Review of Commercial Terms of Durham York Covanta Project Agreement

In November 2010, the Regional Municipalities of Durham and York signed an agreement with Covanta Durham York Renewable Energy Ltd. for the design, construction and operation of a state of the art energy-from-waste waste processing facility (the “Project Agreement”). Covanta Durham York Renewable Energy Ltd. (“Covanta”) is a subsidiary of the parent company Covanta Energy Corporation (“Covanta Energy”).

The 379 page Project Agreement was negotiated by representatives of the parties between April 2009 and October 2010. A high-level summary of the commercial terms of the agreement is set out below. This summary provides an overview of each article contained within the Project Agreement. Given the size of the Project Agreement it is not possible to describe in detail all of the commercial, technical and financial provisions contained therein. For that reason, a copy of the Project Agreement, redacted to remove any commercially proprietary information of Covanta, has been attached hereto for greater detail.

The Project Agreement is divided into three sections. The first section is addressed in Articles 2 – 29 deals with the design and construction of the Facility and payment for same. The second section of the Project Agreement, Articles 30 – 45, deals with the operations phase of the Facility. Finally, the Appendices contain technical and commercial requirements, conditions and guarantees that are applicable both during the construction of the Facility and its operation.

Article 1:

Article 1 contains the definitions of the terms that are used throughout the Project Agreement. It applies to both the design build phase and the operations phase of the project. Of particular note to Regional Council is the definition for Change in Law. This provision makes clear that the risk of a change in law after April 22, 2009, being the date that Regional Council approved Covanta as the preferred proponent, is the Region’s.

This section also contains provisions identifying what documents make up the agreement and the order of precedence between those documents.

Article 2:

Article 2 sets out a variety of rights and responsibilities enjoyed by the Regions during the design-build phase of the Project Agreement. They include:

- the appointment of representatives for project management
- granting Covanta access to the Facility lands
- ensuring the provision of utilities to the Facility lands, and
- providing waste for testing purposes

Article 3:

Article 3 sets out the principles to be applied throughout the Project Agreement when approvals or consents are sought by one party from the other.

Article 4:

Article 4 deals with the Regions’ rights of inspection during the design-build phase of the Project Agreement and the process for the issuance of notices of non-conformance resulting from those inspections.

Article 5:

Articles 5 requires the Regions to issue notice to proceed (“Notice to Proceed”) to Covanta on or before December 31, 2011 provided the conditions precedent, set out in Appendix 35, are met. A failure to issue Notice to Proceed can result in Covanta terminating the agreement; claiming a change order for delay costs; or, treating the failure to issue Notice to Proceed as a termination for convenience and claim compensation.

Issuance of Notice to Proceed triggers the commencement of the project schedule for construction as described in Article 7.

Article 6:

Article 6 describes the parties’ respective obligations pertaining to the design component; build component; the commissioning process; and the acceptance testing protocols for the Facility.

Article 7:

Article 7 establishes the commitment upon Covanta to adhere to the master project schedule for the construction.

Article 8:

Article 8 imposes the obligation upon Covanta to implement a quality management plan.

Article 9:
Article 9 imposes the obligation upon Covanta to implement a health and safety plan and to assume the designation of “constructor” under the Occupational Health and Safety Act for the purposes of the construction of the Facility.

Article 10:

Article 10 imposes the obligation upon Covanta to comply with all applicable environmental laws during the construction and to implement an environmental management plan.

This section makes clear that any pre-existing hazardous substances upon the Facility lands are the responsibility of the Regions to address.

Article 11:

Article 11 contains a variety of miscellaneous commitments by Covanta in relation to the performance of the design build work. Included within those commitments is a requirement upon Covanta to hold the sum of two million dollars ( $2,000,000) for the Regions account to be applied either towards a district heating system, or towards other necessary capital infrastructure or change orders.

Article 12:

Article 12 contains a requirement for Covanta to utilize only the preapproved material subcontractors. It also requires Covanta to, in so far as is commercially reasonable, have their subcontractors contracts adhere to the terms of the Project Agreement.

Article 13:

Article 13 establishes the lump sum price for the design and construction of the Facility and sets forth the manner in which that price shall be escalated during the term of the Project Agreement.

This section also makes clear that the lump sum price may only be adjusted pursuant to a change request under Article 15 or for escalation as provided for in that Article.

Article 14:

Article 14 contains the requirement for the Regions to pay the lump sum price to Covanta upon the attainment of the milestones within the payment schedule. This Article also establishes the mechanism through which payment requests shall be made by Covanta. Interest upon unpaid amounts is provided for in this section.
This section establishes the principle that, subject to three preconditions, Covanta shall continue to proceed with the work despite a dispute regarding the amount of a progress payment.

Article 14 also provides the Regions the right to set-off against the milestone payments any costs arising out of non-conformity of the construction work with Covanta’s contractual obligations, Covanta’s failure to pay its subcontractors or suppliers or its failure to bond off any liens filed against the project.

**Article 15:**

Article 15 is a detailed provision establishing the process by which changes in the work, however initiated, will be addressed. It utilizes a change order/change request process. The change process described in Article 15 applies to both the design-build phase and the operations phase of the Project Agreement.

**Article 16:**

This Article deals with the impact of delays upon the project schedule caused by a *force majeure* event. The definition of what is a *force majeure* is found in Article 1.

**Article 17:**

Article 17 sets forth various guarantees related to the construction of the Facility. These include guarantees related to design, workmanship, and the quality of the equipment and other products used in the construction of the Facility.

This section also enshrines the performance guarantees contained within Appendix 19, and the performance requirements set forth in Article 42.

**Article 18:**

Article 18 establishes a regime of liquidated damages which can be imposed in regards to a number of potential breaches of contractual requirements by Covanta. The types of liquidated damages which can be imposed under this contract as follows:

- schedule liquidated damages for failure to achieve the service commencement by the target date
- lump sum performance liquidated damages for a failure to achieve at Acceptance the required:
  - throughput capacity
  - electrical production rates
- performance liquidated damages for a failure, during operations, to achieve
  - throughput capacity guarantees
  - electrical production guarantees
  - residue quantities guarantees

**Article 19:**

Article 19 imposes the obligation upon Covanta to obtain and maintain the insurance described in Appendix 20.

**Article 20:**

This Article sets out the various forms of security which Covanta must provide to the Regions under the Project Agreement. There are different securities required during the design-build phase and those retained during the operations phase of the project. Those securities are as follows:

- During the design build phase, a performance bond valued at 50% of the lump sum price
- During the design build phase, a labour and material bond valued at 50% of the lump sum price
- Subsequent to the completion of the design build phase, a performance holdback of 5% of the lump sum price for the duration of the recall period, which is two years
- During the operations phase, a renewable performance bond valued at 100% of the total annual operating fee for one year (approximately $14 million dollars)
- During the operations phase, operations performance security in the form of a letter of credit* equal to one quarter of the total annual operations fee for the upcoming year
- a parent company guarantee from Covanta Energy valued at 50% of the lump sum price for matters arising out of the design-build phase and 30% of the lump sum price during the operations phase
- handback security to secure the completion of any handback works, as discussed in Article 44

(*Note: This letter of credit is renewed annually. Additionally, in the event that Covanta Energy’s credit rating drops to a certain pre-established threshold, as determined by Standard and Poors or Moodys Investors Services rating services, then Covanta’s obligation regarding the operations performance security shall increase to the equivalent to three-quarters of the total annual operations fee)

Covanta’s overall liability under the Project Agreement is capped at the total value of the lump sum price.

**Article 21:**
Article 21 of the Project Agreement discusses various tests and procedures that Covanta can be required to conduct and the rights of the Regions to receive copies of those test results. This article also provides for the Regions right to perform testing on their own behalf including the right to install monitoring devices.

The Regions right to perform testing and install monitoring devices is not qualified. However, to the extent that the Regions exercise of these rights impacts Covanta’s ability to achieve their performance guarantees then Covanta will be relieved of said guarantee.

Article 22:

Article 22 lists the various types of reports and information that Covanta must provide, or make available to, the Regions during the design-build phase of the Project Agreement.

Article 22 also establishes the Region’s right to inspect data, contract documents and the Facility itself.

Article 23:

Article 23 deals with Covanta’s obligations in the event that a construction lien is registered against the Facility.

Article 24:

Article 24 deals with the parties respective obligations to indemnify the other under the Project Agreement. Covanta’s obligations to indemnify the Regions is capped at the value of 100% of the lump sum price subject to a number of carve outs from that cap.

Article 25:

Article 25 deals with the ‘without cause’ termination of the Project Agreement by the Regions. The Regions may suspend or terminate the Project Agreement, without a default by Covanta, as follows:

- prior to the last day of the ninth year of the after service commencement provided the Regions are abandoning the project
- after the tenth anniversary of the service commencement date for any reason

A termination without cause under this article may trigger a requirement under Article 27 to pay a termination fee to Covanta.
Article 26:

Article 26 is the default and remedy provision of the Project Agreement. It identifies various events which can be construed a default under the Project Agreement.

Article 26 also sets out the remedies available to the parties in the event of a default.

Article 27:

Article 27 identifies the payments that will be due and owing by the Regions to Covanta in the event that the Project Agreement is terminated, pursuant to Article 25, for convenience.

For terminations for convenience related to project abandonment, the Regions will have to compensate Covanta for:

- the value of work performed to date
- the reasonable costs of cancelling its contracts, including employment agreements, and
- demobilization costs

Terminations for convenience after the tenth anniversary of service commencement, for reasons other than project abandonment, require the Regions to compensate Covanta for:

- the value of work performed to date
- the reasonable costs of cancelling its contracts, including employment agreements
- demobilization costs, and
- a termination fee equal to a fractional amount of one year’s total annual operations fee

Article 28:

Article 28 is the dispute resolution clause in the Project Agreement. Generally contractual disputes are to be resolved by negotiation or mediation to be followed by arbitration.

Article 28 establishes an expedited process for obtaining interim resolution of disputes valued under $250,000 during the construction period. This process allows for an adjudication of the dispute within 30 days of notification. This interim decision is binding upon the parties until after substantial completion, at which point it can be revisited by either party.
Article 29:

Article 29 sets out a variety of representations and warranties by Covanta to the Regions regarding its knowledge concerning the matters addressed in the Project Agreement.

Article 30:

Article 30 is the beginning of the provisions focused upon the operations phase of the Project Agreement. It identifies the scope of the work and the term of the operations phase of the Project Agreement.

The term of the operations phase of the Project Agreement is twenty years with two, qualified, five-year rights of renewal.

Article 31:

Article 31 deals with the management of the Facility during the operations phase. It contains provisions requiring Covanta to:

- cooperate with the Regions regarding inspections of the Facility and business and financial records during the operations phase
- develop and provide the Regions with copies of operations and maintenance manuals for the Facility
- adhere to requirements pertaining to the human resources to be employed by Covanta at the Facility
- to maintain the Facility and the Facility lands in a proper state during the term of the operations phase
- maintain all required equipment, consumables, spare parts, fuels and chemicals on-site during the term of the operations phase, and
- maintain adequate security and fire protection throughout the operations phase pursuant to the terms of this Article

This Article also establishes the Regions’ right to operate the weigh scales throughout the operations phase.

Article 32:

Article 32 identifies that only the Regions may bring waste to the Facility for processing.

The Regions are obliged to pay Covanta for processing 140,000 tonnes of waste regardless of whether it is or is not delivered.
In the event that the Regions fail to deliver at least 90% of the guaranteed throughput for the Facility, then Covanta will be relieved from its electricity production guarantees due to the insufficiency of available fuel.

Article 32 relieves Covanta from any liquidated damages for failing to achieve electricity production guarantees in the event that the caloric value of the waste falls outside of the guarantee range of 11 – 15 MJ/kg.

In the event that unacceptable waste is delivered to the Facility, then Covanta and the Regions will work together to separate, remove and dispose of this waste, at the Regions cost.

Article 32 requires the Regions and Covanta to optimize the flow of waste from the Regions to the Facility.

Article 33:

Article 33 addresses a variety of operational requirements including:

- operating hours
- hours for the receipt of waste
- standards of operation
- provisions dealing with ensuring the safe and efficient flow of traffic into and out of the Facility
- the weighing of waste
- a waste screening protocol
- provisions dealing with the recovery of ferrous and non-ferrous metals from the bottom ash
- provisions dealing with the management of the fly ash
- and provisions dealing with the annual shutdowns of the Facility for maintenance and refurbishment
- environmental operating requirements, and
- residue storage

The commitment to operate the Facility in compliance with all applicable environmental laws is contained within this provision. The Regions right to conduct monitoring and stack tests of the Facility is contained in this Article.

Article 34:

Article 34 requires Covanta to sell all metals recovered from the ash to a recycling facility approved by the Regions and to share the revenue with the Regions.

Article 34 commits Covanta to dispose of the fly and bottom ash produced by the Facility.
Covanta is responsible for the transport and disposal of all by-pass waste (being acceptable waste not capable of being processed due to the Facility not being operating at the time).

The commitment not to dispose of residue and by-pass waste in the state of Michigan is contained within this article.

**Article 35:**

Article 35 sets out the provisions dealing with testing requirements. Covanta is required to have an independent testing consultant conduct stack emissions testing for the purposes of providing said reports to the Ministry of the Environment.

Covanta is obliged to have an independent testing agent test and report to the Regions on the bottom ash generated by the Facility.

**Article 36:**

Article 36 identifies Covanta’s reporting obligations to the Regions. These obligations include:

- report re interruption in operation
- a detailed monthly operating report
- a detailed year-end report
- daily reports from the Continuous Emissions Monitoring Systems (“CEMS”)
- on-line access to CEMS data
- an external electronic display monitoring board displaying the CEMS data
- a web-site for public access to CEMS data, and
- outage reports on scheduled and unscheduled shutdowns of the Facility

Article 36 requires Covanta to establish annual and five-year service and maintenance plans and a life-cycle plan for the Facility.

**Article 37:**

Article 37 deals with payments to Covanta during the operations phase of the Project Agreement and with performance incentives and revenue sharing.

Covanta is paid an annual fee (the “total annual operating fee”) for 140,000 tonnes of processed waste regardless of whether anything less than that is delivered to the Facility.
Different components of the total annual operating fee receive different treatment for escalation during the term of the Project Agreement. Some receive full escalation, others receive 80% escalation, and others no escalation. In addition, certain components of the total annual operations fee are flow-through items, the actual cost of which will be paid for by the Regions. The flow-through items are purchased utilities, insurance costs, taxes and auxiliary fuel costs.

Article 37 requires the sharing of revenues from the recovery of metals from the ash and any beneficial reuse of the ash generated by the Facility. These revenues are shared between Covanta and the Regions on the basis of different proportions.

Article 37 implements several potential performance adjustment’s to the total annual operating fee designed to provide positive and negative financial incentives to Covanta with respect to its environmental record, its service level, and the amount of steam it generates for electricity. These performance adjustments allow for:

- an Environmental Performance Adjustment which:
  - provides for a potential positive or negative adjustment of the total annual operating fee of up to 2 percent based Covanta’s emissions during the previous year

- the Service Level Adjustment which:
  - provides for a potential positive or negative adjustment of the total annual operating fee of up to 1 percent documented operating conditions at the Facility during the previous year

- a Steam Generation Adjustment which:
  - provides for a positive adjustment to the total annual operating fee in the event that Covanta exceeds its electricity production guarantees. The adjustment would be in an amount equivalent to 50 percent of the value of any additional electricity generated

Finally, Covanta is required to make arrangements for the transportation and disposal of by-pass and non-processible waste, the costs of which are to be reconciled with the Regions immediately after year end.

Article 38:

Article 38 provides detailed direction as to how Covanta is to invoice the Regions, and how the Regions are to pay Covanta.

Article 39:
Article 39 sets Covanta’s data and record-keeping obligations during the operations phase of the Project Agreement.

Also contained within this Article is Covanta’s commitment to ensure the Facility is accessible for inspection by the MOE and the Regions throughout the term.

Article 39 provides the Regions the right to audit Covanta’s financial records pertaining to the operation of the Facility.

**Article 40:**

Article 40 references that changes in the operations work initiated by the Regions shall be addressed through the change process in Article 15.

**Article 41:**

Article 41 sets out the process to be utilized in the event that either the Regions or Covanta propose to construct a capital improvement to the Facility. Any impacts upon Covanta’s time and/or cost to perform the work covered by the Project Agreement are to be addressed through the change process stipulated in Article 15.

Article 41 also addresses the process to be used in the event that the Regions request the production of greater than 7.4 MW of thermal heat from the Facility for district heating. Covanta guaranteed electricity production premised upon an assumption that the thermal draw for district heat would not exceed 7.4 MW. In the event that the greater than 7.4 MW is proposed, then the parties must investigate and agree upon the impact of that upon Covanta’s guarantees, cost of performing the work, and the total annual operating fee. Only upon the agreement of the parties upon these issues can a thermal load in excess of 7.4 MW be taken from the Facility for district heat.

**Article 42:**

Article 42 sets out a number of specific operating requirements for the Facility including:

- and annual availability of 7884 hours in a twelve month period;
- to process all Acceptable waste received
- and to meet or exceed the performance guarantees as addressed in the Project Agreement.

Article 42 also contains covenants from Covanta pertaining to the operation of the Facility including:
- to operate the Facility so as to maximize the production of energy and meet its electricity production guarantees
- to at all times comply with the law
- to operate the Facility in compliance with all environmental laws
- to implement an environmental management system consistent with ISO 14001
- to transport and dispose of fly ash in compliance with all environmental laws

Article 42 then sets out the obligations upon Covanta in the event that it violates any of the aforementioned provisions.

Finally Article 42 makes clear that a breach of the provisions requiring Covanta to take immediate and diligent action in good faith to cure the breach will entitle the Regions to exercise their remedies under Article 26.

Article 43:

Article 43 contains a variety of representations and warranties by Covanta related to ensuring payment for labour, materials and services are made when due and that any liens registered against the Facility or its lands are paid or bonded off.

Article 44:

Article 44 sets out the requirements that come into effect at or around the end of the term of the Project Agreement. These requirements include:

- Covanta and the Regions conducting a survey of the condition of the Facility three years prior to the end of the term
- if the survey indicates that the Facility will not be in the condition stipulated in the handback requirements in Appendix 27, then Covanta must:
  o provide the Regions with a proposal to conduct such work during the remaining term of the Project Agreement as to bring it within those requirements
  o Upon approval of that plan, Covanta must secure its commitment by providing a letter of credit for the cost of the handback works, and
  o Covanta must carry out the handback works
  o In the event that Covanta fails to meet its requirement to complete the handback works then the Regions may use the security posted to perform the works.

Article 45:

Article 45 sets out a variety of miscellaneous legal provisions.
Appendices to Project Agreement

Appendix 1:

Appendix 1 contains the technical requirements pertaining to the design, construction and operation of the Facility.

Appendix 2:

Appendix 2 sets out the requirements for the quality management plan that Covanta is obliged to prepare.

Appendix 3:

Appendix 3 will be the environmental management plan that Covanta must prepare prior to substantial completion of the Facility.

Appendix 4:

Appendix 4 will be where Covanta identifies its material subcontractors within 60 days of receiving notice to proceed.

Appendix 5:

Appendix 5 is the master project schedule.

Appendix 6:

Appendix 6 is the form for the project manager’s certificate for approval of a milestone payment request.

Appendix 7:

Appendix 7 is the form for a milestone billing report to be delivered by Covanta with the milestone payment request.

Appendix 8:

Appendix 8 is a form for a milestone payment request to be delivered by Covanta to the Regions.

Appendix 9:

Appendix 9 is the milestone payment schedule stipulating the percentage of the total lump sum price to be paid upon the achievement of each milestone.
Appendix 10:

Appendix 10 sets out the pre-acceptance and acceptance testing protocols, procedures and requirements.

Appendix 11:

Appendix 11 will be where Covanta sets out the hourly rates for its trades within 60 days of receipt of notice to proceed.

Appendix 12:

Appendix 12 references the training plan to be developed by Covanta prior to start-up of the Facility.

Appendix 13:

Appendix 13 references the commissioning plan that Covanta must develop prior to commencement of the commissioning of the Facility.

Appendix 14:

Appendix 14 is the form for the acceptance test declaration to be submitted by Covanta upon completion of the acceptance test work.

Appendix 15:

Appendix 15 is the form for the acceptance test certificate to be delivered by the Regions upon receipt and review of the acceptance test declaration from Covanta.

Appendix 16:

Appendix 16 is the form of the performance bond required to be put up as security by Covanta.

Appendix 17:

Appendix 17 is the form of the labour and materials bond required to be put up as security by Covanta.

Appendix 18:
Appendix 18 is the form for the acceptance certificate to be issued by the Regions upon acceptance of the Facility.

Appendix 19:

Appendix 19 contains Covanta’s performance guarantees related to electricity production, throughput capacity, residue quality, residue quantity, metals recover, other material recovery, Facility availability, and emission limits.

Appendix 20:

Appendix 20 sets out the specific insurance requirements to be maintained by Covanta throughout the phases of the Project Agreement.

Appendix 21:

Appendix 21 references Covanta’s occupational health and safety plan to be developed and submitted prior to substantial completion.

Appendix 22:

Appendix 22 references Covanta’s communications plan to be developed and submitted prior to substantial completion.

Appendix 23:

Appendix 22 references Covanta’s emergency services plan to be developed and submitted prior to substantial completion.

Appendix 24:

Appendix 24 is a placeholder appendix.

Appendix 25:

Appendix 25 contains the form for the parent company guarantee to be provided by Covanta Energy.

Appendix 26:

Appendix 26 is where Covanta will identify its rates for rented equipment, which rates shall be provided prior to substantial completion.

Appendix 27:
Appendix 27 sets out the handback requirements discussed in Article 44 of the Project Agreement.

Appendix 28:

Appendix 28 contains the requirements that Covanta must adhere to in the preparation of an annual service plan pursuant to Article 36 of the Project Agreement.

Appendix 29A:

Appendix 29A contains the requirements that Covanta must adhere to in the preparation of a five-year maintenance plan pursuant to Article 36 of the Project Agreement.

Appendix 29B:

Appendix 29B contains the requirements that Covanta must adhere to in the preparation of a life cycle plan pursuant to Article 36 of the Project Agreement.

Appendix 30:

Appendix 30 contains the form for the renewable performance bond that Covanta must provide during the operations phase of the Project Agreement.

Appendix 31:

Appendix 31 contains Covanta’s Form 3 submission from the RFP-604-2008 containing their pricing information for the operation and maintenance of the Facility.

Appendix 32:

Appendix 32 references the noise control plan that Covanta must develop and submit prior to substantial completion.

Appendix 33:

Appendix 33 references the odour control plan that Covanta must develop and submit prior to substantial completion.

Appendix 34:

Appendix 34 contains the criteria for determining the acceptability of waste to be delivered to the Facility. This appendix contains daily, weekly and monthly maximum delivery amounts which may be delivered to the Facility.
Appendix 35:

Appendix 35 identifies the conditions which the parties must attain, or waive, in order for the contractual obligations of the parties under the Project Agreement to commence. Largely these preconditions relate to the attainment of the regulatory approvals, and there having been no change in law which materially impacts the cost or operation of the Facility. The Conditions precedent contained within Appendix 35 must be attained or waived by the parties on or before December 31, 2011 failing which either party may terminate the agreement.