PUBLIC-PRIVATE PARTNERSHIP GOVERNING BOARD
Policy Circular No. 06 - 2015
25 March 2015

FOR : **All Heads of Departments, Bureaus, Offices, Commissions, Authorities or Agencies of the National Government, Government-Owned and/or Controlled Corporations, Government Financial Institutions, State Universities and Colleges, and Local Government Units**

SUBJECT : **TERMINATION PAYMENT FOR PUBLIC-PRIVATE PARTNERSHIP (PPP) PROJECTS**

I. Introduction

1. Termination Payment (TP) refers to the amount payable by the Government or the Concessionaire on the occurrence of an event or series of events provided for in the PPP contract that results in the termination of said contract.

2. Termination of a PPP contract may take place during pre-construction, construction, post-construction, or operations period of a PPP project. Events that may lead to termination may include, but are not limited to the following:

    2.1. Government's default;
    2.2. Concessionaire's default; and
    2.3. Force majeure.

3. TP provisions are integral part of a PPP contract. Said provisions are central to the risk-sharing arrangement between the Implementing Agency (IA)[1] and the Concessionaire, and play an important role in reducing uncertainty, thereby giving confidence to all the key stakeholders involved in the project.

4. The parties to a PPP contract shall exert all diligent efforts to deliver the PPP project from pre-construction to completion and thereafter until hand back of the project, including facilities thereof, to the government. Termination shall be the last resort after all remedial means specified in the contract have been fully exhausted. Notwithstanding, and given the long term nature of PPP projects, parties to the PPP contract must deal with the consequences of early termination, including provision of compensation to the other party, to be specified in the contract. The method of determining the amount of compensation will depend on the

[1] Implementing Agency – Refers to the department, bureau, office, instrumentality, commission, or authority of the national government, including government-owned-or-controlled-corporations (GOCCs), state universities and colleges (SUCs), government financial institutions (GFIs), government instrumentalities with corporate powers (GICPs), government corporate entities (GCEs), and other government corporate entities (OGCEs) as defined in Republic Act No. 10149 or local government units (LGUs), which undertake PPP projects in accordance with the law.

nature of termination for which the compensation is being sought, and shall likewisebe specified in the contract.

II. Legal Basis for TP

Existing law provides that PPP contracts shall contain mandatory terms, including, among others, grounds for and effect of contract termination.

III. Scope and Applicability

This Policy Circular shall apply to all PPP contracts.

IV. Termination Events

The specific events that may lead to a termination shall be determined on a project to project basis, such as, but not limited to, the following:

(i) Failure of the Concessionaire or the IA to satisfy the conditions precedent under the contract;
(ii) Occurrence of a force majeure event, the effects of which is prolonged or not remediable;
(iii) Abandonment of works by the Concessionaire;
(iv) Violation of any laws, rules and regulations of the Republic of the Philippines;
(v) When the Concessionaire assigns, transfers or otherwise disposes of any of the rights under the PPP contract without the consent of the IA;
(vi) Insolvency;
(vii) Poor performance of the Concessionaire or persistent breach of its obligations under the PPP contract;
(viii) A Material Adverse Government Action (MAGA) event where the parties are unable to agree to a MAGA compensation;
(ix) Default of the Government as defined in the contract; and
(x) When banks or lenders call the Concessionaire in default.

V. Consequence of a Termination Event

Upon termination of a PPP contract, either party may be entitled to compensation depending on the nature of termination event.

VI. Principles of Termination Payment Calculation

6.1. All PPP contracts shall define the events that give the IA or the Concessionaire the right to terminate the contract, and prescribe the rights of the relevant parties. It can vary from project to project.

6.2. As a general rule, the method of calculation of termination payment agreed in a PPP contract shall allow lenders to recover the outstanding senior debt[2] on the core asset of the project as of the date of termination, except debt owed to related entities as defined in the

[2]Senior Debt – Indebtedness to principal source of finance (i.e. banks). This excludes debts owed to company shareholders (i.e. subordinated debt)

contract. Such amount of senior debt shall be subject to applicable caps and shall be net of settlement accounts.

An illustrative example of calculation of TP is enclosed as Appendix A.

6.3. **In the case of Government's Default**, the Government shall pay the outstanding senior debt, subject to applicable government-mandated caps, incurred by the Concessionaire and shall allow the latter to realize a reasonable rate of return, as may be allowed under the law.

6.4. **In the case of Concessionaire's Default**, the Government shall pay the Concessionaire as much as the outstanding senior debt used to fund the core asset, subject to applicable caps, at the time of termination and as may be allowed under the law.

6.5. **In case of termination due to a Force Majeure**, the Government shall pay either the (a) depreciated book value of the assets or (b) value of *the assets appraised at their damaged condition, at the time of* termination.Costs of restoring the assets to its condition prior to the occurrence of the force majeure event may be shared with the Concessionaire.

6.6. The Government may also pay breakage costs subject to all applicable government-mandatedcaps.

6.7. Settlement amounts such as liquidated damages will be included in the calculation of termination payment.

6.8. In all instances, applicable government-mandated caps may be in place such as for cost overruns, financial leverage, and settlement costs.

6.9. Viability Gap Funding provided for by the Government shall be deducted from the termination payment where relevant.

6.10. Viability Gap Funding provided by the Government and concession fees paid by the Concessionaire shall be net of amortization.

VII. Effectivity

This Policy Circular shall take effect immediately upon approval by the PPP Governing Board.

I hereby certify that this policy circular was approved by the PPP Governing Board at its meeting held on 25 March 2015

COSETTE V. CANILAO
Undersecretary and Executive Director
Head, PPP Governing Board Secretariat

APPENDIX A. ILLUSTRATIVE EXAMPLES OF CALCULATION OF TERMINATION PAYMENTS IN PPP CONTRACTS[1]

I. GOVERNMENT DEFAULT BEFORE OPERATIONS

Notation	$TP_{td} = \{\sum_{t=1}^{d}[((DC_t + PPaid_t + BV_t) \times CAP_t) - CS_t - OCF_t] \times (1 + PIRR^{6mon})^{d-t}\} + T_{Con} - L_{td}$
Valuation Portion	$\{\sum_{t=1}^{d}[((DC_t + PPaid_t + BV_t) \times CAP_t) - CS_t - OCF_t] \times (1 + PIRR^{6mon})^{d-t}\}$
	- The valuation portion of the formula is premised on accounting for the cash invested in particular assets and compounding them from the time they were invested up to the time termination occurs. These include development costs (DC), premiums paid upfront (PPaid), fixed assets constructed (BV). - These amounts pertain only to the cash invested for the core asset. - The amounts invested in time t are multiplied to a capping factor (CAP). This is the ratio between the approved budget for capex and the actual expended capex at time t. CAP has a maximum value of 1, therefore if actual expenditure in the denominator exceeds the approved budget, the ratio will decrease below 1 and ultimately bring down the amount of the invested items to their budgeted levels. - The amounts accounted for and capped are reduced by the amount of upfront government subsidy or VGF (CS) and the net operating cash flows received by the concessionaire assuming there are early operating phases before the full delivery of the committed infrastructure asset (OCF). The Operating Cash Flow figure stops accruing when normal operations begin. - OCF can operationally also include actual cash and cash-like assets in the balance sheet as of termination date. - These are then compounded assuming a semi-annual reckoning by the compounding rate (PIRR). PIRR is assumed to be a rate descriptive of the unlevered project returns or weighted average cost of capital expected of the project.
Settlement Items	$T_{Con} - L_{td}$
	- Common settlement items include the payment of potential breakage costs (Tcon) and the offsetting of any unpaid concessionaire liquidated damages (L) - Breakage costs are likewise capped.
General Principles	- The valuation portion is based on investing cash flows going into particular types of assets. As this termination regime is in force during the time when construction risk is highest, the idea is to value the payment to the concessionaire on the basis of what has been actually constructed as evidenced by what was already spent

[1] Note that these are merely **sample illustrations** to execute the principles stated in the policy circular on termination payment.

	for particular assets. - The reportorial requirements to get the inputs for valuation can be traced through custom reportorial requirements or periodic financial statements. No projections are required. - It is ideal to establish the PIRR at the date of signing of the PPP contract rather than on termination date.

II. GOVERNMENT DEFAULT DURING OPERATIONS

Notation	$TP_{td} = ([D_{td} \times CAP_{td}] - CA_{td}) + \sum_{t=1}^{d} [([E_t \times CAP_t] - Dis_t) \times (1 + EIRR_t{}^{6mon})^{d-t}] + T_{con} - L_{td}$
Valuation Portion	$([D_{td} \times CAP_{td}] - CA_{td}) + \sum_{t=1}^{d} [([E_t \times CAP_t] - Dis_t) \times (1 + EIRR_t{}^{6mon})^{d-t}]$
	- The valuation portion of the formula is premised on accounting for investments made by source of financing or claims. Outstanding debt (Dtd) at the time of termination is reduced by the amount of cash and cash-like assets in the balance sheet (CAtd) to reflect the net debt position that needs to be liquidated. Equity claims are valued by determining the cash invested into the endeavor by the sponsors compounded from the time of actual investment up to the time of termination. - These amounts pertain only to those invested for the core asset. - The debt and equity base values are multiplied to a capping factor (CAPtd). This is the ratio between the approved budget for capex and the actual expended capex at time t. CAP has a maximum value of 1, therefore if actual expenditure in the denominator exceeds the approved budget, the ratio will decrease below 1 and ultimately bring down the base amount of the claims to their proportionate budgeted levels. - The compounding process only applies to equity since Debt and accrued interest are explicitly valued in the formula. The compounding factor for equity infusions (EIRR) is assumed to be a rate descriptive of the returns due to equity (as opposed to project or unlevered returns in regime I).
Settlement Items	$T_{con} - L_{td}$
	- Common settlement items include the payment of potential breakage costs (Tcon) and the offsetting of any unpaid concessionaire liquidated damages (L) - Breakage costs are likewise capped.
General Principles	- The general principle of this formula is compensation for capital currently at risk. The idea is to pay back all outstanding debt subject to the applicable caps and estimate a fair value for equity exposures based on the relative timing of investment and expectations of return for such investments.

	- The reportorial requirements to get the inputs for valuation can be traced through custom reportorial requirements or periodic financial statements. - It is ideal to establish the EIRR at the date of signing of the PPP contract rather than on termination date.

III. CONCESSIONAIRE DEFAULT (BEFORE AND DURING OPERATIONS)

Notation	$TP_{td} = \{[((BV_{td} - Dep_{td}) \times BVCAP_{td}) - CS_{td}]\, x\, Lev_{td}\} - CA_{td} - L_{td} - R\ - CFUnpaid_{td} - T_{gov}$
Valuation Portion	$\{[((BV_{td} - Dep_{td}) \times BVCAP_{td}) - CS_{td}]\, x\, Lev_{td}\}$
	- The valuation portion of the formula is based on selected balance sheet items referring to actual fixed assets delivered or currently under construction. Fixed assets should include capitalized financing costs. - These amounts pertain only to the cash invested for the core asset. - Leverage ratio is capped. - Accumulated Depreciation at the time of termination (Deptd) is deducted to adjust the gross amount of fixed asset (BVtd) to reflect the relevant book value of the asset being purchased. - A capping coefficient (BVCAP) based on the ratio of the approved capex over the actual capex spent is applied in similar fashion to regimes I and II. - Government subsidy paid out (CS_{td}) net of amortization is also deducted to reflect the portion of the assets to be compensated to only refer to those funded by the concessionaire. - This net valuation is then multiplied to the leverage ratio (Levtd) which is the ratio of net debt to total net capitalization. This is intended to approximate the amount of the asset's book value that is attributable to senior debt funding.
Settlement Items	$-CA_{td} - L_{td} - R\ - CFUnpaid_{td} - T_{gov}$
	- Settlement items include the deduction of cash and cash equivalents which are assumed to be liquidated immediately to service debt, unpaid concessionaire liquidated damages, estimate of restoration costs relating to restoring the asset up to MPSS at the time of termination if applicable, the balance of unpaid concession fees if applicable and government breakage costs.

	- Breakage costs are likewise capped.
General Principles	- The general principle of this formula is compensation for selected assets in the balance sheet that is attributable to debt funding. The intention is that in a situation of concessionaire default, government will purchase the fixed assets intended to deliver the public service envisioned in the project's conceptualization and approval. - The application of the leverage ratio is intended to demonstrate that only debt capital proportionate to the book value of such selected assets will be compensated. Equity claims are forfeited. - The formula demonstrates punitive measures to concessionaire default and is implicitly meant to be a deterrent to serious contract breaches by the concessionaire.

IV. FORCE MAJEURE TERMINATION (BEFORE AND DURING OPERATIONS)

Notation	$TP_{td} = [(BV_{td} - Dep_{td}) \times BVCAP_{td}] - CA_{td} - CS_{td} + CFPaid_{td} + DC_{td} + \frac{T_{Con}}{2} - L_{td}$
Valuation Portion	$[(BV_{td} - Dep_{td}) \times BVCAP_{td}]$
	- The valuation portion of the formula is based on balance sheet items referring to actual fixed assets delivered or currently under construction. Fixed assets should include capitalized financing costs. - These amounts pertain only to the cash invested for the core asset. - Accumulated Depreciation at the time of termination (Deptd) is deducted to adjust the gross amount of fixed asset (BVtd) to reflect the relevant book value of the asset being purchased. - A capping coefficient (BVCAP) based on the ratio of the approved capex over the actual capex spent is applied in similar fashion to regimes I and II.
Settlement Items	$-CA_{td} - CS_{td} + CFPaid_{td} + DC_{td} + \frac{T_{Con}}{2} - L_{td}$
	- Settlement items include the **deduction** of cash and cash equivalents which are assumed to be liquidated immediately to service debt (CA), amortized net government support or VGF (CS), unpaid concessionaire liquidated damages (Ltd). - Settlement items also include the **addition** of amortized net concession fees paid (CFPaid), amortized net development costs (DCtd) and half of concessionaire breakage costs. - Breakage costs are likewise capped.
General Principles	- The general principle of this formula is to compensate the concessionaire on the basis of the depreciated value of assets in place right before the force majeure event has occurred. - It also assumes cost sharing with regard to the breakage costs that concessionaire must pay to their lenders as a result of termination. - It also assumes the return of any net premium paid to the concessionaire or any net cash support paid to the government. - The cost of restoring the core business assets to the condition they were in prior to force majeure (the portion of this cost not covered by insurance) shall be deducted from the termination payment.