REQUEST FOR PROPOSALS 100 – 2009 C
CITY OF WINNIPEG
STRATEGIC PARTNER PROCUREMENT

TERM SHEET # 5

ISSUED NOVEMBER 18, 2009

Conceptual Framework for the Strategic Partnership Arrangement Compensation Model

INTRODUCTION

The City outlined a Strategic Partnership Program Compensation Schematic in Figure 1 at page 8 of the RFP. During Strategic Partnership Development Workshops with each Proponent, the City Project Team then considered various compensation models and suggestions based on Proponent experience in like public-private sector arrangements.

Set out in this Term Sheet # 5 with Exhibits attached is an update for the City's original Schematic including values and rates solely for illustrative purposes. More detail and additional concepts have been developed to further guide Proponents in the preparation of their Proposals.

Each Proponent is entitled, in accordance with RFP Section 5.10 – Exceptions, to consider and give notice in its Proposal if it so chooses, to take exception to any contents of the City's Term Sheet, not only with a view to advising what the Proponent may find unsatisfactory from its own risk/reward point of view, but also to point out potential benefits to the City upon improvements being made to the Framework now provided.

Although the Exhibits to this Term Sheet do not set out such a scenario, the Establishment Workshop will necessarily address and the parties must establish a commercially reasonable maximum or cap for the private sector partner's potential gain under the Strategic Partnership Agreement.

Definitions

Aggregate Program Target Cost means, at any given point in time, the total of: (i) all Component Target Costs and (ii) the best estimate by the parties of all outstanding Component Target Costs required to deliver the balance of the overall Program to the end of the 30 year Term.

Aggregate Program Target Outturn Cost means the Aggregate Program Target Cost plus Fees of all Components of the Program at any given point in time.

At Risk Amount (ARA) means the private sector partner's portion of the minimum amount of risk for the City on outstanding Components of the Program as assessed and agreed by the parties and recorded in the Risk Register from time to time throughout the Term of the SP Agreement.

Compensation Framework means all Registers, concepts, processes and mechanisms established or to be established by the parties to the SP Agreement for measurement of performance success against Whole-life Costs in the Program and calculation of the financial reward payable to the private sector partner from time to time under the SP Agreement.

Component of the Program means one of the four (4) aspects of the Program, namely any one of: (i) Facility operations existing at the outset of the SP Agreement; (ii) capital Projects known at the outset of the SP Agreement; (iii) operational costs of the Facilities as modified by Projects; and (iv) all future capital and operational improvement Projects added to the Program.

Component Target Cost means the Target Cost established by the Strategic Partnership for any single Component of the Program at a given point in time.

Component Target Outturn Cost means the Component Target Cost plus Fee for each Component of the Program.

Cost Performance Register means the record made throughout the Term of the original and each updated Aggregate Program Target Cost.

Earnings at Risk Account (EARA) means the record during the entire 30 year Term of the SP Agreement of all credits earned to a given point in time by the private sector partner from interest, standby fees, earned Fees on completed Components of the Program, and gain shares including those based on KPI , LESS pain shares accrued as a result of poor Program performance, including those based on KPI, none of which EARA amount may be drawn by the private sector partner when the EARA is less than the At Risk Amount (ARA) unless security in an amount and a form satisfactory to protect the City from outstanding risk is first posted.

Fee means the fixed amount to which the private sector partner may become entitled as compensation on a given Component of the Program which Fee shall be determined by application of the appropriate Margin to the Component Target Cost.

Key Performance Indicator Register (KPI Reg.) means the record of credits and deductions accrued on Key Performance Indicators (KPI) which record shall be used in the calculation of the EARA in determining the compensation amount which has accrued at any given point in the Term, to the credit or debit of the private sector partner.

Performance Guarantee Account (PGA) means an account to be established upon execution of the SP Agreement by the private sector partner posting cash or an acceptable alternate form of security (such as a letter of credit or performance bond) in an amount satisfactory to the City (not less than $20 Million (Can) and not to exceed the lesser of $50 Million or the ARA) which amount is to be determined from time to time throughout the 30 year Term of the SP Agreement to stand as security for the City to draw in the event that the private sector partner walks away, becomes insolvent, defaults causing early termination of the SP Agreement, or to offset excess amounts drawn from the EARA in the event that there is a negative balance in the EARA at the end of the SP Agreement. The private sector partner will be credited with the underlying Direct Cost of providing the PGA through the EARA.

Risk Register means the record and procedures to be established by the parties for their joint determination, from time to time throughout the 30 year Term of the SP Agreement, of the outstanding value of Program risk for which the Strategic Partnership shall provide protection for the City.

Part A

Performance Guarantee Account (PGA)

- **What is it?**

The private sector partner will be required to provide a stated performance guarantee amount. This will be in the form of cash or some form of equivalent-to-cash, such as a letter of credit or performance bond. The amount of the PGA will be no less than $20 million (Cdn). The upper limit will be the lesser of $50 million and the At Risk Amount (ARA).

- **What is it for?**

The PGA provides the City with security in the following events:

i) The private sector partner becomes insolvent or for some other reason, becomes financially incapable of fulfilling its responsibilities under the SP Agreement;

ii) The private sector partner "walks away" from its responsibilities before fulfilling its obligations under the SP Agreement;

iii) The SP Agreement is terminated by reason of default by the private sector partner; or

iv) The private sector partner has over-drawn compensation from the EARA leaving a negative balance in that account at the end of the SP Agreement.

- **What compensation will be paid to the private sector partner for posting the PGA?**

The private sector partner will be compensated at agreed upon amounts that will differ depending on the underlying cost of providing the components of the PGA. For instance:

- Agreed upon interest rate would be paid on any cash balance; and/or
- Agreed upon standby fee would be paid for any letter of credit.

- **How does the PGA tie into the Performance Registers and the Earnings At Risk Account described below?**

The purpose of the PGA is solely to provide security to the City for the possibility of the adverse situations previously described.

The compensation on the PGA is at risk based on the provisions of the Earnings at Risk Account.

Part B

Three (3) Performance Registers

1: Cost Performance Register (Cost Reg)

- **Why is this required?**

The premise for the present procurement process is that the Whole-life Cost of the City's sewage treatment plant operations will be lower if managed through a Strategic Partnership arrangement than if the City continued to construct and operate on its own. Because of this focus on Whole-life Cost, the aggregate planned compensation to which the private sector partner is ultimately entitled is dependent on the Strategic Partnership's aggregate or cumulative performance across all Components of the Program.

- **What are the implications for setting of the Aggregate Program Target Cost?**

Because of the focus on Whole-life Cost, there is notionally only one overall, Aggregate Program TC – the TC for the entire Program. Due to the nature of the Program, this aggregate TC must be built up through Components of the Program. There will be three "levels" at which Target Costs will be set and then monitored.

i) At the commencement of the Program, baseline costs for the Program will need to be established for planning purposes. The Strategic Partnership's management of the

relationship between the anticipated capital spend and Whole-life operational costs will progress from this baseline. The parties will then establish an original Aggregate Program Target Cost.

ii) Component Target Costs will be set or re-set as each Component of the Program is assessed or planned in sufficient detail. All Component TCs will ultimately aggregate to form the Program TC, which is the key TC for compensation purposes. Detailed TCs establish the detailed link between capital and operating expenditures.

iii) At the conclusion of the Program, the actual Program costs will be known, and will be measured against the Aggregate Program Target Cost as the basis for concluding on the final compensation to which the private sector partner is entitled.

- **Isn't the private sector partner's Fee established Component by Component?**

The City's Whole-life Cost approach to the Program requires an assessment of performance on the entire Program before the final compensation can be determined.

As the Component TCs are established, the Fee associated with the attainment of the TC on each Component will also be established. Then as the Components are completed, determination can be made of how much of that Fee is credited to the private sector partner. Such Fee credits (see Earnings At Risk Account below) will ultimately be paid to the private sector partner, subject to achievement of satisfactory performance across the balance of the entire Program.

- **Will cost overruns on one Component affect the Fee earned on another Component?**

The Fee is earned across the entire Program. The final aggregate Fee paid will depend on a comparison of the Aggregate Program TC with the aggregate of actual Program costs. Therefore Components on which Actual Direct Costs exceed the Component TC will "count against" past and subsequent performance where Actual Direct Costs are less than Component TC.

- **How will it work?**

See Exhibit 1.

2: Key Performance Indicator Register (KPI Reg)

- **Why is this required?**

In addition to compensation that the private sector partner can earn for cost performance, non-cost areas of performance will be targeted for ongoing improvement. These could include achievement of targets in areas such as safety, effluent quality, efficiency, environmental performance, etc. (final scope and range of KPIs to be determined by the parties).

When such targets are attained, the private sector partner will be credited for the related incentive to which the private sector partner is entitled, provided that there is satisfactory performance on the remainder of the Program.

When KPI targets are not attained by the Strategic Partnership, the private sector partner may face deductions against compensation in the EARA.

- **Are KPI incentives earned at-risk for poor cost performance?**

The private sector partner's compensation will be for the entire Program. The City cannot be in a position where it pays out a KPI incentive when cost performance has been poor. The Earnings At Risk Account section below describes the mechanics of how this would work.

- **Illustration of how will it work?**

See Exhibit 2.

3: Risk Register (Risk Reg)

- **Why is this required?**

As the individual Components of the overall Program are undertaken, the private sector partner will have opportunity, through good cost and KPI performance by the Strategic Partnership to be credited with fees and pain/gain amounts. In addition, interest, standby fees or other similar amounts will accrue to the private sector partner on the PGA.

As described under Part B – Section 1 - Cost Performance Register above, the Fee and performance gain that accrue to the credit of the private sector partner on account of any one Component will only be paid once it is clear that performance on all of the other Components does not undermine or negate gains on the one Component. Ultimately, this will be 100% clear at the end of the Term.

It is anticipated that the private sector partner will want to draw on expected earnings before the end of the 30 year Term. Therefore, the City must have a means of assessing the risk inherent in the remainder of the Program, so that the balance carried in the Earnings At Risk Account (see below) always exceeds the amount that the future Components of the Program might put at risk.

The Risk Register provides the means to assess the risk of the remaining Components of the Program.

- **How will the risk be measured?**

This is yet to be determined. However, ultimately, the assessment of risk, jointly agreed to by the parties will be translated into a minimum balance to be maintained in the Earnings At Risk Account. This minimum will be referred to as the At Risk Amount (ARA).

- **In what circumstances can withdrawals be made from the Earnings At Risk Account?**

Subject to the posting of security, withdrawals can only be made from the Earnings At Risk Account when the balance of the account exceeds the ARA. If the ARA exceeds the balance in the Earnings At Risk account, the private sector partner is not obligated to do anything.

The private sector partner may wish to withdraw cash from the Earnings At Risk Account before the ARA comparison would normally allow. In this event, cash may be withdrawn provided that the private sector partner provides a letter of credit or similar form of security that will allow the City to recoup these early withdrawals if required by subsequent circumstances.

- **How will it work?**

See Exhibit 3.

Part C

Earnings at Risk Account (EARA)

- **Why is this required?**

As the individual Components of the overall Program are undertaken, the private sector partner will have opportunity, through good cost and KPI performance of the Strategic Partnership to be credited with fees and pain/gain amounts. In addition, interest, standby fees or other similar amounts will accrue to the private sector partner on the PGA.

As the Strategic Partnership is focused on the entire Program, strong performance in the early stages, that results in fee, KPI and gain "credits", can be "undone" by poor performance in the latter stages of the Program. If this occurs, then the "credits" earned in the early stages are jeopardized by subsequent poor performance.

The purpose of the EARA is to track the "credits" earned and to deduct the impact of sub-expectation performance from these credits earned. If, hypothetically, there were no withdrawals from the EARA, the final balance in the EARA at the end of the Program would be equal to the fee and pain/gain compensation for the entire Program, as per the Cost Reg, plus KPI incentives achieved plus interest earned. The EARA simply allows the ongoing progress toward the end-of-Program result to be monitored. Through this process, the City gains protection against the risk of poor performance that only comes to light after construction and during the asset life.

- **Are withdrawals permitted from the EARA?**

Withdrawals can be made from the Earnings At Risk Account only when the balance of the Account exceeds the ARA. If the ARA exceeds the balance in the Earnings At Risk Account, the private sector partner is not obligated to do anything. Subject to the posting of security, a cash draw on the Earnings At Risk Account would not be permitted.

- **Does interest accrue on the EARA?**

Yes.

- **What happens if the EARA balance goes negative?**

The EARA balance can go negative. If it does, obviously there are no withdrawals permitted. Also, the negative can be returned to a positive balance by future "credits".

If the EARA is negative at the end of the Program, no amounts are due from the private sector partner to the City unless the private sector partner has made excessive draws from the EARA [due, for example, to risk not having been properly assessed or secured] in which case the PGA or some part of it may be applied to offset such amounts.

The private sector partner may wish to withdraw cash from the Earnings At Risk Account before the ARA comparison permits this to occur. In this event, cash can be withdrawn provided that

the private sector partner provides a letter of credit or similar form of security that will allow the City to recoup these early withdrawals if required by subsequent circumstances.

- **How will it work?**

See Exhibit 4.

Illustrative Examples

Purpose

The purpose of the illustrations attached as ***Exhibit 5*** through ***Exhibit 9*** to this Term Sheet is to show how the Compensation Model will work in certain circumstances over the entire 30 year Term of the Program. Several scenarios are depicted.

Key Pain/Gain Principles

1. Details of the pain/gain mechanism, on a Program basis, are as follows:

    a. If Actual Direct Costs are less than the Aggregate Program TC, the private sector partner earns its aggregate Fee amount and 50% of the difference between the Aggregate Program TC and Actual Direct Costs up to a cap yet to be agreed;

    b. If Actual Direct Costs are equal to the Aggregate Program TC, the private sector partner earns the Fee and there is no pain/gain adjustment;

    c. If Actual Direct Costs are between the Aggregate ProgramTC and the Aggregate Program Outturn Cost, the private sector partner's Fee is reduced by 50% of the difference between Actual Direct Costs and the Aggregate Program TC;

    d. If Actual Direct Costs exceed the Aggregate Program Target Outturn Cost, the private sector partner receives that part of the Fee, if any, that is not eroded by the pain deduction calculation.

2. In all cases, the private sector partner is paid to cover all Direct Costs incurred.

ILLUSTRATIONS:

A. Ex. 5

Actual Direct Costs equal Aggregate Program Target Cost

B. Ex. 6

Actual Direct Costs are Below Aggregate Program Target Cost

C. Ex. 7

Actual Direct Costs exceed Aggregate Program Target Cost, but are below Aggregate Program Target Outturn Cost

D. Ex. 8

Actual Direct Costs exceed Aggregate Program Target Outturn Cost

E. Ex. 9

Actual Direct Costs exceed Aggregate Program Target Outturn Cost by a Large Amount

Scenarios: Compensation Framework for the Entire Wastewater Treatment Program

Purpose

The purpose of these scenarios is to seek a common understanding how Compensation Framework will operate in a variety of circumstances. The spectrum of circumstances will be the same as those for which Illustrative Examples of the Fee/Pain-Gain mechanisms were prepared in Exhibits 5 through 9. Namely, they are:

AA. Actual Direct Costs equal Aggregate Program Target Cost	Ex. 10
BB. Actual Direct Costs are Below Aggregate Program Target Cost	Ex. 11
CC. Actual Direct Costs exceed Aggregate Program Target Cost, but are below Aggregate Program Target Outturn Cost	Ex. 12
DD. Actual Direct Costs exceed Aggregate Program Target Outturn Cost	Ex. 13
EE. Actual Direct Costs exceed Aggregate Program Target Outturn Cost by a Large Amount	Ex. 14

Approach to each scenario

For each scenario, certain assumptions have been made as follows:

PGA	For purposes only of this illustration, it is assumed that the full PGA is secured by a line of credit. For illustrative purposes only the City pays a fee of 1% annually for this arrangement.
Cost Performance	In each scenario, the assumed Aggregate Program TC and Actual Costs will be the same as in the illustrative examples A to E in the preceding section.

KPI Performance	The Program will ultimately establish the exact number of KPIs and the targets for each. For purposes of the scenarios, and for the sake of simplicity, three KPIs will be shown. For each, the most positive performance will earn an incentive credit of $1.5 million. Also, very poor performance in that KPI area could result in pain of as much as $1.2 million. The KPI incentive credits or deductions in the scenarios are meant simply as examples. There are no assumptions on how they were arrived at. The numbers presented presume an appropriate evaluation, scoring and linkage to incentive credit or deduction.
Risk Register	For each scenario, an At Risk Amount (ARA) will be assumed for the remainder of the Program, following the completion of that Component. There has been no effort to provide illustrative evaluations of risk or to reflect the linkage between the risk evaluation and the ARA.
Earnings at Risk Account	The EARA will be calculated upon completion of each Component. In addition, there will be a comparison of the EARA and the ARA to reflect whether a private sector partner draw on the EARA would be permitted and in what maximum amount. For illustrative purposes only, interest of 6% has been calculated on the ending balance of the EARA at the end of the prior year. Also for illustrative purposes, the SEWPCC construction is presumed to be complete at the end of the existing operations year and the NEWPCC construction is presumed to be complete at the end of operations year 2.