperate so as to try to find solutions that may not have occurred to the designer alone.

Also, because of the flexibility of the approach, the industry-wide resources that can be brought to bear on any problem or challenge, and the speed with which the entire process moves (and, where necessary, changes direction), the Owner is likely paying less without the risk of receiving less. Improvements can be incorporated fast, at little expense, and with no defensiveness or blaming on either side. There is nothing to say that all these different resources couldn’t and shouldn’t work effectively together regardless of the contract format, but no other format pushes the parties together in a community of interests quite as effectively as Design-Build.

- **Early confirmation of price**

  The cost of the project is known early in the process. This facilitates financing and ensures budget compliance. However, this also means that there is a shift of costs from the Owner to the contractor for additional work performed as a result of poor design. Since enormous risks are assumed by the Design-Builder, the prudent Design-Builder would want to build appropriate contingencies into its price, which obviously is not in the Owner’s best interest.

- **Reduced administration**

  Combining both design and construction eliminates the need for Owner coordination. Administering two or more prime contracts, each with monthly progress evaluations and draws, is reduced to one single evaluation.

- **Professional fee savings**

  In most Design-Build projects so far, it appears that the designer is still largely a fee for service contractor to the constructor. Therefore, since the constructor is taking the financial risk, he will presumably set a rigid professional fee ceiling in consultation with the design partner. This provides the constructor with a bottom line on fees so he can bid for the job in a competitive environment. In this way, there is inherent value engineering and cost control on design fees. To the constructor’s benefit, the negotiated terms of a Design-Build contract may also include extra expenses such as a fee for preliminary designs or formal payment by the Owner before agreeing to provide any preliminary designs.
Disadvantages

- **Complex early planning**

  Unlike traditional forms of project delivery, the Design-Build method relies on the provision of extremely detailed project information at the outset. The Owner should seek qualified assistance when preparing procurement documents to avoid vacuums in delivery and disappointment in the finished product.

- **Using performance-based terminology to define Owner’s desired outcome**

  Unlike traditional forms of project delivery where there are adequate plans and specifications available to describe the finished product, no such documentation is available early in the Design-Build delivery process. Most of these projects are solicited using performance-based terminology defining a projected or desired outcome. Therefore, complete control of the project is in the hands of the Design-Build who can, if the Owner has not described its expectations in sufficient detail, deliver a completed product on a range of forms, all meeting the description and specifications requested by the Owner. The risk can be mitigated by the Owner by using considerable care to address each component and system that is critical to the successful use of the project, and by the Owner reserving certain approval rights over the design and construction project.

- **Design builder also assumes the responsibility for its own inspection**

  Conventionally, in the Traditional model of project delivery, the Owner would hire a design professional to prepare documents that would later be issued to various contractors for pricing. The design professional, in theory, would act as the Owner’s watchdog to ensure the project was constructed in accordance with the construction documents. This would hopefully protect the Owner from possible defects and deficiencies in the contractor’s work.

  A hurdle in using the Design-Build option is that the design professional’s conventional role is eliminated. In this scenario, the Owner’s best interests may not be realized, since the design consultant’s obligations are aligned with the contractor, not the Owner. Suspicion can be cast on the integrity of the end product because the design-builder also assumes the responsibility for its own inspection in the Design-Build team of which it is a part. This often results in the Owner hiring a separate project manager or professional consultant to safeguard his or her own interests, through interaction with the Design-Build firm during the course of the construction.
On the same note, the designer will no longer have the same interest in satisfying the Owner’s expectations if those expectations will result in additional construction costs to the design-builder. Unless the Owner is clear and specific in the procurement documentation as to the desired level of life cycle and maintainability of the project, there is a possibility that such goals could be sacrificed for profitability. Care and diligence are paramount in establishing sound and verifiable performance standards in the procurement documentation.

- **Owner relinquishes control over both design and construction**

  The Owner’s input on the details of a project may be limited in the Design-Build approach because the contractor drives the overall responsibility. The most common approach, in this instance, is for the Owner to express the desired outcome in terms of design and performance characteristics. The Owner should have a damage clause to protect itself in the event of the contractor’s inability to design and/or construct in accordance with terms of reference for the Design-Build contract.

  To further protect itself, the Owner should take time to understand the entire scope of the project. There is a strong obligation for the Owner to prepare clear performance specifications for Design-Build proposal call, and how the parties will demonstrate that these criteria will be met. Proponents must understand what aspects of the project are essential and non-negotiable and what areas are open to innovation. The Owner should also look for ‘qualifications’ or ‘exclusions’ that conflict with the Owner’s understanding of the commitments made by the Owner to it’s lender or tenants.

- **Lack of available seamless risk coverage**

  In the Design-Build scenario, coverage problems would arise under traditional insurance policies issued to contractors, since they exclude design activities related to professional services. Furthermore, under the professional indemnity policies issued to the design professionals, there would be exclusion for construction activities that fall outside the scope of normal, professional services rendered by the design professional in question. The Owner, through insurance or otherwise, needs to protect itself from losses incurred as a result of actions and omissions of the design-builder and other project participants. The Owner should insist that all claims arising out of any type of service be properly insured by the design-building team.

- **Lack of available administrative experience**

  Inexperienced Owners may lack the skills needed to judge whether a project, as it progresses through design and construction, meets the expressed performance criteria.
Limited law and precedent

Established traditional forms of project delivery have, over the years, accumulated a solid body of law relating to design and construction process. Since the re-emergence of the Design-Build method of delivery, new relationships have to be re-evaluated against the existing body of law, as there is very little available legal precedents exclusive to the Design-Build method.

V. DESIGN BUILD OPERATE

Main Features

Under this project delivery method, there is an obligation on the part of the consortium who is designing and building to also operate the project’s asset/service. It is frequently used in the privatization of formerly public projects, and it differs, for example, from a budget project which does not involve any appreciable ongoing labour or energy costs.

Risk

In this case, the Design-Build-Operate consortium is ultimately responsible for any defects or deficiencies in the building of the structure, as well as any defects or deficiencies in the design and performance of the project structure. The operator is also responsible for costs relating to operation and maintenance. Typically, the Owner has no legal responsibility for the project until the end of the operation period.

The consortium must also absorb any additional costs that occurs as a result of design and construction, and which cannot be recovered through operating revenues. Further, any uncertain future events need to be allocated. In a private entity partnership with a public government body, policy shifts leading to changes in legal requirements may impose additional costs on the private partner. Provision should be made in the project agreements with respect to whom will bear the additional costs.

Advantages

Single-source responsibility

The advantages associated with Design-Build-Operate are many of the same advantages associated with Design-Build above. For the Owner, the risks associated with the project are further pushed down the chain of players, and the model truly provides single-source responsibility for the
complete development process (minus financing), as well as implementation of the required service. As well, since the operator’s cost to maintain the project will be directly affected by the preceding design and construction phases, there is an incentive to both design better and build better in order to reduce future costs and incur minimal, foreseeable operating problems.

On a related note, since the Design-Build-Operate team bears the brunt of responsibilities, the Owner’s role may be extremely limited. The Owner will need to consider and provide for terms upon which changes can be made to any members of a developer/operator consortium and to any and all contractors or subcontractors retained by the developer/operator. The Owner also needs to determine its on-going role through the operating period.

- **Implementation of public services which may not otherwise be provided**

  If the Owner is a public entity, reduced public sector risk, reduced project implementation time, and maintained or improved service levels, are all advantages which may serve to convince the public sector entity to undertake procurement for the service.

**Disadvantages**

- **Interests of Owner and operator are not aligned towards the end of the operation period**

  At the beginning of the operating period, the interests of the Owner and the operator are aligned, in that it is in the interests of both to maintain and rehabilitate the infrastructure in a manner suitable from a long-term perspective. However, towards the end of the operating term, the interests of the Owner and the operator are no longer aligned, in that the Owner continues to take a long-term perspective while the operator’s perspective is limited by the end of the operating period. As a result, the operator will tend to postpone maintenance and rehabilitation, to the extent possible.

  It is important to have clear “handback” standards to ensure that the Owner receives the structure in a condition appropriate for its age on transfer, even if operating standards (i.e. a minimum baseline performance) could continue to be met otherwise.
VI. DESIGN BUILD OPERATE FINANCE

Main Features

Under this project delivery method, there is an obligation on the part of the consortium who is designing and building to also finance the capital and operating requirements of the project, ideally without reliance on the Owner’s capital funds. Public-private partnerships have significant interest in this project delivery method. A public-private partnership entails an arrangement between government and private sector entities for the purpose of financing and delivering a public purpose infrastructure and services. The Design-Build-Operate-Finance team, which is a special purpose company having an area of expertise which enables them to carry out the distinct four functions, fronts all expenses and construction costs. The project company’s shareholders typically include major construction companies and operation/facility management companies. Normally, repayment of the debt is accomplished through a lease or contract purchase obligation with the Owner.

Where an Owner is the government, the lease or contract purchase obligation must be properly authorized by those responsible for imparting the “power of Parliament.” Most importantly, steps must be taken to ensure that the government acquires the necessary authorizations to provide a commitment to the design-build-operate-finance consortium for the duration of the outstanding obligation (i.e. beyond the current government’s term in office).

Risk

The special purpose company bears any cost overruns in respect of the construction and maintenance of the assets and the provision of services. The special purpose company may also pass on construction risk by entering into fixed-term and Design-Build construction contracts with other contractors. The risks relating to financing are unlike those risks of the contractor or designer because while the designer and contractor are concerned with risks associated with the efficiency of construction, the lender is primarily concerned with threats to cash flow and cash flow projections. To be attractive to financiers, the completed project has to have resilient cash flows over it’s long life (30 years or more is not unusual).
Advantages

- **The many advantages of single-source responsibility**

  This delivery method truly provides single-source responsibility for the complete development process. When a single consortium is responsible for all aspects of the project, the concerns of lenders ultimately correspond with the concerns of the consortium. The risks are contained within the syndicate, therefore, the need for efficiency, turning out a high-quality, fully functional project, proper planning, and collaboration are exemplified.

  Single-source responsibility is important to lenders in financed projects. The design-builder can give a fixed price for the whole project and provide the performance and delivery guarantees that lenders require. Where the financiers are the construction companies and operation/facility management companies responsible for the project, other forms of security will not be sought, such as guarantees from Owners, contractors or government authorities to ensure repayment of debt. If the Owner is a public entity, reduced public sector risk, access to new sources of capital, reduced project implementation time, maintained or improved service levels, and a clear balance sheet (i.e. not increasing the public debt) are all advantages.

- **Increased control over managing the risks**

  Financier(s) can ensure that suitable performance bonds and insurance are in place and that the intended contractor(s) has/have adequate financial strength and suitable qualifications to complete the project.

- **Increased cost and schedule control**

  Private sector decisions recognize the time value of money, and also recognize the value of time itself. When the same consortium finances a project that it is responsible for delivering, it acknowledges the time sensitivity under which it works and recognize that correcting small mistakes as they proceed will cost less overall than using a longer process without mistakes.

  When dealing with a public service project, a real benefit is the transfer of risk to the special purpose company and its contractor. There is an incentive to avoid cost and time overruns during construction, which are usually endemic in public sector contracts.
Mutual benefits in public-private partnerships

The third party approach to this development offers advantages to both the government and the developer. The government fulfills its needs for a public service infrastructure with little or no outlay of funds, while the developer has an opportunity to tap a known market.

Disadvantages

- **Long concession periods**

  In this project delivery structure, concession periods are long, heightening the potential for risk in even the most basic project. Long-life concession projects are exposed to a high risk of dependence on a single asset and the vulnerability of projecting key variables (such as taxation, inflation, life cycle maintenance costs, etc) over a 30 year period.

- **Increased cost of borrowing for the private sector**

  It has been argued that the cost of capital is higher for private sector versus public sector entities. However, this is a factor that cannot be looked at in isolation. Cost savings that ensue from design, construction, operation and maintenance far exceed the additional cost of borrowing, such as the decreased time for delivery which makes the asset operational (and productive) much earlier than might otherwise be the case.

- **High overall risk for the private sector partner in a private-public partnership**

  In private-public partnership agreements, lenders to a project will be concerned about any action, such as the introduction of a competitive project, or the amendment of any relevant legislation, or inaction, by government which will have the effect of adversely impacting upon the stream of payment.

  There is a range of tri-party agreements available which will create certain rights and protections for the lender. These agreements create a contractual relationship between the Owner and the lender which give the lender step-in rights in the event of default by the private partner. There are benefits to the government’s co-operation in protecting the lender’s interests. A failure to provide meaningful protection to lenders will make financing by the private sector difficult, and will adversely impact on the value received by government either in terms of purchase price or project pricing. Some beneficial measures include providing a lender with additional notice rights or rights to cure a default than are given to the developer or operator, and giving the operator/developer or lenders protection in the event that the
government takes action, or fails to take action, that will have a material and adverse effect on the income derived from the project.

A successful bid process is one that will attract the highest number of capable bidders. However, bidders who are being asked to commit millions of dollars and countless hours to the privatization of a public service/asset may be discouraged by the possibility of a repeated “Pearson factor.” To enable a significant number of viable parties to participate in the bidding process and obtain the necessary financing, it is advisable for the government to agree to discriminatory action and termination for convenience clauses. The measures seek to compensate the private party and lenders for any discriminatory action taken by the government that is not of general application, and that has a material adverse effect on the business that the private sector secured the rights to operate. In short, while one recognizes that it is difficult from both a policy and practical vantage point for government to provide what may constitute a protected monopoly to the private sector, express protections for a private party may be required as against adverse government policies. Otherwise, capable bidders may be off-put by the difficulty in securing financing, as well as the possibility of contracts being voided in the future at Parliament’s discretion, without the concomitant right to legal action and compensation for financial loss.