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Inconvenient Termination: The Financial Impact of Terminating Public-Private Partnership ("P3") Projects

The enormous success of the P3 model in delivering on time and on budget public infrastructure¹ can see troubled waters when new Governments arrive with a different political ideology or merely a different set of priorities. This risk came to fruition when new Governments in British Columbia and Alberta both cancelled projects and rejected the P3 methodology.²

With the introduction of a new Progressive Conservative government in Ontario on June 7, 2018, it is possible that P3 projects which are underway in Ontario may meet a similar fate. While Conservative parties have traditionally supported the P3 model, there are three issues that may lead the new Government to a different approach that could result in the cancellation of current procurements and, in some cases, existing projects. First, there was no explicit commitment by the Conservative campaign to the P3 model. Secondly, in some markets where existing projects are in the market, the campaign indicated a willingness to pursue other ways of

¹ See, for example, the report on the [economic impact of P3s in Canada](#), released by The Canadian Council for Public-Private Partnerships.

² In late 2017, British Columbia's New Democratic government cancelled the George Massey Tunnel Project, and in 2014, the Alberta New Democratic government put on hold the construction of 19 schools. Both projects were introduced by the prior Liberal and Progressive Conservative governments, respectively, and utilized the P3 model.

proceeding, including by providing municipalities with the discretion as to how to proceed. Finally, the differing fiscal priorities of the incoming Government may result in it deciding to divert expenditures to its major platform commitments. In this context, the early termination of some P3 projects is a clear possibility. As a result, it is important for all stakeholders to understand the rights of the authority to terminate a project in its various stages and the financial consequences to taxpayers of the same.

Terminating at the Request for Qualifications Phase

If the Government of Ontario cancels a procurement during the request for qualifications ("RFQ") phase of a project, prospective bidders are almost certainly going to be sent home empty-handed. In Ontario, the customary form of RFQ expressly provides the authority with the right to cancel the project at any stage during the RFQ process. Moreover, all costs and expenses incurred by an applicant in the preparation and submission of its response to the RFQ are entirely borne by the applicant, and neither the authority nor its representatives will "be liable for any costs or expenses of any applicant or prospective applicant or to reimburse or compensate an applicant or prospective applicant in any manner whatsoever under any circumstances, including... if the [authority] decides not to proceed with the project."

In addition to the absence of any reimbursement or break fee, the RFQ will further typically state that cancellation of the RFP will not give rise to any liability on the part of the authority for damages incurred by an applicant. Notably, an applicant's rights at common law to claim for any costs or damages as a result of participating in a cancelled RFQ are limited as well. For example, the RFQ typically includes a clause which expressly provides that the RFQ is not intended to create a bidding contract, which limits an applicant's probability of a successful breach of Contract A claim during the RFQ period.

While the probability that an applicant would incur significant damages as a direct result of the cancellation of a project during the RFQ stage is likely low relative to other stages during the

procurement process, an applicant will nevertheless incur administrative and personnel costs in preparing and delivering its RFQ submission, which, according to the terms of the RFQ, it will not be able to recover from the authority in the event the project is cancelled during the RFQ stage.

Terminating at the Request for Proposals Phase

Shortlisted applicants identified through the RFQ process are invited to respond to the project's Request for Proposals (the "RFP"). As part of its response, proponents will submit technical and financial information to meet the requirements of the project as set out in the RFP. Most, if not all, forms of the RFP used in Ontario to procure P3 projects also reserves the authority's right to terminate the project at any stage prior to Financial Close. While a proponent's rights in the face of a cancelled project are considerably greater during the RFP stage compared to the RFQ stage, there are limitations on the amount that a proponent is entitled to recover from the authority. Such recovered amounts are likely not sufficient to cover a proponent's costs for preparing and submitting a response to a RFP.

The rights of a qualified bidder responding to a formal RFP that the Government cancels depends upon the language of the RFP. In some cases, a cancellation of the RFP process will lead to payment by the authority to eligible proponents of a break fee, which base amount is predetermined and set out in the RFP, but such break fee will often be stated in the RFP to be subject to Ministry of Finance approval and adjustment. If offered by the authority, a proponent is eligible to receive the break fee if (i) in the case where the project is cancelled prior to the submission of proposals, the proponent has demonstrated to the authority its active participation in the RFP process; and (ii) in the case where the project is cancelled after submission of proposals, the proponent has submitted a "full and proper" proposal. Whether a proposal is "full and proper" for the purposes of payment of a break fee will be determined by the authority, but will usually include certain criteria including whether the bid was compliant with the RFP requirements and whether the final proposal received a predetermined threshold score.

Accordingly, even if a break fee is offered for a project, there is no

guarantee that a proponent would be able to recover the entire amount (or at all).

A qualified bidder may also have rights at common law during the RFP stage. The RFP is, *prima facie*, a bidding contract and therefore any material breaches by the contracting authority leading to a termination the RFP could give rise to a breach of Contract A claim. However, the authority's liability for any damages as a result of such breach prior to submission of RFP proposals is limited (typically to the lesser of the claimant's proposal preparation costs and a predetermined amount or the break fee, if applicable, or the design and bid fee, if applicable). Any liability of the authority to an applicant following submission of RFP proposals is limited to the design and bid fee or the break fee, if offered.

Terminating a Project Agreement

Upon execution of the Project Agreement with the successful proponent ("Project Co"), the RFP and the RFP phase will terminate, and the Project Agreement will govern the rights and obligations of the authority and Project Co in respect of the project. The rights and remedies of the private sector partner for a cancelled P3 project are significantly enhanced once the parties have entered into a formal Project Agreement.

The form of Project Agreement typically seen in the Ontario P3 market allows the authority to terminate the project for convenience – that is, in the absence of any default or supervening event – upon prior written notice to Project Co. In such circumstances, a termination for convenience sum will be payable by the authority. The calculation of such payment amount requires Project Co to mitigate its losses upon termination of the Project Agreement and deducts certain sums which are owing by Project Co to the authority at the time of termination (such as prior authority claims which are determined to be owing by Project Co). However, the termination payment is intended to make Project Co whole and as a result, the authority's financial and political exposure could be significant.

The payment owing to Project Co by the authority upon a termination of the Project Agreement for convenience, prior to any deductions, will typically be calculated such that it is sufficient to pay the following stakeholders in the project:

- **Senior Lenders:** The senior lenders who finance the project can be assured that where the Project Agreement is cancelled by the authority, the termination amount will be sufficient to cover all principal, interest and makewhole amounts owing under their lending agreements with Project Co. Importantly, because the Ontario P3 template provides that the termination payment will under no circumstances be less than such amounts owing to the senior lenders, the debt amounts owing by Project Co, even in the absence of any other liabilities, could result in significant financial costs to the Government for terminating a Project Agreement, particularly if the project is in its early stages.
- **Subcontractors:** Termination of the Project Agreement will result in termination of Project Co's main subcontracts, and the authority's termination payment will include sums that Project Co owes to its construction contractor and maintenance services contractor pursuant to the terms of their respective subcontracts. While the compensation on termination amounts in construction contracts and maintenance services contracts vary from project to project, typically the amounts payable by Project Co under such agreements will include commercially reasonable breakage fees and the subcontractors' direct losses.
- **Equity Providers:** Subject to certain adjustments, the termination payment under the Project Agreement will also include payments of projected profits owing to Project Co's partners who contributed equity towards the project. In Ontario, the amount owing to such equity providers will be calculated using a base case internal rate of return, established at Financial Close. Since the Ontario formula limits compensation to the net present value of the original equity investment using the original base rate of return (unlike that in certain other jurisdictions, such as British Columbia, which allows bidders to choose a fair market value formula) some equity investors, particularly those who

have purchased their equity at a later stage for a higher price, may not be made fully whole.

- **Project Co:** The authority's termination payment will include employee termination amounts, Project Co's wind up costs, and any payments that have accrued over the life of the project and which are owing by the authority to Project Co.

The authority will be obligated to pay Project Co the termination amount within a certain number of days of receipt of an invoice from Project Co for the same, and will further pay interest on any late payment amount.

The Project Agreement will usually state that payment of the termination amount is in full and final settlement of all claims arising as a result of termination of the Project Agreement. However, the authority will continue to have financial risk and exposure for claims unrelated to termination, even after the project is cancelled.

Indemnities given by the authority to Project Co under the Project Agreement, as well as certain other obligations and liabilities of the authority thereunder, will survive cancellation of the project. This creates further risk of financial losses for the authority if a Project Agreement is terminated early by the authority.

Aside from the enormous financial costs to the Government for terminating a Project Agreement early, the Government could also face political repercussions. As many remember, under mounting public pressure, in 2010 and 2011 the Ontario Government at the time cancelled two gas plant projects in Ontario, resulting in costs estimated by the Ontario Auditor General to be in excess of \$1.1 billion, well over the initial estimate. The public backlash was significant and arguably its political impact continues to be felt eight years later.

Conclusion

While the authority has the right to terminate a project at any stage, such action may be associated with significant financial and political costs for the Government. As one would expect, the authority's financial exposure due to cancellation of a P3 project is related to the

phase during which the project is cancelled – the more advanced the parties are in the procurement process, the more costly it will be for the authority to terminate the project. Accordingly, while it may seem unlikely that the authority would terminate a project that is well underway, public sentiment or political reasons to terminate a project may, in the Government's view, outweigh the financial costs to taxpayers. It is yet to be seen whether the new Progressive Conservative Government will lead Ontario to follow in the steps of its sister provinces with respect to P3 projects.

by the McMillan Projects Group

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a cautionary note

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