

THE PUBLIC-PRIVATE  
PARTNERSHIP  
LAW REVIEW

THIRD EDITION

**Editors**

Bruno Werneck and Mário Saadi

THE LAWREVIEWS

THE PUBLIC PRIVATE PARTNERSHIP  
LAW REVIEW

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# PREFACE

We are very pleased to present the third edition of *The Public-Private Partnership Law Review*. Notwithstanding the number of articles in various law reviews on topics involving public-private partnerships (PPPs) and private finance initiatives (in areas such as projects and construction, real estate, mergers, transfers of concessionaires' corporate control, special purpose vehicles and government procurement, to name a few), we identified the need for a deeper understanding of the specific issues in this topic in different countries. The first and second editions of this book were the initial effort to fulfil this need.

In 2014, Brazil marked the 10th year of the publication of its first Public-Private Partnership Law (Federal Law No. 11,079/2004). Our experience with this law is still developing, especially in comparison with other countries where discussions on PPP models and the need to attract private investment into large projects dates from the 1980s and 1990s.

This is the case for countries such as the United Kingdom and the United States. PPPs have been used in the United States across a wide range of sectors in various forms for more than 30 years. From 1986 to 2012, approximately 700 PPP projects reached financial closure. The UK is widely known as one of the pioneers of the PPP model; Margaret Thatcher's governments in the 1980s embarked on an extensive privatisation programme of publicly owned utilities, including telecoms, gas, electricity, water and waste, airports and railways. The Private Finance Initiative was launched in the UK in 1992 aiming to boost design-build-finance-operate projects.

In certain developing countries, PPP laws are more recent than the Brazilian PPP law. Argentina was the first country in Latin America to enact a PPP Law (Decree No. 1,299/2000, ratified by Law No. 25,414/2000). The Argentinian PPP Law was designed to promote private investment in public infrastructure projects that could not be afforded exclusively by the state, especially in the areas of health, education, justice, transportation, construction of airport facilities, highways and investments in local security. In Mozambique, Law No. 15/2011 and Decree No. 16/2012 govern the Public-Private Partnerships (PPP) Law and other related PPP regulations, which establish procedures for contracting, implementing and monitoring PPP projects. In Paraguay, a regulation establishing the PPP regime has been enacted (Law No. 5,102) to promote public infrastructure and the expansion and improvement of services provided by the state; this law has been in force since late 2013.

In view of the foregoing, we hope a comparative study covering practical aspects and different perspectives regarding PPP issues will become an important tool for the strengthening of this model worldwide. We are certain this study will bring about a better dissemination of best practices implemented by private professionals and government authorities working on PPP projects around the world.

With respect to Brazil, the experience evidenced abroad may lead to the strengthening of this model in our country. In our last preface, we called your attention to one specific feature of the PPP law in Brazil: state guarantees. This feature permits that the obligation of the public party to pay a concessionaire be guaranteed by, among other mechanisms authorised by law: (1) a pledge of revenues; (2) creation or use of special funds; (3) purchase of a guarantee from insurance companies that are not under public control; (4) guarantees by international organisations or financial institutions not controlled by any government authority; or (5) guarantees by guarantor funds or state-owned companies created especially for that purpose.

The state guarantee pursuant to PPP agreements is an important innovation in administrative agreements in Brazil; it assures payment obligations by the public partner and serves as a guarantee in the event of lawsuits and claims against the government. This tool is one of the main factors distinguishing the legal regimen of PPP agreements from ordinary administrative agreements or concessions – one that is viewed as crucial for the success of PPPs, especially from private investors' standpoint.

Nevertheless, the difficulty in implementing state guarantees on PPP projects has been one of the main issues in the execution of new PPP projects in the country. This point is made worse due to the history of government default in administrative contracts.

In other jurisdictions, however, state guarantees are not a rule. Unlike PPP projects in developing countries, government solvency has not historically been a serious consideration in other jurisdictions. That is the case in countries such as Australia, France, Ireland, Japan, the United Kingdom and the United States.

We expect that the consolidation of PPPs and the strengthening of the government in Brazil may lead to a similar model, enabling private investments in areas where the country lacks the most.

Brazil must adopt cutting-edge models for awarding PPP agreements. The winner is usually chosen based solely on the price criterion (offering of lower prices or highest offers), which sometimes leads to projects lacking advanced or tailor-made solutions. Despite the legal provisions on the role of technical evaluation of offers, they are becoming less relevant. However, some ongoing discussions regarding amendments to the Brazilian procurement legislation and new criteria, which are based on the international experience, could (fortunately) be approved.

In this field, we highlight the current discussions regarding the amendment to the Federal Procurement Law (Federal Law No. 8,666/1993), which is expected to expedite public procurement in Brazil. One of the main innovations proposed in this debate is the competitive dialogue, a type of bid in which the authority engages with bidders to discuss and develop one or more solutions for the tendered project. After the conclusion of the dialogue phase, the authority will establish a term for the submission of bids.

The competitive dialogue is a reality in many jurisdictions (e.g., Australia, Belgium, China, France, Ireland, Japan, and the United Kingdom). In Japan, for example, some projects are procured through the competitive dialogue process. This process may be adopted if a relevant authority is unable to prepare a proper service requirement, in which case it proposes a dialogue with multiple bidders simultaneously to learn more about the specific service it seeks to implement. As another example, in France a dialogue will be conducted with each bidder to define solutions on the basis of the functional programme. At the end of the dialogue period, the procuring authority will invite the candidates to submit a tender based on the considered solutions. After analysis of the tenders, a partnership contract will

be awarded to the bidder with the best price in accordance with the criteria established in the contract notice or in the tender procedure.

We hope the importance of this tool is recognised in Brazil and reflected in our legislation.

In the second edition of this book, our contributors were drawn from the most renowned firms working in the PPP field in their jurisdictions, including Argentina (M&M Bomchil), Australia (Allens), Belgium (Liedekerke), China (Zhong Lun), Denmark (LETT), France (White & Case), India (Seth Dua), Ireland (Maples and Calder), Japan (Mori Hamada & Matsumoto), Mozambique (TPLA), Nigeria (G Elias), Paraguay (Parquet & Asociados), Philippines (SyCip Salazar Hernandez & Gatmaitan), Portugal (Vieira de Almeida), Tanzania (Velma), the United Kingdom (Herbert Smith Freehills) and the United States (Kilpatrick Townsend & Stockton). We would like to thank all of them and our new contributors for their support in producing *The Public-Private Partnership Law Review* and in helping in the collective construction of a broad study on the main aspects of PPP projects.

We strongly believe that PPPs are an important tool for generating investments (and development) in infrastructure projects and creating efficiency not only in infrastructure, but also in the provision of public services, such as education and health, as well as public lighting services and prisons. PPPs are also an important means of combating corruption, which is common in the old and inefficient model of direct state procurement of projects.

We hope you enjoy this third edition of *The Public-Private Partnership Law Review* and we sincerely hope that this book will consolidate a comprehensive international guide to the anatomy of PPPs.

We also look forward to hearing your thoughts on this edition and particularly your comments and suggestions for improving future editions of this work.

**Bruno Werneck and Mário Saadi**

Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados

São Paulo

March 2017

# ARGENTINA

*María Inés Corrá and Ximena Daract Laspiur*<sup>1</sup>

## I OVERVIEW

A public-private partnership (PPP) is an institution designed to develop an infrastructure project through a stable partnership between the public and private sectors, and on the grounds of joint interests and a distribution of risks.

Under a PPP regime, individuals and companies may enter into a cooperative agreement with the state to develop infrastructure projects or to provide public services.

The main characteristics of these particular partnerships are: (1) a community of interest between the public and private sectors; (2) a proper distribution of risks; (3) the financial sustainability of the project; (4) reductions of the costs of the infrastructure projects; (5) better conditions to access the capital markets; (6) safeguards for early termination by the state, based on the criteria of opportunity, merit or convenience; and (7) prohibition or limitation of the use of *ius variandi* power by the state.

In Argentina, the first legal framework to govern PPPs was established by Decree No. 1299/2000, ratified by Law No. 25,414 (2000). This Decree aimed at promoting private investment in public infrastructure projects that could not be afforded exclusively by the state, especially in the areas of health, education, justice, domestic transportation, airport facilities, highways and homeland security.

In particular, according to the provisions of Decree No. 1299/2000, partnerships had to be created through a contract, in accordance with the corresponding contracting procedure. Likewise, the improvement of the financial conditions and the reduction of costs became possible as a result of the creation of a fiduciary fund, which secures the payments and costs related to the project.

Since Argentina is a federal country, with both federal and provincial levels of legal organisation, the federal government and each province have their own body of law on public infrastructure. Following the passage of Decree No. 1299/2000, several provinces adhered to the regime approved therein.

In early 2001, Law No. 25,414 was abrogated by Law No. 25,556. Therefore, Decree No. 1299/2000 was deemed abolished from that time on.

On 16 August 2005, the Executive issued Decree No. 967/2005, published in the Official Gazette on 15 August 2005 (still in force). This Decree approved the General Regime for Public-Private Partnerships as Annex I (the 2005 Regime). Several provinces adhered to this Decree.

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<sup>1</sup> María Inés Corrá is a partner and Ximena Daract Laspiur is an associate at M & M Bomchil. The authors would like to thank Magdalena Carbó, an associate at M & M Bomchil, for her contribution to the chapter.

This second legal framework emphasised the necessity of obtaining financial resources from the capital markets. To do so, the regime stated that partnerships shall be constituted and organised as trust funds or publicly traded companies.

Just as in the regime approved by Decree No. 1299/2000, the 2005 Regime attempted to provide legal certainty and predictability by limiting the regulatory risk, in order to reduce the costs and to improve the conditions to access the capital markets.

Finally, on 30 November 2016, Congress passed Law 27,328 on Public-Private Partnership Contracts, which became effective from 9 December 2016 (the 2016 PPP Regime). The purpose of the new regime is to regulate and stimulate private investment in key sectors of the economy, such as infrastructure, housing, services, production, applied research and technological innovation.

Pursuant to Section 1 of the new regime, PPPs can pursue the following public purposes: (1) design; (2) construction; (3) expansion; (4) improvement; (5) maintenance; (6) exploitation; (7) operation; (8) financing of projects; and (9) the supply of equipment or other goods.

According to the 2016 PPP Regime, public-private contracts are deemed as an alternative way for the state to perform public works or to develop public services, different from the administrative regime set forth in Laws No. 13,064 on Public Works Act, No. 17,520 on Concession of Public Works Act and Decree No. 1023/2001 on General Public Procurement, any of which are applicable to public-private contracts. The Executive shall decide in each case what is the most suitable system to satisfy the public needs.

Like in the prior regimes, the provincial states and the City of Buenos Aires have been invited to join the new regime by issuing similar laws in their jurisdictions.

The implementing decree of the new Law is still pending.

As for the future prospects, the new environment resulting from the December 2015 elections and from the enactment of Law 27,328 creates reasonable expectations on having more opportunities to access capital markets and to take advantage of the PPP tool for the development of infrastructure projects in several strategic areas of public interest.

## **II THE YEAR IN REVIEW**

Several key initiatives have been promoted during 2016 in order to create an investment-friendly environment. The set-up of the 2016 PPP Regime is one of those key initiatives aimed at encouraging foreign and domestic investments in strategic sectors all throughout the country.

Other relevant initiatives are: (1) the creation of the Argentina Investment and Trade Promotion Agency; (2) the removal of capital controls and repatriation and of export taxes and import restrictions; (3) the re-launch of the National Statistics Bureau (INDEC); (4) the payment of defaulted debt, regaining access to global financial markets; and (5) the implementation of a government e-platform for tenders and public accounts.

As for the most recent PPP developments, we may note the Renewable Energy Programme launched by the federal government during 2016 under a tailor-made PPP regime set up by Law No. 27,191 (the Renewable Energy Law) and by Decree No. 882/2016 (RenovAR), as a result of which almost 60 renewable energy projects have been awarded, representing a US\$4 billion investment.

The 2016 PPP Regime has been adopted as a general framework. Among other relevant projects promoted by the federal state, the 2016 PPP Regime could help to develop

partnerships for exploration and exploitation of conventional and non-conventional hydrocarbons, especially in the Vaca Muerta shale basin, located in the province of Neuquén.

### **III GENERAL FRAMEWORK**

#### **i Types of public-private partnership**

Section 1 of the 2016 PPP Regime sets forth that PPP contracts shall be designed in accordance with the special features of each project and its financial needs.

Under that flexible criterion, Section 7 of the 2016 PPP Regime sets forth that the PPPs in charge of the execution and performance of the PPP contract may be organised as a special purpose vehicle (SPV), a trust fund, or any other vehicle or associative organisation.

SPVs shall be incorporated as corporations. Trust funds shall be organised as financial trust funds pursuant to the Civil and Commercial Code provisions on the matter. Furthermore, PPPs may be constituted and organised in such a way that allows them to issue securities under the provisions of the Capital Market Law No. 26,831.

Further, the 2016 PPP Regime explicitly allows the state to create new corporations or trust funds to perform PPP projects (Section 8).

#### **ii The authorities**

Under the 2016 PPP Regime, the performance of the PPP contract is subject to the control of the public contracting party or the public body created for that purpose in the relevant jurisdiction. In addition, the implementing decree or the bidding terms and conditions of the PPP project might require the appointment of external independent auditors to supervise the performance of the project (Section 21).

Furthermore, pursuant to Section 22 of the 2016 PPP Regime, the General Audit Agency shall control all PPP contracts, their performance and results.

In addition, the new regime sets forth two new bodies: (1) the Public-Private Partnership Unit (the PPP Unit), which shall centralise the regulation of PPP contracts, assist in the development and regulation of the PPP projects and assist the public procurement agencies in the design and structuring of PPP projects (Sections 28 and 29); and (2) a Congress bicameral commission in charge of monitoring the PPP projects' performance and compliance with the PPP Regime (Section 30).

#### **iii General requirements for public-private partnership contracts**

In accordance with the 2016 PPP Regime, PPP contracts shall regulate, at a minimum, the items described in the law (Sections 4 and 9).

Some of those items are: (1) the contractual term and potential extensions, which cannot exceed 35 years in whole and which must ensure recovery of investments, repayment of financing and a reasonable profit; (2) the parties' duties and obligations and a fair and efficient distribution of the contract contributions and risks between the parties, ensuring the best conditions to prevent, assume or mitigate them, in order to minimise the cost of the project and facilitate the financing conditions; (3) the minimum technical requirements applicable to the infrastructure involved in the project; (4) the procedures for the revision of the contract price so as to preserve its economic-financial equation; (5) the state's power to unilaterally introduce modifications should be restricted only to the project performance and under no circumstance exceed 20 per cent above or below the total contract amount. Any such modification shall be compensated so as to keep the original economic-financial

balance; (6) the guarantee of minimum income if such provision is agreed upon; (7) the events and procedure applicable to the contract's termination and applicable compensations. If termination operates based upon public interest grounds, no state liability limitation can apply, neither directly nor supplementarily or analogically; (8) the assignment of the PPP contract rights or receivables arising thereof as collateral, as well as the right to securitise cash flows; (9) the right to temporarily suspend performance of obligations in case of state default; (10) the contractor's right to totally or partially assign the PPP contract to the extent the assignee meets the proper conditions to be a contractor and at least either 20 per cent of the contractual term has expired, or 20 per cent of the committed investment has been made. Contract assignment shall be subject to the state contracting party, funders and guarantors' approval. Under these conditions, the assignment releases the original contractor of all duties and changes; (11) the assets regime; and (12) the procedures and mechanisms of settling contractual disputes. Arbitral agreements setting forth foreign venues shall be expressly approved by the Executive and communicated to Congress.

#### **IV BIDDING AND AWARD PROCEDURE**

##### **i Expression of interest**

Pursuant to Sections 1 and 4(a) of the 2016 PPP Regime, the submission of a project to the PPP Regime requires a previous justification by the state on the reasons why the PPP structure is suitable for the satisfaction of the public interest pursued through it.

By the same token, Section 13 sets forth that, prior to any invitation for a PPP public tender, the tender authority shall issue an opinion on, *inter alia*, the feasibility of the PPP project and the reasons underlying the submission of the project to the PPP Regime as the most suitable solution for the public interest. That opinion shall be communicated to the PPP Unit for its publicity.

##### **ii Call for proposals**

The contractor may be selected by public or competitive, national or international tender depending on the complexity of the project, the ability of local companies to participate, economic and/or financial reasons connected to the project's special features, and/or the origin of the funds in the case of projects that require external financing.

Pursuant to the 2016 PPP Regime, the provision of assets and services made in the context of PPP contracts shall have a minimum domestic component of 33 per cent (Section 12). This legal requirement may be exceptionally set aside or limited by the Executive if the project special features require so (Section 12).

In case the PPP contract commits resources from the public budget, prior to the call for tenders or competition, it must obtain the authorisation to commit future fiscal exercises, as provided in Section 5 of Law 24,156 (Section 16).

If necessary, when the complexity or size of the project require so, a transparent procedure of consultation, discussion and exchange of views between the contractor and the prequalified parties may be established, allowing the development and definition of the most convenient solution to the public interest on the basis of which the tenders should be formulated (Section 14).

The 2016 PPP Regime makes special focus on the need of transparency, publicity and competitive conditions for bidders, and includes specific anti-corruption provisions.



### **iii Evaluation and grant**

The contract shall be awarded to the most convenient offer, in accordance with the conditions established in the bidding terms and conditions. This Regime also requires the inclusion of selection guidelines that give comparative advantages in favour of domestic companies and small and medium-sized enterprises. Nevertheless, these comparative advantages may be excluded if that is deemed necessary or convenient due to the particular features of the project (Section 15).

## **V THE CONTRACT**

### **i Payment**

As regards the state's contributions and payments, according to Section 9(g) of the 2016 PPP Regime, these contributions may consist of: (1) contributions of money; (2) assignment of funds obtained from public credit operations; (3) ownership of assets (budgetary, fiscal, contractual or of any other nature), the assignment of which is permitted by the applicable regulations; (4) the assignment of rights; (5) the constitution of surface rights over public and/or private property; (6) the granting of guarantees, tax benefits, subsidies, franchises; (7) the concession of rights of use and/or exploitation of public and/or private property; and (8) any other type of contributions that may be made by the state.

The PPP contract shall set forth the payment regime. Payments could be made by the state, users or third parties, depending on the specific project's particular conditions.

According to Section 18, payments may be made through: (1) specific allocation and/or transfer of tax resources, assets, funds and any kind of public credits and/or revenues, with the relevant authorisation from the Federal Congress; or (2) creation of trust funds and/or use of existing ones.

Moreover, pursuant to Section 20, in case of use of trust funds, instructions by the trustor or the state bodies to the fiduciary are expressly forbidden.

The 2016 PPP Regime excludes the application of (1) Section 765 of the Civil and Commercial Code (which allows the payment of US dollar debts in the domestic currency); and (2) Sections 7 and 10 of Law No. 23,928 (which avoids the indexation of contractual debts) to the PPP contracts.

### **ii State guarantees**

In order to secure the payments, Section 18 provides for (1) the granting of security bonds and guarantees of entities of recognised solvency in the national or international market, and/or (2) the constitution of any other instrument that fulfils the function of guarantee accepted by the current law.

Further, the 2016 PPP Regime allows contractual provisions on guarantees on minimum incomes.

Finally, pursuant to Section 19, the contractor may be authorised to grant guarantees on rights of exploitation of public or private property granted in order to secure the repayment of the necessary financing to carry out the project.

### **iii Distribution of risks**

The PPP regulations attempt to distribute risks between the state and the private party in order to reduce the related costs.

In this line, Section 9(b) provides, as a general principle, for the fair and efficient distribution of contributions and risks between the parties to the contract, by contemplating the best conditions to prevent, assume or mitigate them, in order to minimise the cost of the project and facilitate the financing conditions. By the same token, PPP contracts shall foresee the consequences arising from acts of God, force majeure and extraordinary economic events affecting the contract economic equation and the early termination of the contract.

#### **iv Adjustment and revision**

Section 9(i) of the 2016 PPP Regime allows unilateral variations to the contract instructed by the state, but limits them only to the performance of the project, with a maximum limit of 20 per cent of the total value of the contract. Furthermore, those variations shall be adequately compensated.

Likewise, under the 2016 PPP Regime, PPP contracts may foresee procedures for price revision in order to preserve the original economic-financial balance of the contract and the possibilities and conditions of financing.

#### **v Ownership of underlying assets**

Regarding the ownership of the underlying assets, and pursuant to Section 9(o) and (v) of the 2016 PPP Regime, the ownership, exploitation, assignment and destination of the property, moveable and immovable, used and/or constructed during the term of the contract, shall be governed by the provisions of the PPP contract. In particular, those assets that are to be reverted or transferred to the state shall be duly specified in the respective contract.

Furthermore, the 2016 PPP Regime states that agreements under which the ownership of the work or infrastructure is constructed may only revert to the state after full execution of the contract.

#### **vi Early termination**

Early termination is a widely known power of the state, and it may be used for several public interest reasons. It is one of the main regulatory risks that PPPs could face and for that reason it seems important for a PPP regime to reasonably limit its consequences.

According to Law 27,328, in case of early termination of the PPP contract by the state, compensation shall be fully paid out to the contractor before taking possession of the assets. In no case can compensation be lower than the non-depreciated investment. Furthermore, financing repayment shall also be guaranteed (Section 10).

The parties' liability shall be governed by the new PPP law, its implementing regulations, the bidding terms and the PPP contract. The Civil and Commercial Code shall also be applicable on this matter (Section 11). Therefore, PPP contracts are expressly excluded from all legislation restricting government liability or excluding compensation for lost profits in the event of early termination on public interest grounds.

Finally, the suspension or nullity of the contract on the grounds of illegitimacy may be declared only by a court.

## **VI FINANCE**

The PPP regimes aim at promoting private investments in public infrastructure projects that the state cannot, or deems not convenient to, afford alone. Therefore, PPP contracts shall

adopt a flexible design in order to adapt their structure to the specific requirements of the project and its financing needs (Section 1 of the 2016 PPP Regime).

For the same reason, the entity in charge of the performance of the PPP contract shall adopt a legal form able to access the capital markets to develop the project (Section 7).

As it usually happens, the resources needed to finance the projects of this kind are sought at the domestic and financial capital markets. Accordingly, the 2016 PPP Regime explicitly promotes the development of the domestic market and access to the foreign market (Section 4(j)). As a consequence, cross-border finance could be included in the terms of the tendering process for awarding the PPP contract.

In addition, the 2016 PPP Regime sets forth that the state contracting party may collaborate with the private party in order to obtain the necessary financing for the project (Section 9(n)).

As a remarkable feature, under the new regime, the PPP contract may include the conditions for the transfer of the controlling shareholding of the SPV or the certificates of the trust funds to the funders in case of default of the SPV's or the fiduciary's obligations, in order to facilitate the restructuring of the debt and the project performance continuity ('step in rights'). Likewise, the PPP contract may allow the assignment of the collection rights for securitisation (Section 9(r)).

## VII RECENT DECISIONS

Due to its recent enactment, there are no records of PPP projects under the 2016 Regime explained in this chapter. Accordingly, no relevant judicial decisions are publicly available on the matter.

## VIII OUTLOOK

2016 has been a year with relevant legal, political and economic changes, especially those aimed at bringing legal and economic predictability to the financial and economic community to thus create a more 'business-friendly' environment. The 2016 PPP Regime is framed under these changes.

The new PPP framework in force seems to be a good tool for promoting investment in public infrastructure and services. The key factors of any PPP regime (such as payments, state guarantees and limitations of state power) are regulated by the new law, although the regulation process shall be completed through the implementing decree, which is still pending. The fact that the basic features of the regime are now set forth in a law (rather than in an executive decree) reinforces the legal certainty needed to attract private investment. In emerging countries, with a history of economic crisis and high political risks, explicit legal rules protecting private interests are *sine qua non* prerequisites for promotion of investments through PPP projects.

Some of the most remarkable provisions of the new PPP regime are those aimed at facilitating access to capital markets by (1) providing sufficient freedom to the parties to design the best contractual structure for the PPP project and its financing needs; (2) allowing the transfer of the controlling shareholding to the funders in case of default of the PPP entity; (3) securing prior compensation for the contractor and for the funders in case of early termination of the PPP contract by the state; and (4) allowing the submission of contractual disputes to arbitration in foreign venues.

The new regime also contains several provisions aimed at promoting domestic industry and small to medium-sized enterprises. Nevertheless, the Law also empowers the competent authorities with sufficient faculties to exclude or set aside those protective provisions if the development of the project requires so.

Finally, the 2016 PPP Regime shall be complemented by an implementing decree. If the implementing rules respect the spirit of the Law, there should be reasonable expectations on the development of the most strategic sectors under the benefits of the new PPP Regime.

# AUSTRALIA

*David Donnelly, Nicholas Ng and Timothy Leschke<sup>1</sup>*

## I OVERVIEW

PPPs have been used in Australia for nearly 30 years, and began through state governments developing their own implementation and development models. Victoria was very much a front runner, establishing the Partnerships Victoria body and developing models based on the United Kingdom's 'private finance initiative' in the early 2000s. The term 'public-private partnership' (PPP) was formally adopted to cover those types of public and private arrangements, and policies developed in other Australian states were heavily based on the Victorian model. A national approach was implemented in 2005, with the Australian federal government introducing the National PPP Policy and Guidelines, with the aim of harmonising all Australian governments' approaches to PPP implementation and development.

Australia does not have a specific legislative framework for PPPs, but rather the National PPP Policy and Guidelines set out the processes that authorities should follow in the investment, procurement, development and operations stages of PPPs, along with standard risk allocations and commercial principles to be adopted. State governments have their own jurisdictional requirements and departures that are read in conjunction with the National Guidelines.

The current trend, particularly in New South Wales, of capital recycling bodes well for an increase in PPP activity, not only through the construction of new infrastructure, but also through sales or long-term leases of government assets (such as the A\$10.25 billion long-term lease of part of the New South Wales government's 'poles and wires' business, and the long-term lease of the Port of Darwin).

The current economic and political climate in Australia suggests that government is more than willing to use the PPP delivery model. Recent examples include new hospitals, such as the Northern Beaches Hospital in NSW, awarded in 2015, and schools, like the Victoria New Schools PPP and Western Australia Schools PPP.

Virtually all categories of public infrastructure have been or are prospectively subject to PPP transactions in Australia. Transport and social infrastructure projects feature most prominently in all Australian states and territories, but there have also been energy, water and telecommunications projects.

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## **II THE YEAR IN REVIEW**

The Australian PPP market continued to grow in 2016, with several new projects coming to market and others transitioning from development into their operations phase. Stage 2 of the Gold Coast Light Rail PPP, the Victorian High Capacity Metro Trains PPP, the Eastern Goldfields Prison PPP and the ACT Capital Metro Light Rail PPP reached financial close. New projects tendered in the market through expressions of interest or requests for proposal included the Victorian Outer Suburban Arterial Roads PPP, Canberra Street Lighting PPP, Melbourne Metro Rail PPP, Grafton Prison PPP and the NSW Social and Affordable Housing Projects PPP.

2016 also saw the completion of the first two tranches of the New South Wales government's electricity recycling programme, with financial close being achieved on the sale of Ausgrid and Transgrid. This programme will provide a crucial funding source for future PPPs and other major infrastructure projects in New South Wales going forward.

There has also been an increase in market-led proposals received by all levels of government in Australia, which bodes well for continued private sector investment in delivering infrastructure, including through PPPs. The first major market-led proposal under Queensland's Market Led Proposal framework, Transurban's Logan Renewal Project, achieved financial close in 2016.

## **III GENERAL FRAMEWORK**

### **i Types of public-private partnership**

There are several structures of PPP that have historically been used in Australia, including DCM (design–construct–maintain), DCMO (design–construct–maintain–operate), BOO (build–own–operate) and BOOT (build–own–operate–transfer) forms of project delivery, but in essence, PPP projects are frequently simply another version or versions of the BOOT scheme. The design–build–finance–operate (DBFO) model is commonly used for PPP projects in Australia, particularly where the project has a 25- to 30-year term and as a result is required to take a whole-of-life approach to service delivery.

A common theme for recent PPPs has seen the inclusion of some form of government contribution. Contributions are generally structured as cash payments and may be made during the development phase, immediately following completion or on establishment of steady-state operations. Payments are usually subject to pre-agreed conditions being met.

### **ii The authorities**

Within each government, both federal and state, there is usually a centralised PPP authority associated with the treasury department (such as the Commercial Group within Queensland Treasury). However, in most jurisdictions individual projects are usually procured by, or in conjunction with, the specific government department that is most appropriate to deliver the project. For example, Transport for NSW or the Roads and Maritime Service would administer a road or rail infrastructure project in the state of New South Wales.

This also means that certain Australian government departments have more experience in the PPP landscape than others, purely due to the nature of the functions they administer, for example, government departments that deal primarily with road and other transport infrastructure. The experience of government departments with PPPs can greatly influence

both the bidding and delivery processes, owing to knowledge of risk profile and market standards for similar projects.

While not an authority that awards PPPs, Infrastructure Australia is a seminal Australian statutory body that works with industry and government to develop all other aspects of the PPP process. Established under the Infrastructure Australia Act 2008 (Cth), which came into effect on 9 April 2008, Infrastructure Australia's primary function is to provide advice to the Commonwealth, state, territory and local governments on infrastructure matters, including advice regarding the harmonisation of policies and laws relating to the development of, and investment in, infrastructure. This includes publishing the National PPP Policy and Guidelines, as well as other publications regarding infrastructure investment and PPPs.

### **III GENERAL REQUIREMENTS FOR PPP CONTRACTS**

There are few limitations in Australia when it comes to the use of the PPP delivery model by government (which, beyond the National PPP Policy and Guidelines, are also subject to change depending on the contracting government). At the present time, there are no projects or services that are deemed 'off limits' for consideration as a PPP project in Australia, especially considering the wide range of industries that have already used the model. That said, when assessing whether a PPP model is to be used, governments ordinarily perform a detailed business case assessment to ensure a PPP is likely to deliver better value for money to government than more traditional forms of government procurement.

The federal and state governments all have a value threshold for which they must consider PPP as a potential procurement method, but the value varies between governments, and is usually around A\$50 million to A\$100 million. Projects under this value threshold can also be considered for PPPs if they represent significant value for money, but it is not mandatory to do so. Some jurisdictions also permit the bundling of projects to meet this value threshold.

Most Australian governments also require a public interest, public benefit or public policy test when considering a PPP delivery method. This usually involves conducting a business-case assessment, which includes considering the impact of the project on the public, especially on those stakeholders identified as being directly affected by the project. Reviews of this nature should undergo further development in the interim business case with a focus on issues that may arise through project development and delivery. The National Guidelines also recommend liaising with public interest groups and other relevant bodies and considering possible outcomes of a qualitative or quantitative nature that may impact upon the value-for-money analysis.

There are also no legal restrictions on foreign entities engaging in the PPP process with Australian governments, apart from building licensing obligations in some jurisdictions. This freedom has resulted in many foreign entities being involved in consortia that have bid for and won Australian PPP projects. These have included the New Generation Rollingstock project in Queensland, and the Victorian Desalination Plant.

### **IV BIDDING AND AWARD PROCEDURE**

#### **i Expressions of interest**

To ensure adherence to the value-for-money principles that underpin the National Guidelines, it is typical for a competitive tender process to be used to procure a PPP. This process is

carried out in accordance with strict probity rules in relation to issues such as confidentiality and tenders submitted by related companies.

The procurement process usually comprises two phases: the publication of a broad invitation to submit expressions of interest, followed by a targeted request for proposals from a shortlist of selected tenderers. The exact process varies between Australian governments, but ordinarily includes a degree of interaction with government throughout the tender process.

## **ii Requests for proposals and market-led proposals**

Government parties may consider market-led proposals for PPP transactions. In fact, there has been a recent growth in the private sector putting forward market-led proposals in Australia due to the reduced bid costs of the market-led proposal process compared to a traditional tender process. For example, the NorthConnex project was a market-led proposal brought to the New South Wales state government and the Logan Improvement Project was a market-led proposal brought to the Queensland state government.

Market-led proposals have become more popular in Australia in recent years due to the benefits of the process, and a number of states updated their policies in 2015 to provide transparency and certainty for the private sector in putting forward market-led proposals. While the traditional tender process offers value for money through competitive bidding of tenderers, market-led proposals offer value for money in a different context (generally through the private sector proponent offering a 'unique' element that would not otherwise be available). The overall process is usually less expensive than going to tender and often the uniqueness of the project is such that the proponent is the only entity that can actually implement the project, at least in the form brought to government. Each state's market-led proposal policy is designed to evaluate this uniqueness against other factors (including transparency) so that value for money can be demonstrated to the public.

## **iii Evaluation and grant**

It is usual practice for governments to publish a detailed set of evaluation criteria in the request for proposal documentation sent out to tenderers. These criteria would usually relate to the tenderer's technical solution, compliance with a proposed form of contract, and price (in particular, comparative value for money).

The scope is usually defined in terms of an output specification clearly setting out the outputs the government is seeking. It is designed to promote innovation and, accordingly, the government party is usually open to receiving deviations. The government may consider proposals that deviate from the scope or technical characteristics of the work included in the procurement documentation during the procurement process.

Deviations are generally assessed on the value for money provided by the proposed solutions, both in quantitative and qualitative terms.

Upon considering all the proposals against the criteria and any deviations from documentation, the government will pick a preferred bidder and enter into negotiations. This process is ideally progressed as quickly as possible in order to achieve financial close and to minimise the number of issues that must be resolved in an environment of reduced competitive tension. It is usual for government to have reached agreement with a bidder on all or substantially all of the issues raised in the bidder's proposal before announcing the preferred bidder.



## **V THE CONTRACT**

### **i Payment**

Payment for private parties under PPP contracts in Australia usually depends on the type of asset that is being built as part of the project.

Economic infrastructure, such as toll roads, bridges and tunnels, has traditionally used a 'user-pays' system whereby the end-user of the asset (e.g., a motorist) pays tolls, fares or other similar charges for use of the asset directly to the private party. These charges are calculated such that the revenue covers all costs for the project, including construction, operating costs, and repayment of debt, as well as provide a return to investors. However, significant differences between modelled and actual traffic figures resulted in the failure of some early Australian greenfield road PPPs. In light of this history, investors and financiers are very hesitant to 'bank' any PPP on the basis of forecast patronage or usage, and recent economic infrastructure PPPs have utilised an 'availability payment' approach discussed below.

Social infrastructure, such as hospitals, schools and correctional facilities, typically operates on an availability-based system, and is reliant on payment directly from the government party. The payment regime will usually be dependent on the private party achieving certain criteria or key performance indicators while performing the services over the life of the PPP, with performance directly influencing the amount of service payments.

Some commentators suggest that the time may be right to return to the private sector having some degree of 'patronage' or 'market' risk for economic infrastructure (through, for example, the government underwriting minimum revenue levels) but this has not yet been seen in the Australian market.

### **ii State guarantees**

In the current market, Australian governments do not generally provide guarantees for PPP projects. The exception is New South Wales, which has specific legislative procedures for its treasury to issue sovereign guarantees.

Australian government credit ratings mean sovereign guarantees are not typically necessary when contracting with the Crown. However, difficulty arises where the contracting government entity is not a major department, but another entity, such as a government-owned corporation. This may potentially raise creditworthiness concerns for private investors who may consider that a government guarantee is necessary.

Both the private company and its financiers may wish to seek some certainty and avoid assuming the credit risk of the contracting entity, especially where it is likely that the entity may be privatised during the life of the PPP (a possibility which has been heightened with the current trend of government asset and business divestments), or the industry in which the company operates is likely to be restructured and adversely impact projected revenue streams.

As with any payment from a government entity, it must be ensured that the government entity has both the power to grant the guarantee and the actual ability to appropriate funds for the purposes of the guarantee. This, of course, needs to come through the correct appropriation channels, but it is fundamental that this is considered as part of the guarantee issue.

Where a government entity decides to not provide a guarantee, there are additional means by which the private entity or its financiers can receive some form of government support. These mechanisms are rare in the Australian market.

### **iii Distribution of risk**

Risk analysis is usually undertaken in the preliminary stages of the bidding and award procedure by both parties under an Australian PPP. The National Guidelines (with jurisdiction-specific amendments) offer specific guidance on both the risks that will arise and optimal risk allocation in most PPPs. This is also an excellent indicator for private investors as to the position that will usually be offered by the government entity.

The following is a list of the main risks that are usually considered in PPP contracts and the standard allocation of these risks. Risk is ideally allocated in such a way that the party best able to manage a risk bears that risk, as it has the best opportunity to reduce the likelihood of occurrence and deal with the consequences. However, while there are market-standard positions, ultimately the risk allocation will depend on what is agreed by the parties and the risk assessment for the relevant project.

#### ***Project delays***

The risk of delay is prominent in all aspects of an infrastructure project, even before the financial close of the project. Fulfilment of conditions precedent to financial close is normally a shared responsibility of the parties.

Similarly, risk of delays in construction are generally borne by the private party, except where explicitly agreed otherwise. The government party may be required to grant extensions of time and pay delay or prolongation costs under certain agreed circumstances, ordinarily including delays caused by government or certain delays beyond the private party's reasonable control.

Conversely, risk of delay for approvals is usually divided between the parties, with the government party obtaining most of the 'whole of project' environment and planning approvals, and the private party obtaining all other approvals.

#### ***Risks outside the control of parties***

Specifically defined risks that arise outside of the private party's control ordinarily entitle the private party to relief from default or termination and also extensions of time for performance in some circumstances. The National Guidelines offer some guidance in this regard. These risks are ordinarily referred to as 'relief events'.

Where relief events materially impede performance for significant periods of time, the government ordinarily has the right to terminate the project contract.

Project contracts also usually define a narrow category of events beyond the private party's control (ordinarily matters within the control of the government party) the occurrence of which will entitle the private party to relief from performance, an extension of time for performance and compensation.

#### ***Political, legal and macroeconomic risks***

Primarily, political risk is borne by the government party in a PPP in Australia. The government will usually bear the monetary and performance impacts of a project-specific change in law; other changes in law are usually a shared risk.

Macroeconomic risk is usually dealt with through variation of the service charge (see subsection iv, *infra*), although 'rise and fall' type provisions are rare.

### ***Insurance***

In an Australian PPP, the private party is ordinarily required to obtain project-specific insurances that cover both the private party and the government party. The insurances that are typically acquired for a PPP include:

- a* contract works insurance;
- b* industrial special risks insurance;
- c* property or material damage insurance;
- d* advanced consequential loss insurance;
- e* public or products liability insurance;
- f* professional indemnity insurance;
- g* workers' compensation insurance;
- h* motor vehicle insurance; and
- i* marine cargo or transit insurance.

The private party must typically demonstrate the currency of these insurances for the life of the project. The government may also effect and maintain insurances where the private party fails to do so and deduct premiums from amounts owing to the private party under the PPP agreement.

Insurance proceeds are usually required to be used to rectify insured damage to the project before a claim can be made upon the government.

### **iv Adjustment and revision**

It is usual for PPP contracts to have an inbuilt change or modification regime to deal with variations to the contract's technical scope or commercial terms throughout the concession period.

The change or variation mechanism usually contains a methodology for calculating the financial implications of the change, as well as the impact of the change upon the performance and other requirements under the contract. Changes are, once ordered by government, ordinarily self-executing and do not require the PPP contract to be formally amended.

Service charges can also be varied independently of a specific change to the services provided. There will often be a regime in place to vary the service charge in response to inflation, usually through a pre-agreed indexation regime. Projects may also employ a cost benchmarking regime throughout the term to ensure that the government entity is not paying in excess of market rates over time.

### **v Ownership of underlying assets**

For most PPP projects in Australia, the government party will own the project assets from commencement of the operations phase at no cost. There will also usually be a handover period at the end of the term with specific conditions on the private party transferring the asset, such as ensuring the serviceable condition of the asset.

To the extent the private party owns any project assets, the government will ordinarily prohibit the project company from collateralising those assets except under approved project finance arrangements.

## **vi Early termination**

Termination rights under PPPs are usually limited to those expressly stated in the terms of the PPP contract. The government party usually has greater rights for termination than the private entity. Beyond termination for breach of the PPP agreement, other common rights that give rise to termination are:

- a* where there is an extended event outside of the parties' control that materially disrupts the project (a force majeure event); or
- b* the private party becomes insolvent.

A generous cure regime (including separate financier rights) usually applies.

The government normally also has a right to terminate the PPP agreement for convenience without the need for default by the private sector party, but such a provision also requires the payment of compensation to the private contractor. This is effectively a compromise that allows the government to terminate for reasons beyond default or insolvency of the private contractor, such as change of policy, and also reduces sovereign risk for the private party entering into an agreement with a government entity.

It is extremely rare for the government to terminate a PPP for convenience. However, the Victorian government's decision to terminate the proposed East West Link project in early 2015 provides an example of an Australian government terminating for convenience in unusual circumstances.

The A\$5.3 billion contract for the first stage of the East West Link was signed on 29 September 2014, two months prior to an election. It was publicly known prior to signing that the then-opposition government strongly opposed the project and would not proceed with the project if elected. They were elected, and followed through in deciding to terminate. The government and the consortium negotiated a commercial settlement. According to a report published by the Victorian Auditor-General's Office in December 2015, the settlement involved the state paying A\$424 million to the consortium to cover costs it had incurred to date (including A\$81 million in respect of establishing the loan facility for the project), and the state acquiring the consortium and project assets, including the interest rate swap facilities (which was estimated to cost A\$218 million to close out as at 30 June 2015). The settlement also provided the state with discretionary access to future debt funding through a A\$3.1 billion uncommitted note issuance mandate with some members of the consortium's banking group (independent of the loan facility established for the East West Link project). Notwithstanding East West Link, terminating a PPP for convenience remains highly unusual in the Australian market.

## **VI FINANCE**

Australian PPPs are typically financed through the combination of bank debt and equity provided by investors, although recent projects also typically include a monetary or other contribution by government during the development phase. There has been some speculation around the use of bond financing for both the development and operation stages of the PPP lifespan, but this has not yet featured prominently in Australia.

It is typical for debt financiers to also directly contract with the government to ensure the financiers have extensive cure rights to avoid termination of the project contract for default.

Some commentators have speculated that there is the possibility that governments may seek to take a greater role in procuring finance in the future, as opposed to tenderers arranging finance as part of their bid. Governments would conduct their own financier bid process and present a 'preferred financier' to the tenderers during the tender process. This has not yet been seen in an Australian PPP.

## VII RECENT DECISIONS

There have been few recent Australian decisions that directly deal with aspects of the PPP process or involve a PPP project.

The most significant case in recent times was *Murphy v. State of Victoria*.<sup>2</sup> This case related to the A\$15 billion proposed East West Link in Melbourne. The circumstances leading to the legal dispute involved the State of Victoria (the State) (with the assistance of the Linking Melbourne Authority (LMA)) announcing and promoting the business case for Stage One of the East West Link motorway.

Mr Tony Murphy brought an action against the State and the LMA alleging that the project proponents, through the published business case and media releases, had made representations in connection with the project that were misleading or deceptive in contravention of Section 18 of the Australian Consumer Law as applied in Victoria by the Australian Consumer Law and Fair Trading Act 2012 (Vic).

Mr Murphy also sought an interim injunction restraining the State and the LMA from entering into contracts with the East West Connect consortium relating to construction of the motorway. This application was unsuccessful and the construction contract was signed in September 2014.

While this litigation was largely concerned with civil procedure and the approach taken by the trial judge, the Victorian Court of Appeal also made comments regarding the misleading or deceptive conduct allegations.

Essentially, the Court indicated that a government could be found to be engaging in misleading and deceptive conduct during the tender process, as the government can be considered to be carrying on a business as soon as it starts to take steps to acquire the asset for the purposes of that operation. The Court emphasised that there is nothing in the activities of informing and engaging the community regarding the claimed benefits of a proposed infrastructure project which renders the exercise an essentially governmental activity. A government can also be carrying on a business at the same time as performing its regulatory functions.

Overall, the Court did not present its statements as final determinations and emphasised that the outcome would depend on findings of facts to be determined at trial. Since the litigation has been halted due to abandonment of the motorway project, the statements are helpful to indicate that, in certain circumstances, a government or project proponent may be liable for misleading or deceptive conduct from the representations made in the course of promoting a PPP in the marketplace.

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2 (2014) 313 ALR 546.

## **VIII OUTLOOK**

2017 promises to be another active year in the infrastructure space in Australia.

Following the successful financial close of Stage 2 of the Gold Coast Light Rail PPP (the first major augmentation of an existing operations-phase PPP), a number of augmentations of existing PPPs are likely to either be tendered or be the subject of market-led proposals. These transactions are expected to span across both economic infrastructure (such as the Sydney Metro project) and social infrastructure (such as a number of prison augmentations around the country).

Some uncertainty will continue to exist as to the project pipeline, particularly in Queensland and Western Australia, given upcoming state government elections and ongoing fiscal challenges caused by a downturn in the mining sector in both of these jurisdictions. Those state government elections may, however, also lead to a change in infrastructure agenda, and proposed projects (such as the Queensland Cross River Rail and Brisbane Metro projects) gaining renewed momentum.

A number of new projects are currently in their bid phase, and are expected to achieve financial close during 2017. Many of these projects are funded largely through asset recycling transactions carried out over the past 12 to 18 months.

It is likely that government at all levels will continue to receive numerous market-led proposals in 2016, some of which will progress through to investment evaluations and an exclusive mandate for the proponent to deliver the project. The trend towards seeking to undertake a fully contestable procurement process for parts of these projects (such as the design and construction of them) is likely to continue, even when a project is a market-led proposal.

In relation to existing projects, a number of projects will move from their higher risk development phase into operations. This transition is a natural time for the investor mix within a project to change, due to the change in overall project risk profile, which may drive activity within the equity investor market.

Overall, indications are for a year of strong market activity, albeit with some uncertainty as to the project pipeline in some states.

# BELGIUM

*Christel Van den Eynden, Frank Judo, Aurélien Vandeburie and Marjolein Beynsberger<sup>1</sup>*

## I OVERVIEW

While the development of infrastructure projects and the provision in general of public services in Belgium in the form of public-private partnerships (PPPs) is not new, its importance in government policy has grown rapidly over the past two decades. Historical underinvestment in qualitative infrastructure, the demand for better quality projects to be realised more quickly for the same price, and, importantly, a lack of available public funding necessitating spreading out investment needs over time, have all made for the strong revival of PPP projects in recent years. This has largely occurred at a federal level but to an even greater extent in the Flemish Region, where PPP was one of the pillars of the government's investment policy during the 2009–2014 administration. However, the evolving views on ESA-conformity have inspired the Flemish government to adopt a more reserved position during the 2014–2019 administration.

At the federal level, prominent examples of large PPP projects include the development of a new railway connection between the City of Brussels and the national airport and the construction of a prison complex in Haren that will become the largest prison complex in Belgium.

In the Flemish Region, major investments were made in the creation of the Flemish PPP Knowledge Centre to further boost the introduction and implementation of PPPs. As a result, a large number of PPPs have been tendered in various sectors, including transport and related infrastructure projects, renewable energy infrastructure and social infrastructure.

So far, PPPs have been less of a factor in the Brussels and Walloon Regions. Nevertheless, some large investments have been made through PPP projects in these regions, including transport, social infrastructure and, more recently, shopping malls comprising leisure facilities and apartments.

## II THE YEAR IN REVIEW

### i Major awards granted

No major awards were granted in 2016.

Yet the important projects which in 2015 reached 'preferred bidder' stage of financial close are following their course, such as the construction and operation of a new national

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football stadium in the Heysel area, the construction and maintenance of various sports facilities ('Flemish Sports Cluster 3') and the construction and maintenance of a new tramline through northern Antwerp ('Brabo 2').

## **ii Procedures initiated**

Other major PPP projects currently under tender include the construction of 500 rental accommodations in Brussels, the construction of a congress centre and a hostel in the northern part of Brussels ('NEO 2'), the construction of accommodations, economic facilities and a municipal school in Flémalle ('Flémalle-Neuve'), the installation of LED street lights across the Walloon motorway network, the new tram line in Liège and the refurbishment of the Belgian military airbase in Melsbroek.

## **iii Significant legal changes**

The Belgian legislation on public procurement was recently amended pursuant to the final transposition of the Public Procurement Directives 2004/17<sup>2</sup> and 2004/18<sup>3</sup> and the adoption of the implementing royal decrees of the Public Procurement Act of 15 June 2006.<sup>4</sup> These new rules entered into force on 1 July 2013<sup>5</sup> and apply to all public procurement contracts that have been published or, in the absence of any publication requirements, for which from that date onwards an invitation to participate has been sent.

The entry into effect, on 1 September 2014, of the ESA 2010 Rules<sup>6</sup> (replacing the less stringent ESA 95 Rules)<sup>7</sup> is also key and has had and will have an impact on the structuring of pending and future PPP projects. The ESA 2010 rules retroactively apply to the entire period between 1995 and 2014, so that the ESA neutrality of some existing PPP projects suddenly raised budget neutrality issues. Some of these lost ESA neutrality and had to be shifted onto

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2 Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sector, Official Journal, 30/04/2004, L 134.

3 Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, Official Journal, 30/04/2004, L 134.

4 Law of 15 June 2006 on the procurement procedures and certain procedures for public works contracts, public supply contracts and public service contracts, Official Gazette, 15 February 2007.

5 Royal Decree of 2 June 2013 relating to the date of entry into force of the Public Procurement Act and the implementing royal decrees, Official Gazette, 5 June 2013.

6 Regulation (EU) No. 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union, Official Journal, 26/06/2013, L 174. All EU Member States are required to comply with the rules on the European System of National and Regional Accounts (the ESA Regulation). The ESA Regulation is the system of national and regional accounts and defines the accounting standards/framework for all EU Member States, allowing each EU Member State to calculate its annual budget (deficit) and the total government debt.

7 Council Regulation (EC) No. 2223/96 of 25 June 1996 on the European system of national and regional accounts in the Community, Official Journal, 30 November 1996, L 310.



the government's balance sheet.<sup>8</sup> In addition, for those PPP projects that are currently being negotiated,<sup>9</sup> the risks associated with the contractual obligations of the contracting authority have been or are being scrutinised.

The new ESA rules are stricter than the 1995 version in that they set forth additional requirements in order for PPP assets to be deemed 'non-government assets', which may be booked on the private partner's balance sheet. In addition to requiring that the private partner take on the construction risk and either the demand or the availability risk (as under ESA 95), the new ESA Rules consider that the risks associated with a PPP project are deemed not to have transferred to the private partner, to the extent that:<sup>10</sup>

- a* during the construction phase, the termination clause requires the contracting authority to refund the capital cost without any penalties being due by the private partner and, during the operating phase, the compensation due to the private partner exceeds the current market value of the assets, which is to be assessed by an independent expert;
- b* the distribution of risks under the contract is significantly shifted;
- c* in case the contracting authority has a stake in the special purpose vehicle (SPV), it bears more than 50 per cent of the total capital cost of the project or the contracting authority has a controlling (minority) stake in the SPV; and
- d* all or part of the debt service transfers to a public body as a result of a guarantee provided by it, the guarantee covers more than 50 per cent of the capital cost of the project or there is a change of the economic ownership of the assets resulting in a transfer of the risks when the guarantee is called upon.

Implementing the 2014 European directives on public procurement and concession agreements, the 2016 Public Tenders Bill and 2016 Concession Bill were published on 14 July. As stated in the previous edition, both bills are not expected to bring revolutionary changes in the specific matter of PPPs.

However, as the implementing provisions have not yet been published, the current legislation will remain in force for the time being.

### III GENERAL FRAMEWORK

#### i Types of public-private partnership

PPPs in Belgium can take many forms. Because of the complexity of its political and administrative context, Belgium does not really have a unified policy or a true Belgian PPP model. A basic distinction is that between 'contractual' PPPs and 'participative' PPPs. While the contractual variant still bears a resemblance to an employer–contractor relationship, the

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8 The ESA Regulation provides that certain long-term debts contracted by the authority can be ESA-neutral, which means that – except for the actual costs made in a given financial year – the investments made will not increase the annual budget deficit and the outstanding government debt. For instance, owing to the recharacterisation of some PPP projects in 2013, Belgium's annual budget deficit increased by €50 million and the total government debt by €500 million.

9 Such as the tram line PPP project in Liège and the Haren prison complex PPP.

10 According to Eurostat, where the usual approach based on risks and rewards is inconclusive, the control criterion should be used to assess the degree of government involvement in the definition of the PPP assets and the services to be delivered from them.

participative variant implies the setting-up of an SPV by both the authority and the private partner. Combinations of both variants are also possible, but the participative variant has recently come under pressure following the entry into force of the ESA 2010 Regulation.

Various contractual structures are used, including (1) a more traditional (more basic) contract setting forth specific performance criteria with limited PPP characteristics; (2) a more integrated contract approach with either a design and build contract (DB), a design, build and finance contract (DBF) or a design, build, finance and maintain contract (DBFM), possibly combined with an operating contract (DBFM(O)). Another model introduced in Belgium is the DBM + F, whereby the DBM and the finance tenders are split at bidding phase and merged afterwards.

In other structures, long-term lease agreements, building rights agreements, concession agreements, other *sui generis* contracts, or a combination thereof are used.

## ii The authorities

Each public body, whether at national, regional or local level, can initiate a PPP. No previous authorisation is required, except in the Flemish Region, where the Flemish PPP Knowledge Centre has to give its 'advice' before a project of a Flemish public body can formally be accepted as a Flemish PPP.

The responsibility for structuring, awarding and implementing PPPs remains a task of the relevant administration, but the supervising authorities (at the relevant regional, community or national level, as applicable) can always repeal or reform the decisions of the lower public bodies.

In Flanders, the Flemish PPP Knowledge Centre advises and guides the PPP policy of all public bodies and supports PPP projects in the Flemish Region. It assumes an advisory role (both in general and with regard to the specific project) and collects and shares PPP knowledge, experience and models with all parties involved. It has contributed substantively to standardising the contractual approach to PPPs in the Flemish Region.

There is no equivalent public body at federal level or in the Brussels Region.

In the Walloon Region, the government has established the Financial Reporting Cell, an entity of the Walloon administration that provides advice on PPPs for the Walloon Region, the French Community and for related public bodies before the adoption of a decision to implement PPP projects. It also has a role in the follow-up and assists these entities with the implementation of a PPP.

## iii General requirements for PPP contracts

Although there are no specific legal constraints or requirements that apply to PPPs, general public procurement rules (as interpreted by case law) apply.<sup>11</sup> The Flemish and Walloon Regions have also adopted additional regulations with a view to facilitating PPPs in their respective regions.<sup>12</sup>

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11 See Section IV, *infra* with respect to the rules applicable to the awarding of contracts.

12 The rules applicable in the Flemish Region concern the various PPP projects, while the rules applicable in the Walloon Region and the French Community are sector specific. For instance, the Flemish Decree of 18 July 2003 concerning public-private partnerships, by means of which certain constraints in the public procurement rules were addressed, such as, under specific conditions, the participation of public bodies in PPP projects and the granting of security rights on public domain, the Ministerial Decree of the Walloon Government concerning the establishment of a reporting cell for alternative financing and financial

Public contracts, including PPP contracts, remain equally subject to general administrative law<sup>13</sup> and the Civil Code, as well as to more specific legislation such as the Companies Code, tax legislation and insurance legislation, except to the extent explicitly provided otherwise.

From a contractual point of view, the competent authority is free to organise its projects as it sees fit,<sup>14</sup> no value threshold applies and, except for traditional services and missions of the state, such as the police and the army, all types of public works, supplies and services can be contracted through a PPP structure.

Two important modifications included in the 2016 Bill will specifically affect the general requirements which the contracting authority must observe while concluding PPP contracts. First, the contracting authorities shall apply, on top of the principles of equality and of non-discrimination, the principle of proportionality. For example, this implies that minor irregularities committed by a candidate regarding facultative exclusion grounds can justify his or her exclusion only in extraordinary circumstances. Second, environmental standards will play a more prominent role. Indeed, authorities will be able to take into account environmental labels during the bidding and award procedure and the failure to respect such environmental obligation by the contractor and/or one of his or her subcontractors during the execution of the contract may be considered as a breach of contract and could therefore lead to the termination of the contract.

#### IV BIDDING AND AWARD PROCEDURE

To the extent the PPP contract falls within the scope of the Belgian public procurement rules,<sup>15</sup> the general public procurement rules apply. In accordance with the EU Public Procurement Directives, Belgian public procurement rules cover all contracts in writing for consideration between a contractor, a supplier or a service provider and a public purchaser for the undertaking of works, supplies and services.

Belgian public procurement legislation distinguishes between the following types of procurement procedures:

- a* adjudication: award exclusively on the basis of the lowest price;
- b* quote request: award on the basis of the award criteria, and not exclusively the price;
- c* negotiated procedure; and
- d* competitive dialogue.

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statements of independent public authorities (Official Journal, 13 April 2005) and the Ministerial Decree of the French Community regarding the establishment of a reporting cell for alternative financing and financial statements of independent public authorities (Official Journal, 5 April 2006).

13 Including the principles of equality upon award, transparency, due motivation, fair play, etc.

14 This being said, the Flemish PPP Knowledge Centre evaluates whether a proposed project is suitable to be structured as a PPP and the Walloon Financial Reporting Cell examines the legal, financial and accounting aspects of a contemplated PPP project.

15 Law of 15 June 2006 on Public Procurement; Royal Decree of 15 July 2011 concerning the award of public procurement contracts in the ordinary sectors; Royal Decree of 16 July 2012 concerning the award of public procurement contracts in the Utility Sector; Royal Decree of 14 January 2013 concerning the general contracting conditions for public procurement contracts and for concessions of public works (collectively 'the 2006 Public Procurement Rules'). See, for more details, Lindemans, Judo, Vandeburie and Maeyaert, 'Belgium', *The Government Procurement Review*, Law Business Research, London, 2016, pp. 26–37.

The negotiated procedure with prior notification, based on Article 30.1 b) of the Public Procurement Directive 2004/18/EC,<sup>16</sup> is the procedure most commonly used to award DBFM contracts.<sup>17</sup> It is also often applied to award concessions for public works,<sup>18</sup> but less for build and finance contracts.<sup>19</sup> More recently, however, some PPP projects have been awarded under the competitive dialogue procedure.<sup>20</sup> The conditions for using the negotiated procedure and the competitive dialogue are those provided in the Public Procurement Directives. The awarding authority must substantiate its choice for one procedure over the other.

It is important to note that the new legal regime brought some minor changes as to award procedures for PPPs. As competitive dialogue has proven itself to be effective in complex projects, European and national legislators wished to further enhance its use. Hence, the 2016 Bill considerably widens the cases in which contracting authorities are authorised to make use of this procedure. When the 2016 legal regime enters into force, competitive dialogue will therefore be subject to the same conditions as for the negotiated procedure.

In a similar manner, ‘innovation partnership’ has been set up in the law as a new award bidding procedure. Therefore, when a public authority’s needs do not meet the existing market, it can decide to conclude an innovation partnership in order to develop products, services or pioneering work, which can later be purchased by the same authorities. The 2016 Bill now gathers in one award bidding procedure two formerly distinct procedures of development and purchase.

Additionally, even if a contracting authority will still be authorised to start a bidding procedure only on the basis of the price criterion, there will no longer be a formal distinction between the quote request and adjudication; the general criterion of the ‘most advantageous offer’ will be the applicable criterion in all tendering procedures.

## **i Expressions of interest**

The invitation of interested parties and the assessment of expressions of interest are governed by the public procurement rules, provided that the project falls within their scope. All public contracts, whatever their value, must be advertised in advance in the Belgian Public Tender Bulletin, which is an annex to the Belgian Official Gazette. If contracts meet the European threshold level, a notice should also be published in the Official Journal. The negotiated procedure with prior notification and the competitive dialogue are restricted procedures, which means that only the preselected tenders are invited to submit an offer. As long as the principles of transparency and equal treatment are respected, the tendering authority is allowed to contact the candidates to ask for clarification or to complete their expression of interest.

For PPP contracts that fall outside the scope of the Belgian public procurement rules, such as land agreements and service concessions, appropriate advertising is also required.<sup>21</sup> In

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16 Contracting authorities may award public contracts by negotiated procedure, after publication of a contract notice, in the following cases: ‘in exceptional cases, when the nature of the works, supplies, or services or the risks attaching thereto do not permit prior overall pricing’.

17 This procedure was used for projects including the prison complex in Haren, the Bus Depots Cluster II, the Project N60 Ronse and the cluster of school infrastructure projects in the Flemish Region.

18 This procedure was used, among others, for a complex public parking in Liège, a rest home in Moerbeke and typically also for gas stations along the highway such as the concession in Nazareth.

19 For example, for the Belgian Embassy in Kinshasa, social housing and the Design Centre in Liège.

20 Such as the Neo project, the tram route in Liège and the ‘Ecoquartier de Genappe’.

21 CJE, 14 November 2013, C-221/12, *Belgacom*; Council of State, 26 May 2014, No. 227.535, *Belgacom*.

the absence of any specific rules, the awarding of such contracts is subject to the basic standards regarding advertising and contract award that are mentioned in the European Commission's Communicative Interpretation on the Community Law.<sup>22</sup> The contracting entities are responsible for deciding the most appropriate medium for advertising their contracts. Other adequate and commonly used means of publication include the internet, national journals specialising in public procurement announcements, newspapers with national or regional coverage and specialist publications. The awarding authority can set criteria for qualitative selection, again, as long as the principles of transparency and equal treatment are respected. It is also allowed to contact the tenderers to ask for clarification or to complete their expression of interest, under the same conditions.

## **ii Requests for proposals and unsolicited proposals**

The use of e-tendering to solicit or submit a bid is permitted, required or prohibited, depending on the public procuring body involved. The federal authorities have developed IT tools to process public contracts electronically, which are also made available to the authorities of the other levels.

If a bidder has not been selected during the selection phase, he or she cannot submit an offer, except together with another bidder who has been selected.

With the 2016 Bill, however, the exclusion of a bidder will no longer be irrevocable. Bidders excluded during the selection phase will indeed be able to take 'corrective measures', in order to correct the irregularities of their offer.

## **iii Evaluation and grant**

In the context of the negotiated procedure with prior notification and the competitive dialogue, the contracting authority may provide that the procedure is conducted in stages, by applying the award criteria in the contract documents so as to reduce the number of tenders to be negotiated. Bidders are invited to submit a second offer or a best and final offer. The same procedure can be organised for the contracts that fall outside the scope of the public procurement rules.

During the negotiation procedure, as long as the object of the contract remains the same and the principles of transparency and equal treatment are respected, the offers can be amended. There are no specific legal provisions regarding changes at the preferred bidder stage. It is, however, generally accepted that 'substantial' changes to the contract are no longer possible at that stage.

During the competitive dialogue, the alternatives proposed by the candidates can be amended as long as the bidders do not deviate from the 'essential' elements mentioned in the contract notice and contract documents. Also, once they have been submitted, the essential elements of the final offers cannot be modified. After the selection of the most economically advantageous tender, only minor changes to this offer are still allowed.

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22 Commission interpretative communication on the Community law applicable to contract awards not or not fully subject to the provisions of the Public Procurement Directives (2006/C 179/02), Official Journal, 1 August 2006, C-179.

On the basis of the award criteria, the contracting authority shall designate a preferred bidder. Normally, but not always,<sup>23</sup> the other candidates are placed in a 'waiting room' in case the negotiations with the preferred bidder fail, which allows the contracting authority to designate another preferred bidder without having to organise a new tendering procedure.

Once awarded, all awards of contracts meeting the European threshold levels are to be published in both the Public Tender Bulletin and the Official Journal, with the exception of contracts that fall outside the scope of the public procurement rules.

## V THE CONTRACT

### i Payment

The payment mechanism is modelled in such a way that it allows the private partner to cover its costs and realise a 'normal' return on investment, while simultaneously providing for the desired quality at the lowest possible price.

In the majority of Belgian DBFM contracts, the payment consists of periodic payments made by the authority, usually starting at provisional acceptance, namely, the availability date of the entire assets or works, or a specific part thereof. Those payments are intended to cover the design, build, finance and maintenance and their amount is fixed. However, as a rule, the amount of the payment for the facility services, if any, is variable and takes into account the volume of the services to be provided (number of meals, number of users, etc.). To ensure that the private partner offers the required quality, a penalty point system typically applies and the payments to be made are abated with availability deductions or performance deductions. Sometimes, a bonus system is provided, for instance, in case of early availability.

A DB contract will typically involve milestone payments, namely, one-off payments usually made upon the provisional acceptance of (a specific part of) the assets or works. A combination of both payment mechanisms is also possible and will largely depend on the budget that is available to the contracting authority.

Payments in the context of other contract forms, such as a long-term lease agreement or a buildings rights agreement may be structured differently and may, for instance, merely consist of an indemnity corresponding to the value of the works upon termination.

### ii State guarantees

State guarantees play an important role in the financing of PPP projects as they allow the private partner to optimise the financial part of its offer since the risk premium that the debt providers charge will decrease.

State guarantees have been institutionalised in the Flemish Region with the adoption of:

- a the Decree of 7 May 2004 relating to provisions with respect to cash, debt and guarantee management of the Flemish Region;<sup>24</sup> the value of this guarantee is somewhat limited since it only applies to the principal amounts and can only be called upon in the last resort; and

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23 For the prison complex to be built in Haren, the other candidates were not put in the waiting room.

24 Official Gazette, 16 July 2004. The guarantee was, for instance, already applied in the context of the Bus Depots Cluster I PPP project of De Lijn.

- b* the Decree of 24 April 2009 relating to the refinancing guarantee and the continued payment guarantee with respect to the availability payments and certain termination payments in the framework of certain Flemish PPP projects of the Flemish Transport Company (De Lijn).<sup>25</sup>

Often, depending on the contracting authority, a combination of *ad hoc* ‘guarantees’ is offered consisting of, for example, subsidy agreements,<sup>26</sup> reservations in the budget and guaranteed loan agreements.<sup>27</sup>

As stated, the amount and the nature of the state guarantee that is provided may impact the ESA neutrality of a project.

### iii Distribution of risk

Although the 2006 Public Procurement Rules<sup>28</sup> generally apply to PPP projects, typically the (major) Belgian PPP projects will have detailed risk allocation provisions in the project contracts, which will specifically exclude the application of the 2006 Public Procurement Rules in many respects.<sup>29</sup>

A typical PPP contract will distinguish (1) ‘risks of the authority’ (i.e., risks borne by the contracting authority); (2) force majeure events (i.e., risks more or less equally borne by the contracting authority and the private partner); and (3) all other risks (i.e., risks borne by the private partner). The risks of the authority and the force majeure events are, generally, exhaustively listed in the DBFM agreement (or similar).<sup>30</sup>

Generally speaking, the exact allocation of risks will differ from project to project and is subject to, among others, the cost allocation, the nature of the project or the existence of

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25 Official Gazette, 4 June 2009. This guarantee was already applied, among others, in the context of the Bus Depots Cluster I and Cluster II PPP projects of De Lijn.

26 Such as the Ministerial Decree of the Walloon Government of 24 November 2005 concerning the grant by the Walloon Housing Company of assistance to public service housing companies to promote the installation, development and implementation of PPPs (Official Gazette, 16 December 2005); the Ministerial Decree of the Walloon Government of 19 June 2008 concerning the grant to real estate operators of a subsidy to encourage the installation, development and execution of partnership operations (in the social house sector) (Official Gazette, 14 July 2008) and Article 404, 14° and 1490 of the Walloon Code of Social Action and Health (Rest Homes) (Official Gazette, 30 August 2013).

27 Such as the Decree of the French Community of 24 November 2008 on exceptional financing programmes for renovation, construction, reconstruction or extension of school buildings through public-private partnerships (Official Gazette, 3 March 2009).

Also, for example, the case in the Brabo II PPP project (construction of tram infrastructure and renewal of adjacent streets and urban spaces in Antwerp), the ‘national’ football stadium in Brussels, the cluster of school infrastructure projects in the Flemish Region and the A-11 Bruges–Zeebrugge.

28 See footnote 12, *supra*.

29 See Article 9 of the 2006 Public Procurement Rules.

30 Authority defaults, interruption of the works due to the authority (or any affiliated persons), third-party interference (for instance, protests, vandalism, social conflicts), permitting issues, loss of ESA neutrality and a change in relevant law are generally deemed to be at the risk of the contracting authority.

Natural disasters, war, terrorism, radioactive contamination, etc., blockades or embargoes in Belgium or the European Union and other circumstances of an abnormal nature resulting in a party being unable to fulfil all its obligations, insofar these circumstances could not reasonably be foreseen or were unavoidable are generally deemed force majeure events.

special circumstances, but there are signs of a market standard trend towards uniformity. The current preoccupation with the requirement of ESA neutrality<sup>31</sup> has led to private partners having to accept a shift of risks.

In PPP projects with a shorter duration, or in case of ancillary works to the 'main' DBFM agreement (for example, in a separate DB or DBF agreement), the risk allocation principles set out in the 2006 Public Procurement Rules are more often applied without providing exceptions. In such cases, if the private partner encounters delays or suffers a prejudice resulting from circumstances attributable to the contracting authority or its personnel, the private partner is entitled to apply for an extension of the execution periods, a revision or termination of the contract or damages.

#### **iv Adjustment and revision**

Any amendments to the PPP contract during its term should respect the transparency of procedures and the equal treatment of bidders, meaning that the amendments should not come down to a renegotiation of the essential terms of that contract.<sup>32</sup>

In PPPs using the DBFM model, the procedure for amendments, as well as the financial consequences of those amendments, are addressed in the contract. The private partner will only be compensated for additional costs in case of amendments upon request of the authority or due to a relevant change in law.

In contractual structures subject to the 2006 Public Procurement Rules (DB agreement, long-term lease agreement, etc.) a revision of the contract will only be possible upon request of the private partner in case it suffers a very important prejudice, while the contracting authority can request such revision if the private partner has realised a substantial advantage pursuant to external factors,<sup>33</sup> but then only up to a maximum of 15 per cent of the total price.

Price revision constitutes a special case of revision and is built into the contract to allow flexibility and to lower the price; the price revision mechanism usually works both ways and is normally realised through a formula based upon indexation. Price revision is subject to some conditions.<sup>34</sup> Often, it is limited to the maintenance and operation costs as the design and construction period is relatively short. To ensure that the services performed are always remunerated at market prices, a benchmarking mechanism or market testing mechanism is sometimes built into the contract.

Such contractual revision principle has been especially established in the 2016 Rules, which state that the execution provisions shall organise a 'mechanism of revision for the cases wherein the contractual equilibrium is breached due to unforeseen circumstances'.

#### **v Ownership of underlying assets**

Whether the authority or the private partner is the owner of the underlying assets will depend on the type of contract that is entered into.

Typically, in cases where the PPP project is structured on the basis of a long-term lease agreement or a building rights agreement, the private partner will temporarily be the owner

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31 See Section II, *supra*.

32 CJE, 19 June 2008, C-454/06, *Presstext*.

33 Articles 56 and 60, 2006 Public Procurement Rules.

34 Article 57 of the Law of 30 March 1976 concerning economic recovery measures, Official Gazette, 1 April 1976.



of the infrastructure. At the end of the contract, and in some cases of early termination, the private partner will be entitled to compensation by the authority, in principle, on an asset market value basis at the time of termination. Special requirements with respect to the condition of the assets upon transfer may apply.

If the private partner erects the constructions on the land owned by the authority on the basis of a *sui generis* right, the ownership will automatically vest with the authority as the works progress through accession. In a DBFM Agreement, the private partner will remain responsible for the maintenance of the asset, typically for 10–30 years. Although the authority will be the owner of the asset, the responsibility for the asset will only transfer to it upon the expiration of the term of the DBFM agreement. Special requirements with respect to the condition of the assets upon expiration of the contract will apply.

In a DB agreement, typically a one or two-year guarantee period after provisional acceptance will apply during which the private partner has to execute the works necessary to maintain the good condition of the infrastructure, make repairs and replace parts as necessary, allowing for the use of the infrastructure in accordance with the output specifications.

Granting of security over the assets will only be possible if the contractual framework allows for a transfer of real estate rights, which is normally not the case in DBFM structures, but is more often the case in other PPP structures.

#### **vi Early termination**

In PPP structures governed by public procurement rules, the provisions on early termination set out in Article 54 et seq. of the 2006 Public Procurement Rules will, in principle, apply, allowing either party encountering a substantial delay or suffering a substantial prejudice as a result of an omission, delay or other facts attributable to the other party, to request the termination of the agreement, damages, or both. In addition, the private partner can also terminate the agreement in case of force majeure.<sup>35</sup>

However, in the majority of PPP projects in Belgium, the parties will negotiate specific termination clauses. Typically, in DBFM agreements, the following early termination clauses can be found:

*a* Generally, the contract will contain an exhaustive list of events which, upon their occurrence, allow the contracting authority to ‘immediately’ terminate the contract, such as not reaching financial close, bankruptcy of the private partner or poor performance. In addition, the contracting authority will also be able to terminate the project agreement in case of a default of the private partner that is not remedied within a reasonable period of time.

In case of termination, the contracting authority will generally compensate the private partner for the works that have already been carried out after deduction of certain amounts.<sup>36</sup>

*b* The private partner will be entitled to terminate the project agreement in case of serious shortcomings by the contracting authority with regard to its obligations under the contract, such as the repeated failure to pay the availability payments.

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35 Insofar as this force majeure event results in a significant prejudice for the contractor, equaling at least 2.5 per cent of the amount of the contract, or exceeding €100,000.

36 Compensation for additional costs, insurance payments received, etc.

The private partner will typically be compensated up to the outstanding amount under the financing agreements (including any breakage costs) and will also receive a (partial) compensation for the loss of profits.

- c Where a force majeure event or a risk of the authority (see footnote 30) occurs and the contract cannot be pursued, usually either party will be entitled to terminate the agreement with immediate effect.

Due to the nature of this cause for termination, both parties will bear some of the financial consequences of the termination.

- d In case of voluntary termination by the contracting authority, whether or not specifically provided for by the contract, the private partner will usually be compensated as if a default on the part of the authority had occurred.

Finally, PPPs that fall outside the scope of public procurement rules are subject to general rules of contract law unless the parties mutually agree upon termination provisions.

## VI FINANCE

Usually, PPPs are financed through long-term debt ranging from 70–90 per cent of the total investment cost, while the remaining part is financed through equity (shareholder loans, equity bridge facilities, etc.).

Market practice reveals that, especially for larger projects (above €200 million), sponsors and lenders are looking for alternative solutions with medium-term debt to be refinanced, ranging from seven to 10 years ('mini-perm' loans),<sup>37</sup> bond issuance solutions,<sup>38</sup> third-party subsidies,<sup>39</sup> alternative investment strategies,<sup>40</sup> etc., since funding for the whole life cycle of a PPP project is both expensive and difficult to obtain. For larger PPP projects, cross-border finance is also available. Furthermore, a secondary market has developed, where international funds and investors acquire existing SPVs or running management and operation contracts.

Lenders can take security over, *inter alia*, subcontracts, receivables, bank accounts and shares. Granting of security over real estate will only be possible if the PPP contract provides for and allows a transfer of real estate rights. Lenders may also have step-in rights, but those should be contractually provided.

## VII RECENT DECISIONS

In 2016, the Belgian Council of State ruled that the award of the DBFM contract for the Neo project was not illegal<sup>41</sup> and thus confirmed the validity of this PPP contract that was based on the competitive dialogue procedure. Nevertheless, the negotiated procedure with prior

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37 The Flemish schools project (2010) was financed by means of a six-year mini-perm loan for the construction phase and refinanced by a long-term debt upon completion, combined with a guarantee from the Flemish government.

38 The A11 highway (Bruges-Zeebrugge) has, for instance, been financed with EIB-supported project bonds.

39 For instance, subsidies from the European Union.

40 Such as the participation of insurance companies or institutional investors like pension funds.

41 Council of State, 5 January 2016, No. 233.376 to 233.379, *Uplace*. For a similar conclusion on the Neo project and competitive dialogue procedure, see also Council of State, 18 July 2016, No. 235.523, *BAM Contractors & Galere*.

notification remains the procedure most commonly used for PPP projects. Case law has also confirmed the validity of PPP contracts based on this provision; in two decisions of 2014, the Council of State indeed confirmed that the negotiated procedure with prior notification can be used for DBFM contracts for PPP projects such as for a major prison<sup>42</sup> and for an office building.<sup>43</sup>

## VIII OUTLOOK

Although the implementation of ESA 2010 initially gave rise to serious discussions as to the future of PPP projects, market practice reveals that PPPs have a future beyond ESA 2010, although their appearance has changed: on the one hand a number of ongoing projects are being or have been renegotiated,<sup>44</sup> while new projects are being structured in line with ESA 2010 to guarantee budget neutrality<sup>45</sup> and, on the other hand, projects are carried out despite being 'on balance sheet'.<sup>46</sup>

As the ability of respective governments to invest directly is still limited, cooperation with the private sector, especially for infrastructure projects, still takes a prominent place in the Belgian PPP market.

The European Fund for Strategic Investments (EFSI)<sup>47</sup> has been up and running since autumn 2015, keeping the ambitious timetable set by President Jean-Claude Juncker to implement the Investment Plan for Europe. The future of PPPs in Belgium will, among other things, depend on the funds that will be made available by the EU for investment in infrastructure projects, as a means to support economic growth, and the ability of Belgian authorities to secure the necessary European subsidies through the European Investment Bank and the European Fund for Strategic Investments.<sup>48</sup>

2017 will bring several changes to the legal framework for PPPs in Belgium as the implementing provisions will shape and put into practice the new legal regime published in 2016. However, no date has yet been announced for the finalisation of the public tender legal regime.

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42 Council of State, 8 July 2013, No. 224.298, *Besix Group*.

43 Council of State, 27 June 2014, No. 227.922, *Fedimmo*.

44 For example, Brabo 2; the Flemish public transport operator De Lijn was originally slated to hold a 26 per cent stake in the project, but this has been 'significantly reduced' as a result of a contract restructure to make the PPP compliant with ESA10.

45 For example, the Albert canal bridges PPP; under the terms of the contract, the project will involve no equity contribution from the public sector because the government wants to avoid the risk that the project is classified as a public sector asset in light of ESA10.

46 Such as the Antwerp police PPP project.

47 The EFSI is a €16 billion guarantee from the EU budget, together with an allocation of €5 billion of the European Investment Bank. These amounts (together €21 billion) should allow the EFSI to unlock €315 billion of investments. See Regulation (EU) 2015/1017 of the European Parliament and of the Council of 25 June 2015 on the European Fund for Strategic Investments, the European Investment Advisory Hub and the European Investment Project Portal and amending Regulations (EU) No. 1291/2013 and (EU) No. 1316/2013 – the European Fund for Strategic Investments.

48 The Flemish government has already identified six priority sectors for which it shall examine the possibility to apply for support from the EFSI including infrastructure and mobility, renewable energy, schools and social housing. The Flemish government has also set up an EFSI work group that is responsible for the coordination of the construction sites and the contacts with the EIB.

Tax incentives endorsed by the federal government with regard to construction of school premises are expected to broadly strengthen PPPs, especially in Flanders where many public schools are refurbished or constructed in this way (e.g., the ‘Scholen van Morgen’ project, which was resumed after the application of these tax incentives). Furthermore, the release of the Guide to the Statistical Treatment of PPPs by EPEC and Eurostat will help to deliver some clarity with regard to the ESA rules applied to PPPs. Both events should help kick-start the PPP market, which suffered a decrease in use in 2016.

# BRAZIL

*Bruno Werneck and Mário Saadi*<sup>1</sup>

## I OVERVIEW

The creation of the public-private partnership (PPP) model in Brazil dates back to 2003 with the publication of the PPP Law for the State of Minas Gerais (State Law No. 14,868/2003). Subsequently, in 2004, the PPP Law for the State of São Paulo (State Law No. 11,688) and Federal Law No. 11,079 (the Federal PPP Law) were also published reinforcing this type of partnership. The PPP legislation was born of the need to attract private investment in infrastructure projects in Brazil in the following areas: water and sewage, health and hospitals, administrative facilities and logistics, including roads, urban mobility, underground transportation and transportation in general.

The parties involved in a PPP contract are: the private investor, the concessionaire, which is the investor interested in investing in an infrastructure project, and the government (which includes all entities of the Brazilian government, such as agencies, public foundations, state-owned companies and other entities controlled by the federal, state or local governments and the federal, state and local governments themselves, 'granting authority').

In Brazil, a PPP is a specific form of concession, which differs from ordinary concessions (governed by Federal Law 8,987/1995). In ordinary concessions, the economic-financial feasibility of the project is based exclusively on the levying of tariffs on users of the granted activities (services). The PPP model allows the granting to private parties of services in which the government is the user (directly or indirectly) and concessions for public services and other activities in which payment by the granting authority is deemed necessary for the structuring of a project and fees are charged by the concessionaire to users of the services provided.

The main distinction between a PPP project and ordinary concessions involves the payment the granting authority executes to a PPP concessionaire throughout the performance of the agreement. The concessionaire and the government share the risks of the project in a PPP and a state guarantee is created, at the beginning of the project, to guarantee payments by the government to the concessionaire.

In view of the foregoing, a PPP is a great option for projects that are not self-sustaining, projects that require, or benefit from, significant investments and projects that involve the provision of long-term services; PPPs encourage private-sector participation in government-related projects.

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## **II THE YEAR IN REVIEW**

The past years have been crucial for PPP projects in Brazil. In 2014, the Federal PPP Law reached its 10th anniversary without raising any constitutional challenge and with projects being implemented in the most varied sectors. Related tools, including requests for proposals from private parties, gained more strength and attracted significant participation from interested parties.

However, Brazil faced two severe crises in 2016: the former president, Ms Dilma Rousseff, was removed from office due to accusations of violation of fiscal laws, and the economy was (and still is) flat due to recession on many segments, including infrastructure. These factors adversely affected the execution of PPP agreements in the country and led to discussions related to early termination of PPP agreements (including, for instance, the Maracanã Stadium PPP in the city of Rio de Janeiro).

Despite this scenario, the federal government recently undertook important reforms and approved legislation aimed at helping the economy recover. We highlight two of them: the Constitutional Amendment No. 55 of 2016, which limits the increase in government spending for the next 20 years, and the creation of the Investment Partnerships Programme, Federal Law No. 13,334 of 2016, which provides a roadmap for concessions and privatisations in the infrastructure and energy sectors. Those measures are attracting interest from foreign investors and may bring a new wave of investment in the Brazilian infrastructure sector.

In addition, there are many ongoing discussions to update Brazilian administrative laws. One of them is an amendment to the Federal Procurement Law (Federal Law No. 8,666/1993), which is expected to expedite public procurement in Brazil. Another initiative is a restructuring of the federal agencies. Altogether, the above laws seek to foster private (mainly foreign) investment in Brazil in the coming year.

As we anticipated, the major PPP projects in 2016 involved public lighting systems. The largest project was structured in the city of São Paulo and the tender process for the maintenance, optimisation, operation and expansion of the city's public lighting network (the largest and most complex project for public lighting in the world, which included the replacement of more than 600,000 lighting points with an estimated value of 7 billion reais) has begun. The tender, however, was not finalised and it is now expected that the new city mayor will restructure the PPP with the purpose of implementing public guarantees in favour of the future concessionaire. Other relevant cities, including Belo Horizonte (state of Minas Gerais) and Cuiabá (state of Mato Grosso), successfully carried out similar initiatives. The cities concluded the relevant tender processes for granting public lighting services in May and December, respectively.

## **III GENERAL FRAMEWORK**

### **i Types of public-private partnership**

A PPP is a mechanism under which the government hires a supplier of services to implement a relevant infrastructure project, which in turn commits to make investments pursuant to the agreement and is granted the right to operate the project throughout the long-term agreement.

There are two types of PPP concessions in Brazil. The first is the sponsored concession, whereby the private concessionaire, pursuant to the PPP agreement, receives fees from users of the services supplied and the agreed payments from the public partner.

The second type is the administrative concession, whereby the government is the direct or indirect beneficiary of the service to be provided by the private partner. In this case, payment is made exclusively by the government.

In both of the above cases, the concessionaire is allowed to explore ancillary activities to the concession or associated projects. This permission increases the concessionaires' revenues and the investors' interest in PPP projects. However, a portion of the additional revenue earned by the concessionaire on the provision of ancillary services must be shared with the granting authority or with service users.

The method of payment for ancillary services must be determined in the PPP agreement and the granting authority might elect to discount its share of payments on the payment it is obligated to the concessionaire or it might retain its share on the tariffs to be paid by users.

PPPs are largely useful for the government; they permit contracting for construction, management and provision of services with better payment methods and, as a result, they attract the interest of private investors who might introduce new methods and technologies. The government manifestation of interest, for instance, looks to PPPs when investments in key areas are needed but public funds or public expertise are lacking.

## **ii The authorities**

PPPs may be executed in Brazil by the government, including special funds, agencies, state-owned companies, mixed public-private corporations and all other entities that are directly or indirectly controlled by the Brazilian federal government, the states, the federal district and municipalities.

At the federal level, the PPP Management Committee has jurisdiction to set priorities for services to be performed under a PPP model. The Management Committee is responsible for the coordination of such projects and is composed of members from the Ministry of Planning, Budget and Management, which is subordinated to the Ministry of Treasury and the Brazilian Presidency.

The Federal PPP Project Unit, which is responsible for outlining the technical, economic and financial aspects of federal projects and for undertaking feasibility studies, is part of the Ministry of Planning.

Additionally, other government branches at the federal level may develop their own projects and have powers to stipulate procedures for the execution of agreements and to authorise the commencement of competitive bidding processes as well as approve bidding documents.

As an alternative to boosting PPP projects, the federal government has recently created the Investment Partnership Programme to boost infrastructure in the country. The plan stipulates conditions for attraction of investments in infrastructure projects and creates an environment for greater integration between the public and private sectors.

The projects developed under the Program, by choice of the President, are subject to guidelines and extensive and long-term regulatory planning and rules regarding guarantees of the project, providing greater legal stability to the concessionaire. For instance, Federal Law No. 13,334 requires federal authorities to create long-term policy frameworks prior to the execution of PPP agreements in order to align contractual matters and public planning. In order to advise the President as to which projects should be included in the Program and the guidelines for planning and regulating these initiatives, Federal Law No. 13,334 created the Programme Board. It is composed of the Investment Partnership Programme's Executive Secretary, the Ministry of Interior, the Ministry of Finance, the Ministry of Planning,

Development and Management, the Ministry of Transport, Ports and Civil Aviation, the Ministry for the Environment, and the presidents of two federal state-owned development banks (Banco Nacional do Desenvolvimento Econômico e Social and Caixa Econômica Federal).

Although the federal government has not yet made use of the Federal PPP Law, the federal Management Committee model has been followed by some states.

The states of São Paulo, Minas Gerais, Bahia and Pernambuco have all developed relevant PPP programmes with the execution of projects in different sectors, such as underground transportation, roads, stadia, public health and sanitation. Those states rely on the Management Committee, PPP units and state-owned companies or funds granting state guarantees in favour of concessionaires.

São Paulo State Law No. 11,688 of 2004, further regulated by State Decree No. 48,867/2007, created São Paulo's PPP Unit, which is responsible for its PPP projects. Since 2004, São Paulo has executed the following projects under PPP agreements:

- a* Urban Railway Line 4 (2006): operation and maintenance of underground Line 4 in São Paulo.
- b* Alto Tietê Water Sanitation System (2008): operation, maintenance and expansion of water and wastewater infrastructure related to Alto Tietê Water Production System.
- c* Maintenance work for trains of the Urban Railway Line 8 (2010): work and services necessary for the maintenance and repair of trains operating in the urban railway Line 8 in the city of São Paulo.
- d* São Lourenço Water Sanitation System (2013): operation, maintenance and expansion of water and wastewater infrastructure related to São Lourenço Water Production System.
- e* Medicine Manufacturing Plant in Américo Brasiliense (2013): work, management and operation of a plant to manufacture medicine in the city of Américo Brasiliense, as well as manufacturing and sale of medical products to the state of São Paulo's public health system.
- f* Urban Railway Line 6 (2013): construction, operation, maintenance and management of underground transportation Line 6 in the city of São Paulo.
- g* Urban Railway Line 18 (2014): construction, operation, maintenance and management of underground transportation Line 18 in the city of São Paulo.
- h* Hospital installations (2014): work, maintenance and management of hospital installations throughout the state of São Paulo. Additionally, the concessionaire must provide all non-medical services necessary for the operation of the hospitals (i.e., patient admission, management of patient schedules, etc.).
- i* Tamoios Highway (2014): work, maintenance and expansion of the State Highway Tamoios, which connects the northern coastline cities of Caraguatatuba and São Sebastião to the state's countryside.
- j* Housing for low-income citizens (2015): work and services necessary to provide housing to low income citizens in the city of São Paulo.
- k* Integrated Metropolitan System of Santo's Coastline (2015): concession of passenger multimodal transportation services (bus, light railway and minivans) connecting São Paulo's south coastline cities of Bertioga, Cubatão, Guarujá, Itanhaém, Mongaguá, Peruíbe, Praia Grande, São Vicente and Santos.



In the state of Minas Gerais, Law No. 14,868 of 2003, further regulated by State Decree No. 43,102/2003, created Minas Gerais' PPP Unit. Since 2003, Minas Gerais has executed the following projects under PPP agreements:

- a* State Highway MG-050 (2007): work, maintenance and expansion of the State Highway MG-050 (Jatuaba–São Sebastião do Paraíso).
- b* Minas Gerais' Prison Complex (2009): construction, maintenance, operation and management of a prison complex that includes a number of incarceration units throughout the state.
- c* Governador Magalhães Pinto (Mineirão) Stadium (2010): works, maintenance, operation and management of Mineirão Stadium.
- d* Integrated Unit of Services (UAI) Phase I (2010): implementation, management, operation and maintenance of the state's UAIs, a place where Minas Gerais state provides a number of essential services to local citizens (i.e., issuance of official documents) in the cities of Betim, Governador Valadares, Juiz De Fora, Montes Claros, Uberlândia and Varginha.
- e* Integrated Unit for Services to the General Public Phase II (2013): implementation, management, operation and maintenance of the state's UAIs in 23 cities within the state.
- f* Water and wastewater infrastructure in Rio Manso Sanitation System (2013): operation, maintenance and expansion of water and wastewater infrastructure in the Rio Manso Sanitation System, which supplies water for consumers at the Metropolitan Region of Belo Horizonte.
- g* Integrated Unit for Services to the General Public Phase III (2014): implementation, management, operation and maintenance of the state's UAI at Praça Sete in the city of Belo Horizonte.
- h* Solid Waste Sanitation Services (2014): provision of sanitation services, including the collection, treatment and final disposition of solid waste in the Metropolitan Region of Belo Horizonte.
- i* Regional Airport Presidente Itamar Franco (2014): concession of the state's regional airport located in the city of Guianá, including the provision of recovery work, maintenance and management of airport infrastructure.
- j* Wastewater Sanitation System of Divinópolis (2015): operation, maintenance and expansion of the wastewater infrastructure in the city of Divinópolis.

In the State of Bahia, Law No. 9,290 of 2004, further regulated by State Decree No. 9,322/2005, created Bahia's PPP Unit. Since 2004, Bahia has executed the following projects under PPP agreements:

- a* Jaguaribe wastewater system (2006): operation, maintenance and expansion of the wastewater infrastructure of System Jaguaribe, including the work and operation of the infrastructure necessary to allow the disposition of wastewater generated in the city of Salvador.
- b* Octávio Mangabeira Stadium (Fonte Nova Arena) (2010): work, maintenance, operation and management of Fonte Nova Arena.
- c* Salvador's Suburb Hospital (HS) (2010): construction, operation and management of Salvador's HS, including provision of medical services to patients.
- d* Salvador – Lauro de Freitas Underground (2013): work, maintenance and management of an urban railway system connecting the cities of Salvador and Lauro de Freitas.

- e* Operation of Couto Maia Institute Hospital Unit (2013): provision of construction work, maintenance and management of the Couto Maia hospital complex in Salvador. Additionally, the concessionaire is responsible for providing all non-medical services necessary for the operation of the hospital complex (i.e., patient admission, management of patient schedules etc.).
- f* Imaging diagnosis (2015): operation and management of Bahia's Imaging Diagnosis Centre and provision of ancillary services to hospital units including imaging diagnosis as part of patient care initiatives encompassing the provision of radiology, mammography, tomography and magnetic resonance tests.

Finally, in the state of Pernambuco, Law No. 12,765 of 2005, further regulated by State Decree No. 35,378 of 2005, created Pernambuco's PPP Unit. Since 2005, Pernambuco has executed the following PPP agreements:

- a* Access Bridge and Highway System of Praia do Paiva (2006): work, maintenance and operation of the access bridge and highway system connecting the Industrial Complex of Suape and Pernambuco's northern coastline.
- b* Operation of a Prison System in Itaquitinga (2009): construction, maintenance, operation and management of a Pernambuco's Prison Complex in the City of Itaquitinga.
- c* Pernambuco's Multi-use Arena (2010): construction, maintenance, operation and management of Pernambuco's multi-use arena.
- d* Water supply and wastewater sanitation services (2013): water supply and wastewater sanitation services in the metropolitan region of Recife. The scope of services includes construction and maintenance services necessary for the expansion of Recife's water sanitation infrastructure.

### **iii General requirements for PPP contracts:**

Generally, the following rules must be observed in PPP agreements:

- a* the government may not delegate its regulatory and jurisdictional activities, or its exercise of police powers and other inherently public activities;
- b* the parties must stipulate fiscal responsibility in the PPP agreement;
- c* the parties must show transparency in their procedures and decisions;
- d* the parties must objectively allocate the risks that may arise during the performance of the granted services; and
- e* the financial sustainability and socio-economic advantages of a PPP project must be taken into account.

In addition, there are three main limitations on the use of PPPs: (1) the amount of the contract may not be less than 20 million reais; (2) the term of the contract may not be less than five and more than 35 years, including any applicable extension. The term must also be compatible with the repayment of the investment made; and (3) the PPP may not result in agreements with the sole purpose of hiring labour, supplying installation equipment or implementing public work projects.

The execution of a PPP agreement must also be preceded by a competitive bidding procedure and the commencement of the project is conditioned to the following:

- a* authorisation from the relevant authority accompanied by a technical report demonstrating the convenience and timing of the partnership and the reasons that justify the choice of a PPP (the value-for-money test);

- b* preparation of a financial impact estimation in the years in which the PPP agreement will be in force;
- c* preparation of an estimate containing the inflow of necessary public funds to perform the obligations undertaken by the government during the term of the agreement; and
- d* the inclusion of the scope of the PPP in the government multi-annual plan.<sup>2</sup>

#### **IV BIDDING AND AWARD PROCEDURE**

A competitive bidding process must precede the execution of a PPP. Before the commencement of the competitive bidding, drafts of the invitation to bid and agreement to public consultation must be published in the official press, newspapers of general circulation and electronic media. This notice must stipulate the purpose for the bidding process, the identification of the scope of the project, the length of the contract and its estimated value. The notice must also stipulate a period of at least 30 days for comments and at least seven days must elapse between the time for comments expire and the date of the official publication to bid.

The enactment of the notice of competitive bidding might also be subject to prior environmental permit or the issuance of directives for the environmental licensing of the project, depending on the scope of the contract.

##### **i Expressions of interest**

PPP projects in Brazil may be drawn up directly by the government or in collaboration with a private party. A private investor may take part in the preparation of the request for proposals issued at the behest of the granting authority or the authority may grant private investors an authorisation to conduct feasibility studies for a PPP not proposed by the government.

A manifestation of interest or an unsolicited proposal is used for obtaining feasibility studies on specific public work projects. It is a tool employed by major public and private entities, and it seeks to encourage private parties to participate in the organisation of infrastructure projects. At the federal level, Decree No. 8,428 of 2015 governs expressions of interest.

Manifestations of interest may be prepared by public or private entities (such as companies under government control) and they make it possible to obtain from private-sector partners certain technical, legal, and economic information regarding proposed infrastructure projects. Public authorities may also request additional studies to obtain a higher level of expertise from private partners.

##### **ii Requests for proposals and unsolicited proposals**

Unsolicited proposals precede the request for proposals. It begins with a formal request by any interested party to the government seeking to assess the feasibility of a specific PPP project. The government will review the request and in case of approval, it will publish a notice or announce its intention via digital media.

The government's notice will include the purpose of the solicited proposal and it must include:

- a* an announcement of the government's intention to receive proposals from interested private parties;

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<sup>2</sup> The multi-annual plan is a budgetary tool used to estimate the expenses of the government for the following four years.

- b* the procurement of studies into the technical, financial, economic, environmental and legal viability of a project;
- c* an invitation for contributions that investigate methods and systems for implementing the project;
- d* demonstration of cost reduction when the proposed PPP model is compared with other models, which must be conducted by the granting authority;
- e* demonstration that the proposed project conforms to the most appropriate model; and
- f* preparation of feasibility studies concerning the project.

The public notice introducing the request for proposals must also indicate the scope of the project and specify the nature of the relationship between the public and private entities. The notice must establish the term during which interested parties will have to undertake research about the proposed project, as well as guidelines governing the use of this procedure by the government entity.

### **iii Evaluation and grant**

The competitive bidding process for execution of PPP agreements may include a qualification stage under which bidders not able to reach a minimal standard will not be allowed to participate in subsequent stages.

Additionally, the government must either award the concession to the bidder with the lowest cost to the government or the bidder with the best proposal, when considering both the criteria above and the best technical skills available, according to a weighting system established in the invitation to bid.

The bidding documents must also state the manner in which bidders must present their proposals. Bidders might be required to provide written proposals in sealed envelopes, or written proposals followed by an invitation to bid. The latter must always be prepared inversely to the grading order of the written proposals. The invitation to bid cannot limit the number of proposals to be offered by the bidders. Nevertheless, the bidding document may limit the number of invited bidders to those whose written proposals have not exceeded 20 per cent of the amount set forth in the best proposal previously put forward.

Competitive bidding documents may also establish the reversal in the order of qualification and awarding stages, in which case once the stage of grading of offers has ended, the envelope containing the qualification documents of the highest-graded bidder must be opened to determine whether the conditions established in the invitation to bid have been met. The bidder will be declared after it has been determined that its bid meets the requirements set forth in the invitation to bid.

## **V THE CONTRACT**

### **i Payment**

A PPP agreement must stipulate the form of payment to the concessionaire by the public party. Payment must be made by bank transfer orders, assignment of credits other than tax credits, granting government rights, granting rights on public assets or any other means permitted by law.

A PPP agreement may establish that payment be conditioned to the performance of the service by the concessionaire. The granting authority must inform interested parties in the bidding documents that this will be the type of payment. Such requirement may vary case by case and depends on the operational and technical aspects applicable to each PPP agreement.

Generally, payment by the public party will be preceded by the completion of the work by the concessionaire. The main goal here is to create incentives for the concessionaire to complete all the work and timely commence the provision of services pursuant to the agreement.

As a result, only after the concessionaire begins to perform the service will the granting authority be obligated to make the payment. Nevertheless, the authority may be authorised, depending on specific terms agreed in a PPP agreement, to make payments that relate to portions of the service already available for use.

In addition, the granting authority may provide funds in favour of the concessionaire for the acquisition of certain assets required to carry out the concession. Such funds may be allocated prior to the beginning of the granted services. This type of advanced payment may help the implementation of the work and purchase of goods necessary for the provision of services. These goods will be reverted to the granting authority at the end of the concession period and may work as a financing alternative to the concessionaire.

## **ii State guarantees**

Among the mechanisms authorised by law, payment obligations undertaken by the public party in PPP agreements may be guaranteed by: (1) pledge of revenues; (2) creation or use of special funds contemplated in the law; (3) purchase of guarantees from insurance companies that are not under public control; (4) guarantees by international organisations or financial institutions not controlled by any government authority; or (5) guarantees put by guarantor funds or state-owned companies created especially for that purpose.

The state guarantee feature, which is permitted in PPP agreements, is an important innovation in agreements with the Brazilian government; this feature ensures payment of public partners' obligations and serves as a guarantee in the event of lawsuits and claims against the government. This tool is one of the main factors that distinguishes the legal regime of PPP agreements from ordinary administrative agreements or concessions.

Based on the alternatives for the creation of public guarantees inaugurated by the Federal PPP Law, each PPP agreement should have mechanisms for the implementation of such guarantees. The alternatives would rely, for example, on the existence of (1) revenue to fund the project; (2) public goods, which could be assigned to the private party; or (3) government corporations or funds organised with the purpose of guaranteeing PPPs projects.

## **iii Allocation of risk**

PPP agreements must establish allocation of risks between the parties, including those relating to acts of God, force majeure, acts of state and extraordinary economic risks. The public partner must be responsible for relevant risks, especially those that may generate financial effects, including expropriation and geological issues, which are difficult to measure.

The São Paulo State Court issued a decision in September 2014 in a case discussing whether expropriations could be undertaken by a concessionaire of a project to build an underground subway line according to a PPP agreement. The responsibility related to the compensation for the expropriation was allocated to the granting authority. The owner of some properties in the affected area sued the concessionaire, alleging that it was illegal for a concessionaire to proceed with the expropriations.

The judges assigned to the case reviewed the relevant statutes, namely: the Federal Constitution, the Federal Concessions Act, the Federal PPP Law, the São Paulo State PPP Law, and the PPP agreement. They decided that since the São Paulo State PPP Law authorises the allocation of expropriations to the concessionaire and the PPP agreement established that

the concessionaire was tasked with the obligation to undertake necessary expropriations, the concessionaire was entitled to proceed with such expropriations, even though the required compensation would be paid directly by the state.

The Court in that case upheld the PPP statutes and the reporting judge reminded the Court that the law establishes the PPP regime in Brazil, which is supported by specific rules that have not been declared unconstitutional and therefore must be maintained.

In a nutshell, a well-addressed risk matrix is the means for ensuring the protection of private interest when executing PPP agreements. Generally, the risk should be allocated to the party that is able to manage it at the lowest cost.

#### **iv Adjustment and revision**

PPP agreements must contain methods for payment adjustment and indexation, as well as mechanisms for maintenance of the services throughout the years. Contract clauses establishing automatic payment adjustment based on mathematical indexes and formulas do not need to be submitted to the public party for approval; the concessionaire should send the invoice with the adjusted amount to the public party, which will have 15 days from the submission of the invoice to reject it, in which case it must include reasonable grounds for the rejection.

Contract adjustments and review methods must be stipulated in the PPP agreement and must be based on services to be executed and implemented during the concession.

#### **v Ownership of assets**

At the time of the execution of a PPP agreement, the granting authority must transfer to the concessionaire all public assets necessary for the performance of the service. The concessionaire will be tasked with maintenance of these assets. In addition, the concessionaire must purchase all equipment and products necessary for the adequate performance of the service. The assets involved in the provision of the granted services will become public property at the termination of the PPP agreement.

Upon termination of the concession, all assets and rights transferred to the concessionaire by the granting authority for the performance of the service must be returned to the granting authority, which will render the service (directly or by means of a new competitive bidding). The reversion of assets and equipment at the end of the contractual term is conditioned to an indemnification of the portion of the amount paid for the assets subject to reversal less their natural depreciation.

#### **vi Early termination**

Early termination of PPP agreements may occur as a result of:

- a* conclusion of the contractual term;
- b* public interest demand (as a result of a takeover launched by the granting authority);
- c* forfeiture;
- d* lawsuit initiated by the concessionaire against the granting authority;
- e* annulment; or
- f* bankruptcy or extinction of the concessionaire.

During the concession period, the granting authority may request the recovery of the service from the concessionaire based on collective public interest. This recovery requires prior

payment of indemnification to the concessionaire and a specific law authorising the takeover of the service.

If the concessionaire is in breach of a PPP agreement, the granting authority reserves the right to either declare forfeiture of the PPP agreement or apply contractual penalties. The declaration of forfeiture must precede declaration of breach of the PPP agreement by the concessionaire through an administrative proceeding; the concessionaire will have the right to full defence and due process of law in the administrative proceeding. The forfeiture must be declared by a decree from the granting authority, regardless of prior indemnification, which will be determined in the course of a specific proceeding.

The PPP agreement may also be terminated by the concessionaire in the course of a lawsuit initiated by the concessionaire against the granting authority for breach of contract. The concessionaire of a PPP agreement must not interrupt the service until publication of a final court decision on a case in favour of the concessionaire.

## **VI FINANCE**

Pursuant to the PPP model in Brazil, the concessionaire is responsible for financing and investing in the project. The financing structure is usually partially equity investment by sponsors of the project (i.e., shareholders of the special purpose company incorporated with the purpose of implementing and managing the partnership project) and part in debt investment usually contracted with state-owned or private financial institutions.

State-owned banks usually play a role in the financing of PPP projects offering credit lines with favourable market rates. Moreover, governmental measures have been developed to improve financing mechanisms involving public projects, such as infrastructure bonds.

## **VII RECENT DECISIONS**

A recent court decision in 2017 addressed the importance of the public guarantee feature in PPP projects. The case related to a dispute involving a PPP contract executed by the municipality of Rio das Ostras for the expansion and operation of its municipal sewage system. A guarantee fund was created to ensure the municipality's financial obligations. A financial institution was hired by the municipality to manage the fund and to provide the guarantee. The concessionaire began providing the service agreed on the PPP agreement in 2009 and received regular payments by the public partner.

However, in January 2013, all payments due to the municipality's suppliers (work executors, material suppliers and service providers) were temporarily suspended by a municipal decree enacted by the newly elected mayor of Rio das Ostras. As a result, payment of services performed between January and February 2013 were not made by the granting authority.

The concessionaire then requested payment from the financial institution that provided the guarantee. At that point, the municipality attempted to terminate the fund's management agreement with the financial institution. According to the concessionaire, the termination of the agreement between the municipality and the financial institution sought to frustrate the guarantee and avoid further payments. The concessionaire sued the municipality to protect the enforceability of the guarantee.

The court recognised that PPP agreements involve relevant public interest, considerable capital investment and long-term relationships. It seemed clear to the court that without the effective guarantee of payments, the interest of private parties in executing agreements with the government would be severely affected. Considering that PPP agreements may reach terms of 35 years, the main purpose of state guarantees in such agreements is to grant stability to private parties.

The court ordered that the financial institution in charge of the fund's management comply with its contractual obligations and pay the amounts due under the guarantee in favour of the concessionaire in case of public default and until another institution was hired to replace it.

The decision was received by the market with great enthusiasm and it has been seen as a precedent that could serve to mitigate political risks and disputes. However, a justice from the Superior Court of Justice, Minister Francisco Falcão, on an appeal to that decision seeking to suspend it, granted, on 18 May 2015, the suspension of the effects of that decision. The justice reasoned his decision on the increased possibility of financial difficulties by the granting authority as a result of the current political crisis in Brazil, a reduction on the amount passed on to public entities by the federal government, the crisis within Petrobrás, and a reduction in the price of a barrel of oil.

The justice did not understand that the courts are not tasked with management of public resources and determined the transfer of amounts related to oil royalties, which was against the municipality's laws and the Court of Justice's decision, which did not examine the municipality's current financial constraints. The Superior Court of Justice confirmed the decision on 2 March 2016.

## VIII OUTLOOK

After celebrating its 10th anniversary, the Federal PPP Law has been very well accepted in Brazil. It was created to attract capital to finance infrastructure projects in the country and it has been broadly adopted in the most diverse sectors. Although the federal government has not implemented any PPP project in the past decade, state governments have made extensive use of this mechanism. Some efforts have been made to develop PPP projects in specific sectors at the federal level such as highways, irrigation and defence projects, but none of them have been granted yet.

The expectation of PPP law in Brazil is that it will continue to play a decisive role in ensuring the viability of major and much-needed infrastructure projects in the country in the next few years, including airports, railways, urban transportation, hospitals, solid waste, sanitation, water supply and public lighting projects at the federal, state and municipality levels.

At the federal level, the opportunities for 2017 relate to projects embraced by the Investment Partnership Programme, including:

- a* international airport infrastructure: airports in Porto Alegre, Salvador, Florianópolis and Fortaleza;
- b* port terminals: lease of port terminals in Santarém, Rio de Janeiro, Salvador and Paranaguá;
- c* road systems: Federal Road Nos. BR/365/GO/MG and BR 101/116/290/386/RS32;
- d* railroads: concessions of EF-151 SP/MG/GO/TO Norte-Sul, EF-170 MT/PA – FERROGRÃO and EF-334/BA – FIOLE;



- e* water and sanitation utilities: privatisation of mixed-ownership government corporations, including Companhia de Águas e Esgoto do Estado do Rio de Janeiro (CEDAE), Companhia de Saneamento do Pará (COSANPA) and Companhia de Águas e Esgoto de Rondônia (CAERD);
- f* power utilities: privatisation of mixed-ownership government corporations, including Amazonas Distribuidora SA, Boa Vista Energia SA, Companhia de Eletricidade do Acre, Companhia Energética de Alagoas, Companhia Energética do Piauí and Centrais Elétricas de Rondônia; and
- g* lottery privatisation of Loteria Instantânea Exclusiva (LOTEX).

Municipal elections in Brazil (which took place in October 2016) may also lead to an increase in opportunities at the municipal level, particularly public lighting services and social-impact projects. In this regard, investors should be attentive to platforms for the implementation of smart cities, health and education related projects.

# CANADA

*Bradley Ashkin, Dana Porter, Erik Richer La Flèche and Jamie Templeton<sup>1</sup>*

## I OVERVIEW

In 2016, the transportation sector continued to attract significant private investment in public-private partnerships (P3s). Municipalities were a significant source of P3 opportunities, particularly in the water treatment and transportation sectors, and could become an even larger source if the trend towards ‘bundling’ smaller infrastructure projects to form larger, more economically attractive P3 opportunities continues. The supply of capital in the Canadian market continues to be very strong, with the capital affiliates of engineering and construction enterprises appearing more frequently in the ranks of the primary investors. Although the Canadian market is ultimately much smaller than the US market, it is a mature market with substantial political and public buy-in to the P3 concept and a reliable project pipeline.

## II YEAR IN REVIEW

The transportation sector, and especially the rapid transit sector, continued to turn to P3 for the completion of large-scale infrastructure projects – those approaching or exceeding the C\$1 billion mark.<sup>2</sup> For example, construction began in Toronto in the spring of 2016 on the Eglinton Crosstown Project: a 19-kilometre light rail transit (LRT) system which is proceeding by way of a design–build–finance–maintain (DBFM) P3 valued at C\$9.1 billion (including inflation) over the life of the project.<sup>3</sup> The spring of 2016 also saw construction begin on Phase I of the Valley Line Project in Edmonton, consisting of the first 13 kilometres of a planned 27-kilometre addition to that city’s existing LRT system. Phase I is proceeding by way of a C\$1.8 billion design–build–finance–operate–maintain (DBFOM) P3.<sup>4</sup> The request for the qualification period for Phase II of this project, estimated at C\$1.4 billion, has not yet commenced.

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1 Bradley Ashkin is a senior associate and Dana Porter, Erik Richer La Flèche and Jamie Templeton are partners at Stikeman Elliott LLP. The authors would like to thank Andrew Cunningham, Laura Delemere and Tara Mandjee for assisting with the preparation of this chapter.

2 PPP Canada, Annual Report 2015–2016: Transforming Infrastructure Delivery, online: [www.p3canada.ca/en/about-us/transparency-and-accountability/annual-reports/2015-2016-annual-report/](http://www.p3canada.ca/en/about-us/transparency-and-accountability/annual-reports/2015-2016-annual-report/).

3 Infrastructure Ontario, Eglinton Crosstown LRT, online: [www.infrastructureontario.ca/Backgrounder-Project-Innovation-Eglinton-Crosstown-LRT/](http://www.infrastructureontario.ca/Backgrounder-Project-Innovation-Eglinton-Crosstown-LRT/).

4 ‘\$1.8B Edmonton Valley Line Reaches Financial Close’, *ReNew Canada* (17 February 2016), online: <http://renewcanada.net/2016/1-8b-edmonton-valley-line-reaches-financial-close/>.

Municipalities continued to emerge as a significant source of P3 opportunities in 2016 as the trend of ‘bundling’ small-scale infrastructure projects – those under C\$50 million – has become more widely used to create economically attractive P3 opportunities. For example, in December 2015, construction began on the City of Saskatoon’s Bridging to Tomorrow Project, which is proceeding as a C\$252.6 million DBFOM P3.<sup>5</sup> When structuring this project, the City of Saskatoon bundled its Traffic Bridge reconstruction project – individually estimated at C\$41.2 million – with its North Commuter Parkway construction project in order to take advantage of economies of scale and competitive project pricing. In January 2016, the City of Saint John, New Brunswick entered into a DBFOM P3 contract for its Safe Clean Drinking Water Project, which bundles the upgrading of its Spruce Lake Water Treatment Plant with the construction or replacement of 20 kilometres of water transmission and distribution pipes to create a project that, in the aggregate, will cost C\$216 million.<sup>6</sup>

In 2016, P3 projects continued to make up a significant proportion of the Top 100 Projects list, which is published annually by *ReNew Canada* to recognise the biggest infrastructure projects in Canada. More than one-quarter of the Top 100 Projects recognised in 2016 were designated as P3s, including the Valley Line Project in Edmonton and the Eglinton Crosstown LRT in Toronto.<sup>7</sup> The Eglinton Crosstown LRT also received a National Award for Innovation and Excellence from the Canadian Council for Public-Private Partnerships in November 2015 for outstanding achievement in P3 project financing, particularly for its achievement of being the first transit project to receive funding through ‘green bonds’, which are issued by the government of Ontario to finance environmentally friendly infrastructure.<sup>8</sup>

### III GENERAL FRAMEWORK

#### i Types of public-private partnership

Various types of P3 have been developed over the years as an alternative to the conventional delivery model of design–bid–build (DBB), in the hope of achieving better value for money. P3 models used in Canada most commonly include build–finance (BF), design–build–finance (DBF), DBFM and DBFOM. Other models, such as the operation and maintenance (O&M) and the design–build–operate–maintain (DBOM), are used less frequently.

Risk allocation is the key concept in any P3 model. Moving across the spectrum from the basic DBB model to the DBFOM P3 model, risk is progressively shifted from the public sector to the private sector. In Canada, there is a preference for the DBFOM model in most types of P3, since maintenance and operation are included as part of the project, thereby increasing the certainty of a long-term, secure revenue stream in the course of a project

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5 City of Saskatoon, North Commuter Parkway and Traffic Bridge: Bridging to Tomorrow, online: [www.saskatoon.ca/business-development/major-projects/current-projects/north-commuter-parkway-traffic-bridge-replacement-project](http://www.saskatoon.ca/business-development/major-projects/current-projects/north-commuter-parkway-traffic-bridge-replacement-project).

6 Connell Smith, Saint John’s water agreement shows operating company can be sold (7 April 2016) CBC News, online: [www.cbc.ca/news/canada/new-brunswick/saint-john-drinking-water-1.3525601](http://www.cbc.ca/news/canada/new-brunswick/saint-john-drinking-water-1.3525601); City of Saint John Announces \$216 million P3 Plan to Overhaul Its Water System, Water Canada, 11 February 2016, online: <http://watercanada.net/2016/city-of-saint-john-announced-216-million-p3-plan-to-overhaul-its-water-system/>.

7 Top 100 Projects, online: <http://top100projects.ca>.

8 The Canadian Council for Public-Private Partnerships, 2015 National Award Winners, online: [www.on-sitemag.com/construction/p3-project-award-winners-announced-today/1003869438/](http://www.on-sitemag.com/construction/p3-project-award-winners-announced-today/1003869438/).

agreement that will typically be in place for 25 to 35 years.<sup>9</sup> For example, Quebec's first P3 project, the A-25 highway bridge in Montreal, was a DBFOM.<sup>10</sup>

In each of the P3 models discussed above, the public owner awards the infrastructure project to a private partner upon the completion of a two-stage request for qualifications/request for information (RFQ/RFI) and request for proposals (RFP) process, which is further described in Section IV, *infra*. Once the private partner is awarded the project, a 'special purpose vehicle' legal entity is created to provide the services contemplated by the applicable P3 model (DBF, DBFM, DBFOM, etc.). This entity is usually referred to as the 'consortium' or the 'ProjectCo'.

Under the P3 structure, the main contract is the 'project agreement' or 'concession agreement', which is entered into between the ProjectCo and the public owner for a term of 25 to 35 years or more, at the end of which the public owner takes over the asset and responsibility for its continued maintenance and operation. Unlike conventional infrastructure project delivery, the ProjectCo acts as a general contractor and enters into subcontracts with the relevant partners of the project, such as the design/construction contractor, the O&M contractor and the lenders. In other words, the ProjectCo assumes the risk of delivering the project on time and on budget to the public owner. Accordingly, and given that the ProjectCo is a single purpose vehicle, the contractual agreements are structured so as to ensure that the rights and obligations of the ProjectCo under the project agreement are passed down to the contractors under the applicable subcontracts on a back-to-back basis. As a result, the terms of the two main subcontracts under the DBFM and DBFMO models – the construction agreement and the O&M agreement – must be negotiated with reference to the project agreement.

The O&M model is less frequently used in Canada but presents a simpler structure. Under this model, the public owner simply transfers to the private operator the responsibility to operate and maintain a publicly owned asset under a fixed-term contract, while the public owner retains ownership of the asset.<sup>11</sup> This model is specifically considered in industries where private operators tend to be technologically sophisticated operations and maintenance experts who can enhance efficiency in those areas. Tolling of highways and wastewater are examples of sectors in which the O&M approach is often taken.<sup>12</sup> Another model to consider is the DBOM, also known as 'turnkey procurement'. This model differs from the DBFOM insofar as the public sector secures the project's financing and, where applicable, retains the operating revenue risk and any surplus operating revenue. The DBOM model has been retained for the Lac La Biche Biological Nutrient Removal Wastewater Treatment Facility in Alberta, with a contribution of up to C\$3.8 million secured from the government of Canada through the P3 Canada Fund.<sup>13</sup>

9 Association of Consulting Engineering Companies, Understanding Public Private Partnerships in Canada, online: [www.acec.ca/files/resources/acec\\_P3\\_report\\_v3.pdf](http://www.acec.ca/files/resources/acec_P3_report_v3.pdf).

10 'Autoroute 25', *The Canadian Business Journal* (n.d.), online: [www.cbj.ca/autoroute\\_25/](http://www.cbj.ca/autoroute_25/).

11 The Canadian Council for Public Private Partnerships, Introduction to Public-Private Partnerships, online: [www.pppcouncil.ca/web/Knowledge\\_Centre/What\\_are\\_P3s\\_/Definitions\\_Models/web/P3\\_Knowledge\\_Centre/About\\_P3s/Definitions\\_Models.aspx?hkey=79b9874d-4498-46b1-929f-37ce461ab4bc](http://www.pppcouncil.ca/web/Knowledge_Centre/What_are_P3s_/Definitions_Models/web/P3_Knowledge_Centre/About_P3s/Definitions_Models.aspx?hkey=79b9874d-4498-46b1-929f-37ce461ab4bc).

12 United States of America, Department of Transportation, P3 defined, online: [www.fhwa.dot.gov/ipd/p3/defined/om\\_concession.aspx](http://www.fhwa.dot.gov/ipd/p3/defined/om_concession.aspx).

13 Government of Canada Press release, online: [www.p3canada.ca/-/media/english/press-releases/files/government%20of%20canada%20and%20lac%20la%20biche%20county%20join%20in%20public-private%20partnership.pdf](http://www.p3canada.ca/-/media/english/press-releases/files/government%20of%20canada%20and%20lac%20la%20biche%20county%20join%20in%20public-private%20partnership.pdf).

In the past decade, there has been a shift in Canada in the type of projects being considered for P3s, from vertical and social infrastructure asset classes (e.g., hospitals, courthouses) towards linear and other alternative asset classes (e.g., transit, highways, water/wastewater, solid waste).<sup>14</sup> For instance, the South Fraser Perimeter Road, a DBFOM, was completed in 2013 as part of the British Columbia's Gateway Program, which aims at improving roads and bridges for people, goods and transit in Metro Vancouver. This project was recognised for including the largest environmental and agricultural mitigation and enhancement plan for a highway construction project in British Columbia and for the efficient changes to the design, which were proposed by the private sector as a result of the competitive process. It won the CCPPP Award of Merit – Project Financing (2010) and the Silver Award for Infrastructure (2014).<sup>15</sup>

## ii The authorities

Several authorities are involved in the P3 market including the federal government, the provincial governments and dedicated specialised agencies. In recent years, municipalities have also acted as the public partner in a number of infrastructure projects, such as the AMT Maintenance Centre and Garage in Montreal (a DBF) and the City of Winnipeg's Disraeli Bridge replacement project (a DBFM).

From a constitutional perspective, the allocation of responsibilities between provinces and the federal government is such that the majority of large-scale infrastructure projects fall under provincial jurisdiction. An example of a type of infrastructure falling under federal jurisdiction would be an international bridge or border crossing, such as the planned Gordie Howe International Bridge between Windsor, Ontario and Detroit, Michigan. Moreover, in most Canadian jurisdictions, the federal government and the provincial governments have established specialised arm's-length agencies, which evaluate, structure and manage the procurement of P3 projects.

### *Federal level*

At the federal level, three main groups are involved in P3s: (1) PPP Canada (also known as P3 Canada), (2) a P3 group at Public Works Government Services Canada, and (3) a P3 team at Treasury Board.<sup>16</sup>

PPP Canada is a federal crown corporation that was established to work with the public and private sector to support P3s and to encourage the further development of Canada's P3 market. It promotes P3 best practices and capacity-building and has shown particular interest in providing financial support and expertise for large capital projects at the municipal level.<sup>17</sup> P3 Canada also acts as an adviser on various aspects of P3s, including in assessing the suitability of the P3 model over the traditional model for certain projects by conducting the 'value for money' analysis.

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14 P3 Fundamentals conference, 3 Session 1: Learning the Basics, online: <http://hosting.epresence.tv/livemedia/145/Watch/941.aspx>.

15 The Canadian Council for Public Private Partnerships, Project details, online: [http://projects.pppcouncil.ca/ccppp/src/public/project/?project\\_id=161&scope=view](http://projects.pppcouncil.ca/ccppp/src/public/project/?project_id=161&scope=view).

16 Association of Consulting Engineering Companies, Understanding Public Private Partnerships in Canada, online: [www.acec.ca/files/resources/acec\\_P3\\_report\\_v3.pdf](http://www.acec.ca/files/resources/acec_P3_report_v3.pdf).

17 Public-Private Partnerships: A Guide for Municipalities, online: [www.p3canada.ca/en/about-p3s/p3-resource-library/public-private-partnerships-a-guide-for-municipalities/](http://www.p3canada.ca/en/about-p3s/p3-resource-library/public-private-partnerships-a-guide-for-municipalities/).

P3 Canada also administers the P3 Canada Fund, which assists in the financing of infrastructure projects launched by Canadian governments at all levels. Eligibility criteria for the P3 Canada Fund's merit-based programme include whether a project would foster economic growth, support a cleaner environment or promote stronger communities. P3 Canada Fund initially started with C\$1.2 billion in funding but there has been a recent commitment from P3 Canada to add C\$1.25 billion through 2018, specifically in the sectors of transportation, water/wastewater and solid waste disposal.<sup>18</sup>

Moreover, in November 2016, the government of Canada confirmed that it was taking steps towards creating a new Canadian infrastructure bank, which will make at least C\$35 billion available to relieve Canada's infrastructure deficit. In other words, the federal government will be creating an institution from which other levels of government can borrow at the federal government rate in order to reduce the borrowing costs in large P3 projects.<sup>19</sup>

### ***Provincial level***

At the provincial level, several provincial governments have created a specialised agency. Among the most active are Infrastructure Ontario, Partnerships BC, Alberta Infrastructure, Infrastructure Québec and SaskBuilds. In the maritime provinces, specific government departments have been identified to manage delivery of P3s, such as the New Brunswick Department of Transportation and Infrastructure and the Nova Scotia Ministry of Infrastructure and Transportation. Provincial organisations such as Partnerships New Brunswick have also procured social infrastructure including schools and highways. Manitoba does not have a dedicated public infrastructure agency. These specialised agencies or dedicated government departments are the machines behind the P3 market, assisting the P3 stakeholders from project inception through procurement, construction and, in some cases, operation.

At the provincial level, Ontario and British Columbia have led the way by developing and adapting to the Canadian market the original P3 documentation from Australia and the UK at an early stage. As a result, their template documentation often serves as a model for the other provinces and they play a key role in advising on the interpretation of the documentation and in continuously improving these templates. It should be noted that Infrastructure Ontario also offers its project management services to lower tier governments and agencies while Partnerships BC has been lending its expertise to the Province of Nova Scotia.

### ***Ontario***

The Ontario Infrastructure and Lands Corporation (generally referred to as Infrastructure Ontario) is a crown corporation established by the provincial government in 2006. Infrastructure Ontario is dedicated to the renewal of Ontario's infrastructure, including public hospitals, courthouses, roads, bridges and water systems. Recently, there has been a notable shift towards transit projects, such as Toronto's Eglinton Crosstown LRT and Scarborough LRT Lines, Highway 407 East Phase 2, ION (the Region of Waterloo Rapid

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18 Ontario Infrastructure and Lands Corporation, 2014–2017 Business Plan, online: [www.infrastructureontario.ca/WorkArea/DownloadAsset.aspx?id=2147492687](http://www.infrastructureontario.ca/WorkArea/DownloadAsset.aspx?id=2147492687).

19 Canada Infrastructure Bank, online: [www.budget.gc.ca/fes-eea/2016/docs/themes/infrastructure-en.html](http://www.budget.gc.ca/fes-eea/2016/docs/themes/infrastructure-en.html).

Transit System), the GO Transit East Rail Maintenance Facility and the Toronto Transit Commission's Sheppard Maintenance and Storage Facility.

Ontario remains Canada's most active P3 market, with C\$35 billion allocated to infrastructure through 2016.

### *British Columbia*

Partnerships BC, a British Columbia crown corporation, was established in 2002 to promote, support and identify P3 opportunities in British Columbia. It is the lead agency in British Columbia for long-term concessions. In recent years, Partnerships BC started to focus more on social accommodation projects such as hospitals as well as jails, courthouses and energy and water/wastewater projects, including the City of Victoria's McLoughlin Point Wastewater Treatment Plant Project and the Greater Vancouver Sewerage and Drainage District's waste-to-energy project.

### *Alberta*

Alberta has a dedicated P3 (Alternative Capital Financing) office within the Alberta Treasury Board and another group within the Ministry of Transportation. Unlike Ontario and British Columbia, project agreements in Alberta have been simplified, as has the procurement selection process. From a focus on education and transportation, recent projects such as the Evan-Thomas Water Treatment and Wastewater Treatment Facility,<sup>20</sup> reflect a shift towards water/wastewater. We also note a shift towards rapid transit projects.<sup>21</sup>

### *Saskatchewan*

In 2012, the province of Saskatchewan created SaskBuilds, a crown corporation with the mandate to integrate, coordinate and prioritise infrastructure spending, including promoting P3s where advisable. In the past year, SaskBuilds has proven to be very successful with the financial close of four P3 competitions, including the Regina Bypass and the new Saskatchewan Hospital North Battleford projects.<sup>22</sup> The City of Saskatoon is also currently implementing a project for the development of new transit facilities as well as the new North Commuter Parkway and redeveloped Traffic Bridge referred to in Section II, *supra*.

### *Quebec*

Infrastructure Québec was established in 2005 to advise the government of Quebec on infrastructure projects (including P3) as well as to serve as a bank of knowledge and expertise for all stakeholders in the Quebec P3 market. Several large infrastructure projects have since been completed, including in the transportation sector with the light rail maintenance centre in Montreal's Pointe-Saint-Charles borough.

Another major infrastructure project in Quebec is the proposed 67-kilometre integrated electric light-rail public transit network (REM) intended to connect downtown Montreal, the

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20 Government of Alberta Ministry of Infrastructure, Evan-Thomas Water Treatment and Wastewater Treatment Facility, online [www.infrastructure.alberta.ca/3755.htm](http://www.infrastructure.alberta.ca/3755.htm).

21 Government of Alberta Ministry of Infrastructure, Ring Roads – Edmonton & Calgary, online: [www.transportation.alberta.ca/610.htm](http://www.transportation.alberta.ca/610.htm)

22 SaskBuilds, Annual Report 2015–2016, online: [www.saskbuilds.ca/about-us/SB%202015-16%20Annual%20Report%20for%20web.pdf](http://www.saskbuilds.ca/about-us/SB%202015-16%20Annual%20Report%20for%20web.pdf).

South Shore, the West Island, the North Shore and Montreal-Trudeau International Airport, spearheaded by the Caisse de dépôt et placement du Québec. Once completed, the REM will be the fourth-largest automated transportation system in the world after Singapore, Dubai and Vancouver. The estimated cost of the entire project is C\$5.9 billion.

### iii General requirements for P3 contracts

P3s remain the exception to the conventional model of infrastructure project delivery; indeed, although they have proven very successful for certain projects, they are not suitable for every infrastructure project. As a result, certain criteria need to be considered in order to determine whether a P3 would be an appropriate approach in a given situation, and, if so, which model of P3 (e.g., DBF, DBFOM, etc.).

In terms of legislative and regulatory burdens, certain statutes do specifically regulate the agencies and other authorities described in subsection ii, *supra*, and there are certain federal and provincial laws and some guidelines and policies that apply to P3 processes more generally, but overall, Canadian P3s are not generally subject to burdensome legislation or regulations. Of course, P3s are subject to general principles of common law and civil law, unless otherwise agreed (to the extent authorised under the relevant jurisdictions).

### *Criteria relevant to use of a P3 model*

Both quantitative and qualitative criteria should be looked at in deciding whether to use a P3 model. The ‘value for money’ (VFM) analysis corresponds to the quantitative assessment, whose objective is to determine which model will offer greater value for money. In other words, in considering the full cost of delivering a project under both the conventional method and under a P3, this analysis will determine the model under which the infrastructure asset would be delivered at the lowest cost. In assessing the cost, a VFM analysis takes into consideration the following:

- a base construction costs;
- b financing costs;
- c ancillary costs (e.g., for project management and professional and legal services);
- d costs related to governmental agencies involved in the project; and
- e pursuit costs.

It also factors in the cost associated with the risk being retained by the public owner and the value of risk transferred to the private partner.

Infrastructure Ontario conducts a VFM analysis before agreeing to work on a project using the P3 model and, for transparency purposes, it makes its analysis public – an example being Toronto’s Eglinton Crosstown LRT project, where the VFM analysis came out in favour of a P3 approach.<sup>23</sup> Infrastructure Ontario’s standard VFM methodology can be used as a guide by any authority or province.<sup>24</sup>

Although no legislation imposes a minimum or maximum dollar value or project size above which a P3 will be selected, there is a general agreement that larger projects will

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23 Value for Money Assessment, Eglinton Crosstown Light Rail Transit, February 2016, online: <http://infrastructureontario.ca/WorkArea/DownloadAsset.aspx?id=34359739089>.

24 Assessing Value for Money: an Updated Guide to Infrastructure Ontario’s Methodology – March 2015, online: [www.infrastructureontario.ca/WorkArea/DownloadAsset.aspx?id=2147492776](http://www.infrastructureontario.ca/WorkArea/DownloadAsset.aspx?id=2147492776).



tend to have more of the potential synergies and efficiencies that would justify a P3.<sup>25</sup> The government of Canada also imposes a requirement that federal departments give consideration to a P3 approach for any infrastructure project with a term of at least 20 years and capital costs of C\$100 million.<sup>26</sup> On the other hand, P3 agencies have set thresholds under which they will not consider delivering the project by way of a P3 model: both Infrastructure Ontario and Partnerships BC recently increased their initial threshold of C\$50 million to C\$100 million. Of interest, we note that in certain provinces, a few projects that were below the C\$50–C\$100 million threshold were ‘bundled’ in order to reach the threshold to make the P3 model attractive, including in Alberta with multiple school projects and in Saskatchewan with Saskatoon’s combined Traffic Bridge and North Commuter Parkway projects.<sup>27</sup>

It is also generally recognised that projects with terms of 25 to 35 years, driven by long-term demand for the asset and a sufficient operating period, are more suitable for P3 procurement, given that the term allows the private partner to recover its investment over time. Even if other provisions of the P3 documentation are not expressly regulated, we also note a tendency towards standardisation of the documentation such that the main provisions found in P3 documentation are fairly uniform and typically not extensively negotiated.

Risk allocation is another element to consider when deciding between P3 procurement and the conventional delivery model. Simply put, a P3 model should be preferred where the public sector can benefit from transferring responsibilities and risk to the private sector, which it is better able to manage. Similarly, if a project has a significant operational component, it can be advantageous to have a private partner take on the operational activities in order for it to focus on whole-life cost minimisation and to maximise efficiencies. Other elements that may be considered include market capacity, potential for innovation and whether performance can be measured through quantifiable output specifications.

P3 procurement is generally more suitable for new projects rather than for refurbishment projects where the private partner may not be able to price the latent defect risk that it is being asked to assume. Nonetheless, in the Bridgepoint Hospital project, a special feature was the restoration and adaptive reuse of the former Don Jail, an architectural landmark and heritage site in Toronto.<sup>28</sup>

### ***Legislation and guidelines***

Over the years, policies and guidelines have been developed by provinces and municipalities for use in the assessment of capital projects for potential P3 procurement. Although not binding, these policies and guidelines have set out the best practices and standards which are being complied with in the industry. They also serve as banks of information for the various stakeholders involved in infrastructure projects in Canada.

Alberta took the lead with the Alberta’s Public-Private Partnership Framework and Guideline, which outlines Alberta’s principles for P3s and the assessment and procurement

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25 PPP Canada FAQ, online: [www.p3canada.ca/en/about-p3s/frequently-asked-questions/](http://www.p3canada.ca/en/about-p3s/frequently-asked-questions/).

26 Infrastructure Canada, 2014 New Building Canada Fund: National Infrastructure Component, online: [www.infrastructure.gc.ca/plan/nic-vin-prog-eng.html](http://www.infrastructure.gc.ca/plan/nic-vin-prog-eng.html).

27 Saskatoon North Commuter Parkway and Traffic Bridge Replacement, online: [www.p3canada.ca/en/about-p3s/project-map/saskatoon-north-commuter-parkway/](http://www.p3canada.ca/en/about-p3s/project-map/saskatoon-north-commuter-parkway/).

28 CCPPP, Project Details, Bridgepoint Hospital, online: [http://projects.pppcouncil.ca/ccppp/src/public/project/?project\\_id=106&scope=view](http://projects.pppcouncil.ca/ccppp/src/public/project/?project_id=106&scope=view).

frameworks for P3 projects.<sup>29</sup> British Columbia also issued the Capital Asset Management Framework and, in 2014, Saskatchewan's SaskBuilds issued the Public-Private Partnership Project Assessment and Procurement Guideline. PPP Canada also published the following two guides: PPP Canada P3 Business Case Development Guide and Identifying P3 Potential, A Guide for Federal Departments and Agencies. In recent years, some municipalities also issued policies to ensure transparency and consistency, including the City of Calgary P3 Policy<sup>30</sup> and the policy statement of the City of Edmonton, which (among other things) take into consideration local community objectives.

In terms of regulations, the Ontario Infrastructure and Lands Corporation Act 2011 and the Act respecting Infrastructure Québec established the agencies referred to in the statutes' respective titles and provide for the scope of their services and competence. In Quebec, the Act Respecting Transport Infrastructure Partnerships 2000 also regulates partnership agreements, specifically in the transportation sector. We also note the British Columbia Transportation Investment Act governing highway P3 projects and the Health Sector Partnerships Agreement Act. Lastly, in Manitoba, the Public-Private Partnerships Transparency and Accountability Act came into force in 2014 and applies to major capital projects having a projected total cost of C\$20 million or more. This threshold is considerably lower than the one in Ontario and British Columbia, yet it is high enough to exclude most municipal projects in Manitoba.

In 2002, Parliament passed the Canada Strategic Infrastructure Fund Act, which governs the eligibility for projects that include positive impacts for the public to receive federal contributions. Moreover, to the extent that a project is to be funded by the P3 Canada Fund, it must go through an approval process which can involve the Board of Directors of PPP Canada, the Minister of Finance and the Treasury Board.<sup>31</sup>

Lastly, in Quebec, the authorisation of the Autorité des marchés financiers (AMF), the Quebec securities regulator, is required in certain circumstances. Under An Act Respecting Contracting by Public Bodies, enterprises that are competing in a call for tenders or an award process for contracts with Quebec government departments and agencies involving an expenditure greater than C\$5 million for P3 agreements must obtain an authorisation from the AMF. This requirement is also applicable for contracts with Quebec cities and municipalities but the thresholds vary. A companion guide is available on the website of the AMF, providing details on the application for authorisation.<sup>32</sup>

#### IV BIDDING AND AWARD PROCEDURE

In Canadian P3 projects, it is typical for a significant amount of planning and preparation to take place long before the procurement process gets under way. Detailed analysis of the demand for a project, and the support of various stakeholders, is carried out, and the priority

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29 Alberta's Public-Private Partnership Framework and Guideline, prepared by Alberta Treasury Board, dated March 2011, available on the Alberta Treasury Board's website.

30 CCPPP, A Guide for Municipalities, online: [www.p3canada.ca/-/media/english/resources-library/files/p3%20guide%20for%20municipalities.pdf](http://www.p3canada.ca/-/media/english/resources-library/files/p3%20guide%20for%20municipalities.pdf).

31 PPP Canada Inc., Summary Corporate Plan 2010–2015, Operating and Capital Budgets 2010/11, online: [www.p3canada.ca/-/media/english/corporate-plans/files/2010\\_11\\_summary\\_corporate\\_plan.pdf](http://www.p3canada.ca/-/media/english/corporate-plans/files/2010_11_summary_corporate_plan.pdf).

32 Companion guide for enterprises wishing to obtain or renew an authorisation to enter into a public contract/subcontract, online [www.lautorite.qc.ca/files/pdf/contrats-public/guide-accompagnement-cp-demande-sel\\_v1-an.pdf](http://www.lautorite.qc.ca/files/pdf/contrats-public/guide-accompagnement-cp-demande-sel_v1-an.pdf).

of the project relative to other government initiatives is determined. Detailed specifications of what is required are prepared, typically with assistance of outside consultants, and a VFM analysis is conducted to determine whether a P3 model is the optimal way to proceed. It is only after a proposed project has been through this process that procurement commences.

### **i Expressions of interest**

The first step in the procurement of a P3 project is the issuance by the public sector sponsor of an RFQ. The RFQ is generally made available to the public by way of publication on a procurement website. It is usually open to response by any interested parties. The RFQ requires that bidding consortia submit packages detailing the experience of their team on similar or relevant projects, as well as relevant information about their organisations and financial wherewithal. The focus tends to be on technical qualifications of the team members. The sponsor will review the submissions and develop a shortlist of bidding consortia which it approves for progress to the second stage. The shortlist is typically three consortia, although in some cases (usually DB or DBF) it can be more.

### **ii Requests for proposals and unsolicited proposals**

Once the shortlist of qualified proponents has been established, those proponents are notified by the sponsor and a formal RFP is issued to all of them. The RFP will typically be accompanied by a draft form of project agreement, various ancillary documents, and specifications for the project. After the RFP is issued, there will be a series of commercially confidential meetings (CCMs) held between the sponsor and each of the proponents to discuss various matters, including risk allocation, project specifications, due diligence matters, and the cost implications of all of these, as well as impacts on the draft form of project agreement. Each proponent's RFP response must be accompanied by the form of project agreement and ancillary documents which they are prepared to enter into, as well as committed financing. In order to submit a compliant RFP response, each proponent must essentially be in a position to close (and, by submitting their RFP response, are contractually bound to do so should they be selected as the preferred proponents).

Unsolicited proposals for P3 projects are atypical in Canada. This may be due in part to the significant amount of advance planning that goes into all P3 projects before the procurement process gets under way, and in part to the highly structured approach taken in the procurement process.

### **iii Evaluation and grant**

Evaluation of the RFP responses will be in accordance with a scoring formula contained in the RFP. There will be a number of factors in the formula, but in most cases the primary consideration will be pricing. Some procurements will use a two-stage procedure where submissions are first screened for technical compliance before being evaluated for price.

The highest-ranking proponent will be notified, and there may be some negotiation of selected outstanding points at this stage. Because the project agreement is generally settled (or very close to settled) at this stage of the process, the period of time between selection of the preferred proponent and execution and delivery of the project agreement ('commercial close') is short – often less than 60 days. The execution and delivery of the financing documentation ('financial close') occurs contemporaneously with commercial close or shortly thereafter.

## V THE CONTRACT

### i Payment

Most Canadian projects to date have been based on the ‘availability model’ (as opposed to the ‘revenue’ or ‘demand’ models), meaning that payment to the ProjectCo is not affected by the demand for or volume of use of the asset. This is due in part to the fact that, with very few exceptions, most infrastructure projects in Canada have not been revenue producing, and so are ultimately funded exclusively by the government.

The payment stream on DBFM and DBFOM projects is typically structured such that, on substantial completion or commissioning of the asset, after various conditions have been met, there is a lump sum substantial completion payment made. This substantial completion payment represents some, but not all, of the construction cost of the completed asset. From that point onward, during the balance of the contract term, periodic (usually monthly) payments are made. These payments include components representing the balance of the construction cost, the cost of financing, and the ongoing costs of the maintenance and, where applicable, operation. These periodic payments vary in amount over time, being ‘sculpted’ to reflect fluctuations in costs that the ProjectCo will incur over time. The project agreement will typically provide that the stream of payments will be reduced or stopped in the event of issues with the availability of the asset (e.g., lane closures on a highway) or the quality of the operation of the asset (e.g., wait times exceeding a specified threshold in a social infrastructure project). As the last few years of the contract term are reached, there will typically be requirements that the asset be inspected to determine its condition. If it appears that it will not measure up to the minimum specifications for handover to the authority, further reductions in or holdbacks from the periodic payments may be imposed.

Some projects are carried out on a phased basis, such that different components of the project are completed or commissioned at different times. In these situations the payment mechanism is usually phased as well, with different substantial completion dates for each component.

As noted above, the revenue or demand model for project financings has not been frequently used in Canada. However, there are examples of revenue producing projects: the A-25 and A-30 expressways in Quebec include tolled bridges and the 407 expressway in Ontario is a toll road. It is likely that we will see more of this in the future, as the focus of development shifts from social infrastructure projects (which are less likely to produce revenue) to civil ones. A number of new bridges, including the planned Gordie Howe International Bridge at Windsor-Detroit, are being tolled. The availability of these revenues opens up the possibility of payment being based on the revenue model. The REM light rail transit system proposed for Montreal is being planned based on the developer – CDPQ Infra – receiving a portion of the revenues, and bearing the ridership risk.

### ii State guarantees

In most cases, the relevant Ministry or crown agency (the ‘public sector sponsor’) is a party to the project agreement, and so bears the contractual obligation to make payments to the ProjectCo. Consequently, a guarantee is not necessary to establish this link. In some instances, the public sector party to the project agreement is not the crown, but rather, an entity funded by the crown. An example is hospital projects, where the project agreement is typically entered into between the ProjectCo and the hospital corporation itself. In these cases, state guarantees are not generally provided, so there is some payment or covenant

risk. However, the private sector seems to treat this risk as theoretical. A large number of hospital P3s have been completed successfully across the country without any issues in this regard, and the likelihood of a provincial health ministry allowing a hospital to default on its payment obligations (particularly where the obligations have been taken on as the result of a process run by a crown agency) is seen as remote.

The obligation of any Ministry or crown agency to pay is subject to expropriation or budget risk, although this is also seen as a very remote risk.

### **iii Distribution of risk**

Under any P3 model, risk is transferred from the public owner to the private partner. The key principle of risk allocation in such projects is that risks should be borne by those who are best able to control or manage them. For instance, the risk of late project completion and the consequential impact on financing of the project should be borne by the construction contractor unless it resulted from a 'force majeure' or a 'relief event'. This risk transfer is key to the success of the model, because ultimately the risk is being priced in the project documentation, and value for money will only be maximised if risk has been transferred in an optimal way.

There are three main categories of risk:

- a* commercial risks: counterparty risks, late completion of project, overrun costs, operation risks, loss on default, uninsured risks, etc.;
- b* macroeconomic risks: interest rate fluctuation, inflation, currency exchange rates, etc.; and
- c* regulatory and political risks: change in law, currency convertibility, expropriation, war and civil disturbance, etc.

Before entering into any P3 project, a comprehensive risk analysis is typically conducted with a detailed risk matrix allocating risks among the respective parties. For example, a counterparty risk can be mitigated by including provisions entitling the ProjectCo to easily replace the defaulting counterparty while realising on parent guarantees that will have been obtained. Parties can also enter into interest-swap agreements to hedge the risk of fluctuation in interest rates. With respect to the risk of change in law, there can be substantial negotiations among the parties. Ideally, the ProjectCo would prefer that the government or public owner retain this risk (on the theory that it has better visibility in this area).

In general, the ProjectCo will bear most of the risk under the project agreement. This can become problematic to the extent that the ProjectCo wishes to raise finance. The lenders financing the ProjectCo will ask for some assurances with respect to the risk and will want to ensure that the ProjectCo is dropping down most of the risk to the subcontractors on a back-to-back basis. From a legal perspective, the ProjectCo will have to ensure that there are compatible provisions in the different project contracts. For instance, if the construction contractor is entitled to a relief event under the construction contract as a result of an event which is outside of the constructor's control, this relief event should be mirrored under the project agreement in order for the ProjectCo's performance to be similarly excused vis-à-vis the public owner. If it is not the case, it could trigger a default under the project agreement for which the ProjectCo will be at loss that cannot be passed on to anyone.

The key principle for lenders is risk minimisation, given that lenders only have downside. Unlike the government or public sector sponsor, lenders do not benefit if the

project goes well, while they could lose money if it goes badly. In DBFM and DBFOM models, the ProjectCo contributes equity, thereby mitigating the lenders' financing risk.

Among the contractors, risk is allocated in accordance with the applicable periods of the project: the construction contractor is usually liable for risks associated with construction up to the point of project completion, at which time the operation and maintenance contractor will take over and assume risks associated with the operation of the infrastructure asset, including with respect to technology, performance degradation and escalating utility costs. Even after completion, the construction contractor will remain liable in accordance with the warranty against latent defects. A 10-year warranty for latent defects is fairly standard.

In Ontario, given the large number of LRT projects that are under way, the province is facing a new risk in the form of a lack of supply of vehicles for its projects. As a result, consideration has been given to including the supply of vehicles in the procurement as an obligation of each bidder, such that the risk of limited supply would be borne by the private sector. However, this approach might produce a less competitive bidding process, depending on the number of eligible providers of vehicles.

#### **iv Adjustment and revision**

Most project agreements will contain a procedure for 'variation' of the work being done under the contract. This is usually a detailed, formal procedure that can be invoked by either the ProjectCo or the public sector sponsor and which ultimately leads to an amendment of the project agreement. Common amendments include changes to the description or scheduling of the work and/or to the compensation formula.

Project agreements usually contain a detailed formula for calculating the costs involved in any change, which will in turn be reflected in an amended payment schedule. The mechanism usually allows for consequential changes to the ProjectCo's financing of the project. It also typically provides for the public sector party to the project agreement to approve limited changes (in order to permit the work on the project to continue uninterrupted) as a stopgap measure while determinations of matters such as compensation are worked out.

#### **v Ownership of underlying assets**

In Canadian P3 projects it is very rare for the ProjectCo to have any proprietary interest in the asset or the underlying real estate. This may, in part, be a consequence of political sensitivity about the ownership of social infrastructure assets such as hospitals and schools, which represented a large proportion of the first wave of Canadian projects. Instead, what the ProjectCo typically has is a licence or other contractual right to occupy the land and the asset, but this is a right *in personam*, rather than a right *in rem*. This being the case, the ProjectCo is not in a position to grant a mortgage or hypothec over any land or fixtures as security for its financing. All it is really able to offer as security to its lenders is a charge over the stream of payments under the project agreement. For the lenders, then, the continued performance by the ProjectCo of its obligations under the project agreement is critical. Their protection on this count is a tripartite agreement among the lenders, the ProjectCo, and the public sector sponsor, in which the lender is entitled, in the event of a default by the ProjectCo under the project agreement, to step into the ProjectCo's shoes and cure that default.

#### **vi Early termination**

Most project agreements will provide for termination in several different circumstances. The ProjectCo will generally have the right of termination in the event of certain defaults by the

public sector sponsor, although this is rarely, if ever, resorted to. The public sector sponsor will usually have the right to terminate in the event of a default by the ProjectCo that is not remedied, if the project has been delayed by certain events (including force majeure) and for convenience. The compensation payable in the event of termination will vary, depending upon the circumstances and the cause of the termination. If the termination is for convenience, the compensation to the ProjectCo is generally formulated so as to keep the ProjectCo and its subcontractors and lenders whole. If the termination is the result of a default by the ProjectCo, the compensation will be much more limited.

## **VI FINANCE**

The typical financing model for a majority of Canadian P3 projects continues to involve equity commitments by project participants and a combination of short-term bank loans and long-term privately placed bonds. This approach has evolved as the leading financing structure for large-scale projects, particularly involving long-term operations or maintenance components. Debt repayment and return on equity is generally scheduled to coincide with substantial completion of the asset and, as applicable, periodic availability or maintenance payments from the contracting authority for the balance of the project term.

A variety of domestic and international banks will loan into Canadian P3 projects. Bank loans historically represented a source of long-term P3 financing. But after the financial crisis and retreat at that time by international lenders from the Canadian project finance market, bank loans tended towards short-term obligations, now generally coinciding with scheduled construction completion. The shift away from long-term bank loans brought about the increased use of bonds to finance project obligations.

Bonds for large-scale projects regularly receive investment-grade ratings and pricing (relative to Canadian government bonds) that generally reflect a low risk for default. While Canadian insurance companies and institutional investors have been common participants for this debt, offerings are not limited to club deals and are frequently completed on a broadly marketed, underwritten basis. Given that project bonds are now familiar to numerous domestic-market participants, including underwriters, ratings agencies and investors, they are likely to remain a significant source of liquidity for public assets procured through P3s in Canada.

In addition to participation by international bank lenders, investment by non-Canadians in P3 projects would generally be accepted for both equity and bond components. However, investment would be subject to compliance with applicable domestic and foreign securities regulations. Furthermore, to the extent that an investment by a non-Canadian provided for control of a Canadian business, it would also be subject to review and approval by the Canadian federal government in certain circumstances.

## **VII RECENT DECISIONS**

Given the delays and costs which are often associated with litigation, there is a tendency to rely on other mechanisms to resolve issues in a more efficient way. Under P3s, there are two noteworthy mechanisms: dispute resolution procedures and deductions from payments. The second mechanism allows a party who receives a service or product that does not meet the specified standards to reduce its next payment accordingly; it is akin to performance deductions.

In November 2016, the Superior Court of Quebec dismissed a safeguard order and interlocutory injunction brought by Groupe Infrastructure Santé McGill, SENC (GISM) against Centre Universitaire de Santé McGill (CUSM) in connection with deductions in payments totalling C\$20,000. GISM and CUSM had concluded a DBFOM contract for the CUSM's Glenn Campus, which agreement included a right for CUSM to deduct certain amounts from the payments as a result of defects or defaults not otherwise remedied by GISM. CUSM sent several notices to GISM advising GISM of defaults, which GISM did not remedy. As a result, CUSM started to deduct certain amounts from its monthly payments to GISM. Disagreeing on the method of calculation of these deductions, GISM sent notices of dispute to CUSM, which failed to reply. CUSM continued to deduct the same amounts from the monthly payments, as a result of which GISM brought an interlocutory action to enjoin CUSM from doing so until such time as the dispute could be resolved.

The court found that GISM did not meet the criteria to be granted an injunction or a safeguard order for several reasons, including the following: (1) CUSM had an express right under the agreement to deduct from the payments in the event of defaults not otherwise remedied; (2) it had notified GISM of the defaults and gave it an opportunity to remedy them; (3) the right to deduct was not expressly subject to the dispute resolution procedure other than to require the amounts being contested to be placed in escrow, which CUSM did; and (4) GISM failed to pursue all remedies available to it under the agreement. Indeed, upon failure by CUSM to reply to the notices of dispute, GISM was entitled to seize the court to appoint an expert to proceed with the dispute resolution. This decision illustrates how the deduction mechanism can operate as a protection against defaults in performance while resulting in major financial losses for the other party. It also highlights the importance of concise contractual drafting and of pursuing all remedies available under the agreement.



# CHINA

Hui Sun<sup>1</sup>

## I OVERVIEW

In mainland China (China), public-private partnership (PPP) has been defined as the partnership between the government and the social capital. County or upper level governments are in charge of implementing the PPP projects within their territory. Social capital includes domestic and foreign enterprises acting as legal persons, but will not include so-called ‘platform companies’ established by the government in the territory of the project, which have the function of raising capital for the government.<sup>2</sup> Foreign investors’ participation in PPP projects is also subject to market entry policies.

China has gone through three stages towards accepting the PPP model. The first stage was around the 1990s, which began with building power stations using the build-operate-transfer (BOT) model, and followed with investments in toll roads. The second stage began with the landmark issuance of an administrative rule in 2004 by the then Ministry of Construction regarding the administration of concessions, as of which BOT, transfer-operate-transfer (TOT), build-own-operate (BOO) and other models became formally accepted in the field of public utilities such as roads, water supply facilities, sewage/garbage treatment plants and gas stations. As the beginning of the third stage, the past several years have witnessed a burst of growth of PPP in China. From the end of 2013 the Chinese government started to promote PPP in more aspects of public product and public service fields. It is encouraged to adopt the various types of PPP to provide public services in more sectors, including energy, transportation, water conservancy, environmental protection, agriculture, forestry, science and technology, affordable housing, medical treatment, public health, elderly care, education, and culture, etc.<sup>3</sup> The requirements for PPP investment are increasing consistently. In August 2016, it was informally reported that the requested investment for projects listed in the PPP project library established by the Ministry of Finance (MOF) totalled 10,600 billion yuan. This does not include those projects listed in the PPP project library by the National Development and Reform Commission (NDRC). In 2016 the Chinese government continued to develop the PPP model and included relevant content into the 2016 Government Work Report.<sup>4</sup>

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1 Hui Sun is a partner at Zhong Lun Law Firm.

2 See the Guidelines for Implementation of Mode of Cooperation for Government and Social Capital (Trial Version) (the MOF PPP Guidelines) and the Notice of the General Office of the State Council on Forwarding the Guiding Opinions on Promoting the Public-Private Partnership Mode in Public Service Field (the Guiding Opinions). See Section II, *infra*.

3 See the Guiding Opinions.

4 Improving the PPP model, making good use of the 180 billion yuan in seed funds, and strictly honouring contracts in accordance with the law, so as to bring the enthusiasm of private investors to the table was

The PPP related documents currently in force are relatively low in the legal hierarchy. It is reported that a law more specifically governing PPP is being drafted.

## II THE YEAR IN REVIEW

In 2016, the PPP Law of China was still being drafted. There were still different opinions in certain industries and fields regarding whether the MOF or the NDRC should be the coordinating agency for developing PPP. The issues regarding asset-based securitisation of PPP projects were put on the agenda.

More PPP related rules were issued, the most noteworthy of which are discussed below.

On 28 May 2016, the MOF and the NDRC jointly issued the Notice on Further Jointly and Effectively Conducting the Work concerning Public-Private Partnership (Cai Jin [2016] No. 32), which provides that each of the ministries and commissions shall coordinate in the aspects of steadily, properly and orderly advancing PPP work, further strengthening coordination and cooperation, effectively conducting the preliminary work of PPP projects, establishing and improving a reasonable mechanism of return on investment, raising in priority the financing efficiency of PPP projects, enhancing supervision and administration and strengthening the information disclosure of PPP projects.

On 10 August 2016, the NDRC issued the Notice on Effectively Implementing the Public-Private Partnership related Work in the Traditional Infrastructure Fields (Fa Gai Tou Zi [2016] No. 1744) providing that Development and Reform Commissions at all levels should fully understand the importance of PPP in the field of infrastructure (including the sectors of energy, transportation, water conservancy, environmental protection, agriculture, forestry and major municipal works), increase the reserves of projects, implement joint review of projects, make the right decisions regarding projects, build a sound investment-return mechanism, normalise the implementation of projects, establish a multiple exits mechanism, enable financial institutions to function well, encourage and guide private and foreign investment and optimise the social credit environment.

On 24 September 2016, the MOF issued the Interim Financial Measures on Public-Private Partnership Projects (Cai Jin [2016] No. 92), which includes seven chapters and 40 articles and provides that financial departments at all levels shall, jointly with other departments concerned, make a comprehensive arrangement of the financial funds, national assets and other public assets and public resources so as to cooperate with the social capital in PPP projects on an equal and mutually beneficial basis. The measures also provide specific provisions on recognition and demonstration of projects, government procurement, budgetary revenues and expenditures, performance management, asset-liability management, information disclosure as well as supervision and inspection.

On 11 October 2016, the MOF issued the Notice on Promoting the Work of Public-Private Partnership in the Field of Public Services (Cai Jin [2016] No. 90), which provides that financial departments at all levels shall further promote the application of PPP in the fields of public services, including the fields of energy, transportation, municipal works, agriculture, forestry, water conservancy, environmental protection, affordable housing, medical and health services, elderly care services, education, culture, sports and tourism, etc.

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written into the PRC 2016 Government Work Report. See: III. The major areas of work for 2016, 3.

Tap the potential of domestic demand to increase the space for development, Report on the Work of the Government (2016).

On 24 October 2016, the General Office of the MOF issued a document which solicits advice on the Guidelines for Value for Money Assessment in Public-Private Partnership (Revised Edition Draft for Opinion) (Cai Ban Jin [2016] No. 118), which proposes numerous amendments to the former Guidelines for Value for Money Assessment issued in December 2015. Among others, amendments and improvements concerning the principle and method of quantitative analysis have been made in the new edition.

Also on 24 October 2016, the NDRC issued the Notice on Issuing the Guiding Rules for Implementing Public-Private Partnership Projects in Traditional Infrastructure Fields (Fa Gai Tou Zi [2016] No. 2231) (the Guiding Rules), which includes six chapters and 25 articles, providing the operation progress of PPP projects in the traditional infrastructure field. In addition, the traditional fields of infrastructure, to which the guidance applies, includes the fields of energy, transportation, water conservation, environmental protection, agriculture, forestry and major municipal works, etc.

On 21 December 2016, the General Office of the NDRC issued the Administration Measures on Public-Private Partnership (PPP) Project Library in the Traditional Fields of Infrastructure (Trial) including four chapters and 16 articles, which combines the operating requirements of the online approving and supervising platform of the investment projects and further normalises the operating progress of PPP projects in the traditional infrastructure field. This document applies to the PPP project databases established by the Development and Reform Departments at all levels.

Also on 21 December 2016, the NDRC and the China Securities Regulatory Commission (CSRC) jointly issued the Notice on Relevant Work of Promoting the Asset Securitisation of Public-Private Partnership (PPP) Projects in the Traditional Infrastructures Field (Fa Gai Tou Zi [2016] No. 2698), vigorously promoting and supporting securitisation of PPP projects on the agenda. According to this Notice, the NDRC shall select, support and guide appropriate PPP projects, based on recommendations by provincial Development and Reform Commissions at the beginning of 2017, aiming at issuing PPP project securitisation products as early as possible, summarising experiences while communicating and promoting such practice.

Besides publishing rules, both the MOF and the NDRC promote PPP projects by promoting PPP project libraries. In 2016 the NDRC issued the Administrative Measures on PPP Project Library in the Field of Traditional Infrastructure Field to strengthen the administration of its PPP project library. The MOF published, collectively with the Ministry of Land and Resources, the Ministry of Environmental Protection and other ministries and commissions, the third batch of demonstration PPP projects.

### **III GENERAL FRAMEWORK**

#### **i Types of public-private partnership**

The types of PPP explicitly mentioned in the MOF PPP Guidelines mainly include operations and maintenance (O&M), management contract (MC), BOT, BOO, build-own-operate-transfer (BOOT), TOT, and rehabilitate-operate-transfer (ROT).

The type of PPP project is chosen in light of the specific conditions of each project and business and/or political requirement of the parties. In fact, neither the MOF Guidelines nor other government guidelines prohibit the selection of other types of PPP. That said, although the build-transfer (BT) model formerly applied in some previous public utility projects, it is not deemed a type of PPP in China in practice. Based on our understanding, this is because,

first, BT is generally prohibited in most public projects when being deemed as a disguised form of government debt raising, and secondly, BT does not cover the operation and maintenance of a project, and does not comply with the long-term/full life cycle cooperation and risk-sharing nature of PPP projects, which is emphasised in China.

## ii The authorities

At the central government level, ministries of the state council take charge of the guidance and supervision of PPP promotion in relevant fields according to the division of functions. The MOF and NDRC act as coordinating authorities in developing PPP in different fields by establishing project libraries, organising evaluations and approvals, and improving the relevant systems and mechanisms. Both the MOF and NDRC have issued guideline opinions on PPP and published guidelines on PPP contracts. Both authorities have also published PPP project lists and project libraries so as to promote PPP. Generally, the MOF will be in charge of coordinating PPPs in the field of public service, and the NDRC will be in charge of coordinating PPPs in the field of traditional infrastructure. But for certain fields or industries that provide public service with traditional infrastructure (e.g., transportation, municipal works, agriculture, forestry, water conservation, environmental protection), there is still a difference of opinion on which of these two departments will be the coordinating authority. This has raised some confusion in practice.

Alongside the coordinating authorities, the industrial administrative departments<sup>5</sup> shall, in light of the characteristics of the industry, make active use of the PPP model to provide public services and explore and improve the relevant regulation systems.

In practice, most PPP projects are promulgated by county, municipal or upper level local governments. Besides following rules and policies issued by the central level government, the local level governments are in charge of promulgating specific policies and carrying out the implementation thereof pursuant to the existing plan and the realities of the region. Based on provisions of MOF or NDRC rules, in a specific PPP project, the competent county or upper level government is mainly responsible for the review, organisation and coordination, as well as the examination and supervision of the PPP project.

For the purpose of implementing a single PPP project, the government will appoint an implementation institution to be responsible for the preparation, procurement, supervision and transfer work of the project. According to the MOF PPP Guidelines, the local government itself and functional departments or non-profit institutions appointed by the local government could be the implementation institution of a PPP project. In practice, local governments may authorise a government invested company to act as implementation institution in some PPP projects. This could be a remnant left by the former practice and, besides other possible negative effects, may lead to failure of the relevant PPP project to be listed in the MOF demonstration projects list, and thus become unable to apply for the reward under the Reward Notice.

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5 This includes the departments of education, science and technology, civil affairs, human resources and social security, national land and resources, environmental protection, urban and rural construction, transportation, water conservation, agriculture, commerce, culture, healthcare and family planning, etc.

### iii General requirements for PPP contracts

As mentioned, PPP projects are currently implemented in accordance with rules and guidelines regarding PPP and/or concessions, as well as laws, regulations and rules regarding fixed asset investments, construction, contracts, and the relevant industries.

The NDRC and MOF respectively have PPP project libraries, and the requirement for projects listed in these project libraries varies a little according to the rules of the two ministries.

The PPP project library of the NDRC is established on the basis of the online approval and supervision platform for investment projects, which means that the fixed asset investments of the projects listed in the PPP project library have already been approved by the government. The PPP project library shall be used as an important basis to arrange government investment, determine and adjust prices, issue corporate bonds and determine entitlement to special PPP policies.<sup>6</sup> Projects listed in the PPP project library will be implemented in batches under the coordination of the industrial authority of the local government.

The requirement for projects listed in the PPP project library of the finance authority mainly requests the confirmation of the local finance administration authority. The project library has three categories: the storage project library, the implementing project library and the demonstration project library. Before being listed in the storage project library, the proposed PPP project will go through the examination of a provincial finance department. Before being listed in the implementing project library, the project must pass the value for money (VFM) assessment, and, for projects involved in the government payment or viability gap funding (VGF), the fiscal capability verification. If a project fails to be listed in the PPP project library of the MOF, its expenditure will principally not be listed in the government budget.<sup>7</sup> This means payment by the government in this project cannot be made. As a principle the MOF requires that the total expenditure for all PPP projects shall not exceed 10 per cent of the general public budget of the local government.<sup>8</sup> Otherwise, new projects will not pass the the fiscal capability verification and thus cannot be listed in the implementing project library.

Social capital shall be selected through a legal procedure. Public bidding is the most accepted choice. The choice of other methods will be subject to approval of the department at a certain level of government (see Section IV, *infra*). The bidding invitation should provide whether the social capital is required to establish an SPV to execute and perform the PPP contract with the implementation institution. The government may appoint certain institutions to participate in the SPV.<sup>9</sup>

According to the Concession Measures, the term of concession shall not exceed 30 years, but for projects with large investment and a long return cycle, a longer concession term is permitted.<sup>10</sup> There is no mandatory requirement for the minimum term of a PPP project under the effective laws and regulations. According to an unofficial version of the MOF consultation draft of the PPP Law, the minimum term of a PPP project will be no less

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6 See Article 6 of the NDRC Guiding Rules.

7 See the Notice on Regulating the Operation of the PPP Integrated Information Platform (the Platform Notice).

8 See Article 25 of the Guidelines for verification of the Fiscal Capacity relating to PPP.

9 See the MOF Guidelines and the Concession Measures.

10 See Article 26 of the Concession Measures.

than 25 years. No value thresholds for PPP contracts are specifically provided for in legislative documents.

#### **IV BIDDING AND AWARD PROCEDURE**

As indicated in the PPP Procurement Measures and the MOF PPP Guidelines, social capital shall be selected through legal procedure. The MOF provides that the selection of social capital should be a government procurement (PPP procurement), and provided five methods for PPP procurement, including public bidding, invitation bidding, competitive consultation, competitive negotiation, and single source procurement.<sup>11</sup> If a method other than public bidding is proposed to be selected, the implementation institution should first apply for approval of the finance department of a certain level of government.

The NDRC Guiding Rules also provide that the social capital shall be selected through public bidding, invited bidding, two-stage bidding, competitive negotiation, etc. However, the NDRC Guiding Rules further provide that, for PPP projects of which the engineering investigation, design, construction, supervision and supply of important equipment or materials are to be contracted to or supplied by the social capital investor itself, the social capital must be selected through bidding according to the Bidding Law.

##### **i Expressions of interest**

MOF and NDRC procedures are similar in this respect. An announcement of pre-examination of qualifications shall be released via the government procurement information release media designated by the relevant finance department at or above the provincial level (for projects listed in MOF project library) or on media appointed by the NDRC (for projects listed in the NDRC project library). The time period for submission of application documents for pre-examination of qualifications shall not be less than 15 working days from the date of release of the announcement (requirement of the MOF) or five days after the bidder issues the pre-examination invitation document (requirement of the Bidding Law). Where there are at least three social capitals that pass the pre-examination of qualifications, the implementation institution may continue the preparation of bidding documents. Where there are fewer than three social capitals that pass the pre-examination of qualifications, the implementation institution shall organise a new round of pre-examination of qualifications after adjusting the content in the announcement of the pre-examination of qualifications.

The bidding documents of a PPP project shall contain all procedural and substantive requirements of the project, and shall contain the evaluation method and criteria, draft contracts and other legal instruments for the PPP project. Among others, the bidding documents shall point out those details of the project contract that are variable during the negotiation for confirming procurement results. The PPP bidding documents shall also expressly state that the project contract must be submitted to the people's government at the corresponding level for approval and shall not take effect until it is approved.

The MOF further provides that, where a competitive negotiation or competitive consultation procurement method is adopted, the project procurement documents shall, in addition to the contents prescribed in the preceding paragraph, specify the contents that may

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<sup>11</sup> See the Measures for Administration of Government Procurement in Public-Private Partnership Projects (Cai Ku [2014] No. 215) (the PPP Procurement Measures).

be substantively changed by the evaluation team based on negotiations with social capitals, including the technical and services requirements under procurement needs and the terms of the draft project contract.

## **ii Requests for proposals and unsolicited proposals**

Generally the requirements for bidding documents are set forth in the documents calling for bids. If selection of PPP social capital is carried out through bidding, generally the proposal of bidders will respond to the substantial requirements and conditions as provided in the documents calling for bids.<sup>12</sup>

Compared with the public bidding procedure, the other methods, especially by way of competitive negotiation and consultation, provide relatively more space for the social capitals respecting the variable details. Briefly speaking, in the process of competitive consultation, the consultation group may make material changes to the technical and service requirements of the procurement and terms of the draft contract based on the consultation documents and the actual consultation situations.<sup>13</sup> The material changes shall be effective parts of the consultation documents and be sent to all candidate social capitals. The candidates will submit a new response document accordingly.

A PPP project can be proposed by both the government and social capitals, but is usually proposed by the government. Both the MOF and NDRC confirmed in their respective ministry guidelines that social capitals may propose PPP projects. According to the MOF PPP Guidelines, the recommendation of potential PPP projects by social capitals shall be made to the financial departments (PPP centre) in the form of a project proposal.<sup>14</sup> The Administration Measures on Public-Private Partnership (PPP) Project Database in the Traditional Infrastructure Field (Trial) issued by the General Office of the NDRC provided that a PPP project can be filled in and submitted by industrial departments, public institutions and various types of enterprises to the project database so as to be listed in the PPP project library.

## **iii Evaluation and grant**

A legally established evaluation team shall be responsible for pre-examination and bid evaluation. The members of the evaluation team shall sign the qualification pre-examination report and the evaluation report.

The implementation institution shall establish a special working group responsible for the negotiation and confirmation of the final bidding results according to law.

The public body and the bid-winning social capitals to conclude transactions shall enter into PPP project contracts within 30 days after the notice of winning the bid or concluding transactions is issued.

Public notification and public announcements are requested for each step above.

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12 Please refer to Article 34 of the Implementing Regulations of the Government Procurement Law.

13 See Article 20 of Interim Measures for the Management of Competitive Consultation in Government Procurement.

14 The MOF PPP Guidelines, Article 6.

## V THE CONTRACT

### i Payment

There are three main kinds of payment mechanisms in PPP projects in China: government payment, user charges, and VGF.

The three mechanisms apply to different kinds of PPP projects. Public transportation such as highways, bridges and subways and public infrastructure for water and heat supply usually takes user charges. VGF refers to the economic subsidies the government provides to the project company to fill the gap for those PPP projects in which the user charges cannot cover the input cost and reasonable profits.

In practice, VGF can take different forms such as investment subsidies, equity investment, concessional loans, grant of other developing and operating rights and interests related to concession projects and so forth.<sup>15</sup> In some projects applying the VGF mechanism, the government takes partial payment responsibility during the operation period.

According to the Guiding Opinions, the principle for the price of public utilities includes cost compensation, fair return, resource conservation, high quality and high price, and equitable burden sharing. In practice, the price is decided during the PPP procurement procedure, but is also subject to the restriction by the government. For PPP projects applying the government payment mechanism or VGF mechanism, the proposal of PPP projects including a payment and/or subsidies arrangement must pass verification of fiscal capacity before the project applies the mode of PPP. For PPP projects applying the user charges mechanism, the price shall be subject to the approval of the price administration bureau, if it is listed in the catalogue of prices fixed by the government.<sup>16</sup>

Both the guidelines for PPP contracts of the NDRC and MOF confirm that the parties will provide the adjustment of price in the PPP contract. The adjustment of price will be according to the project execution situation and performance evaluation results. A public hearing will be held before the price is adjusted.<sup>17</sup>

The General Contract Guidance on Public-Private Partnership Projects (2014 edition) (the 2014 General Contract Guidance) provides that the contracts of PPP projects shall specify the method by which private capitals will obtain payment. According to the nature and characteristics of the specific projects, the sources of income of the projects mainly includes user charges, the combination of user charges and government subsidies and the government procurement for the services.<sup>18</sup>

### ii State guarantees

According to Chinese law the government is prohibited from providing a guarantee.<sup>19</sup>

The relevant rules provide that the minimum requirement risk of a PPP project may be taken by the government side. The measures for the government to take this risk in a project will be provided in the project proposal prepared by the implementation institution; among others, by making payment to the SPV for the margin between the guaranteed usage and the actual usage.

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15 See Article 17 of the Concession Measures and the definition of VFM in the MOF Guidelines.

16 See the Price Law of China.

17 See Article 10 of the Guiding Opinions.

18 See Article 8 of the 2014 General Contract Guidance.

19 See the Guarantee Law of China.



The payment made by the government is subject to the government fiscal budget. In practice the most popular method of the local government to ensure its payment to the social capital according to the PPP contract is, although not of a guarantee nature and not 100 per cent without risk, to confirm to the social capital that the expenditure of the PPP project will be listed in the local annual budget of the pay year. Previously the confirmation was generally in the form of a comfort letter, which has the risk of being deemed as invalid.<sup>20</sup> The current system construction work for PPP shed light on listing the government payment and subsidy under the PPP contract into budget in a formal and more controllable way. According to the Guiding Opinion, China will set up systems to guarantee sustained and healthy development of the PPP model by including operating subsidies, correct operating charges and other considerations in the annual budget and medium-term financial planning, reflect and manage the same in the financial reports of the government, and report to the people's congress at the same level or its standing committee. The Concession Measures also provide that the payment or subsidy by the government in VGF concession projects shall be linked up with the government's annual budget and mid-term fiscal planning to ensure the requirements of fund appropriation. According to the Opinion of State Council on Setting Up Mid-term Fiscal Planning (2015), China shall begin setting out a medium-term financial planning administration system.

### **iii Distribution of risk**

According to the MOF Guidelines, risks shall be allocated among the government and the social capital according to the principle of risk allocation optimisation, risk return equivalence and risk controllable, and upon overall consideration the management capability on government risk, the project return mechanism and the management capability on market risk. In principle, the commercial risks including design, construction, finance, and operation and maintenance of the project shall be borne by the social capital, and the risk of laws, policies and minimum requirements shall be borne by the government. Force majeure and other risks shall be borne by the parties jointly on a reasonable basis. NDRC also provided a similar risk allocation principle and arrangement in the PPP guidelines promulgated by it.

### **iv Adjustment and revision**

Generally in practice, the PPP contract contains a general term saying that the contract can be revised or modified by the parties through mutual agreement and the revisions shall be in writing and formally signed by both parties. Even though the PPP contract does not have this term, the revision of contract by both parties through mutual agreement is a right under Contract Law. The Consultation Draft of the PPP Law requests the parties to sign a supplementary agreement through negotiation when it is necessary to make an alteration during the cooperation period. And the material change to the cooperation agreement shall be submitted to the original approving authority for approval.<sup>21</sup>

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20 Government organs are now prohibited to issue this kind of comfort letter. See Notice of the Ministry of Finance, the National Development and Reform Commission, the People's Bank of China and the China Banking Regulatory Commission on Deterring the Illegal Financing Behavior of Local Governments (2012).

21 PPP Law of People's Republic of China (Consultation Draft), Article 32.

The parties may also provide in the PPP contract conditions or restrictions for the revision of contract on a specific issue. Of course the conditions and restrictions can be abandoned through negotiation.

**v Ownership of underlying assets**

The transfer of the ownership of the underlying assets depends on the different type chosen (for example, BOT, BOOT, TOT, etc.) and the terms of the PPP contract. In some types of PPP projects as listed in the MOF Guidelines, the ownership of the underlying assets is not necessarily required to be transferred to the social capital together with the transfer of occupation (for example, O&M). Some types of PPP projects do not have the necessity of ownership transfer, such as BOO. But most types of PPP projects have one or more asset ownership transfer step. For example, in a BOOT project, the social capital (in most cases through its SPV for the project) build the project asset, own the asset and operate the same in the cooperation period according to the PPP contract. Upon the expiry of the contract or early termination, it will transfers all the facilities, rights and interests therein (land use rights, etc.) to the government or the institution it appointed.

Transfer includes the transfer of occupation, and the transfer of ownership. Some PPP contracts do not emphasise the ownership of underlying assets, but owning assets during an operation could be important for projects having an asset-backed securities (ABS) plan by the social capital. PPP contracts generally prohibit the asset being used as security for other projects. Besides the above, competent authorities generally use the performance test to ensure the perfect function of the assets and the validity of the intellectual property rights and technical documents.

**vi Early termination**

PPP contracts may be terminated early in the following situations: (1) by the social capital due to the default of the government partner; (2) by the government due to default of the project company; (3) the government partner unilaterally terminates the contract under specific circumstances according to its legal power, which shall strictly follow the law and accompanied by adequate compensation; (4) any party may terminate the contract due to force majeure incidents which last so long or accumulate to some extent; or (5) a mutual agreement is reached to terminate upon negotiation.<sup>22</sup>

**VI FINANCE**

Besides traditional bank loans, financing PPP projects with new financial methods is encouraged. Social security funds, insurance funds and other public funds are permitted to support the project financing through debt, equity investment and other ways. Furthermore, PPP SPVs are encouraged to conduct structural financing and issue project earning bonds, project earning notes, asset-backed notes, among others.

The debt financing instruments based on project income are still in the preliminary stage of development in China. The first project earning bond was issued successfully by the Fourth Refuse Incineration Power Plant Project in Guangzhou in 2014. On 5 August 2015,

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22 The Guide on Contracts for PPP Projects (30 December 2014, MOF) mentioned the first four occasions.

the NDRC released the Interim Measures for the Administration of the Project Earning Bond, which provides guidance on the main aspects of the bonds.

In addition, the above-mentioned Chinese Government and Social Capitals Corporation Financing Support Fund was established this year and it is expected that government investment funds will play a larger role in the financing of the PPP projects at all levels in the near future.

The main obstacle faced by social capital remains the guarantee issue. Although policies say that earnings of PPP projects may be used as pledge to support loans,<sup>23</sup> there is no legal support from the law. Where a finance provider deems this as a risk, it will be hard for the PPP project to be financed in the mode of project finance.

With respect to cross-border finance, foreign-invested SPVs are free to raise cross-border loans within the surplus between the total investment and the registered capital of the SPV. The foreign exchange rate risk involved is generally considered as commercial risk and usually assumed by the social capital.

By the end of 2016, the NDRC and CSRC collectively issued the Notice on Relevant Work of Promoting the Asset Based Securitisation of Public-Private Partnership (PPP) Projects in the Traditional Infrastructures Field, promoting ABS as one important financing method in infrastructure, especially for PPP projects.

## VII RECENT DECISIONS

According to the Administrative Litigation Law and the Explanation of the Supreme People's Court regarding the Administrative Litigation Law, a concession agreement is an administrative contract and lawsuits against the government's failure to perform the concession agreement, or illegally modify or early terminate the concession agreement, should be heard by the court in accordance with the Administrative Litigation Law. Based on the above, many disputes over concession agreements have been submitted to the administration tribunal of the court.

In the second edition of this publication we introduced a case: *Henan Xinling Highway Investment and Construction Company v. Huixian City Government*, Henan Higher People's Court, Civil Ruling No. 1-1 (2015). In this case the plaintiff launched a civil suit against the local government for the compensation for buying back the BOT project. The defendant argued that the BOT agreement on which the plaintiff's claims were based was an administrative contract and ruled according to the Administrative Litigation Law. The Court finally decided in favour of the plaintiff, holding that the matters about financing, remuneration and default are agreed by the both parties as equal civil parties and the disputes arising therefrom are civil disputes.

The defendant, Huixian City Government appealed to the Supreme People's Court in May 2015, and the Supreme People's Court rejected the appeal.<sup>24</sup> In 2016 the Supreme People's Court published the written verdict, the rationale of which is noteworthy. The Supreme Court held that, in this case, the main purpose of the project was to develop and operate the Xinling Highway and to set up the highway toll station, which has a profitable nature and does not provide free public services to the public. Although one party of the

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23 Article 23 of the Concession Measures mentioned that the prospective earnings pledge loans for concession projects shall be explored and utilised. Support shall be granted to using relevant earnings as a source of repayment.

24 See (2015) Minyizhongzi No. 244.

contract was Huixian City Government, the other party of the concession agreement had enough autonomy upon reaching the agreement, and was not forced by the unilateral administrative act of the government. The concession agreement had rights, obligations and liability for breach clauses, showing the agreement was a consensus between the two parties on the basis of equality and equivalence. The concession agreement contained not only issues concerning administrative review, approval and licensing, which was only the component part of the contract and cannot decide the nature of the concession agreement. The purpose, obligations, parties, performance and contents of the contract in this case all showed a clear civil and commercial nature of this legal relation, and therefore this highway construction agreement should be identified as a civil contract. Thus, this case did not conform to the situations provided in the Administrative Procedure Law.

Another case – *Hebei Huazhang Heating Co. Ltd v. Zhangbei Government*, Zhangjiakou Intermediate People’s Court (2016) Jixingchu No. 2 Administrative Judgment – concerned the situation in which the concession right of the concessionaire was taken back by the government unilaterally. In October 2015, the plaintiff learned that its concession right had been taken over by the defendant, after which the plaintiff raised a lawsuit to the court in February 2016.

The court found out that the defendant failed to inform the plaintiff of its decision to take back the concession right according to the Administrative Measures regarding Concession in Civil Public Utility in Hebei, and thus breached the legal process. However, because this case relates to a public utility and the concession right had been re-granted to a third party, the cancellation will potentially affect the legal right of the third party and the public interest of the area.

The court rendered a judgment in August 2016, stating that the administrative act of the defendant for taking back the concession right from the plaintiff by a meeting solution was illegal, and the defendant was ordered to take remedial actions within two months of the judgment.

## VIII OUTLOOK

Compared with previous years, the PPP legal system matured in 2016. Looking at recent trends, detailed provisions and definite requirements rather than principles will be increasingly provided in PPP rules in the future. With the development of practice, the government is becoming more experienced in using the PPP model. Hopefully the draft PPP law will be published for opinion in the near future.

Considering the concern that in some cities the limit provided by the MOF – that total expenditure for all PPP projects shall not exceed 10 per cent of the general public budget of the local government – will soon be reached, end-user payment projects might become more popular. On the other hand, the possibility cannot be ruled out that the said limit be increased abstemiously.

Some investors are beginning to consider the liquidity of PPP assets. It is quite possible that ABS of PPP projects, or the transfer of assets to financial investors, will be taken into consideration.

# DENMARK

*Henrik Puggaard and Lene Lange*<sup>1</sup>

## I OVERVIEW

Public-private partnerships (PPPs) (in Denmark referred to as OPPs) have existed in Denmark since 2005, when the first PPP project was procured.

In 2004, the concept of PPP was introduced for the first time in the Danish government's action plan owing to the need for future facilitation of the interaction between public and private resources in the establishment of infrastructure, etc., not least aiming at gaining positive effects on the life cycle economy over time. As a matter of course, particular inspiration came from the experience gained from abroad, particularly the United Kingdom and other European countries, where this kind of project model had been endorsed for more than 10 to 20 years at that time.

The first PPP project was a school project procured by a municipality and the project was procured simultaneously with the new procurement rules on competitive dialogue being applied (see Section IV, *infra*). In Denmark, the negotiated procedure has been used only in connection with procurement of concession agreements and agreements in the utilities sector, while the competitive dialogue procedure has been applied in many of the PPP projects providing for procurement of complex contracts to last for 25 to 30 years.

At the time of commencement of the first municipal procurement of a PPP project, the state (the Danish Building and Property Agency) had already worked diligently to procure a PPP project for new archive facilities for the Danish State Archives, and this project became the second one in 2006.

During the 12 years Denmark has been involved in PPPs, approximately 40 projects have been procured, of which around 38 have been contracted, including about 30 in the past seven years (and roughly 25 were procured in the years 2013–2016).

In the first three to four years until the financial crisis in 2008, the PPP projects centred on school projects (procured by municipalities), courthouses and office buildings (procured by the state).

As stated below (see Section III.i), the market changed slightly during the financial crisis, which did not result in a reduced number of procurement procedures, but it did change the framework conditions, especially the financing model.

In the past five years, the Danish regions<sup>2</sup> have been particularly active in procuring PPP contracts, and thus, major car parks and hospital facilities have been procured under a PPP project.

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2 The Danish regions are responsible for providing hospital services and are also responsible for some of the traffic infrastructure.

In recent years, this sector has attracted pension funds as financing sources of PPP projects, not least because of the project volume.

Looking at the period from 2005, and particularly the past four years, it is clear that the project amounts have on average represented around €20 million, ranging from approximately €10 million to €300 million. In addition to the motorway Kliplev-Sønderborg (M1) in Southern Jutland in 2006, the project sum of which totalled approximately €300 million, two hospital projects have been procured in the past two years of the same magnitude as well as a government office building at around €150–200 million.

## II THE YEAR IN REVIEW

Compared to the two preceding years, 2016 has been relatively silent when it comes to new PPP projects in Denmark. The state has initiated no new projects. This is probably – at least to some extent – due to the fact that the government in 2016 only consisted of The Liberal Party of Denmark (Venstre), which represented a minority of the Parliament and as such, it faced troubles in realising the announced PPP strategy. In late 2016, the government was extended by another liberal party (Liberal Alliance) and the Conservative Party, and the government now represents a majority. Soon after the change in government in late 2016, the government announced three future infrastructure projects as potential PPP projects. Also in late 2016, the Property Agency announced an expected offering of a PPP project for new premises for Rail Net Denmark in Ringsted. The procurement procedure is expected to commence in early 2017.

In 2016, the regions and municipalities only initiated a few projects. At the regional level, a PPP project regarding a water treatment plant and a PPP project regarding a new hospice in Aalborg have been initiated, while a PPP project regarding a new health centre in Helsingør has been initiated at the municipality level.

Two public-private innovation (PPI) projects were initiated in 2016: one regarding innovation on solving dehydration problems in elderly care and one regarding innovation on solving the need for climate adaptation.

## III GENERAL FRAMEWORK

### i Types of PPP

In Denmark, primarily two PPP structures are used, one of them being with private financing and the other with public financing upon entry into operation.

The most used one has been the PPP with private financing, which was also the one originally used in 2005. In connection with the financial crisis and as a result of the impossibility of borrowing money at a fixed interest rate over 30 years (or at least it was extremely expensive), a new model was developed under basically the same framework as the PPP with private financing.

This was done in connection with the PPP motorway project in Southern Jutland (M1) from Kliplev to Sønderborg, being the largest project at that time of €300 million.

Since a fixed interest rate over 30 years was excluded due to unreasonable costs, a model was developed in competitive dialogue with the various suppliers and operators whereupon the entire capital investment, or the majority thereof, was paid by the public party upon commencement of the asset's entry into operation and any remainder was to be repaid during the term of the contract.

This alternative model results in the ownership of the asset constructed during the construction phase being transferred, at the time of commencement of the asset's entry into operation, from the private party to the public party against the public party's paying the before-mentioned capital investment, or the majority thereof.

These PPP projects with public financing paid upon commencement of the asset's entry into operation were applied in subsequent years to school projects and other projects where the public party preferred to provide financing based on the public interest rate (risk-free interest rate is extremely low in Denmark) rather than borrowing from the private market.

In some of the projects applying this model, the PPP contract provides for the allocation of 'owner's risks' to the private party as if the private party was the owner of the asset during the contract period.

It should be noted that the PPP projects have not been procured by the Danish public authorities based on financial needs as the public authorities have typically been able to afford to invest and borrow at a very low interest rate owing to the very high credit rating of public authorities in Denmark.

The decision to procure PPP projects has mainly been based on the idea of generating positive effects on the life cycle economy by the facilitation of the construction design with the operating economy over 30 years, resulting in very proactive financial control from private lenders that ensures a constant focus on the underlying budgetary assumptions and not least performance of the functional requirements laid down by the public party. The latter stems from 'penalties' having to be paid in the event of non-performance (see Section IV, *infra*).

In addition to the two main types of PPP projects – the one with private financing and the one with public financing – the latter has also resulted in a model facilitating the support financing arrangements for the establishment of social housing (including in the care sector, etc.) with the PPP structure by using public financing upon the asset's entry into operation. Thus, two PPP projects have been contracted for care centres where the law on cooperative housing associations and the possibility of state-subsidised housing financing have been used. These projects have also resulted in care services having to be provided during the operational phase under the PPP contract.

In 2015, the first real PPP project was also procured for innovation or development of equipment (referred to as PPI). Two regions joined forces to procure the development of a new psychiatric care bed in connection with the procurement of two new large psychiatric hospitals with more to come, and the OPI contract therefore became very attractive in terms of volume for various industrial parties. The project was a success and a private party was awarded the contract. The result and the finished product, the new psychiatric care bed, have already been presented and the psychiatric care bed is now being contracted by all psychiatric hospitals for a long contract period. As mentioned in Section II, *supra*, another two PPI projects were initiated in 2016.

Finally, there have been attempts to combine the PPP contractual framework with more traditional property financing, for example, in construction of stadiums where part of the construction could be regulated contractually under a usual PPP structure while another part would be regular property financing based on commercial rental over 10–15 years. In the next few years, it will be interesting to see if these types of large complex capital investments are realisable by a combination of PPP and other usual contractual structures in the property market.

## **ii The authorities**

In Denmark, PPP projects are procured by the state through their respective departments (roads, office buildings, court buildings, defence, etc.). The municipalities also procure PPP contracts, typically in connection with new schools or office buildings, but also in regard to swimming facilities and care centres.

Finally, Danish regions have procured PPP contracts, so far, primarily within the health sector, which is their sphere of responsibility. These projects have involved major parking facilities at hospitals and hospital expansions around the country.

In particular, the state has been very dedicated in applying the PPP model where appropriate (see more information below). The municipalities and the regions have typically used the same small group of PPP advisers who have also been dedicated to the actual PPP model, and the contractual framework has thus been allowed to develop on the same platform, thereby avoiding the need to begin from scratch each time. Thus, the initial contract from 2005 has steadily been improved in line with the considerations and aspects learned from the subsequent PPP projects and, in this regard, there have always been some new aspects such as, for example, (1) four court buildings having to be managed in one contract, (2) more square metres having to be renovated besides the new building procured under typical PPP, and (3) care service having to be included.

## **iii General requirements for PPP contracts**

At the time when PPP became part of the government's action plan (which it has been since then under successive governments), some accessory tools (comparative studies) were prepared under state auspices, and a ministerial decree stipulated that all future capital investments exceeding a certain size had to be reviewed to determine if a PPP model was preferable instead of a traditional procurement procedure for the construction work.

Subsequently, the municipalities were instructed to do the same some years ago and today all PPP projects are typically subject to a pre-project review (see Section IV.i, *infra*). The public party's advisers (legal, financial and technical) arrange for such pre-project reviews to be set up whereby the PPP model is compared with a traditional turnkey contract with subsequent separate operation and, in the same context, an assessment is made on whether it should be a PPP with private financing or public financing.

The latter assessment is based mostly on the extent to which the public party wishes to allocate risks of the asset to the private party (as if the private party was the owner of the asset) and, in that case, the private party will charge a risk premium for the assumption of such risks during the 30-year payment plan.

PPP with public financing results in a very low (risk-free) interest rate, but also some costs to be paid in premium for the private party's assumption of owner's risks. By contrast, the PPP model with private financing will have included such owner's risks in the determination of the internal rate of return to the private party owning the asset (amortisable).

The PPP contract is a dynamic contract in which it is agreed how to act in case of changes during the contract period of 25 to 30 years, and the actual PPP contract being a framework agreement is typically accompanied by operational annexes such as:

- a* functional requirements (relating to the construction and design and operation and maintenance and functionality) and the functional requirements are output-based and not input-based;



- b* payment mechanisms (regular payments, extraordinary payments and adjustments herein and, in this context, penalties/reductions for non-performance of the functional requirements);
- c* security documents (bank guarantees or the like);
- d* financial closing;
- e* transfer of asset (if the public party is to transfer or lease property/land on which new buildings are to be constructed; and
- f* rules of cooperation; and
- g* rules on employee rights and corporate social responsibility.

## **IV BIDDING AND AWARD PROCEDURE**

### **i Expressions of interest**

When a public party is considering using PPP in connection with a forthcoming infrastructure project, the public party frequently identifies the interest in the market by mentioning the potential projects at seminars, etc., and the public authority often formally invites relevant parties to a technical dialogue used for market research among interested suppliers and operators. The invitation to technical dialogue is used to discuss different aspects being considered by the public authority in connection with either construction or the operation, in particular, the services intended to be included as well as the extent to which private financing partners find that there are abnormal risks in the project description.

### **ii Requests for proposals and unsolicited proposals**

On the basis of any such market research and consultation with contractors, operation and facility management or service providers and financing parties, the public authority inserts a contract notice in the Official Journal of the European Union in which private bidders (consortiums consisting of the suppliers necessary for the project) are invited to apply for prequalification.

The public authority typically invites potential bidders to compete on their technical skills and experience (within both construction work and facility management) as well as financial strength and stability and three to five bidders are typically prequalified.

The contract is typically procured under a competitive dialogue. Until 1 January 2016, this procurement procedure was applicable only to ‘highly complex’ contracts. As from 1 January 2016, it is possible to use competitive dialogue as well as the negotiated procedure in all Danish PPP projects.

The competitive dialogue is used when the public authority is in need of a dialogue with the bidders in order to be able to define the technical terms to be complied with in order to meet the needs and objectives of the project, or if the public authority is not objectively able to specify market-consistent legal or financial issues in connection with a project without such dialogue.

In other words, the competitive dialogue is a need to test the functional requirements laid down in dialogue with the market to get an idea of the market supply, including solutions and risk tolerance to reassure the public authority that the solutions, needs and objectives laid down in connection with the project are achievable.

In connection with the procurement procedure, the prequalified bidders receive the dialogue material and after the competitive dialogue has been conducted (typically two to four meetings), the contract documents of the public authority are adjusted based upon input

received during the dialogue phase, and the bidders then prepare a final bid for the final contract to be submitted within a fixed closing date.

In addition to the dialogue meetings, it is possible to ask questions or receive answers in writing during the entire process.

To date, many projects conducted by the state have been procured under a restricted procedure under which no actual dialogue is conducted, but only an information meeting. Thus, in many projects, the state has been of the opinion that its projects involved a standard supply of an office building only, and thus, that the condition for applying the Public Procurement Directive to the competitive dialogue was not fulfilled. It is likely that we will see more projects being procured by the state under a competitive dialogue owing to the change in legislation.

### **iii Evaluation and grant**

Once the bidders have submitted their bids, the public authority assesses whether the bids meet the minimum requirements laid down in the contract notice, and compliant bids are evaluated in accordance with the provided tender conditions.

In PPP projects, the public authority typically has four to five award criteria under which, for example, the price is weighted relatively high (typically less than half), while the other award criteria will be based primarily on the quality and functionality, financial stability and less on organisation, cooperation and architecture.

The price criterion is typically a calculation of the present value (net present value) of all the total payments during the term of the contract and is typically assessed based on a scoring from zero to 10.

The award criteria may have sub-criteria that are also provided to the bidders. Upon notification of the award of the contract to a successful bidder, there will be a standstill period of 10 calendar days during which the unsuccessful bidders may contest the award if they believe that the competition rules have not been complied with. After this period, certain 'technical clarification' and minor adjustments will take place whereupon the signing and financial close (if the bid has contained a financial risk in the period from the submission of the bid and until the signing of the contract) take place.

## **V THE CONTRACT**

### **i Payment**

In Denmark, a PPP contract with private financing typically has a duration of 25 to 30 years during which period the payments to the private party (typically being a special purpose vehicle (SPV)) will begin upon commencement of the asset's entry into operation (once the operational phase is initiated).

The payment consists of a 'construction part' (amortisation of the capital investment over the contract period at the agreed exit value including interest rate of return) and the current operating payments (management, maintenance, ongoing restoration, supply, etc.).

The payment mechanism defines these regular payments as well as how these can be adjusted – both ordinarily (indexing) and extraordinarily. Extraordinary adjustments are typically penalty payments representing deductions from the payments. The penalty is determined at the same time as the regular payments typically made on a quarterly basis. A penalty will be imposed if the agreed service or functional requirements are not being effectively rendered to meet the key performance indicator requirements. Experience shows

that the need for penalties in Danish projects has been non-existent, which is an indication of strong cooperation and good quality in the construction and the operation.

It has typically been the case in Danish PPP contracts with private financing that the public party's right to set off such penalties was allowed only against the portion of the payment involving the operating payment, leaving the portion of the payment involving the construction unaffected. In this way, the private party's amortisation of the capital investment has been secured.

In return, the public party is typically secured by other rights (see Section II) to be invoked by the public party in the event of non-performance of the PPP contract.

In addition, the contract will provide for the public party being entitled to terminate the contract prematurely, if a maximum number of penalty points (stipulated in the contract) has been reached (see Section VI).

In this situation, the public party is secured full compensation for such penalties through a combination of the right to set off against the operating payments, other security from supplier, the SPV's equity and the right of termination for breach on the part of the private party in which case an additional penalty is typically imposed by way of write-offs on the exit value (for example, 10 to 15 per cent reduction from the exit value).

## ii State guarantees

In Denmark, we are in the fortunate position that the Danish state and public authorities generally have the best possible credit rating, and guarantee structures used to guarantee payment by the public party to the private party are thus not employed.

## iii Distribution of risk

The risk management, especially the risk allocation among the private and the public parties, are the main element of the PPP contract.

The risk allocation ensures the right incentives for performance of the functional requirements and places the risk of the basic assumptions changing over 30 years on the party most capable of handling it both financially as well as operationally.

The tables below, based on experience from projects procured up to 2012, show that the risk issues have been very common in relation to the general PPP market in Europe and particularly involve:

- a* changes to the legislation over the 30 years;
- b* construction risks such as delay, soil conditions, authorities processing and weather conditions; and
- c* risks during the operational phase, including particularly supply, energy, and price development for planned maintenance, etc., user behaviour and legal requirements in connection with various regulatory changes affecting public benefits and services to be handled by the private party.

### Illustration of the risks usually transferred to the private party/PPP provider (approximate percentage of projects)

	Yes	No	Partly
Observance of functional and service requirements during the operation phase	100%	-	-
Compliance of time schedule	100%	-	-
Risks connected with the day-to-day construction and maintenance	90%	-	10%

Risks connected with the condition of the asset at the end of the contract term	85%	-	15%
Risks connected with the weather during the construction periods	85%	7%	8%
Compliance of construction and operation budget	85%	-	15%
Financial risks (interest level during the construction and exploitation phase)	75%	17%	8%

**Illustration of the risks rarely transferred to the private party/PPP provider (approximate percentage of projects)**

	Yes, risk has been transferred	No, risk has not been transferred	Partly	Undisclosed
Consumption – units concerning electricity, water and heat (construction operation)	8%	76%	8%	8%
Contamination and other site matters	18%	40%	44%	8%
Consumption units concerning electricity, water and heat (other operations)	22%	33%	45%	-
Consumption unit prices for electricity, water and heat	30%	7%	55%	8%

**iv Adjustment and revision**

Since the first PPP projects in 2005, the Danish PPP contracts have provided for a change mechanism defining a procedure and consequent management as a result of the public party requesting changes to the functional requirements either in respect of the construction or the operation.

In this, the financial model will immediately reflect the impact of the changes on the total payments in respect of both the construction and operation. Similarly, the parties have agreed on terms for refinancing in the event that certain qualified financial circumstances arise in the market. These terms have also been uniformly applied in PPP contracts in the past 10 years, however with the natural adjustments that the financial markets have given rise to; see also Section VI, *infra*.

**v Ownership of underlying assets**

In PPP projects with private financing, the underlying asset (school, road, courthouse, etc.) is owned by the private party, typically an SPV in which the actual private investors are the shareholders.

In these projects, the public party is likely to be in possession of land or existing buildings or property to be included in the project. In these cases, the PPP contract contains agreed terms for the transfer of this asset to the private party in connection with the PPP contract being initiated and it is, furthermore, agreed in the PPP contract how and on what terms the asset is to be transferred back to the public party at the expiry of the contract term.

In some cases, the contract is structured in a way that the public party has not transferred an existing property, but simply leased it to the private party (if land only) on which land the private party has then constructed the new building (the new asset) as owner until it is transferred back to the public party after the end of the contract period.

In PPP projects with public financing, it is the private party constructing the asset at its account and risk, but so that the asset is transferred to the public party upon commencement of the asset's entry into service (once the operational phase is initiated) while also receiving payment for the capital investment in whole or in part (see above).

**vi The transfer upon exit of the contract**

In PPP contracts in Denmark, it is now customary practice that the contract term on the transfer of the asset back to the public party is designed so that the public party has a buy option and the private party a put option at end of the contract (a fixed price/calculation.) In this way, both parties are ensured that the asset may be transferred back to the public party at the end of the contract, but the transfer has not been agreed beforehand.

The reason for this arrangement is a result of tax discussions or considerations in connection with the first PPP projects where the tax authorities in Denmark questioned whether the private party – owing to some tax aspects in the contract – was to be qualified as owner for tax purposes, even if the private party would be the owner under civil law. If the private party could not be qualified as owner for tax purposes, the party would not be eligible for amortisation or exempt from VAT, resulting in a substantially more expensive project.

Another issue in relation to these tax considerations in respect of the PPP structure in Denmark has been the size of the exit value at the end of the contract, and the capital investment is therefore typically only depreciated down to approximately 50 per cent during the contract period, which will then form the basis of the transfer price upon exit.

In the first period, it was not really possible nor relevant to use the asset as security as the PPP contract was registered in priority to any other mortgage debt. However, times have changed and today the asset is typically allowed to be used for conventional mortgage financing under the Danish model, and customary user rights under the PPP contract can be registered on the property.

**vii Early termination**

PPP contracts in Denmark contain a well-consolidated regulation on early termination in the event of material breach on the part of the private party (or the public party). In this case, the termination will typically result in the asset being transferred back to the public party at a further specified value according to current amortisation and then adjusted for general compensation such as costs, lack of maintenance under the maintenance plan and penalty provisions (typically involving write-offs on the outstanding debt in the range of 10 to 15 per cent).

Similarly, there are penalty provisions (liquidated damages) in favour of the private party if the early termination is due to breach on the part of the public authority.

Furthermore, the contracts typically include a provision governing an actual annulment which may become relevant if the private party is unable to render the services due circumstances of force majeure. In this situation, both parties are entitled to terminate the agreement after a considerable period in accordance with the provisions on termination, however with the exception of the liability provisions.

At present, there are no known examples in Denmark of early termination on account of breach due to the parties, apparently, having been able to handle the factors and basic assumptions having changed during the process in accordance with the provisions of the PPP contract on requested changes, etc.

**VI FINANCE**

In the first two to three years until the financial crisis in 2008, debt was primarily financed through the banks based on specific requirements to the equity of the SPV, typically owned by the operators (construction and facility management).

The players were mainly foreign banks familiar with the project form, but a few Danish banks also engaged in the process. However, as they typically had a conventional approach such as property financing, they were not ready to assume the cash-flow risks involved in using the model (special reduction for deficiencies).

During the financial crisis, the possibility of borrowing ‘long-term money’ at fixed interest rates was lost, but when it became possible again around 2009–2010, a few private investors (contractors and developers) had come into play and realised the ‘bond-like’ aspects of the model.

In 2012, interest in the pension market increased and several pension funds came forward as investors (sponsors) for various operators. This is still the financial landscape today and there is still a good appetite.

Minor projects with capital sums of approximately €10 million are also attracting high net worth private investors, and investing funds are beginning to show an interest in learning more about these projects.

The approach of these finance sources is basically to run a risk only on the inflation, placing all other construction and operational risks with the SPV for the actual operators to handle under various security arrangements usual in connection with turnkey contract and operation, respectively.

In addition, the operators are liable to the extent of their equity for their own supply and often also, according to agreement, to some extent for the joint responsibility or liability related to the functional performance of the asset during the operational phase.

In recent years, mortgage credit institutes have also cooperated with banks under a model whereby the banks provide conventional building financing and bridging to mortgage financing upon commencement of the asset’s entry into service. This is owing to the very low interest rate on Danish mortgage debts and, for that matter, bank debts.

## VII RECENT DECISIONS

Until recently, no major decisions were available from judicial proceedings specifically relation to PPP projects. However, on 9 February 2016 the Complaints Board for the Public Procurement Authority rendered a decision in one of the largest PPP projects ever in Denmark, a hospital building.

The case concerned the procurement of construction and operation of a new hospital building combined with a sale of the existing hospital building. The crux of the case was in what manner the price of the existing property was to be included in the overall assessment of the criterion price for the contract award. More specifically, the Complaints Board for the Public Procurement Authority was asked to decide whether the contracting entity had used a different evaluation model from the one specified in the tender conditions.

The Complaints Board held that the tender conditions contained contradictory information as to how the price of the existing property was to be included in the overall assessment of the criterion price for the contract award. Consequently, the contracting entity had acted contrary to the principles of equal treatment and transparency under Article 2 of the Directive on public procurement and the tender conditions could not form the basis of a lawful contract award. As a result, and with reference to the nature of the contracting entity’s non-compliance, the Complaints Board annulled the contract award.

The economic aftermath of the case regarding the payment of damages is currently pending.

## **VIII OUTLOOK**

In Denmark, we have now successfully implemented PPP projects and have adapted to the scope of this type of project model rather than the traditional ones. The public authorities have become more familiar with and accustomed to the model, as well as operating under it, resulting in an increasingly positive approach to life cycle economy, budget security, etc.

The market will increase. The development in project sums and the current governments announcements support this fact. The challenge is whether there are enough operators and suppliers in the market for the necessary competition and, in this respect, how many projects it is possible to conduct at the same time since the suppliers and operators in this field are often the same.

PPP projects involve relatively high bidding costs and quite a lot of resources are used on the processes. However, these appear to be well spent as none of the projects seem to have resulted in subsequent disputes or the like.

From the 2012 report it was concluded, on the basis of the 13 areas addressed by the public authority in respect of the PPP projects at that time, that it had been a great success, both regarding timely commencement of the asset's entry into service, expected economic outlook, possibilities of requested changes, cooperation in general and in particular the experience of quality upon commencement of the asset's entry into service and, for that matter, during the operation period.

# FRANCE

*François-Guilhem Vaissier and Olivier Le Bars*<sup>1</sup>

## I OVERVIEW

In France, public-private partnerships (PPPs) are implemented in many economic sectors (e.g., transport, health, justice, education, urban equipment, environment, energy efficiency, telecommunications and culture) for more than €100 billion of activity each year.

Despite the difficult financial climate faced by some public authorities and the decreasing number of executed agreements due to the weak economic climate, a closer look at 2017 seems to indicate a possible renewal of investments in PPPs for the coming months.

First, the French PPP legal framework has been reshaped through the transposition of the European directives pertaining to public procurement and concession agreements under Ordinance No. 2015-899 dated 23 July 2015<sup>2</sup> relating to public procurement and the partnership agreements and its implementing Decree No. 2016-360 dated 25 March 2016, and Ordinance No. 2016-65 dated 29 January 2016<sup>3</sup> relating to concession agreements and its implementing Decree No. 2016-86 dated 1 February 2016.

Furthermore, several new laws have been adopted to reform the legal provisions applicable to contracts (Ordinance No. 2016-131 dated 11 February 2016), the administrative procedure (Decree No. 2016-1480 dated 2 November 2016), and the procurement procedure (Law No. 2016-1691 dated 9 December 2016 relating to transparency, anti-bribery and modernisation of the economy).

Such changes, along with the renewed support of certain local entities following positive feedback on prior implementation as well as possible decisions following the presidential and legislative elections,<sup>4</sup> could foster a new dynamic in PPP projects and public investments in France.

In this chapter, we will focus on the two main forms of PPP implemented in France: concession agreements – as regulated by the aforementioned Ordinance No. 2016-65 dated 29 January 2016 (the Concession Contract Ordinance) and Decree No. 2016-86 dated 1 February 2016 (the Concession Contract Decree), and partnership agreements – as regulated by Ordinance No. 2015-899 dated 23 July 2015 (the Partnership Contract Ordinance) and Decree No. 2016-360 of 25 March 2016 (the Partnership Contract Decree).

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2 Ratified under Article 39 of Law No. 2016-1691 dated 9 December 2016.

3 Ratified under Article 40 of Law No. 2016-1691 dated 9 December 2016.

4 The French presidential election will take place in April and May 2017; the legislative election will take place in June 2017.



## II THE YEAR IN REVIEW

Even though few partnership contracts were executed in France in 2016, it should still be noted that some landmark projects were finalised in the education sector: a 28-year partnership contract for the financing, design, construction, and maintenance of a new facility for the Ecole Centrale Supelec near Paris<sup>5</sup> by a consortium formed by BOUYGUES Bâtiment Ile-de-France, Bouygues Energies & Services, FIN Partner I and HICL Infrastructure Company Limited; and a 25-year partnership contract for the financing, design, construction, operation and maintenance of two University of Lorraine's buildings by Eiffage Concessions.<sup>6</sup>

With regard to concession agreements, two major agreements were developed in the transport sector: (1) the A355 Strasbourg bypass motorway concession, consisting of approximately 24 kilometres, granted by the state to a consortium led by Vinci Concessions on 2 February 2016; and (2) a 55-year concession agreement for the financing, design, construction, operation and maintenance of the A45 Lyon-Saint Etienne bypass motorway concession consisting of approximately 47 kilometres to be granted by the state.

Moreover, on December 2016, specific provisions relating to the direct railway link to Charles de Gaulle Airport (CDG-Express) have been adopted.<sup>7</sup> This law paves the way for the tendering of a concession agreement relating to the finance, design, construction, operation and maintenance of such infrastructure.

As previously stated, the main event of 2016 was the transposition into French law of the 2014 European directives pertaining to public procurement contracts and concession agreements. This transposition aims to clarify and simplify the complex legal framework applicable to the two types of PPP contracts (partnership contracts and concession agreements) as several categories of contracts existing in the French legal framework.

First, regarding partnership contracts, the Partnership Contract Ordinance transposed the 2014/24/EU and 2014/25/EU public procurement directives.<sup>8</sup> The Partnership Contract Ordinance provides for a new legal framework for the procurement contracts and qualifies the partnership contract as a specific type of public procurement contract, renaming it *marché de partenariat* (instead of *contrat de partenariat*).

Under this new definition the Partnership Contract Ordinance aims to encompass, under a unique type of contract, all the other existing PPP contractual forms existing under French law that were similar to partnership contracts (e.g., administrative long lease or administrative emphyteutic lease).

The new legal framework applicable to partnership contracts takes into account the French recent PPP practice. It secures and strengthens the partnership contracts' regime through the incorporation of French and European principles set out by case law in recent years.

The transposition of the public procurement directives under French law has entirely been achieved with the Partnership Contract Decree. Thus, the chapter describes provisions of the Partnership Contract Ordinance and the Partnership Contract Decree, which is the current legal framework applicable to partnership contracts.

5 [www.partnershipsbulletin.com/news/view/86417](http://www.partnershipsbulletin.com/news/view/86417).

6 [www.partnershipsbulletin.com/projects/view/8875](http://www.partnershipsbulletin.com/projects/view/8875).

7 Law No. 2016-1887 dated 28 December 2016.

8 Directives 2014/24/EU and 2014/25/EU related to public procurement, which were approved by the European Parliament on 15 January 2014 and adopted by the Council on 11 February 2014.

Secondly, regarding concession agreements, the complete transposition into the French legal framework occurred through the Concession Agreement Ordinance and the Concession Agreement Decree.<sup>9</sup>

While preserving certain specificities of French law, the Concession Agreement Ordinance and the Concession Agreement Decree aim to simplify, clarify and unify the existing legal framework governing the awarding and implementation of concession agreements in accordance with recent French and European case law.

This new single legal framework applicable to concession agreements entered into force on 1 April 2016.

### III GENERAL FRAMEWORK

#### i Types of public-private partnership

As stated above, there are two types of PPP that are mainly used in France: (1) concession agreements, which serve to implement major infrastructure projects such as canals, motorways, water distribution systems and toll bridges; and (2) partnership contracts which can be compared to private finance initiative contracts.

Concession agreements<sup>10</sup> and partnership contracts<sup>11</sup> are both administrative contracts under French law. This distinction is important as the contractual relationship in an administrative contract is different from that in a private contract. Indeed, the parties are, *de facto*, unequal insofar as the public person benefits from public authority powers.

As stated in the Concession Agreement Ordinance, a concession agreement is defined as an agreement under which a grantor assigns, for a limited period of time, to one or several economic entities, the performance of works or the management of a service, it being specified that (1) a risk linked to the operation of such works or such service must be transferred to the economic entity in exchange for the right to operate the said works or service; (2) a fee in favour of the entity can be added to such operation right; and (3) the risk transfer to the economic entity necessarily implies a real exposure to the market's fluctuation.

The partnership contract is an administrative contract under which a grantor entrusts to a private party, for a period set according to the amortisation of investment or agreed financing terms, a comprehensive project relating to the design, construction or conversion, maintenance, operation or management of works, equipment or intangible assets necessary to the public service, as well as to the total or partial financing of the latter.

The Partnership Contract Ordinance also clarifies that dismantling and destruction works as well as the management of a public service can also be transferred to the private party under a partnership contract.

The two main PPPs can be differentiated according to their payment terms: under a partnership contract, the grantor will pay rent to the private partner in exchange for the performance of the mission, while under a concession agreement the compensation of the concessionaire will mainly arise from payments made by users of the service.

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9 Ordinance No. 2016-65 of 29 January 2016 about concession agreements.

10 For concession agreements this is stated under Article 3 of the Concession Agreement Ordinance.

11 For partnership contracts this is stated under Article 4 of the Partnership Contract Ordinance.

## ii The authorities

The Concession Agreement Ordinance provides that, in addition to public authorities (the French state, local authorities and their public institutions), private entities (entities specially created to satisfy a non-commercial public interest or formed by several public entities in order to jointly perform certain activities and public undertakings acting as network operators) will be allowed to grant concession agreements.

The Partnership Contract Ordinance is also flexible regarding the grantor that may enter into a partnership contract. The state and its public institutions, local authorities and local public institutions as well as public health facilities, social security bodies and some public or private entities pursuing a public-interest mission and mainly financed by public funds<sup>12</sup> (i.e., public-private joint ventures and state-owned public industrial and commercial institutions) may all enter into partnership contracts.

For partnership contracts executed by the state, the ministries that are involved will depend on the scope of the particular contract. For partnership contracts, approval by the Minister of the Economy and the Budget is additionally required before signature.<sup>13</sup>

The Partnership Contract Ordinance provides for an extended list of potential procuring authorities. Indeed, the granting authorities will be the same as those described in the Concession Agreement Ordinance.<sup>14</sup> As such, private entities could also enter into a partnership contract.

Nevertheless, central administrations, public health facilities and medical cooperation public structures that used to be grantors before the European Directive will no longer be able to enter into partnership contracts.<sup>15</sup>

Another important actor in the PPP sector in France is the PPP Support Service (FIN INFRA). The FIN INFRA is a dedicated unit within the Ministry of the Economy that assists grantors in the implementation of partnership contracts.<sup>16</sup> The FIN INFRA is primarily responsible for the validation of the preliminary evaluations prepared by grantors before launching a tender. The FIN INFRA also assists and advises public authorities in the preparation and negotiation of partnership contracts as well as any other complex public contracts or public contracts implying an innovative financing scheme.

According to the Partnership Contract Ordinance, the FIN INFRA will still be a major actor given that it will also have to issue an opinion about the financial sustainability of each partnership contract.<sup>17</sup> This new requirement should be an efficient way to avoid the financial difficulties deriving from the implementation of some partnership contracts in France.

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12 As mentioned in Articles 10 and 11 of the Partnership Contract Ordinance.

13 See Article 1-II of Decree No. 2012-1093 dated 27 September 2012. A partnership contract may be signed by the state or a state public institution having a public accountant after approval by the Minister of the Economy and the Budget. Such approval will be presumed if no reply is given within one month from the transmission of the contract. For local authorities, the principle of their free administration exempts them from any requirement for state approval. Thus such authorisation by the Minister of the Economy and the Budget is not needed.

14 Article 10 of the Partnership Contract Ordinance and Article 9 of the Concession Agreement Ordinance.

15 Article 71 of the Partnership Contract Ordinance.

16 Before 2016, the FIN INFRA was the MaPPP, which was created by Ordinance No. 2004-1119 dated 19 October 2004 and modified by Decree No. 2016-522 of 27 April 2016.

17 Article 76 of the Partnership Contract Ordinance.

### **iii General requirements for PPP contracts**

Requirements are different for the use of partnership contracts and concession agreements.

The Concession Agreement Ordinance provides that concession agreements must include provisions pertaining to the duration of the contract and tariffs applicable to service users. The Concession Agreement Ordinance also provides that concession agreements can include provisions pertaining to sustainable development and social objectives.

Moreover, to optimise cost monitoring, the Concession Agreement Ordinance aims to increase transparency relating to the performance of concession agreements.

As a consequence, concession agreements must specify that the concessionaire will be required to provide an annual report to the grantor and that the grantor will have to annually publish essential data pertaining to the concession (i.e., type of investments, tariffs).

Contrary to concession agreements, the use of partnership contracts is strictly regulated. The project has to be related to the construction or conversion, upkeep, maintenance, operation or management of work, equipment or intangible assets necessary for public service. Moreover, the concerned projects have to be comprehensive in nature. First, a preliminary evaluation has to be made to demonstrate one of these criteria. A report must set out a general presentation of the project, the objectives of the procuring authority, an analysis of the costs with and without the partnership contract and the consequential budgetary allocation. State procuring authorities (e.g., ministries and public institutions) are obliged to submit their preliminary evaluation to the FIN INFRA for its validation. Currently, local authorities may choose whether or not to submit such an application. However, following various financial and implementation difficulties encountered by local authorities, as of 1 January 2016, they are also obliged to submit their preliminary evaluations to the FIN INFRA for its validation.

The Partnership Contract Ordinance aims to simplify this procedure and answer criticisms raised during the last decade regarding the implementation of partnership contracts. Since 1 April 2016, the grantor is only entitled to enter into a partnership contract if the economic efficiency criterion is fulfilled. Moreover, prior assessments about the different ways to perform the project and a financial sustainability study have to be issued by the grantor.

A partnership contract must include several mandatory provisions such as the duration of the contract, the conditions for sharing risks between the grantor and its co-contracting party, the performance objectives assigned to the co-contracting party, the payment terms and the consequences of termination of the contract.

Both partnership contracts and concession agreements are thus entered into for a period determined by the depreciation period of the selected investments or financing terms.

## **IV BIDDING AND AWARD PROCEDURE**

Bidding and awarding procedures for partnership contracts are closely regulated.

Regarding concession agreements, the Concession Agreement Ordinance and the Concession Agreement Decree regulate the bidding and award procedures for concessions of a value greater than or equal to €5,225,000. The new legal framework applicable for concessions will remain flexible with the aim to ensure effective and non-discriminatory access for all potential bidders (including small and medium-sized companies). Nevertheless, in practice, most of those minimal requirements already existed in French case law.

As regards partnership contracts, the Partnership Contract Ordinance provides that three granting procedures can be implemented:

- a* a competitive dialogue,<sup>18</sup> in the case of particularly complex projects where grantors are not objectively able to define the technical means or specify the legal or financial aspects of a project;
- b* a negotiated procedure<sup>19</sup> for small projects below a certain amount defined by decree;<sup>20</sup>  
or
- c* a restricted call for tenders.<sup>21</sup>

As competitive dialogue is the most common procedure for the awarding of partnership contracts, we will focus on it.

### **i Expressions of interest**

To allow effective competition among applicants (it being specified that applications can be submitted through a consortium), partnership contracts and concession agreements must be the object of adequate publicity.<sup>22</sup>

Nevertheless, partnership contracts may only be used in the following cases: (1) if the value exceeds €2 million for immaterial assets or if the contract contains specific targets on performance; (2) if the value exceeds €5 million for network infrastructures; or (3) if it exceeds €10 million in the other cases.<sup>23</sup>

Regarding concession agreements, publication requirements are less strict. The public tender notice has to be published in a newspaper authorised to carry legal advertisements and in a specialised newspaper of the relevant economic sector. The notice must also specify the procedures for the applications' submission and the essential characteristics of the concession agreement, including its purpose and nature. Granting authorities may also require the production of documents from the bidders in support of their applications (i.e., the presentation of sufficient professional and financial guarantees to ensure the continuity of the public service).

In both cases, the publication notice must specify the deadline for applications.

### **ii Requests for proposals and unsolicited proposals**

For both partnership contracts and concession agreements, tendering documents will be communicated to shortlisted applicants.<sup>24</sup>

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18 Article 42 of the 2015 Ordinance. The grantor conducts a dialogue with the candidates admitted to the procedure with the aim of developing one or more suitable alternatives capable of meeting the specified requirements.

19 The negotiated procedure is defined as the procurement procedure in which 'the contracting authorities consult the economic operators of their choice and negotiate the terms of contract with one or more of them'. The negotiation process enables grantors to negotiate the terms of the contract.

20 Article 42 of the 2015 Ordinance.

21 Article 42 of the 2015 Ordinance.

22 For now this requirement is outlined in 2014/23/EU, 2014/24/EU and 2014/25/EU Directives.

23 Article 75 of Ordinance No. 2015-899 of 23 July 2015.

24 In concession agreements, the public authority lists applicants admitted to tender after consideration of their professional and financial guarantees and their ability to ensure the continuity of public service and equality of service users.

Regarding concession agreements, the grantor shall deliver a programme document to the applicant that defines the quantitative and qualitative characteristics of the required benefits and, if applicable, the service pricing conditions applicable to the end user.

Regarding partnership contracts, in a competitive dialogue, the grantor has to define the detailed needs and objectives that the project will have to meet in a functional programme that will be transmitted to the applicants selected for the dialogue.

Moreover, one of the partnership contract specificities is that a private person can directly suggest to grantors projects to be developed under a partnership contract scheme.<sup>25</sup> However, being at the origin of the proposal does not guarantee the awarding of the partnership contract. Indeed, the grantor will make a preliminary evaluation and then selects the private partner according to the ordinary advertising and competition rules set out for partnership contracts (see subsection iii, *infra*). The possibility of an unsolicited proposal is not contemplated for the concession agreements.

### **iii Evaluation and grant**

For partnership contracts, a dialogue will be conducted with each candidate to define solutions on the basis of the functional programme. The dialogue typically involves two or three phases, which are normally carried out over a period of nine to 12 months.

At the end of the dialogue period, the procuring authority will invite the candidates to submit a tender based on the considered solutions. After analysis of the tenders, a partnership contract will be awarded to the candidate with the most economically advantageous tender in accordance with the criteria set out in the contract notice or in the tender procedure. The awarding criteria must include the overall cost of the tender<sup>26</sup> and performance objectives defined according to the purpose of the contract. As soon as the preferred bidder is selected, the contracting authority shall inform the unsuccessful candidates that their tender was rejected. A standstill period of at least 16 days is required between the date of notification of the decision and the date of execution of the contract<sup>27</sup> to allow for any eliminated candidate to initiate a summary proceedings challenge on grounds of a breach of the relevant procurement rules.<sup>28</sup>

For the sole partnership contracts to be entered by the state or entities linked to the state, the FIN INFRA must assess the impact on public finances and the fiscal sustainability of such agreement before its execution.

For all partnership contracts, once the signature occurred, the procuring authority is required to send an executed copy of the partnership contract to the FIN INFRA.

At the end of the awarding procedure, a notification must be sent within 30 days to the European Union Official Journal.

Regarding concession agreements, before the negotiation phase, the grantor selects the potential bidders based on their capacities and abilities in accordance with the criteria set out

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25 Article L1414-11 of the General Code for Local Authorities.

26 The 2004 Ordinance specified that overall cost of the tender is intended to mean the sum, in current value, generated by the design, financing, construction or conversion, upkeep, maintenance, operation or management of works, equipment and intangible assets, and the provision of services specified for the term of the contract.

27 The duration is either 11 or 16 days depending on certain criteria (i.e., in case of electronic transmission of the decision to the rejected bidders).

28 Article L551-1 of the Code of Administrative Justice.

in the publication notice.<sup>29</sup> Once, they have been selected, applicants have to submit tenders that will be freely negotiated with the contracting authority. At the end of these negotiations a concessionaire will be chosen and the applicants who have had their offers rejected will be notified. A standstill period shall, however, be respected.<sup>30</sup>

## V THE CONTRACT

### i Payment

Concession agreements and partnership contracts can be differentiated according to their payment terms.

Under a concession agreement, the operating risk is transferred to the concessionaire and this transfer necessarily implies a real exposure to the market's fluctuations. As such, the compensation of the concessionaire is linked to the results of such operation. Therefore, the concessionaire's compensation mainly arises from service users.

However, this requirement does not prevent the payment of subsidies by the procuring authority. Given the requirements that could be imposed by the concession agreement, maintaining the financial viability and economical balance of the concession agreement is necessary so that the concessionaire does not apply very high rates to service users. For example, significant financial contributions are paid in concession projects related to railway infrastructure (high-speed railway) or motorways. Local authorities usually subsidise public transport or school catering concessions.

Apart from the revenue collected from service users and subsidies granted by public authorities, the concessionaire may also earn additional revenues (e.g., proceeds from side activities such as advertising and fines).

Unlike concession agreements, partnership contracts are characterised by the payment of rents by the grantor to the private partner throughout the term of the contract. This remuneration is determined for the services provided by the private partner (works, intangible investments, supplies and services) and is divided into several parts. One part represents the compensation of the partner for the supply of equipment and the cover costs for servicing the loans contracted to carry out the investment, financing costs, taxes and fees that the partner pays on its investments. The compensation also takes into account the services provided by the private partner. Finally, the compensation of the partner must cover the maintenance costs and expenses for major maintenance and the renewal of certain infrastructures.

The partnership contract shall define the terms of the rents calculation and disbursement of the payment, which may be monthly, quarterly or half-yearly.

Under partnership contracts, the compensation is not necessarily fixed as it can take into account:

- a* the completion of performance objectives – the compensation of the private partner may depend on performance targets set in the partnership contract. Premiums or bonuses may be paid (e.g., if the works are completed before the date specified in the contract). Likewise, penalties (e.g., in case of a delay in completion) may reduce the amount of the rent to be paid by the grantor; and

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29 Article 22 of the Concession Agreement Decree.

30 Article 1-1 of the Decree No. 93-471 of 24 March 1993 and in 2016, Article 29 of the Decree No. 2016-86 of 1 February 2016.

- b the collection of ancillary revenues<sup>31</sup> – the Partnership Contract Ordinance allows the private partner to develop structures and equipment in order to benefit from complementary incomes.

The Partnership Contract Ordinance specifies that should a partnership contract include the transfer of a public service management, the contractor could receive direct payments from service users on behalf of the public authority responsible for this public service. As such, the cash flows of each parties will have to be expressly distinguished in order to avoid any confusion with the legal framework applicable to concessions.

## ii State guarantees

There are no state guarantees *per se* issued for PPPs in France.

However, in early 2009, the state established a guarantee system for priority PPP projects in response to the financial crisis, which was affecting a number of very large PPPs. The MaPPP examined four projects worth a total of over €13 billion, but only one project – under a concession agreement scheme – was selected to benefit from the guarantee: the high-speed railway, Sud Europe Atlantique, which was the biggest rail PPP ever launched in Europe (financing of €7.8 billion). This concession agreement was granted by Réseau Ferré de France to a consortium led by VINCI and the state guaranteed a €1.06 billion senior secured debt to the lenders.

Unlike the state, local authorities may guarantee loans subscribed by the project company under a concession agreement or a partnership contract.

Moreover, the contracting authority (including the state) may enter into direct agreements with the private party and its lenders to cover specific issues (cancellation or nullity of the concession agreement or the partnership contract) and preserve the lenders' interests.

## iii Distribution of risk

PPPs rely on a clear allocation of the risks between the public and the private entities. This allocation of risks is negotiated by the parties and is usually the object of a 'risk matrix'. Except for the risk of use of the works, the risk matrix is fairly similar for concession agreements and partnership contracts.<sup>32</sup>

Risks relating to the performance of the contract (e.g., delays in the completion and delivery of the works, archaeological discoveries and design risk) are generally transferred to the private entity.

In France, particular attention is given to public authority powers (i.e., powers to unilaterally amend or terminate the contract on general interest grounds) as the contract provisions may define the financial consequences of the use of public authority powers by the grantor.

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31 The collection of ancillary revenues serves as a financial incentive for the partner, but also for the public party. Indeed, the rent paid by the public body may be reduced depending on ancillary revenues collected by the partner.

32 Under concession agreements, the risk of the works being used by the end user is borne by the concessionaire.



#### **iv Adjustment and revision**

Being long-term agreements, PPPs often include specific clauses for the review of contractual terms, such as tariff-variation clauses, indexation clauses<sup>33</sup> and meeting clauses.

Amendments can also be entered into, but only if the overall structure of the contract is not materially altered. Should the grantor be a public authority, the PPP contract can be unilaterally modified by it. As stated in subsection iii, *supra*, French administrative case law establishes the possibility for the public authority to unilaterally amend the contract for reasons of general interest. However, the power of amendment is regulated so that the modification cannot result in a disruption of the overall structure of the contract. Administrative case law protects the co-contracting party of the administration. In fact, the economic balance of the contract must be maintained and the private co-contractor must be adequately compensated for the damages suffered.

Regarding concession agreement, all duration which is more than five years will be determined in light of the period needed to amortise the investments required.

In addition, the Concession Agreement Decree clarifies the legal framework applicable to concession agreements' amendments by stating six alternative cases allowing a valid modification of the concession agreement.

The provisions of the Concession Agreement Decree pertaining to the modification of the concession agreements will apply even for concession agreements entered into before 1 April 2016. This is a real improvement as the modification of a concession agreement used to be very strictly regulated, which had led to a lack of flexibility in the implementation of concession agreements.

#### **v Ownership of underlying assets**

The legal regime applicable to concession agreements where the grantor is a public authority is organised around a classification distinguishing three types of assets:

- a* the assets of compulsory reversion that shall revert to the public authority automatically once the contract ends. Because they are crucial to the provision of the public service, these assets are considered, when the contract does not address this issue,<sup>34</sup> as the property of the public authority *ab initio*, that is to say, from the moment the concessionaire acquires an asset or completes specific works. Assets of compulsory reversion must necessarily return free of charge to the public authority at the end of the contract;
- b* the assets of optional reversion, which are useful to the provision of the public service but are not necessary to ensure its continuity. The concessionaire is the owner of such assets for the duration of the concession agreement and they only become the property

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33 These clauses must comply with Articles L 112-1 to L 112-3 of the Monetary and Financial Code that prohibit, with certain exceptions, indices based on overall inflation and requires the use of indices related to the obligations whose price is indexed.

34 The contract may assign: (1) ownership of the works to the concessionaire for the duration of the contract, which, although necessary for the operation of public service, are not established as the property of a grantor; or (2) rights on such property (Supreme Administrative Court, 21 December 2012, *Commune de Douai*, No. 342788). At the end of the contract, if assets of compulsory reversion are not fully amortised, the co-contracting party is entitled to a payment equal to the net book value shown on the balance sheet if the depreciation period of the assets involved is less than or equal to the duration of the contract, or the net book value resulting from the depreciation of these assets over the term of the contract, when the term of the agreement is less than the normal depreciation period of the assets.

of the public authority if the public authority exercises its recovery right at the end of the concession agreement. The terms of payment of such assets are specified in the contract; and

- c the assets that belong to the concessionaire. They are not subject to being returned to or eventually recovered by the public authority as they do not aim to ensure the continuity of public service.

Regarding partnership contracts, the private partner is the owner of the assets. The private partner sets up a financing that covers (1) the acquisition of assets; (2) the cost of the works; and (3) the cost of maintenance and renewal. Consequently, by paying rents to the private partner, the contracting authority pays for the acquisition of proprietary interests in certain assets. At the end of the partnership contract the partner transfers the assets to the contracting authority.

Assets that are not integrated in the financing base (i.e., not acquired by the grantor through the rent) can remain the property of the private partner. However, they may be subject to a contractual provision providing for their transfer against payment to the public authority at the end of the contract.

#### **vi Early termination**

The provisions for early terminations are the same for partnership contracts and concession agreements.

Specific legal frameworks exist for two types of termination: termination on the grounds of general interest and termination for contractual breach by the contracting authority.

##### ***Termination on the grounds of general interest***

Should the grantor be a public entity, it cannot waive its unilateral right to terminate a public law contract on the grounds of general interest. The quantum of the indemnity owed to the private entity is the highest of all termination cases.

##### ***Termination for contractual breach by the public authority***

Should the grantor be a public entity, the termination for contractual breach by the grantor cannot be a contractual ground under which the concessionaire may require the termination of a concession agreement.

To terminate a concession agreement on the basis of a contractual breach by the grantor, the concessionaire must request such termination before the relevant administrative jurisdiction. The concessionaire would then be entitled to be indemnified in accordance with the principles established by administrative case law, namely, to be indemnified in respect of losses suffered, as well as in respect of the loss of profits. Recent case law confirmed the possibility to include in a contract, not related to the performance of the public service, a provision allowing the partner to terminate the contract for a contractual breach by the public authority.<sup>35</sup> Consequently, certain partnership contracts not related to the performance of the public service could potentially include such contractual provision.

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35 Supreme Administrative Court, 8 October 2014, Société Grenke Location, No. 370644. It must be noted that: (1) the case law did not concern a concession agreement or a partnership contract but there is a

***Termination for failure to fulfil the obligations as determined by the Court of Justice of the European Union***

Both the Concession Agreement Ordinance and the Partnership Contract Ordinance provide that the agreement has to be terminated, in case of major breach, if the Court of Justice of the European Union states that the grantor has awarded the contract without complying with the obligations imposed by the European Directive (as provided under Article 258 of the Treaty on the Functioning of the European Union).

Except for these three types of termination that are regulated, the terms and conditions of other forms of termination can be freely negotiated by the parties.

If a force majeure event or an unforeseen event occurs, the contract may be terminated and the contract will usually provide that the private entity will be indemnified on the basis of the ‘useful expenses’ theory developed by the Supreme Administrative Court.<sup>36</sup> As it is a jurisprudential theory, it is still difficult to determine which costs are deemed to be useful expenses and consequently are to be indemnified. However, financial expenses should be indemnified.<sup>37</sup>

One of the major points of both the Partnership Contract Ordinance<sup>38</sup> and the Concession Agreement Ordinance,<sup>39</sup> is the enshrinement of the principle of indemnification of financial expenses incurred under the partnership or the concession agreement in case of judicial cancellation following a third-party challenge.

Indeed, in case of cancellation of the contract, the private entities can seek indemnification for all expenses incurred in accordance with the concession agreement or the partnership contract, which may include the financial expenses incurred to ensure the performance of the contract, to the extent that the said expenses have been useful to the grantor.

In respect of the concession agreement, such financial expenses are defined broadly and include the costs for the concessionaire relating to the financing instruments and those arising from the early termination.

It shall be noted, however, that the indemnification of the useful expenses can only apply when a schedule of the concession agreement and the partnership contract specifies in respect of the concession agreement, the main characteristics of financing to be set up for the purposes of the contract performance, and in respect of the partnership contract, the provision that binds the contracting partner to the financial institutions.

Finally, both the Partnership Contract Ordinance and the Concession Agreement Ordinance provide that, if specified, in the agreements either partnership contract and concession agreement, the indemnification clause is deemed separable from the rest of the said agreements.

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reference to administrative contract; and (2) the termination is not automatic. Indeed the public authority shall have the possibility to contest the termination.

36 Supreme Administrative Court, 19 April 1974, *Société Entreprise Louis Segrette*, No. 82518.

37 The Supreme Administrative Court has recently held that financial expenses can be considered as useful expenses (Supreme Administrative Court, 7 December 2012, *Commune de Castres*, No. 351752). However, it must be specified that in this case, the concession agreement was not terminated on the grounds of a force majeure.

38 Article 89 of the Partnership Contract Ordinance.

39 Article 56 of the Concession Agreement Ordinance.

The Concession Agreement Ordinance clarifies the quantum of the financial indemnification applicable in case of cancellation or termination of a concession agreement by a judge following a third-party challenge.

As a consequence, the concessionaire may request to be indemnified for the expenses incurred under the concession agreement that have been useful to the grantor, including financing expenses and costs.

From a project finance perspective, this express reference to the theory of ‘useful expenses’ (*dépenses utiles*) should be reassuring for both sponsors and lenders.

Indeed the indemnification of useful financial expenses constitutes a major achievement for the lenders and all finance parties involved in a partnership or concession project because it covers the risk of third-party challenge, in particular, should a concession agreement or a partnership contract be held to be void as result of a challenge.

The contract may also be terminated for breach by the private entity. The possibility to terminate the contract on this ground and its consequences must be provided for in the contract. In this case, the private entity cannot receive compensation for the damage resulting from the early termination of the contract.

In any case of termination, it is preferable to contractually provide the financial consequences and terms of payment of owed indemnities in the contract.

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## VI FINANCE

In France, PPPs are usually financed under a project finance scheme. The key feature of project financing is that it is an ‘off-balance sheet’ financing for the sponsors.

Project finance generally involves high debt-to-equity ratios depending on the particular project and market. It refers to a limited recourse (or non-recourse) financing structure that does not impose any obligation on the project sponsors to guarantee the repayment of the project debt, should the project revenues not be sufficient to cover the total debt service. Shareholders of the project company are generally only liable up to the extent of their shareholdings.

In respect of the partnership contract, the Partnership Contract Ordinance provides that the procuring authority must be informed of any change in the project company shareholding. The partnership contract must contain provisions regarding the procuring authority information, and as applicable, the proceeds sharing terms in case of the sale of the project company shares.

The borrowing entity is a project company, namely, a special purpose vehicle (with no previous business or record) that will finance, design, build, operate and maintain the project. In France, project companies are often incorporated as liability companies or partnerships.

The repayment of the project loans by the project company relies on the future cash-flow projected to be generated from the operation of the project (primarily allocated to operating costs and then to debt service).

One of the main concerns of the lenders is to analyse the bankability of the project, which depends on several factors. For instance, the project's cash-flow capacity, the mitigation of the risks between all stakeholders, the project company's contractual documentation and the security package must all be examined to ensure the successful financing of a PPP in France.

Many sources of financing are available, including commercial lenders (banks, insurance companies, credit corporations, etc.), sponsors' equity, public bodies, international (multilateral) agencies, bilateral agencies and bondholders. These financiers might be based in France or abroad.

Prohibited under the 2004 Ordinance, the Partnership Contract Ordinance now contemplates the possibility for a procuring authority to contribute to the financing of the project.

State or local authorities or other public bodies, whether acting as procuring authority or not, are now entitled to take a minority stake in the project company. In this case, the project company by-laws must specify the allocation of risk between the shareholders and the measures implemented to prevent any conflict of interest.<sup>40</sup>

The Partnership Contract Ordinance also provides that partnership contracts are eligible to subsidies or other financial contributions. The terms and the payment schedule of the subsidies and other financial contributions can be adapted to the duration of the contract. Such provision was already provided by the 2004 Ordinance.

In respect of financing adjustment, the Partnership Contract Ordinance also specifies that the procuring authority may provide that financing terms referred to in the final tender can be adjusted, provided that this adjustment may not affect the conditions of the bidding procedure by exempting the procuring authority of the obligation to respect the principle of choice of the most economically advantageous tender or allowing the prospective candidate to affect the economic balance of its tender.<sup>41</sup>

In a typical project finance transaction, the lenders provide different types of debt to the project. Senior lenders provide a debt with a right of payment senior to that of the subordinated lenders. Moreover, some lenders might provide a tranche of debt for a specific period of time and with a specific interest rate and an amortisation differing from the tranche provided by others lenders. A wide range of French law debt instruments are also available to issue subordinated, high-yield or convertible bonds.

The standard types of project finance credit agreements may notably include:

- a* the term sheet – an initial agreement between the project company (in its capacity as future borrower) and the lenders outlining the key terms and conditions of the financing;
- b* senior facility agreements – agreements between the lenders and the project company setting out the rights and obligations of each party regarding the senior debt;
- c* a common terms agreement – an agreement entered into by the financing parties and the project company that defines the terms and conditions that are common to all the financing instruments and the relationship between the parties (for instance, definitions, events of default, order of drawdowns, project accounts, permitted investments, voting process for waivers and amendments, undertakings, covenants, representations and

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40 Article 80 of the Partnership Contract Ordinance.

41 Article 82 of the Partnership Contract Ordinance.

- warranties, etc.). Such agreement ensures that all the finance parties have a common understanding of the key definitions and critical events;
- d* subordinated loan agreements – loan agreements whereby subordinated creditors agree not to be paid until the senior creditors have been repaid. These loans are usually provided by the project sponsors or by third-party investors such as investment funds;
  - e* a shareholders' agreement – an agreement that sets forth the rights and liabilities of each project company shareholder especially with respect to capital contributions, transfers, conflicts of interest and restrictions on competition;
  - f* an intercreditor agreement – an agreement between the project company and the lenders (senior lender, mezzanine lender, hedging counterparty, loan noteholders and intra-group lenders, etc.), which regulates the creditors' rights to receive payments (such as principal, interest and fees) notably in the event of default;
  - g* hedging agreements – agreements that enable the project company to fix the interest rate on all or part of its debt or to limit its exposure to exchange rate risks;
  - h* a direct agreement between the lenders and the project company under which the lenders will be entitled to take over the project (step in) regarding the key project agreements should the project company default under certain circumstances;
  - i* sponsor support and third party guarantee – senior lenders will often require sponsors or third parties to put in place certain credit-enhancement measures (parent guarantee, letter of credit, comfort letter);
  - j* public sector support – public sector support instruments may also be set up (e.g., direct funding support by way of public sector capital contributions);
  - k* contingent support or guarantees by the public sector or other private sector participants involving specific risks which cannot otherwise be effectively controlled by the project company or other private sector participants (e.g., minimum traffic and revenue guarantees for a toll road); and
  - l* EU loan guarantee – an example is the Loan Guarantee for Trans-European Transport Network Projects, which is a credit-enhancement instrument set up and developed jointly by the European Commission and the European Investment Bank, facilitating a larger participation of the private sector involvement in the financing of Trans-European Transport Network infrastructure.

As project finance is carried out on a limited (or non-recourse) basis, it is critical to secure the finance parties through a collateral security package, which also helps to enhance the bankability of the project and the creditworthiness of the project company in its capacity as borrower.

Under French law, a security interest is generally created in favour of the creditor(s) of the secured obligation.

Although there is no concept of parallel debt clause, French law recognises the role of security agent. Pursuant to Article 2328-1 of the Civil Code, a security agent may be in charge of setting up, registering, managing and enforcing any security interest for the benefit of the secured creditors. Indeed, security interests are granted in favour of each lender and not only for the benefit of the security agent, which means that each of the lenders might be entitled to act individually in enforcing its specific security interests rights (subject to any restrictions in the financial documentation). The security agent is thus appointed by the creditors and acts under a power of attorney granted by the lenders.

The most common types of security interests used in PPP project finance transactions in France are:

- a* pledge over bank accounts (governed by Article 2355 et seq. of the Civil Code);
- b* a pledge over securities accounts (governed by the provisions of Article L211-20 of the Monetary and Financial Code) involving a pledge over shares or other financial securities and a pledge over the bank account on which cash proceeds relating to such shares or financial securities are credited (e.g., dividend);
- c* a pledge over the project company's ongoing business (governed by Article L142-1 et seq. of the Commercial Code) notably involving lease rights, logo and corporate name, goodwill, commercial furniture, equipment and machinery used for the operation of business, and certain intellectual property rights attached thereto;
- d* a pledge over equipment (governed by Article L525-1 et seq. of the Commercial Code);
- e* a pledge over intellectual property rights (governed by Article 2355 et seq. of the Civil Code);
- f* a pledge over receivables – including future receivables – (governed by Article 2355 et seq. of the Civil Code);
- g* assignment by way of security over receivables (including contingent or future receivables if such receivables are sufficiently identified). Under French law, receivables are assigned by way of security which is a simplified form of assignment of receivables for security purpose. It transfers the ownership of a receivable to the relevant secured creditor. Such security interest, which is governed by Article L313-23 et seq. of the Monetary and Financial Code is only available provided that: (1) the assignee is a credit institution licensed in France or otherwise licensed to carry out its activities in France through the European Passport; (2) the assigned receivables secure a credit granted by a credit institution (the assignee) to the assignor in connection with its business activities; and (3) the assigned receivables relate to business or professional activities;
- h* delegation of receivables (governed by Article 2355 et seq. of the Civil Code). A delegation is commonly used to take security over receivables under insurance policies. The debtor agrees to make payments directly to the secured creditor; and
- i* security interests (mortgage, lender's lien, antichresis) on real property (land, buildings, rights of way and easements). Such security interests must be entered into by way of notarised deed and registered to the relevant land registry.

At the closing date and before any subsequent disbursement of the loan, lenders will require that the borrower first comply with a set of conditions precedent, including (for the first drawdown): organisation and existence of the project company, execution and delivery of facility agreement and related financing documents, security interests filings, availability of funds, related equity documents, sponsors supports documents, third-party support document, guarantees, enforceability of project contracts, permits, insurances policy endorsements and insurance report, real estate surveys and title insurance, financial statement of project company and other project participants, construction budget and construction drawdown schedule, revenue and expenses projections, engineering report, consultant reports, environmental review, legal opinions, no material adverse change, no defaults and no litigation.

## VII RECENT DECISIONS

In 2016, only a few rulings affecting the legal framework for PPPs were issued by administrative judges.

In a decision dated 11 May 2016,<sup>42</sup> the French Supreme Administrative Court decided to validate the practice for public entities to enter into direct agreements subject to the information communicated to the relevant deliberative body prior to the execution of the main contract. This decision clarifies the contractual efficiency of the direct agreements entered into between the public authority and the private party and/or its lenders to cover certain specific issues (cancellation or nullity of the concession agreement or the partnership contract).

On 9 November 2016,<sup>43</sup> the Plenary Session of the French Administrative Supreme Court, the most prestigious bench of the Supreme Administrative Court, ruled on an application to annul an international arbitral award issued by an arbitration tribunal to settle a dispute that arose between parties to an international administrative contract. The Court's judicial review over an award is akin to the civil court's judicial review, except on one issue: the preliminary analysis of the ability of the parties to bring the dispute before an arbitration tribunal. This specificity can be easily explained since under French law, French public entities cannot resort to arbitration<sup>44</sup> except when legislative provisions and international treaties allow them to do so.

With this ruling, the Supreme Administrative Court confirmed implicitly that the parties were allowed to bring the case before the International Court of Arbitration by directly reviewing the validity of the award. The Court took the opportunity to define, for the first time, the scope of control to be exercised by it over claims brought for the annulment of an international arbitration award.

The Court's judicial review function is limited. It mainly focuses on the parties' ability to bring the dispute before an arbitration tribunal. In addition, the Court's review of the award is strictly limited to (1) a review of the procedure followed by the arbitral tribunal (i.e., whether the tribunal followed the correct procedure); and (2) a review of the award's compliance with the public policy rules of French administrative law.<sup>45</sup>

Moreover, ruling *ultra petita*,<sup>46</sup> the Court held specifically that it has jurisdiction over applications seeking annulment of international arbitration awards issued to settle disputes arising during the performance of PPPs under French public procurement law.

## VIII OUTLOOK

The transposition of the European directives pertaining to concession agreements and public procurements substantially modifies the existing French PPP laws that included several

42 Supreme Administrative Court, 11 May 2016, No. 383768.

43 Supreme Administrative Court, 9 November 2016, No. 388806.

44 Article 2060 of the French Civil Code.

45 According to the State Council, an award is deemed to breach those rules if a contract is motivated by an illegal or improper purpose, if the contract suffers a major defect such as a lack of mutual consent, or non-compliance with a rule from which public entities cannot derogate.

46 The *ultra petita* principle means that a court will make a ruling beyond what is requested by the parties to the case.



regimes with strong specificities (i.e., administrative long-term leases, temporary occupation permits, partnership contracts and concession agreements).

The previous French PPP legal framework was rather complex in comparison with other European countries.

While preserving certain specificities of French law, the new provisions aim to simplify, clarify and unify the existing legal framework governing the award and implementation of concession and partnership agreements in accordance with recent French and European case law.

2017 should be a key year for PPPs in France in the context of potential policy changes that may occur following the presidential and legislative elections. As has been the case in countries that have recently held elections, the retained public policies may trigger new dynamics in public investments and PPP projects in several key sectors (e.g., transport, health, education, urban equipment, environment, energy efficiency and telecommunications).

# GERMANY

*Jan Bonhage and Marc Roberts<sup>1</sup>*

## I OVERVIEW

The German public-private partnership (PPP) market became more dynamic in 2016. The Federal Ministry of Transport and Digital Infrastructure proposed a reform of the motorway administration that may lead to substantially more PPP projects with regard to the construction and operation of the German motorways. Several new projects for the extension of motorways are planned as PPP projects. This may well be an indication of a more active PPP market in Germany following some years with fewer PPP projects. The term PPP is not a legal term and – at least in Germany – not conclusively defined. It involves forms of long-term cooperation between the government and a private company often relating to cost-intensive infrastructure projects.

The PPP discussion in Germany often focuses on projects involving cooperation in the construction, maintenance and/or operation of public roads and buildings (e.g., hospitals). Apart from these projects, public-private cooperation has other – practically important – forms. Many German cities have granted concessions to private partners for the refurbishment and operation of urban electricity grids. Moreover, out-of-home advertisers conclude long-term contracts with major German cities. They offer professional advertisement services to the private sector, but also contribute to the investment in and maintenance of the cities' infrastructure. The German toll collection system for the use of the motorways by heavy-duty vehicles was designed, built and is operated by a joint venture of private sector companies. The agreements require substantial investments from the private sector companies and include cooperation obligations. Further, public authorities and the private sector established institutionalised PPPs in the form of joint ventures, *inter alia*, for the operation of airports (e.g., the international airports in Frankfurt, Düsseldorf and Hamburg). These complex and diverse projects should be taken into account to better understand the potential for public-private cooperations in Germany.

## II THE YEAR IN REVIEW

In October 2016, the federal government proposed a reform of the motorway administration,<sup>2</sup> which could lead to more PPP motorway projects. While the motorways are the property of the Federal Republic of Germany, the federal states are responsible for the administration of

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2 Legislative proposal of the federal government to change the Constitution (Article 90 et al. of the German Federal Constitution), Bundesrat document dated 15 December 2016, No. 769/16.

the motorways. In the past few years, there have been disputes between the federal government and state governments about the use of PPP structures for motorway projects.<sup>3</sup> The federal government proposed a reform of the constitutional provisions applicable to motorways, allowing for a centralisation of the administration at the federal level. The proposal would allow the federal government to establish a private-law entity for the administration of the motorways which could decide – subject to the federal government’s consent – to use PPP structures for financing of motorway projects. In 2015, the federal government initiated a programme for a new generation of PPP projects for 600 kilometres of motorway with a total investment amount of €14 billion: €7 billion for the construction and €7 billion for maintenance and operation. The government published a list of 10 projects for which it reviews the procurement option PPP.<sup>4</sup> In February 2016, the works for the construction of a new section of Motorway 94 between Pastetten and Heldenstein started under a PPP project. The federal government is obliged under the agreements to contribute up to approximately €1.1 billion.<sup>5</sup> In October 2016, a consortium was awarded a PPP contract for the extension of Motorway 6 by 47.2 kilometres with a project volume of approximately €1.3 billion.<sup>6</sup> In 2016, the state government of Bavaria further initiated a public procurement procedure for the construction of a new section of Motorway 3.<sup>7</sup>

In 2016, the federal government initiated a public procurement procedure for the operation of the toll collection system for vehicles on all federal roads. The government envisaged using a call option on the shares in the current project company. The public tender provides for the acquisition of the shares in the project company by a private investor together with a new contract for the operation of the toll collection system for heavy-duty and light-duty vehicles from 1 September 2018 for a duration of 10 to 15 years.<sup>8</sup>

PPP structures are also used for the construction and operation of public buildings, such as hospitals, schools, administrative buildings, sports facilities and prisons. These types of projects had a total volume of (only) approximately €94 million in 2016.<sup>9</sup> However, the volume may increase in the coming years. The federal government in 2009 proposed an amendment to the Constitution according to which the federal government and the federal states may no longer finance costs with new debt (the so-called ‘debt brake’).<sup>10</sup> The debt brake restricts the possibility of the federal government to take out new loans exceeding a total amount of 0.35 per cent of the gross domestic product. According to the Federal Ministry of Finance, PPP projects are partially exempt for the purposes of calculating the debt brake

3 Most notably, the federal government issued a formal instruction to the government of Lower Saxony in 2013 to use a PPP structure for the extension of Motorway 7 between Salzgitter and Goettingen. Although the state finally accepted the instruction, the case shows that the multilayered administration may lead to project delays. See [www.mw.niedersachsen.de/aktuelles/presseinformationen/rechtsgutachten-zu-oepp-a-7-liegt-vor--weisung-trotz-kritik-des-bundesrechnungshofes-rechtlich-unangreifbar--118125.html](http://www.mw.niedersachsen.de/aktuelles/presseinformationen/rechtsgutachten-zu-oepp-a-7-liegt-vor--weisung-trotz-kritik-des-bundesrechnungshofes-rechtlich-unangreifbar--118125.html).

4 [www.bundesfinanzministerium.de/Content/DE/Pressemitteilungen/Finanzpolitik/2015/04/2015-04-30-PM17.html](http://www.bundesfinanzministerium.de/Content/DE/Pressemitteilungen/Finanzpolitik/2015/04/2015-04-30-PM17.html).

5 [www.sueddeutsche.de/muenchen/ausbau-der-a-startschuss-fuer-bau-der-isentalautobahn-1.2850110](http://www.sueddeutsche.de/muenchen/ausbau-der-a-startschuss-fuer-bau-der-isentalautobahn-1.2850110).

6 [www.johann-bunte.de/oepp-via6west-konsortium-mit-bunte-erhaelt-zuschlag-fuer-bab-a6-in-baden-wuerttemberg/](http://www.johann-bunte.de/oepp-via6west-konsortium-mit-bunte-erhaelt-zuschlag-fuer-bab-a6-in-baden-wuerttemberg/).

7 [www.bmvi.de/SharedDocs/DE/Pressemitteilungen/2016/164-dobrindt-vergabestart-oepp-a3.html](http://www.bmvi.de/SharedDocs/DE/Pressemitteilungen/2016/164-dobrindt-vergabestart-oepp-a3.html).

8 [www.bmvi.de/SharedDocs/DE/Anlage/VerkehrUndMobilitaet/Strasse/lkw-maut-informationsveranstaltung-toll-collect.pdf?\\_\\_blob=publicationFile](http://www.bmvi.de/SharedDocs/DE/Anlage/VerkehrUndMobilitaet/Strasse/lkw-maut-informationsveranstaltung-toll-collect.pdf?__blob=publicationFile).

9 [www.pd-g.de/fileadmin/Daten/OEPP-Markt/OEPP-Marktzahlen/161231\\_OEPP-Projekte\\_mit\\_Vertragsabschluss\\_\\_im\\_Hoch-\\_und\\_Strassenbau\\_Investitionsvolumen\\_getrennt.gif](http://www.pd-g.de/fileadmin/Daten/OEPP-Markt/OEPP-Marktzahlen/161231_OEPP-Projekte_mit_Vertragsabschluss__im_Hoch-_und_Strassenbau_Investitionsvolumen_getrennt.gif).

10 See Federal Ministry of Finance, *Kompodium zur Schuldenbremse des Bundes*, March 2015.

and have to be considered in the calculation only in the amount of the actual payment (comparable to other lease agreements).<sup>11</sup> In contrast, infrastructure expenditures and loans for infrastructure expenditures have to be considered in the full amount as of the time of investment. It seems likely that this partial exemption will be an incentive for financing public infrastructure projects by the states through PPP.<sup>12</sup> The actual limitation under these provisions has become binding for the federal government as of 2016.<sup>13</sup> The provisions on the debt brake will become effective also for the federal states as of 2020. In 2016, another major change led to modifications of the legal framework for PPP projects (see Section IV, *infra*).

### III GENERAL FRAMEWORK

#### i Types of public-private partnership

PPP projects may be structured in very different manners in Germany. In practice, for the construction of public buildings (e.g., hospitals, schools or administrative buildings) the public authorities in most cases want to (continue to) hold the property rights in the real estate and only transfer the right to build and operate/manage a building used for public purposes to a private investor.<sup>14</sup> From a legal perspective, it is also possible that the private investor acquires title to the real estate and either has an obligation to re-transfer the real estate to the public authority<sup>15</sup> or remains the owner at the end of the fixed term.<sup>16</sup>

Public authorities may also award concessions to a private investor. The main difference between a public contract and a concession is the type of consideration granted to the contractor.<sup>17</sup> While the contractor under a public contract usually gets a remuneration, a concession holder obtains a right to use or market the provided service or good (e.g., market the service to third parties). These types of contracts are predominant, for example, for the transfer and operation of electricity and gas grids in municipalities and cities (see Section 46(2) German Energy Act) with approximately 20,000 such agreements in Germany.<sup>18</sup> The concession holder obtains the right to market the capacity of the electricity or gas grid to

11 See Federal Ministry of Finance, *Kompendium zur Schuldenbremse des Bundes*, March 2015, p. 21.

12 Political figures tend to argue in this direction. See, e.g., Finance Minister of Lower Saxony, [www.presseportal.de/pm/58964/3449518](http://www.presseportal.de/pm/58964/3449518). In addition, some states have introduced debt brake provisions for their municipalities.

13 See Article 143d (1)(7) Federal Constitution.

14 This model is known, generally, as a build–transfer–operate model. In many cases, the public authority will already be the owner of the real estate and does not require the private investor to acquire title. See Jacob/Kochendörfer/Drygalski/Hilbig, ‘Ten years of PPP in Germany’, *Management, Procurement and Law* Volume 167, p. 180 et seq.

15 Such a build–operate–transfer contract would include a payment for a term sufficiently long for the investor to amortise its investment plus any profit and risk adjustment. See Jacob/Kochendörfer/Drygalski/Hilbig as indicated above.

16 This model – known in Anglo-Saxon practice as build–operate–own – is discussed in Germany as two different types. The difference mainly relates to whether the public authority has an option to acquire the real estate at the end of the term for a fixed price or not. See Jacob/Kochendörfer/Drygalski/Hilbig as indicated above.

17 ECJ, judgment of 10 March 2011, *Rettungsdienste Stadler*, C-274/09, ECLI:EU:C:2011:130, para. 24; ECJ, judgment of 10 September 2009, *Eurawasser*, C-206/08, ECLI:EU:C:2009:540.

18 See Common Guideline of the Federal Cartel Office and Federal Network Agency for the procurement of electricity and gas concessions and to the change of the concession holder in such agreements dated 21 May 2015, p. 2.

third parties (i.e., to electricity/gas providers)<sup>19</sup> for a maximum period of 20 years. Although in recent years some municipalities/cities have shown a tendency to establish or mandate a public entity to operate the electricity and gas grid (re-municipalisation), the law provides that municipalities may not award concessions in-house without a public procurement procedure (see Section 46(4) German Energy Act).<sup>20</sup> Therefore, private sector parties can participate and – with a good offer – be awarded such concessions in a public tender.

In addition, the public authorities may establish joint ventures with private partners (sometimes this is called institutional PPP),<sup>21</sup> for example, in the corporate structure of a limited liability company or a public limited company. Such entities may be used, for example, in the areas of waste management, water supply services and sewage treatment. Public law restrictions generally require that the public authority holds a majority of voting rights in the joint venture. The shareholders' agreement will also include additional safeguards for ensuring the fulfilment of public tasks. This may include a restriction of the statutory purpose of the company to fulfil the public task, obligations to fund the legal entity and options for the public authority to call shares under certain circumstances. Alternatively, a public law structure – institution under public law – has been used for such public-private joint ventures (e.g., previously for the operator of Berlin's water supply system, Berliner Wasserbetriebe). This requires an act of parliament which explicitly allows the participation of a private investor.

## ii The authorities

The 16 federal states in Germany have considerable political competences. For certain tasks – such as military, motorways, federal waterways and rail infrastructure – the federal government has (some) administrative competences. On the federal level, the Federal Republic of Germany often is the contract partner, represented by the ministry in charge of the relevant task (e.g., the Ministry of Transport and Digital Infrastructure, the Ministry of Defence or the Ministry of Finance) or by a subordinated federal authority. Other public tasks and much of the infrastructure is administered by the federal states – such as state roads, universities, schools and prisons. On the state level, the state may be the contracting authority, represented by the state ministries or subordinated state authorities. In addition, projects may also be administered on the municipal or county level. This applies, *inter alia*, to hospitals, schools, local and regional transport by bus and train, electricity and water supply. The contracting authorities on the municipal level are the municipality/city or its entities. In case of regional tasks (e.g., hospitals) the contracting authority may be the county. Municipalities may also form special purpose entities fulfilling certain public tasks, in particular in relation to regional traffic, water supply and waste management.

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19 For the energy sector there are provisions on the unbundling of operator of the network and the provider of electricity and gas.

20 The Federal Court of Justice, judgment of 17 December 2013, Case: KZR 65/12, has confirmed this understanding and has obliged municipalities to award concessions in a transparent and non-discriminatory procurement procedure even if they intend to award the concession to an entity under public law fully controlled by the municipality.

21 Cruz/Marquez, *Infrastructure Public Private Partnerships*, 2013, p. 4.

### iii General requirements for PPP contracts

In Germany, there is no specific act on PPP projects or contracts. The civil law framework and regulatory requirements apply to PPP projects (e.g., laws on taxes, social security, minimum wage, trade unions as well as health and safety). More specific requirements can derive from budgetary provisions, public procurement law and provisions on specific sectors such as the energy sector.

Prior to using a specific procurement structure such as PPP, the government – under budgetary requirements – has to conduct a cost-benefit analysis on different procurement possibilities (see Section 7(2) Federal Budget Act). State legislation contains similar requirements for the states' and municipalities' decisions. Such analysis shall also take into consideration the risks of different structuring possibilities and, in particular, the possibility to involve the private sector for the fulfilment of the task or service. For PPP projects, permits or consents may be required under the budgetary provisions. In particular, the consent of the Ministry of Finance or – for municipalities – the supervisory authority may be necessary for contracts under which the public authority grants a guarantee, takes a loan or enters into an agreement similar to a loan. In addition, approval of the federal/state parliament or the municipal council may be necessary for costs in the budget.<sup>22</sup>

A specific public law entrustment is necessary if the private partner will be authorised to take authoritative decisions vis-à-vis third parties. Such an entrustment may only be granted in or based on an act of parliament.<sup>23</sup> For example, the operator of the German toll collection system has been publicly entrusted with certain tasks in connection with the levying of tolls for the use of motorways by heavy-duty vehicles (see Section 8(2) Act on Levying Tolls on Federal Motorways). However, in most PPP projects the private partner acts only as an administrative assistant and the transfer of such tasks generally does not qualify as a public entrustment. Some limited tasks may not be subject to PPP projects under German law, for example tasks that (regularly) require the use of direct force.<sup>24</sup> The details are controversial and have been discussed, for example, in connection with PPP projects concerning prisons.<sup>25</sup>

## IV BIDDING AND AWARD PROCEDURE

The legal framework for public procurement within the European Union is harmonised for public contracts (including supply, works and services contracts) and concessions that exceed certain EU harmonised thresholds. The relevant EU provisions were reformed in 2014<sup>26</sup> and Germany has implemented these provisions as of 24 April 2016, thus these provisions are relatively recent. The main provisions under German law are implemented in Section 97 et seq. of the Act against Restraints of Competition (GWB). In addition, there are implementing

22 See for the limits of the emergency competencies of the Minister of Finance for permitting expenses:

Constitutional Court of the State of Baden-Wuerttemberg, judgment of 6 October 2011, Case: GR 2/11.

23 Federal Constitutional Court, judgment of 18 January 2012, Case: 2 BvR 133/10. This case related to the transfer of powers for the operation of a facility for the treatment of persons not legally responsible for their criminal acts due to a psychiatric condition.

24 Maunz/Dürig, *GG*, 78. Ergänzungslieferung, 2016, Art. 86 Rn. 119; Burgi, *Funktionale Privatisierung und Verwaltungshilfe*, 1999, p. 209 et seq.

25 Wagner, *Zeitschrift für Rechtspolitik*, 2000, p. 169; Mühlenkamp, *Die Öffentliche Verwaltung*, 2008, p. 525.

26 See Directive 2014/23/EU of 26 February 2014 on the Award of Concessions, Official Journal L 94, 28 March 2014, pp. 1–64; Directive 2014/24/EU of 26 February 2014 on Public Procurement, Official Journal L 94, 28 March 2014, pp. 65–242.

regulations, such as the Public Procurement Regulation, the Concessions Regulation, the Regulation on Procurement in the Sectors of Transportation, Water and Energy Supply and the Regulation on the Procurement in the Sector of National Defence and Security.<sup>27</sup>

### **i Requests for participation**

The contracting authority has to publish a contract notice in the Supplement of the Official Journal of the European Union if the value of a public contract exceeds certain thresholds.<sup>28</sup> The standard format of a contract notice allows, *inter alia*, for information on the type of the contract, its value, the criteria for the selection of the tenderer and the award criteria. The public authority has to review whether the applicants fulfil the selection criteria as defined by the public authority. The selection criteria relate to certain grounds of exclusion, for example, the commission of certain defined criminal acts by the directors or the initiation of insolvency proceedings by the bidder. In addition, the contracting authority may use selection criteria that relate to the economic and financial standing of the bidder (e.g., minimum requirements for the annual turnover or minimum insurance requirements) and criteria that relate to the technical and professional conditions (e.g., references, licences necessary for the business or a sufficient number of suitable employees in order to execute the contract).

### **ii Requests for proposals**

The contracting authority further defines the requirements for the proposals in the tender documents and invitation to tender. This may include requirements on works or service specifications, prices and additional information on the quality of services or works. Generally, the public authority will provide a rather extensive list of requirements for the bid.

### **iii Evaluation and award**

The selection of the successful tender has to be based on the evaluation criteria as provided by the public authority in the tender documents. Permissible criteria are price only or a mix of price and quality criteria, possibly also environmental and/or social criteria. In most PPP projects the public authority will use a mix of criteria and assess the tender taking into account these criteria.

After the selection of the successful bidder the contracting authority has to notify the other tenderers of the envisaged award decision (see Section 134(1) GWB). The public authority may conclude the contract with the successful tenderer after the expiry of 10 to 15 days since submission of the notification – depending on the form used for the notification – unless a competitor has filed a complaint against the award with the competent procurement chamber. The procurement chamber for federal cases is the procurement chamber at the Federal Cartel Office in Bonn. The procurement chamber's decision can be appealed at the competent Higher Regional Court. The Higher Regional Court in Düsseldorf is competent for appeals in federal cases.

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27 See Bonhage, in: Meyer-Sparenberg/Jäckle: *Beck'sches M&A Handbuch*, 2017, Section 83 Vergaberecht, on the legal framework in Germany.

28 The value threshold depends on the type of contract. As of 1 January 2016 the threshold for works contracts is €5.225 million and for service contracts €13,000 or €209,000 depending on the type of contracting authority. See Commission Delegated Regulation (EU) 2015/2170 of 24 November 2015. Similar provisions exist for other types of contracts. Below the threshold, certain – limited – procurement obligations may apply.

## V THE CONTRACT

### i Payment

The scope of payment depends on the individual contract type. In PPP projects relating to the construction of a building, the payment may include components of the planning, construction, financing, operation stages and in some cases the transfer of real estate. The public authority will in these cases make regular payments to the private partner for the contract term. The contract, generally, splits up the payments with regard to the individual components. The agreements may contain provisions on inflation adjustments as common also for other long-term service agreements.

With regard to the construction or enlargement of motorways, the public authorities use different types of contracts. Some contracts – such as the recently started contract for Motorway 94 – include a monthly payment by the government to the consortium. The public authority may reduce the payment if the motorway's use is limited, for example, if a motorway lane is blocked for construction or if a speed limitation is necessary due to the (bad) quality of the road (availability model). Other motorway PPP contracts include a payment that is linked to the toll paid for the relevant section of the motorway. In Germany, heavy-duty vehicles have to pay a toll based on the number of motorway sections they use. Under this type of contract, the private investor obtains a claim against the public authority in the amount of the heavy-duty vehicle toll paid for the relevant section by the users (extension model).<sup>29</sup>

### ii State guarantees

The government often uses state guarantees and state grants to assist private investors to secure financing (e.g., in the case of motorway projects the government will often provide state financing for parts of the project). With regard to municipal projects for the construction of buildings for public use, the private partner may apply for loans from public banks, such as the Kreditanstalt für Wiederaufbau or the European Investment Bank. The private partner may also apply for state grants (e.g., under programmes to finance hospitals). It is also possible for the public authority or the state to grant guarantees for the bank loans. Such guarantees require a specific permit or consent from the Ministry of Finance or a municipal supervisory authority. State guarantees and state grants are subject to strict European requirements on state aid. In particular, large-scale public funding may trigger an obligation of the public entity to notify the funding to the European Commission.

### iii Distribution of risk

Major risks for PPP projects relate to the planning stage, the construction stage, and specifically delays in construction, the operation stage and the subsequent use of the asset.<sup>30</sup> With regard to the risk of construction (e.g., obtaining a permit, usability of the real property, delays, etc.), under German law – as a general rule – the risk is allocated to the party from which sphere it originates. If a property provided by the public authority cannot be used for the project because of (severe) environmental damages, the risk is, under German law,

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29 In addition, the government offers a third type of contract that gives the private investor the right to levy an (individual) toll for the use of the relevant road (F-Model). This model has been used for very few bridge and tunnel projects. To date, these projects have been regarded as less successful.

30 Lorson/Haustein/Albrecht/Perlick, *Der Betrieb*, 2015, pp. 2705, 2711.



generally allocated to the public authority (see Section 645 German Civil Code (BGB)). In contrast, if the architect's plan that has been commissioned by the private partner is incorrect and not appropriate for use, this risk is, under German law, generally allocated to the private partner.

The parties may deviate from these general provisions in the contract. With regard to the construction of motorways, the main difference between the models used for PPP relates to the allocation of risks for the use of the motorway (by heavy-duty vehicles). Whereas the private partner has the risk that the motorway is not used (sufficiently) in contracts that base the payments on the amount of toll incurred for the section (i.e., under the extension model), the public authority takes this risk with regard to the model that bases the payment on the availability of the relevant section (i.e., under the availability model; see subsection i, *supra*). Similarly in the case of the award of concessions, in which the private partner obtains a right to market its services to third parties (e.g., use public space for advertisement or levy a fee for the use of a parking deck in the city centre), the private partner assumes the risk that the facility is used sufficiently. In some of these cases, such as awarded electricity or gas concessions, these risks are reduced because the grid constitutes a natural monopoly for the private partner on the relevant services.

#### **iv Adjustment and revision**

Under public procurement law, the adjustment and modification of PPP contracts may require a new public procurement procedure if they materially change the contract (see Section 132 GWB). An adjustment or modification qualifies as material if it changes material provisions of the agreement and the amendment shows the intent of the parties to renegotiate the agreement. Further specific provisions regulate the exchange of the contractor, a change in pricing, a modification of the contract term and of the scope of works or services.

#### **v Ownership of underlying assets**

In most cases discussed in this section, the government would generally retain the private property. However, if the project encompasses a transfer of real estate, such an agreement has to be notarised (see Section 311b(1)(1) BGB). The actual transfer of ownership has to be registered in the private real estate register (see Section 873(1) BGB) In addition, the sale of real property by the public authority may require a permit from the Ministry of Finance or a supervisory authority.

#### **vi Early termination**

The term of PPP contracts may reflect the amortisation period of the project, which in major infrastructure projects is often 20 to 30 years. Fixing the term under German law means that a termination without reason is excluded, unless the agreement contains an explicit right to terminate the agreement. From a procurement law perspective, it is helpful to include options for the prolongation of the agreement. PPP contracts usually contain additional termination rights for the contracting authority, most commonly for a material delay of the project, the non-compliance with material requirements for construction or financing, bankruptcy and cases of non-compliance with the law (e.g., corruption or antitrust violations).

## VI FINANCE

PPP projects are often financed from mixed sources, including private and public funding. There are possibilities for state financing in programmes for specific sectors (see Section V.ii, *supra*). Most PPP projects are at least partially funded by bank loans. In many cases the public authority will have a better credit rating than the private investor. To ensure the lowest interest rate possible, the private investor will have the right to sell its claims against the public authority to the banks in order to finance the project. The public authority will waive its rights to certain or all objections against the payment claim (forfeiting with objection waiver).<sup>31</sup>

With regard to motorway PPP projects that require a significant investment, generally, a mix of different instruments is used. The federal government finances part of the construction costs as advance payment. The rest of the investment amount has to be financed by equity and bank loans. The loans for these projects are provided by consortiums of banks which may include private and public banks. The loan agreements between the project company and the consortium address the main risks for the bank consortium.<sup>32</sup> During the construction phase, the main risk for the bank consortium is that the project is not realised. Therefore, the loan agreement may include partial loan instalments pursuant to a milestone plan. The bank consortium will also require a sufficient equity ratio to be provided by the sponsors and may require the sponsors to make additional contributions in case of changes to the project plan or cost structure. In addition, the bank consortium will require that the construction agreement contains sufficiently strict contractual penalties for the contractor to ensure that the project is realised on time.

## VII RECENT DECISIONS

During past years several municipalities planned to transfer concessions for the operation of electricity and gas grids ‘in-house’ to wholly-owned and controlled subsidiaries. In two landmark decisions on the award of concessions for electricity and gas grids, the Federal Court of Justice ruled that if a municipality awards a concession, this must be done in a non-discriminatory way and the municipality is prohibited from preferring its own municipal utility without objective reasons.<sup>33</sup>

With regard to certain types of PPPs, courts hold that the private sector company may, itself, due to the influence of the state, qualify as a public authority. The Higher Regional Court in Düsseldorf held that even if the state does not hold any shares in a PPP joint venture, the contractual relationships can allow the government to have a dominant influence on the company.<sup>34</sup>

## VIII OUTLOOK

After a considerable period of less activity in the PPP market, 2016 saw some high-level projects, in particular with regard to the construction of motorways. The Federal Ministry of

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31 Lorson/Haustein/Albrecht/Perlick, *Der Betrieb*, 2015, pp. 2705, 2707.

32 Baums, *Recht der Unternehmensfinanzierung*, 2017, Section 67 para. 10 et seq.

33 Federal Court of Justice, judgment of 17 December 2013, Cases: KZR 65/12 and KZR 66/12.

34 Higher Regional Court Düsseldorf, decision of 19 June 2013, Case: VII – Verg 55/12.

Transport and Digital Infrastructure initiated a programme introducing a new generation of motorway PPP projects in 2015, which indicates a potential increase of projects in the next few years. In addition, the effects of the so-called constitutional debt brake, which obliges the federal government and – as of 2020 – also the state governments to propose balanced budgets, may also increase the number of PPP projects. PPP projects under the current budgetary framework are privileged and may help to fund important infrastructure projects.

# INDIA

*Sunil Seth and Vasanth Rajasekaran*<sup>1</sup>

## I OVERVIEW

Infrastructure is the fundamental branch that plays a dominant role in the overall development and economical sustainability of a developing nation. India, as a developing nation in recent years, has shown a remarkable and promising growth both in terms of viable development and economic sustainability. However, a major cause of concern for a steady economic progression throughout has been the lack of proper implementation channels and clean procurement routes. To address such shortcomings, while dealing with fiscal constraints, it was imperative for the Indian government (GOI) to attempt to induce investment through public-private partnerships (PPP). The need for private investment to bolster the economy has been persistently felt since the 1991 economic reforms, and consequently the GOI has also been taking various progressive steps to entice and induce private investment.

India enjoys a federal structure, with the Constitution of India being the *suprema lex*. The Constitution enshrines the principle of division of powers among the union government (central government) and the state legislature (state or local government).

The GOI has actively notified various guidelines, policy frameworks and an appraisal and approval committee to ensure adequate commitment towards infrastructure PPP projects:

- a* setting up of the PPP Appraisal Committee (PPPAC) to streamline the project appraisal process, and to eliminate administrative hurdles;
- b* setting up of India Infrastructure Project Development Fund (IIPDF) for extending financial assistance in infrastructure PPP projects;
- c* formulation of viability gap funding (VGF) scheme for making the infrastructure projects commercially viable;
- d* setting up institutions such as Infrastructure Finance Company Limited for providing long-term financial support and to act as a catalyst in the stream; and
- e* standardising bidding and contractual documents such as request for qualification (RFQ), request for proposal (RFP), model concession agreements (MCA) for making the procurement process swift.

Presently, as per the 12th Financial Plan (2012–2017) investments worth US\$1 trillion are estimated in the infrastructure sector, which is more than double the investments as projected during the Eleventh Financial Plan. The private sector is expected to contribute at least half of the over US\$1 trillion investment planned in infrastructure, thereby creating an immediate need to conceptualise a robust framework to tap such resources.

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The major sectors that have contributed towards the PPP mode of infrastructure development comprise the transport sector, including roads and highways, ports, airports, railways; and urban public transport under which 90 per cent of the PPP projects are envisaged. Other sectors successful in tapping private investment are the energy sector including renewable energy, electricity transmission, electricity generation; the social and commercial sector including education, healthcare and tourism; and the water supply sector including sewage treatment, water treatment plants and water pipelines.

## **II THE YEAR IN REVIEW**

The GOI has also launched its innovative mission of developing ‘Smart Cities’ across India aimed at providing state-of-the-art infrastructure facilities. A total of 100 Smart Cities are expected to be developed through the PPP model. A huge push on various sectors including railways, inland waterways, 24/7 water supply, wastewater treatment, affordable housing and urban development projects coupled with Smart City projects can be seen as one of the biggest infrastructure initiatives, requiring huge fiscal amounts and private participation which can lead to effective and efficient PPP policies when properly implemented.

## **III GENERAL FRAMEWORK**

### **i Types of public-private partnership**

There are various PPP structures and engagement models prevalent in India including Build-Operate-Transfer Model (BOT) categorised into the BOT Annuity Model and BOT Toll Model (which is most commonly used in the road and transport sector and railway sector), the power sector is more inclined towards Build-Own-Operate-Model (BOO).

Apart from the existing common mode of procurement like management contracts/performance based contract and energy procurement contracts, other known models are build-operate-lease-transfer model (BOLT), design-built-finance-operate transfer model (DBFOT) and build-operate-own-transfer model (BOOT).

### **ii The authorities**

The GOI, along with the DEA and MoF, is involved in the structuring and support of PPP projects across India. At the central level, the PPPAC has been constituted under the services of DEA, which is responsible for approval, appraisal and streamlining the PPP process.

The DEA has also conceptualised and institutionalised a PPP Cell which is responsible for all the matters concerning PPP's including policy, schemes and other programmes. The PPP Cell exercises over all central-level PPP projects including clearances of proposals with PPPAC, proposals related to VGF funding and IIPDF, managing training programmes, developing support mechanisms for facilitating PPP, extending support to state and local governments.

Also at the state level PPP cells have been constituted that work in collaboration with the GOI to attract lucrative PPP projects and to successfully design and implement them.

Generally, the PPP projects are sponsored and identified by concerned central government ministry (e.g., Ministry of Civil Aviation, Ministry of Shipping, Ministry of Railways) or central public sector undertakings and the proposal is then submitted before the PPPAC for clearance. Subject to the approval of the PPPAC, an expression of interest (EOI) may be issued in the form of an RFQ followed by an RFP.

### **iii General requirements for PPP contracts**

The requirements for each PPP contract fundamentally originate from their nodal PPP project and its constituting documents. For example, EOI or RFQ documents at preliminary stage of a project and RFP at latter stage. Each PPP project comes with distinct requirements, aligned in accordance with the concerned sector and proposed operating model of PPP. These documents clearly specify details about the proposed project, general and specific requirements for qualification, evaluation criteria for meeting technical and financial requirements by the proposing entity, restrictions applicable and set standards to be achieved under the project.

In case of existing 'conflict of interest', a proposing entity finds itself in a situation to materially affect fair competition or diligent performance of the procurement contract or framework agreement or is prejudicial to the interests of the procuring entity then such entity is required to be excluded by the procuring entity, to ensure transparency and competitiveness in the procurement process.

The general rule prescribed by courts as part of the administrative law of India is that any person having a conflict of interest will not be part of the bid evaluation or award process.

## **IV BIDDING AND AWARD PROCEDURE**

The GOI has formulated various guidelines, schemes and standardised model documents for all the interested ministries, state governments and private players who are intending to venture in PPP projects. These guidelines, being broad and generic, are aimed to ensure competitiveness and provide transparency in the bidding process. The model standard document outlines essentials elements relating to the scope of bidders, eligibility and clarifications on the bidding process involved in PPP projects.

For PPPs in India a two-stage bidding process is generally followed wherein two separate bids, a technical bid and a financial bid, are invited from the bidders. The first stage incorporates a selection of eligible and prospective bidders and is the RFQ or EOI. The second stage, which involves the financial evaluation of bidders, is referred to as an RFP. The bidders are first shortlisted on the basis of the technical bid, and a financial bid of only successful technical bidders is taken into consideration for final selection.

### **i Expression of interest**

In order to emphasise and abide by 'equal opportunity' and 'equitable treatment' for all prospective bidders, considerable significance is given to publishing the pre-qualification document, bidder registration document or bidding document, as the case may be, with a detailed description of the subject matter of procurement.

The procuring entity must elucidate the subject matter of the procurement, the method of procurement that it seeks to follow along with any criteria of pre-qualification as well as any restrictions on bidders that it intends to place before executing a framework agreement or initiating the procurement process.

The objective at EOI stage is to identify experienced bidders who have the requisite technical and financial capacity for undertaking the project.

The prospective bidders at the EOI stage are shortlisted for next stage of bidding process.

## **ii Request for proposal and unsolicited proposals**

At the RFP stage, the pre-qualified bidders are required to submit their financial offers. Only those bidders that have been shortlisted under the EOI or at RFQ stage are required to present their financial bid.

The bidders usually engage in comprehensive scrutiny of the project, including a careful assessment of the capital and operational costs of implementing the project and also the likely revenue streams over the concession period.

Potential risks and assessment analysis in the construction and operation of the project is also conducted.

## **iii Evaluation and grant**

The criteria for evaluation and comparison for bid proposals would be dependent on the specifications prescribed by the procuring entity in its bid documents.

For the purpose of evaluating the technical capacity of a bidder, its experience and track record in building infrastructure projects should be considered. This can be measured either from the construction work undertaken or commissioned by him or her, or from revenues of PPP projects, or from both, during a predetermined number of years preceding the date of application.

The technical capacity of a bidder can be determined on the following parameters:

- a* project experience on PPP projects in the specified sector;
- b* project experience on PPP projects in the core sector;
- c* construction experience in the specified sector; and
- d* construction experience in the core sector.

As per the standardised model RFQ, the bid may be evaluated on the criteria of 'grant' or 'premium' as per the situation. For the purpose of grant, the bidder offering the lowest financial bid based on grant may be enlisted for the next phase of bidding.

Further, in case a 'premium' is offered by the bidder, the adopted procedure would be to select the bidder offering the highest premium based on a revenue-sharing and upfront payment mechanism.

Generally, the financial proposals would be evaluated on the basis of the methods identified above, as applicable, given the nature of the bid process.

In any case, the procuring entity is not bound to accept the bid of the highest evaluated bidder and can select other bidders, subject to the procuring entity being able to demonstrate that the selection process was duly undertaken on a reasonable, fair, transparent and non-arbitrary basis.

The procuring entities may even reject bids that are extremely low or whose financial terms are extremely prejudicial to the bidder.

## **V THE CONTRACT**

### **i Payment**

The payment terms and type of remuneration guaranteed to the private players in a PPP contract is largely co-dependent upon the type of model contract executed between the concerned ministry and private entity (e.g., BOT, BOOT, BOLT BOT (Toll), BFOT, etc.). Sometimes the GOI may choose to pay the private entity directly for services rendered (or some part thereof). For example, in the case of road construction PPPs, instead of asking the

private entity to rely solely on tolls collected, the government may directly pay the private entity a lump-sum amount on a yearly basis (also called an annuity payment). Such type of payment shall be periodic in nature and might extend through the entire concession period.

Sometimes the payment terms are performance based (i.e., the payment is made to the extent the private entity provides services to a specific performance standard). Such type of structure in payment terms is also followed in management contracts or performance-based contracts wherein the private entity is paid a fee step by step for completion of specific responsibilities as detailed in the executed contract.

## **ii State guarantees**

A PPP project would only be deemed successful if it receives active assistance from the both ends. Central/state government's involvement in any manner is a requisite to achieve completion of the PPP project.

The Model Concession Agreements issued by the GOI on National Highways relating to PPPs also provide certain central/state relaxations in the form of extended support and guarantees. These include comfort to the lenders, loan assistance to meet financial obligations in case of political force majeure, support in land acquisition hurdles, environmental clearances.

The enactment of a VGF scheme is also a crucial factor, since the scheme can allow the private entity to receive as much as 20 per cent of the total project cost as upfront grant assistance.

## **iii Distribution of risk**

Various kinds of risks are involved in a PPP project, considering its vast 'initiation, operation and completion' tenure. These risks may broadly include corruption, construction or completion risk, revenue risk, operation risk, financial risk, environmental risk, land acquisition risk and force majeure risk.

In its report the Kelkar Committee has also acknowledged the risk factors involved in a PPP project and its inefficient allocation and mitigation.

Certain guidelines as set out in the report to mitigate and allocate the risk are as follows:

- a* an entity should bear the risk that is in its normal course of its business (for instance, acquisition of land is a normal course of business for public entities);
- b* an assessment needs to be carried out regarding the relative ease and efficiency of managing the risk by the entity concerned;
- c* the cost effectiveness of managing the risk needs to be evaluated;
- d* sophisticated modelling techniques are prevalent to assess probabilities of risks and the need to make provision for them; and
- e* need for *ex ante* provisioning of a renegotiation framework in the bid documents (concession agreement).

## **iv Adjustment and revision**

Given their long-term nature, PPP contracts differ from the contracts entered between two parties in the normal course of a transaction in various ways. Such a long-term commitment makes it impossible for a PPP contract to incorporate all such solutions and outcomes from unforeseen circumstances that may happen during the life span of the project. These unforeseen circumstances may result in unfavourable conditions leading to impossibility of performing or executing the obligations under the contract. This develops a need among the



interested parties to renegotiate or amend the provisions of the contract in accordance with the time allotted and to avoid any risk or massive losses.

Presently, the standard MCAs do not consist of any clauses or reference of adjustment or revision of contract terms and conditions, although the Kelkar Committee report has also acknowledged the need for renegotiations and has given recommendations to the DEA as follows:

The benchmarks to be applied to each proposed renegotiation trigger may include:

- a* evidence that the project distress is material and likely to result in default under the concession agreement at some future point should it continue;
- b* evidence that it is not caused by the private party and likely to cause adverse outcomes for the government or users of the concession assets or both;
- c* evidence that a renegotiated concession agreement is likely to have direct cost implications for the government that are less than the financial outcomes of doing nothing;
- d* the fact it is likely to have social benefits or avoided costs that provide better long-term outcomes; and
- e* it is not materially different in terms of risk allocation to the GOI.

Presently, the DEA has established that model clauses on renegotiations are in the draft stage, and it will also include a scenario for triggering rebidding in the PPP contract.

#### **v Ownership and underlying assets**

The ownership of the underlying assets depends upon the type of PPP model chosen for completing the PPP project. Depending on the characteristic of the PPP model, the ownership would shift from private entity to public entity during the tenure of the PPP agreement.

#### **vi Early termination**

Early terminations of contract in a PPP project are majorly arise owing to force majeure, political force majeure, consistent defaults from public entity, termination as a result of default in services of private entity.

Certain model MCAs (for example, the MCA on national highways) issued by the GOI contain provisions to protect the private entities by ways of compensatory payments from arbitrary and discriminatory termination by the government in exceptional situations such as political force majeure and continuing default from a public entity.

## **VI FINANCE**

Large infrastructure projects supplemented through a PPP initiative are bound to face budget constraints during their long-term tenure. Strong financial support with quick and easy access is a must to ensure the smooth functioning of the project. The capital requirements in such projects can be available through various sources, such as raising funds through equity investors and securing financing by way of loans from national and international financial institutions (debt financing).

A special purpose vehicle (SPV) born under a PPP project can opt for recourse and non-recourse financing structures. In the case of a non-recourse financing structure (prevalent in BOT models), the collateral will be sought in the form of securing cash flows that will be generated from the project and project assets which are created.

The GOI has also taken initiatives to provide financial support to implement and fund PPP projects in India, mainly:

- a* setting up of India Infrastructure Finance Company Ltd, an SPV, to meet the long-term financing requirements of potential investors. It will provide financial assistance through long-term debt, lending up to 20 per cent of the capital cost of the project;
- b* provision of VGF to provide upfront capital grant extending up to 20 per cent of the project cost; and
- c* the Infrastructure Development Finance Company to develop and provide an environment for long-term debt financing.

The Kelkar Committee has also provided recommendations to ensure efficient streamlining of capital funds such as:

- a* MoF to allow banks and financial institutions to issue zero coupon bonds that will also help to achieve soft landing for user charges in infrastructure sector;
- b* RBI to issue guidelines to lenders on encashment of bank guarantees in line with ICC norms;
- c* a review of tax and duties and relaxations for PPP projects; and
- d* identification of viable revenue-generating projects.

The international financing of infrastructure could be in the form of greenfield FDI, ADRs, GDRs, asset securitisation, finance through SPV, etc. Infrastructure financing through the FDI route is another viable prospect. The GOI has relaxed the FDI norms to provide 100 per cent FDI through the automatic route, in sectors such as mining, power, airports, construction and development projects and in certain sectors such as civil aviation, existing airports and telecommunications.

## **VII RECENT DECISIONS**

The framework of PPP is still in a developmental and constant ramification's phase in India. There being no particular law related to PPP in India, no recent decision or judgments concerning PPP have seen the light.

However, there are various court rulings concerning breach of contractual obligations in various management contracts and in relation to causing prejudice in the tender process.

## **VIII OUTLOOK**

Keeping in mind the growing economy of India and robust trend in infrastructure development, PPP projects in India will be in great demand. The need for implementation of projects at a rapid pace and providing quality services to the general public will act as catalyst in bringing innovative PPP models and efficient policy decisions from the government.

# IRELAND

*Mary Dunne and Fergal Ruane*<sup>1</sup>

## I OVERVIEW

Public-private partnerships (PPPs) are the most widely used model of project finance in Ireland. The Irish government set up the National Development Finance Agency (NDFA) in 2003 to procure PPP projects as well as other infrastructure projects with a capital value in excess of €30 million, having first carried out several pilot projects in the schools and roads sectors and determined what model was most suitable for use in Ireland.

The NDFA procures PPP projects other than in the transport, local authority and water and wastewater sectors. Road and light rail projects are procured by Transport Infrastructure Ireland (TII). TII is the result of a statutory merger in 2015 of the National Roads Authority (NRA) and the Railway Procurement Agency. Heavy rail projects are procured by Iarnród Éireann. Local authority projects are carried out directly by local authorities. Water and wastewater projects are procured by Ervia, the parent company of Irish Water.

Project finance is also widely used in the energy sector, particularly on renewable energy projects such as wind farms. This is not the PPP model, but is a very typical structure where finance is secured by way of a power purchase agreement.

The most successful sectors in Ireland in terms of PPPs have been the roads and education sectors. There has been a rolling programme of motorway and school projects since the late 1990s.

## II THE YEAR IN REVIEW

Ireland went through a deep recession between 2008 and 2014 and saw the number of PPP transactions diminish very significantly during this period. Banks were not lending and the Irish government cut back its capital spending as part of the austerity package agreed with the International Monetary Fund and European Central Bank. Indeed, as part of the government's deficit-reduction programme of 2009–2013, a number of PPPs were no longer affordable and were stopped, including:

- a* the National Concert Hall;
- b* the Government Office Decentralisation Programme;
- c* the Third-Level Institutions PPP programme;
- d* Dublin's large-scale mass-transport projects; and
- e* Thornton Hall prison.

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However, Ireland has returned to growth and there has been an increase in the number of projects coming onto the market in the past 24 months as well as a corresponding increase in interest from international bidders. The PPP pipeline, however, is still very slow.

Projects recently procured or currently under procurement by the NDFA are as follows:

- a Schools PPP Bundle 5 consisting of five new schools and an institute of further education. The successful bidding consortium was Inspired Spaces and financial close occurred in July 2016.
- b DIT Campus at Grangegorman, a third-level education facility. The Eriugena consortium was appointed as the preferred bidder in March 2015. However, the procurement process was suspended while a public procurement legal challenge was heard in the Irish Commercial Court (see Section VII, *infra*). Financial close is expected to take place in Q1 2017.
- c The Primary Care Bundle PPP project consisting of 14 primary care centres. The successful bidder was the Prime-Balfour Beatty consortium. Financial Close occurred in May 2016.
- d The Courts Bundle PPP Project consisting of seven courthouses. The contract was awarded to the BAM PPP PGGM consortium in December 2015.
- e The Charlemont Street Social Housing PPP also reached financial close in December 2015. Alcove Properties will develop up to 162 new apartments as part of the scheme.

#### **i TII projects**

The N25 New Ross Bypass PPP Project was awarded to the BAM PGGM Iridium consortium and reached financial close on 26 January 2016 becoming the first Irish project to avail of the European Investment Bank's (EIB) project bond credit enhancement programme.

The Motorway Services Areas – Tranche 2 PPP project. Topaz Energy Group Limited was appointed as preferred Bidder in 2015. However, the procurement process has been challenged and is currently the subject of judicial review proceedings (see Section VII, *infra*).

While the government has made various ambitious announcements about infrastructure spend and PPPs, in particular in the past 24 months, there is only a light pipeline of projects, and following the wider geopolitical concerns caused by Brexit it is difficult to say with any certainty what projects may and may not come to the market in 2017 (See Section VIII, *infra*).

### **III GENERAL FRAMEWORK**

The NDFA developed the Template PPP Project Agreement in 2006 following extensive consultation with stakeholders in the private and public sectors. In addition, it published a User Guide, which has a clause-by-clause commentary on the Template Project Agreement. These are available on the NDFA's website.<sup>2</sup>

The Irish Template PPP Project Agreement is based largely on the UK PFI model adapted to suit the Irish landscape. In summary, the contracts tend to be 25-to-30-year design–build–finance–operate or design–build–finance–maintain contracts. In most cases, the authority retains ownership of the asset and grants the PPP company a licence to occupy

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<sup>2</sup> [www.ndfa.ie/Publications/stdDocumentation.htm](http://www.ndfa.ie/Publications/stdDocumentation.htm).

and operate the land and asset for the term of the project. At the end of this period the licence terminates at the same time as the project agreement, and the asset remains in the ownership of the authority.

The operation aspect of most accommodation PPP contracts in Ireland tends to be confined to 'soft services' such as catering, cleaning and maintenance. This has avoided any real resistance from unions in Ireland as employment-protection issues have been minimised.

In contrast, full operation and maintenance of motorway PPP projects has been successfully included in the PPP contracts that have been entered into by the NRA (now TII).

The earlier motorway PPP projects in Ireland were done on the basis of a user-pays model, with or without subvention from the government. However, as the recent recession took hold, banks refused to finance on this basis and the motorway PPP projects were then executed on the basis of availability payments, in the same way as the financing of accommodation projects.

### **i The authorities**

The NDFA procures PPP projects in Ireland as well as other infrastructure projects with a capital value in excess of €30 million other than:

- a* the road and light rail sectors, which are procured by TII;
- b* the heavy rail sector which are procured by Iarnród Éireann;
- c* the local government sector which are procured by local authorities directly; and
- d* in the water and wastewater projects, which are procured by Irish Water.

While the NDFA advertises the PPP project, runs the procurement process and negotiates all project documentation, it does so on behalf of the public authority and it is the public authority that actually signs the contract. For example, in the case of a schools PPP project, the NDFA will run the entire procurement process and stay involved at contract management stage. However, the PPP project agreement will be signed by the Department of Education and Skills and the monthly unitary payments payable to the PPP company will be made by the Department of Education and Skills.

The Central PPP Unit in the Department of Public Expenditure and Reform aims to facilitate PPPs by developing the policy framework for PPPs and issuing relevant guidance to departments and other authorities.

### **ii General requirements for PPP contracts**

To be classified as a PPP contract, a contract must be for a minimum of five years. However, there is no upper limit on the length of a contract. In practice the longest contracts tend to be for 30 years and the term is dictated by the length of time needed to pay off the capital investment by the private sector and to allow the private parties to make a profit. EU law does not permit outsourcing of public contracts for longer than five years unless there are exceptional circumstances such as the need to pay off a capital investment. Therefore, much longer contracts for upwards of 90 years that can be found in East European countries, are not a feature of the Irish PPP market.

There are no statutory constraints on particular sectors preventing the use of PPPs. However, in practice, the operations side of accommodation projects is confined to 'soft services' such as cleaning and catering and there has been no attempt to outsource services in, for example, the health, education and prison sectors.

Before a procurement process for a proposed project can begin, a rigorous pre-procurement appraisal process must be followed, which is summarised below.

The sponsoring agency (usually the line ministry or the body that will be responsible for the day to day administration of the project), carries out a preliminary appraisal which includes an option appraisal, a cost benefit analysis and a preferred option.

Having completed the preliminary appraisal and received approval to undertake a detailed appraisal from the sanctioning authority, the sponsoring agency must seek the advice of the NDFA, which is the statutorily appointed financial adviser to the state for projects in excess of €30 million.

The sanctioning authority may be the line ministry or the government in the case of large projects (usually in excess of €100 million). It depends on the nature of the sponsoring agency and the size of the project.

The detailed appraisal will include a reasonable estimate of the overall budget required to procure the project. If the detailed appraisal results in the preferred option being a PPP, a PPP procurement assessment should be carried out. The NDFA provides financial, insurance and risk-analysis advice to state authorities to help them decide which is the most appropriate procurement mechanism.

The sanctioning authority will give its approval subject to a project budget. Once it receives this approval, the sponsoring agency either proceeds to procurement or hands the project to the NDFA for procurement on its behalf.

## IV BIDDING AND AWARD PROCEDURE

### i Expressions of interest

PPPs are public contracts and as such are awarded in line with EU public procurement law. The Irish public procurement regulations<sup>3</sup> closely mirror the EU Public Procurement Directives at both the award and remedy stage and such regulations are rigorously applied and regularly challenged.

PPP contracts are almost always procured by way of a competitive dialogue or competitive negotiated procedure (see Section IV.iii, *infra*).

The initial expression of interest or pre-qualification stage follows the requirements of the EU Directives. Candidates are qualified on the basis of objective technical, legal and financial criteria. In the case of the competitive negotiated or competitive dialogue procedure, the authority qualifies at least three candidates, but as many as six may be qualified depending on the sector in which the PPP project is being awarded.

There is a natural reluctance to run up unnecessary bid costs for a larger number of candidates, which is set against the need to ensure a healthy level of competition in case one or more bidders fall out of the process.

The Irish government and the NDFA have for recent accommodation projects in the PPP programme made provision, on an exceptional and non-statutory basis, for some reimbursement of bid costs for unsuccessful tenderers. The invitation to negotiate for each

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3 The 2014 EU Public Procurement Directives were implemented into Irish law from 18 April 2016 by means of SI No. 284/2016 – European Union (Award of Public Authority Contracts) Regulations 2016 and SI No. 286/2016 – European Union (Award of Contracts by Utility Undertakings) Regulations 2016.

PPP project set outs the partial bid costs reimbursement that will apply for unsuccessful bidders.

## **ii Requests for proposals and unsolicited proposals**

Following the closure of the dialogue phase in the case of a competitive dialogue procedure or the end of clarification meetings in the case of a competitive negotiated procedure, tenders are invited by the authority.

There are no formal procedures for submitting unsolicited bids in Ireland.

### ***Competitive negotiated procedure***

The stages involved in a competitive negotiated procedure, following pre-qualification are:

- a* the authority issues an invitation to negotiate (together with detailed technical, legal and financial documents to be returned with the tender);
- b* the authority then provides a period of time to respond to any written questions and to hold clarification meetings with bidders;
- c* submission of tenders;
- d* appointment of a preferred bidder on certain agreed terms; and
- e* the finalisation of project documents with the preferred bidder and the achievement of financial close.

A variation on this may be to have a ‘best and final offer’ stage between the submission of tenders and the appointment of a preferred bidder.

### ***Competitive dialogue***

The competitive dialogue process is similar to the above. However, following pre-qualification, the authority enters into dialogue meetings with each candidate and refines the tender based on suggestions from and dialogue with bidders until a point when it is happy to close the dialogue and invite tenders. Following submission of tenders and appointment of a preferred bidder, negotiation of documents is permissible with the final bidder to reach financial close.

## **V THE CONTRACT**

### **i Payment**

A PPP contract for a typical accommodation project such as a school will involve a monthly unitary charge payment being made from the authority to the project company based on the whole-life costs of designing, constructing, operating, maintaining and financing the project plus an agreed profit for the project company.

The project company may suffer deductions from the monthly unitary charge for poor performance (performance deductions) or where a service is unavailable (availability deductions).

The early roads PPP projects were based on a user-pays model but funders no longer fund on this basis given the uncertainty of traffic forecasts.

The Irish government does not give state guarantees for PPP projects.

## ii Distribution of risk

A typical risk allocation in a PPP project in Ireland is shown in the table below:

Risk		Private sector	Public sector	Shared	
Site risk	Planning	Outline	X		
		Full	X		
	Physical condition/contamination		X		
	Sufficiency of title			X	
	Access to site				X
	Environmental risk		X		
Archaeological risk				X	
Design and construction risk		X			
Demand risk			X		
Availability and performance risk		X			
Change in law	Discriminatory change in law			X	
	General change in law involving capital expenditure during the service period			X	
	General change in the law other than that involving capital expenditure		X		
	Change in VAT			X	
Residual value			X		
Maintenance risk		X			
Insurance	General				X
	Increase in premiums				X
	Uninsurability			X	
Refinancing				X	
Compensation on termination	General				X
	For PPP company default		X		
	For authority default and voluntary termination			X	
	For force majeure, uninsurable risk or change in law				X

## iii Adjustment and revision

PPP contracts have a change mechanism to allow the parties to agree variations throughout the life of the project and a mechanism for agreeing cost.

However, many changes are anticipated and dealt with in specific clauses of the contract and the risk arising from the change is allocated to one party or the other or the risk is shared.

For example, if a project is delayed or has to be altered as a result of an archaeological find, the PPP company may have to pay for the first €100,000 of resultant costs but the public sector will be responsible for any costs after that.

Many contingencies are categorised as relief events (resulting in extra time being given to the PPP company) or compensation events (resulting in monetary compensation and relief in terms of time being given to the PPP company).

Contracts typically provide for three- to five-year benchmarking or market testing of certain services such as cleaning, catering and security and the costs in the financial model will be adjusted accordingly with an upwards or downwards adjustment to the unitary charge.



In summary, given that a typical PPP project has a minimum senior debt exposure of 80 per cent, that ownership of the asset remains with the state, that there are no state guarantees and that compensation on termination may leave the senior lenders exposed in certain circumstances, the senior lenders make sure that as many as possible potential changes are anticipated and the risk allocated and costed in advance.

#### **iv Ownership of underlying assets**

In almost all cases of public infrastructure, the project company at no point owns the asset. It is usually granted a licence by the authority to occupy and operate the land and asset for the term of the project. At the end of this period the licence terminates at the same time as the project agreement, and the asset remains at all times in the ownership of the procuring public body.

#### **v Early termination**

PPP agreements may be terminated by the authority at any time for breach or convenience. The PPP company may terminate for breach. The agreement may also be terminated for force majeure or uninsurability.

The compensation payable by the authority on termination of the PPP agreement, for whatever reason, is a critical issue in the negotiation of any PPP agreement. As the funders do not have security over the asset which remains in the ownership of the authority, the amount of compensation payable is critical to ensure that the debt is paid back.

## **VI FINANCE**

PPP projects in Ireland have typically been financed by senior debt provided by European project finance banks; junior or mezzanine debt – again provided mainly by the equity arm of the same project finance banks; and finally equity provided by the project sponsors. However, recent deals have shown new funders and funding structures, a few examples of which are below.

Senior debt tends to be about 80 per cent of the financing and the split between junior debt and equity varies considerably. During the ‘boom’ years there may have been 19 per cent junior debt and 1 per cent real equity, but since the recession, more real cash equity is required by the banks.

The early PPP projects in Ireland involved the bidding consortia bidding with their funders in place and the funding costed. The funding was then separated from the bids in later projects. The norm now is for the preferred bidder to run a funding competition in conjunction with the NDFA. The NDFA has said that it will look at this model again in light of a return of lenders to the market and may return to fully funded and costed tenders.

The most recent PPP roads project to reach financial close in January 2016 was the N25 New Ross Bypass awarded to BAM PPP PGGM Iridium consortium.

Funding for the €230 million project involved a combination of long-term debt in the form of bonds, and equity, with the senior debt supported by the EIB’s project bond credit enhancement (PBCE) mechanism. The bonds, rated provisional Baa1 (stable) by Moody’s Investor Service, and to be listed on the Frankfurt Stock Exchange, are pre-agreed to be sold to investors managed by Allianz Global Investors GmbH. Listing and a definitive rating will take place post financial close. ProjectCo will issue €146 million fixed-rate senior secured debt in the form of fully amortising bonds, purchased on a deferred basis, and the New Ross

N25 road is the first project in Ireland to benefit from the EIB's PBCE initiative. BAM PPP PGGM Infrastructure Coöperatie UA and Iridium Concesiones de Infraestructuras SA are committing €17 million in equity to the project.

The recent Courts Bundle project awarded to the BAM consortium in December 2015 was funded by the Bank of Tokyo-Mitsubishi UFJ, Ltd (MUFG) including:

- a MUFG providing the senior debt;
- b MUFG arranging a private placement solution placed with Talanx Asset Management GmbH; and
- c BAM PPP PGGM Cooperatie Infrastructure UA as equity investors.

As part of the Primary Care Centre PPP which closed in May 2016, the EIB will fund €70 million of the project debt through the European Fund for Strategic Investment (EFSI), a new initiative between the EIB and European Commission. The project will be the first healthcare project in Ireland to benefit from EIB support and one of the first PPPs in Europe to benefit from EFSI funding.

The NDFA also announced in May 2016 the first ever full re-financing of an Irish PPP transaction. The re-financing took advantage of the substantial fall in borrowing costs since the project reached financial close in April 2014 and achieved savings of €23 million.

## VII RECENT DECISIONS

### i **Somague Engenharia SA & Wills Bros Ltd v. Transport Infrastructure Ireland 2016 IEHC 435**

This recent case related to a legal challenge by an unsuccessful tenderer (Somague Wills (SW) JV) to a public procurement process for the award of the contract for the construction of a 5.6 kilometre extension to the light rail system in Dublin. The applicants contended that the awarding authority (TII) had committed a number of serious errors in conducting the competition and had breached the applicable rules relating to public procurement in awarding the contract to the Sisk Steconfer JV consortium. The alleged breaches included applying non-disclosed or impermissible award criteria and sub-criteria and that TII had erred in not negotiating with the applicant once it was clear that that SW JV had proposed the lowest price and there were less than five marks between them and the successful bid. The Court, in its decision of 28 June 2016, refused the reliefs sought by the applicant on all grounds.

### ii **BAM PPP PGGM Infrastructure Cooperative UA v. National Treasury Management Agency 2015 176 JR**

This ongoing case concerns the tendering process for a 25-year PPP contract to design, build, finance and maintain part of the new Dublin Institute of Technology campus at Grangegorman. BAM PPP PGGM Infrastructure Cooperative (BAM) initiated judicial review proceedings in March 2015 seeking the suspension of the award of the PPP for Grangegorman to a consortium called 'Eriugena' and an order setting aside the decision of the respondents to accept a late tender submitted by Eriugena. Upon the commencement of the judicial proceedings the award of the contract was automatically suspended. Following the introduction of, new retroactive regulations, the European Communities (Public Authorities' Contracts) (Review Procedures) (Amendment) Regulations 2015, the National Treasury

Management Agency succeeded in lifting the automatic suspension and is now progressing towards financial close with the preferred tenderer.

In its judgment of 6 October 2016, the Irish Commercial Court ruled that the National Treasury Management Agency (NTMA) had discretion under the invitation to negotiate and under general law to accept late tender documents, subject to not infringing the general EU principles of equal treatment, non-discrimination, proportionality and transparency. The Court found that the grounds relied upon by the NTMA to accept the late tender documents constituted valid reasons for exercising its discretion and did not infringe the general EU principles.

### **iii Applegreen PLC & Anor v. Transport Infrastructure Ireland 2015 483 JR**

Applegreen plc and Tedcastles Oil Products, which formed a consortium to bid for the design, build, operate and finance of motorway service stations on the Irish national road network, applied to the Court to quash a decision by Transport Infrastructure Ireland to appoint Topaz Energy Group Limited as the preferred tenderer. The matter is still before the Irish courts.

## **VIII OUTLOOK**

While the PPP market in Ireland has been difficult for the past few years, owing to the recession, the economy has now returned to growth and international consortia have again returned to the market. However, while traditionally finance tended to be exclusively from project finance banks, this has been replaced in many instances by private equity. The extent to which future PPPs will similarly be funded by private equity remains to be seen.

Under the current PPP programme the government envisages investing €300 million in social housing projects, which are expected to include:

- a* the development of up to 1,500 housing units as a number of ‘bundles’ of sites;
- b* the provision of services to the developments over a 25-year period following construction that will include the maintenance and upkeep of the housing; and
- c* the return of the asset after 25 years in prime condition.

The Department of Housing, Planning, Community and Local Government will be the sanctioning authority for the programme with the NDFA acting as financial adviser, procuring authority and project manager. The proposed sites for Bundles 1 and 2 have been announced and the OJEU notice for the Social Housing PPP Bundle 1 is due to be published in Q1 2017.

# JAPAN

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## I OVERVIEW

In recent years, the government has presented a very positive attitude towards the promotion of public-private partnerships (PPPs) and more investors have become interested in investing in infrastructure. The national government is intensively promoting PPPs, which offer new business opportunities to the private sector, as a part of its economic strategy.<sup>2</sup> In addition, public authorities operating under severe fiscal constraints have recognised the importance of, and the role of PPPs in, maintaining and improving existing infrastructure. The national government has been particularly promoting concessions of certain infrastructure such as airports, water supplies, sewage and toll roads. Against this backdrop, in 2016, two airport concession projects and one concession project for toll roads started operation.

## II THE YEAR IN REVIEW

In Japan, the Act on the Promotion of Private Finance Initiatives (the PFI Act), enacted in 1999, governs most PPP projects, referred to as private finance initiatives (PFIs). Since its enactment, the PFI Act has brought in 527 projects totalling approximately ¥4.9 trillion as of 31 March 2016.<sup>3</sup>

In 2011, this law was revised to allow the use of concessions and expand ‘user pays’ projects in which the national or a local governmental authority (as applicable, the ‘relevant authority’) grants to a private entity (the concessionaire) the right to operate existing infrastructure and earn income by charging user fees, in contrast to most PFIs in Japan, which are structured under the traditional PFI model in which project companies receive availability payments from the relevant authorities. Subsequently, the national government issued several guidelines providing detailed guidance on practical matters and interpretation of affected laws. In 2015, the PFI Act was further revised to enable governmental authorities to second public officers with expertise to private concessionaires.

In May 2016, the Council for the Promotion of Private Finance Initiatives of the Cabinet Office revised the Action Plan for Promotion of PPPs/PFIs, which highlights (1) the promotion of concessions, particularly those of airports, water supplies, sewage and toll roads as well as cultural and educational facilities and public housing; (2) the preferential

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2 Revision of ‘Japanese Revitalisation Strategy 2016 – For the Fourth Industrial Revolution’, dated 2 June 2016 (published by the government of Japan), Part II, pp. 21–22 and 163–166.

3 See the Cabinet Office website: [www8.cao.go.jp/pfi/pfi\\_genjyou.html](http://www8.cao.go.jp/pfi/pfi_genjyou.html).

study of PFIs/PPPs as will be discussed below; and (3) the development of local platforms for PPPs/PFIs.

Airport concessions lead the way, as they are largely enhanced by new legislation which has made it easier to privatise airports owned and operated by the national or local governments. On 1 April 2016, a concessionaire established by a consortium led by ORIX Corporation and VINCI Airports started operating Kansai International Airport and Osaka (Itami) International Airport. On 1 July 2016, a consortium led by Tokyu Corporation initiated the operation of Sendai Airport through a concession. Aside from commencing the bidding processes for the concession projects for Takamatsu Airport and Kobe Airport in 2016, the relevant authorities have also started looking into several other airport concessions.

Concessions for toll roads, another important area, marked another turning point in 2016. Following the enactment of new legislation which removed obstacles to toll road concessions, the Aichi Prefecture Road Public Corporation offered a toll road concession covering eight toll roads in 2015, which was won by a concessionaire established by a consortium led by Maeda Corporation. Operations started on 1 October 2016.

Water supplies and sewage concessions are expected to follow suit. Hamamatsu City issued a request for proposal for a sewage concession in the Seien area in May 2016. Likewise, several cities have been working continuously towards privatising their water and sewage services through concessions.

In December 2015, to take advantage of private sector funds and expertise for PFIs, the Council for the Promotion of Private Finance Initiatives of the Cabinet Office established guidelines for the preferential consideration of PFIs/PPPs. Under the guidelines, the relevant authority should preferentially study PFIs/PPPs when planning a project for the construction, operation or maintenance of public facilities and the project meets certain requirements. Although the guidelines are not legally binding, the Cabinet Office has requested local governments with a population of 200,000 or more to establish their internal rules in accordance with the guidelines by no later than 31 March 2017.

### III GENERAL FRAMEWORK

#### i Types of public-private partnership

##### *Traditional arrangement*

Until the introduction of concessions, more than two-thirds of traditional PFI projects have been undertaken using build–transfer–operate (BTO) arrangements where:

- a* a private entity as the contractor, usually a special purpose company formed by a consortium of project sponsors, constructs a facility (typically, social infrastructure such as governmental buildings and local public facilities);
- b* after completing the work, the contractor transfers the facility to the relevant authority and subsequently operates it for a specified period; and
- c* the contractor earns its revenues through the availability fees that the relevant authority pays in exchange for the construction and services.

While traditional PFIs feature BTO arrangements, the PFI Act permits other structures. For example, the international passenger terminal and the international air cargo terminal at Haneda Airport were constructed in 2010 and are operated under a build–operate–transfer (BOT) arrangement.

### **Concessions**

As discussed above, the national government introduced the concession system in 2011 to (1) give the private sector a wider range of rights (including the right to determine user fees and earn them as its own revenue) along with more risks and responsibilities; (2) develop the Japanese PFI market; and (3) attract financiers.<sup>4</sup>

In a concession project:

- a* the relevant authority administering an existing facility grants a concessionaire the right to maintain and operate the facility for a specified period (the concession right);<sup>5</sup>
- b* the relevant authority continues to own the facility. The concessionaire may determine and collect user fees or tolls as its own income;<sup>6</sup> and
- c* the relevant authority may charge the concessionaire concession fees for the concession right. The concession fees, which are usually calculated through the discontinued cash flow method but ultimately decided through bidding processes, are paid up front or in instalments depending on the concession agreement.

### **ii The authorities**

All PFI projects are governed by the PFI Act but are procured by the national government, local governments or government-related organisations.<sup>7</sup> Generally, a project would be overseen by a particular division within the relevant authority responsible for the target facility.

PFI s are promoted by the PFI Promotion Office within the national government's Cabinet Office. The PFI Promotion Office has issued its basic policy and the following guidelines regarding practical aspects of PFI s:

- a* the Procurement Process Guidelines;
- b* the Value-for-money (VFM) Guidelines;
- c* the Risk Allocation Guidelines;
- d* the Contract Guidelines;
- e* the Monitoring Guidelines; and
- f* the Concession Guidelines.

The PFI Promotion Office has also standardised the project agreements for traditional BTO projects for social infrastructure and released the 'Model Project Agreement' on its website. These guidelines and the Model Project Agreement, which parties are not legally obliged to use, significantly affect PFI practice.

Other divisions in the national government as well as some local governments have also developed their own PFI policies and guidelines to utilise PFI s for specific areas such as water supply and sewage infrastructure.

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4 Yasuyuki Kurano and Masatomo Miyazawa, *Kaisei PFI Hono Gaiyou (3 kai)* ('Overview of the Revised PFI Act (III)'), *Kinyu Homu Jijo*, Vol. 1927, pp.122–126.

5 PFI Act, Article 2, Paragraphs 6 and 7.

6 *Id.*, Article 23.

7 *Id.*, Article 2, Paragraph 3.

**iii General requirements for PFI contracts**

***Class of facilities***

PFI contracts are available for the construction, management and operation of public facilities and infrastructure listed in the PFI Act,<sup>8</sup> such as:

- a* roads, railways, ports, airports, rivers, parks, water supplies, sewage systems and other public infrastructure;
- b* government buildings, housing for government workers and other official facilities;
- c* public housing, social facilities such as educational and cultural facilities, hospitals, social welfare facilities, prisons and other social infrastructure;
- d* information and communications facilities, heat supply facilities, new energy facilities, recycling facilities (excluding waste treatment facilities), tourist facilities, and research facilities; and
- e* vessels, aircraft and other transportation vehicles, and satellites (including the facilities required to operate these vehicles).

Some public laws, however, restrict the ability of the private sector to manage and operate specific classes of public facilities, including airports and roads.<sup>9</sup> Since the PFI Act does not *per se* override these laws, further legislation is required to enable concessionaires to undertake the management or operation of those ‘restricted’ public facilities. Since the introduction of concessions in 2011, the government has enacted special laws enabling concessions, or has expressed its administrative interpretation of the relevant public laws to the effect that those laws do not hinder concessions, for major infrastructure, including airports, water supplies and sewage systems. Today, roads are the last major infrastructure subject to such restrictions. However, the government enacted special legislation to specifically enable Aichi Prefecture to grant concessions for eight toll road routes, as mentioned above.

***Scope of concession rights***

Concession rights are subject to certain limitations. Generally, a concessionaire may make expansions or renovations that are necessary to operate the facilities<sup>10</sup> though the exact scope of permissible expansions or renovations in a project needs to be clarified by the relevant authority. In contrast, the construction of new facilities and the complete removal and redevelopment of existing facilities are clearly outside the scope of concessions.<sup>11</sup> Nevertheless, it does not mean that the PFI Act prevents greenfield projects, or major renovation projects outside the scope of concessions, from being conducted through a combination of traditional arrangements (for construction or major renovation) and concessions (for operation).

***VFM analysis***

If a potential project falls within the scope of permitted facilities and services, the relevant authority must conduct a VFM analysis to confirm whether the project is appropriate for PFIs and whether it may go ahead.<sup>12</sup> This analysis may be a burden for the relevant authority

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8 Id., Article 2, paragraphs 1 and 2.

9 Basic Policy for the Implementation of PFI Projects, Chapter 4, Section 1(3).

10 Concession Guidelines, Section 11.

11 Id.

12 VFM Guidelines.

but the applicable guidelines suggest a shorter process for traditional projects, such as construction of governmental buildings, by using precedents.<sup>13</sup>

### **Term**

Projects under traditional arrangements usually have contract terms of between 15 and 30 years. Traditional PFIs with the national government are limited to 30 years due to the Public Finance Act limit on the terms of contracts under which the national government is obliged to pay for more than one fiscal year.<sup>14</sup> PFIs with local governments and government related organisations do not have term limits. In addition, some laws restrict the period during which a private entity may use assets owned by a relevant authority. In most cases of land with a building on it, the maximum period of use is 30 years.<sup>15</sup>

There are no restrictions on concession terms, and the PFI Act does not mandate a maximum concession term. Accordingly, a relevant authority may decide the term on a project-specific basis.<sup>16</sup> For example, the relevant authority suggests that airport concessions will basically have terms of between 30 and 50 years.<sup>17</sup> In addition, a concession term may be extended, subject to the conditions in the concession agreement.<sup>18</sup>

## **IV BIDDING AND AWARD PROCEDURE**

The general process for procuring PFI projects, whether using traditional arrangements or concessions, is as follows:<sup>19</sup>

- a* the relevant authority draws up an implementation policy, which outlines the project and the bidding process;<sup>20</sup>
- b* it conducts a VFM analysis and identifies the project scope;<sup>21</sup> and
- c* finally, it conducts a bidding process and awards the project to the selected project sponsor.

The Procurement Process Guidelines provide the general guidance for the bidding process to ensure the transparency, fairness and competitiveness of the process.

The Agreement on Government Procurement (GPA) under the WTO framework applies to certain types of PFI projects above certain thresholds procured by the national government, prefectures, certain major cities and certain government-affiliated organisations. For example, the GPA applies to PFI projects whose main purpose is construction service worth ¥740 million (4.5 million SDR) or more procured by national government agencies or ¥2.47 billion (15 million SDR) or more by local governments. However, concessions in Japan are currently exempted from the application of the GPA.

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13 Revision of the Procurement Process Guidelines and the VFM Guidelines.

14 Strictly speaking, the Public Finance Act provides five years but the PFI Act extended the term to 30 years (PFI Act, Article 68).

15 National Property Act, Article 21, Paragraph 1, Item (iii).

16 Concession Guidelines, Section 15(2)2.(1).

17 Minister of Land, Infrastructure, Transport and Tourism, 'Basic Policy for Airport Concession of National Airports', 2013 (Basic policy for Airport Concessions), Section 2.

18 Id.

19 Procurement Process Guidelines.

20 PFI Act, Article 5.

21 Id., Article 7.



**i Expressions of interest**

Under the Procurement Process Guidelines, authorities are encouraged to invite and assess expressions of interest, proposals and requests for information from the private sector.<sup>22</sup> These proposals may influence the implementation policy as the pertinent relevant authority identifies the project scope and initiates the bidding process.

**ii Requests for proposals and unsolicited proposals**

***Requests for proposals***

Generally, a project sponsor is selected through a competitive procedure. Following the VFM analysis and the decision to initiate a project, the relevant authority starts the bidding process by issuing a request for proposals and a tender package (including the requirements for services and specifications, the criteria for awarding the project, and the drafts of the project agreement and other relevant contracts). Although bidders may be required to post deposits to ensure that they honour the bids, deposits have been exempted in many past projects.<sup>23</sup>

***Unsolicited proposals***

In 2011, the revised PFI Act introduced the unsolicited proposal system through which the private sector may propose a PFI project.<sup>24</sup> Competitive bidding is still required even if the unsolicited proposal induces the relevant authority to start a PFI procedure. Thus, the proponent must participate in the bidding process, although the relevant authority is required to protect the proponent's intellectual property that is contained in the proposal.<sup>25</sup> The revised Procurement Process Guidelines allow the relevant authority, in the bidding process, to consider in the favour of the proponent bidder, how its proposal contributes to the project with attention to fairness, transparency and competitiveness.<sup>26</sup>

**iii Evaluation and grant**

***Qualification***

A relevant authority sets qualifications for bidders in the request for proposal. A bidder may be either a single corporation or a consortium (which is typical in most major projects). The relevant authority also sets qualifications for the consortium or for each member of the consortium, or for both.

A relevant authority may adopt a pre-qualification process or multi-phase selection process if a sizeable number of bidders are expected to participate.<sup>27</sup> In a typical competitive dialogue procedure (see 'Bidding process', *infra*), before the competitive dialogues start, the bidders are shortlisted to around three based on documentary submissions.<sup>28</sup>

The PFI Act and other laws enumerate the grounds for disqualification.<sup>29</sup> A relevant authority may also set additional qualifications for specific projects. In many past cases,

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22 Procurement Process Guidelines, Section 1-2.

23 See the PFI Promotion Office website: [www8.cao.go.jp/pfi/tebiki/jitsumu/jitsumu04.html](http://www8.cao.go.jp/pfi/tebiki/jitsumu/jitsumu04.html), (question 4.7).

24 PFI Act, Article 6.

25 Procurement Process Guidelines. Section 1-2(1).

26 Id. Section 4-1(13)–(16).

27 Id. Section 4-1(11)(i)-2-1 and (ii)-1-2.

28 Id. Section 4-1(11)(i)-2-1.

29 PFI Act, Article 9.

authorities required certain financial capacity and capability for long-term risk management and project management.<sup>30</sup> Although the PFI Act does not restrict foreign sponsors' entry, the relevant authority may set additional qualifications, such as the bidder's experience or knowledge of business in Japan, which some foreign sponsors may find hard to meet. The bidders may also be subject to governmental scrutiny concerning national security, crisis management and contribution to local economy.<sup>31</sup>

### ***Bidding process***

Most PFI projects are procured through either the competitive dialogue procedure or the open and competitive bidding procedure.<sup>32</sup> In the competitive dialogue procedure, which may be adopted if a relevant authority has difficulties setting out the proper service requirements and specifications, the relevant authority may have dialogues concurrently with multiple bidders.<sup>33</sup> Taking the dialogues into account, the relevant authority finalises the service requirements and specifications before the bidders submit their final proposals.<sup>34</sup> In contrast, the open and competitive bidding procedure is less flexible because the requirements cannot be modified or revised once the bidding process has begun; however, the relevant authority is allowed to communicate with bidders to clarify the requirements as long as the transparency and fairness of the process are maintained.<sup>35</sup>

### ***Awarding contracts***

In determining the winning bidder, the relevant authority takes into consideration not only the bid price but also other factors such as the consortium members, the contents and feasibility of business plans and safety and security measures. The weight of each factor is described in the criteria for awarding the project included in the tender package. The authority usually sets up a selection committee consisting of experts with expertise and experience in the pertinent fields and evaluates the bid proposals in consultation with that committee. In general, once the winning bidder is selected, it may not negotiate with the relevant authority to modify the terms and conditions of the project.

The relevant authority and the selected sponsor enter into a basic agreement, which contains the sponsor's obligations regarding preparations for the project. Afterward, the contractor or the concessionaire and the relevant authority execute a project agreement (or a concession agreement for concessions), the main document containing their rights and obligations regarding the project.

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30 PFI Procurement Process Guidelines, Section 4-1(11)(ii)-1-2.

31 Basic policy for Airport Concessions, Section 2-10.

32 PFI Procurement Process Guidelines, Id. Section 4-1(11).

33 Id.

34 Id.

35 Id.

## V THE CONTRACT

### i Payment

#### *Traditional arrangement – availability fees*

In traditional projects, the relevant authority pays availability fees for the services provided by the contractor.<sup>36</sup> The project agreement sets out the calculation mechanism, which is either unitary charges or charges made up of separate elements (such as costs of construction, finance, maintenance and operation).<sup>37</sup> Fees may be deducted or withheld if the services do not meet the agreed performance criteria and standards.<sup>38</sup> Payments are typically made on a semi-annual or a quarterly basis.<sup>39</sup>

#### *Concessions – user fees*

In general, the concessionaire determines and charges user fees for the use of the public facilities and collects the fees as its own revenues.<sup>40</sup> The fee determination, however, may be subject to the concession agreement or to applicable laws and regulations on the pertinent infrastructure (e.g., the Airport Act, the Water Supply Act and the Sewage Service Act).

### ii State guarantees

Generally, there is no state guarantee on a relevant authority's payment obligations to either the contractor or the concessionaire.

### iii Distribution of risk

Several guidelines clarify that proper risk allocation should be accomplished through the principle that the party in the best position to manage a risk bears that risk.<sup>41</sup>

#### *Force majeure*

In traditional projects, the project agreement typically stipulates that if a force majeure event occurs:

- a the parties are relieved of their contractual obligations;
- b the handover date or service commencement date is postponed; and
- c if the force majeure lasts for a certain period of time, the agreement may, upon consultation between the parties, be terminated by the relevant authority or, if allowed in the agreement, the contractor.<sup>42</sup>

To address financial consequences, typical project agreements require that the contractor purchases insurance that meets certain criteria.<sup>43</sup> In many traditional cases, relevant authorities have agreed to bear a substantial portion of uninsurable costs resulting from force majeure.<sup>44</sup>

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36 PFI Contract Guidelines, Section 4.

37 Id., Section 4-3.

38 Id.

39 Id., Section 4-4.

40 PFI Act, Article 23.

41 Risk Allocation Guidelines, Article 1, Section 2.

42 Contract Guidelines, Sections 2-2-9, 3-6, 5-3 and 6-9.

43 Risk Allocation Guidelines, Article 2, Section 6(1)(i)-3.

44 Contract Guidelines, Sections 3-6 and 6-9.

Under concession agreements, the relevant authorities typically bear the costs to repair physical damages to the facilities caused by force majeure except for insurable or relatively minor costs. Concession agreements may also provide for the extension of the concession term to compensate the concessionaire for increased costs or losses arising from force majeure.<sup>45</sup>

### ***Change in laws***

In traditional projects, authorities are required to compensate the contractors for increased costs resulting from a change in specific law or governmental action which applies only to the project or similar projects.<sup>46</sup> In other words, the private sector bears the risk of a change in law that has general effect.<sup>47</sup> The agreement may, upon consultation between the parties, be terminated if a change in specific law makes it impossible to continue the project.<sup>48</sup> The range of the specific laws and governmental actions is determined on a project specific basis. Concession agreements generally provide for similar arrangements, although increased costs may be addressed by extending the concession term, instead of monetary compensation.<sup>49</sup>

### ***Demand risk***

In most traditional projects, the private sector does not bear the demand risk because availability payments from the government remain unchanged irrespective of demand for the provided services.

In concession projects and some BOT projects, concessionaires or contractors generally bear the demand risk because the project revenues are generated mainly from user fees rather than availability payments. Nevertheless, risk sharing mechanisms may be appropriate in some specific areas. For example, the Concession Agreement for the Aichi Prefecture Toll Road Project adopted a risk sharing mechanism which passes on to the relevant authority any increase or decrease in toll revenues beyond 6 per cent from the projected revenues agreed by the authority and the concessionaire.<sup>50</sup>

### ***Latent defect of existing facilities***

In concession projects where concessionaires will operate existing government-owned facilities, the parties need to consider the risk allocation for latent defects in those facilities. While authorities do not bear the risk of latent defects in principle, and the private sector should minimise this risk through intensive due diligence, some authorities have come to understand that authorities should, to a certain extent, bear the risk of latent defects that are difficult to discover even through due diligence.<sup>51</sup> In the Sendai Airport project, for example, the relevant authority will compensate the concessionaire for losses from latent physical

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45 Concession Agreement for Sendai Airport, Section 48.

46 Model Agreement, Section 45.

47 Contract Guidelines, Section 5-3, Paragraph 5.

48 Id., Paragraph 2.

49 Concession Agreement for Sendai Airport, Sections 45 and 73.

50 See the summary of the Concession Agreement for the Aichi Prefecture Toll Road Project, Section 9(3), which was released on the Aichi Prefecture Road Public Corporation website: [www.aichi-dourokousha.or.jp/wp-content/uploads/2016/08/2-gaiyou-shuusei.pdf](http://www.aichi-dourokousha.or.jp/wp-content/uploads/2016/08/2-gaiyou-shuusei.pdf).

51 Sewage Concession Guidelines, Section 3.6.4(1).

defects discovered in certain facilities within a year from the commencement of the project, subject to limitations on the scope of defects and compensation.<sup>52</sup>

#### **iv Adjustment and revision**

In traditional projects, availability fees may be adjusted as set out in the project agreement. Typically, adjustment is limited to indexation to deal with inflation, although many project agreements do not even contain such indexation, partly because of the stable prices in Japan since the 1990s.<sup>53</sup>

In concessions where concessionaires may set the user fees, a concessionaire may adjust the user fees at its discretion unless otherwise limited by the concession agreement or by applicable laws or regulations.

#### **v Ownership of underlying assets**

##### ***Traditional arrangement***

In traditional projects using a BTO arrangement, the relevant authority owns the underlying assets, such as land. On completing the construction of the facility on land leased from the relevant authority, the contractor transfers the ownership of the facility to the relevant authority.<sup>54</sup>

##### ***Concessions***

Likewise, relevant authorities own the underlying facilities in concessions, while a concessionaire is granted concession right in respect of such facilities.

A concessionaire's concession right is assignable subject to the consent of the relevant authority.<sup>55</sup> The PFI Act also allows a concessionaire to mortgage its concession right to its lenders, although the consent of the relevant authority for the assignment of the concession right is necessary when the lenders foreclose the mortgage.<sup>56</sup> To alleviate the lenders' concern on unpredictability in the foreclosure of mortgage over concession rights, the concession guidelines provide that if: (1) the transferee would not have been disqualified as a bidder for the project; and (2) the transfer is appropriate in light of the implementation policy, then the relevant authority must approve the transfer.<sup>57</sup>

The grant, transfer and mortgage of a concession right are registered in a manner similar to real property registration.<sup>58</sup> Concessionaires may take advantage of these features to obtain third-party financing, as also set out below.

For tax accounting purposes, a concession right may be depreciated equally over the concession term.<sup>59</sup>

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52 Concession Agreement for Sendai Airport, Section 16.

53 Contract Guidelines, Section 4-4.

54 Contract Guidelines, Section 2-4-1.

55 PFI Act, Article 24 and Article 26.

56 Id., Article 25.

57 Concession Guidelines, Section 13(1)2.(2).

58 PFI Act, Article 27.

59 Order for Enforcement of the Corporation Tax Act, Articles 13(viii)(k) and 48-2.

### ***Airport projects***

Airport projects may require special arrangements because in many airports in Japan, private or third sector entities own and manage non-aeronautical facilities such as terminal buildings and parking lots, while the national or local governments own and manage the runways and other aeronautical facilities. To integrate aeronautical and non-aeronautical operations, the national government intends to have concessionaires acquire the terminal buildings or shares in entities holding terminal buildings.<sup>60</sup> Under such a scheme, concessionaires will operate the aeronautical facilities as concessionaires and the non-aeronautical facilities as owners, although a single integrated procurement process covers both types of facilities as a package.

#### **vi Early termination**

##### ***Early termination events***

Traditional project agreements generally provide for several causes for early termination, including default, force majeure and a change in law<sup>61</sup> and for the right of the relevant authority to terminate the agreement at any time.<sup>62</sup> Concession agreements are generally the same. Although the PFI Act enumerates the termination events for concessions,<sup>63</sup> in practice, the parties agree on termination events similar to those under project agreements used for traditional arrangements and which are broader than those provided in the PFI Act.

##### ***Consequences of early termination***

In traditional project agreements, the relevant authority agrees to pay the contractor the following costs and losses arising from early termination:

- a* (if termination occurs during the construction phase) the purchase price for the part of the building that the contractor has completed at the time of the termination; or
- b* (if termination occurs after the completion of the construction) the unpaid construction costs.

In either case, payment will be to the extent that the contractor's services meet the required specifications.<sup>64</sup>

In cases of early termination owing to the relevant authority's default or voluntary termination, the compensation covers the contractor's costs and losses, such as financing costs and the availability fees for a certain period.<sup>65</sup> If the agreement is terminated due to force majeure or a change in law, the relevant authority will compensate for a reasonable amount of costs according to the risk allocation under the project agreement.<sup>66</sup>

In many projects, if a project terminates upon the contractor's default, the contractor will pay a penalty and, additionally, actual damages if they exceed the amount of the penalty. The Contract Guidelines suggest that the project agreement may provide for either liquidated damages or penalty.<sup>67</sup>

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60 Basic policy for Airport Concessions, Section 3-2(1).

61 PFI Contract Guidelines, Section 5.

62 Id.

63 PFI Act, Article 29.

64 Contract Guidelines, Section 5-4.

65 Id.

66 Id., Section 5-3.

67 Id., Sections 5-4 and 5-5.

Concession projects generally adopt similar approaches although the parties do not pay damages to each other in cases of termination due to force majeure or a change in law. In addition, some new mechanisms may be anticipated. For example, in concession agreements where the concessionaire must pay the concession fee up front, the relevant authority would agree to refund the portion of the concession fee that corresponds to the remaining concession term.<sup>68</sup>

## VI FINANCE

### i Project finance

Generally, the private sector finances PFI projects through project finance, which relies on the cash flow generated from the project.

In past projects, authorities have not allowed project companies to transfer, collateralise or dispose of project assets without their approval.<sup>69</sup> When granting security interests, the relevant authority will enter into a direct agreement with the lenders concerning: (1) the creation of security interests over project assets and some procedural matters related to the enforcement of the security interests; and (2) the lenders' step-in rights which allow them, following the contractor's default, to propose to replace the defaulting contractor with another private entity.<sup>70</sup> Apart from adding the concession right as a collateral, the foregoing basic practice is generally applied to concession projects.

Given that the contractor (or the concessionaire) is a special purpose company formed by the project sponsor, which is usually a consortium of private companies, lenders usually request the consortium members to pledge their shares in the contractor (or the concessionaire). In past projects, the transfers of those shares, including upon the enforcement of the pledge, require the relevant authority's approval but the current guidelines suggest that the relevant authority has more flexibility for such share transfers. For example, the relevant authority may adopt an arrangement in which share transfers are subject only to an *ex post* facta notification rather than an approval, as long as the transferee does not fall within a pre-agreed blacklist.<sup>71</sup>

### ii Efforts to expand the PFI market

In traditional projects, a substantial portion of the financing consists of loans from Japanese banks, and equity investors usually come from members (such as a construction company) of the project sponsor consortium. The Japanese PFI market characteristically lacks financial investors and foreign investors.<sup>72</sup> This is partly because traditional projects relying on the relevant authority's availability fees, which have constituted most of the deals executed in the Japanese PFI market, do not need much equity investment and the government has easily been able to finance its infrastructure projects at very low costs.

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68 Concession Guidelines, Section 14(3)2(6).

69 Contract Guidelines, Section 6-1.

70 Id., Section 5-1.

71 Id., Section 6-2.

72 Japan External Trade Organisation, 'Public Private Partnerships in Australia and Japan; Facilitating Private Sector Participation', 2010, pp. 25–26.

However, future PFI projects in Japan will likely rely more on private sector investors, including financial investors and foreign investors for the construction and maintenance of infrastructure for two reasons: (1) the government has severe financial problems, and some future PFI projects may require a significant amount of investment by private sector investors; and (2) the ‘user pays’ projects, which the government intends to promote, may involve more subtle risk analysis in relation to demand risks and need to secure investments from new classes of investors who bear such risk. Both the government and the market are trying to create a supportive environment in this regard.

As already mentioned, the current guidelines allow more flexibility for the transfer of shares in project companies. The Contract Guidelines clearly acknowledge that the need to restrict share transfers depends on various factors such as the content and phase of the project, and clarify that conditions to a stock transfer by a consortium member must be kept to the minimum extent necessary to appropriately implement the project, in light of the role of each consortium member in the project.<sup>73</sup> Further, the guidelines suggest that relevant authorities allow investors to freely transfer non-voting shares.

In October 2013, the Private Finance Initiative Promotion Corporation of Japan (PFIPCJ), co-sponsored by the government and the private sector, including banks and insurance companies, was established.<sup>74</sup> To encourage investors to provide risk money for infrastructure, the PFIPCJ is supposed to financially support ‘user pays’ projects mainly by subordinated debts, preferred stocks or other mezzanine finance.<sup>75</sup> The PFIPCJ decided to finance 18 projects, including the Kansai-Osaka (Itami) International Airport project, the Sendai Airport project and the Aichi Prefecture Toll Road project, until the end of 2016.<sup>76</sup>

In 2014, the national government revised the Financial Instruments and Exchange Act to allow investment corporations and investment trusts to invest in concession rights. In April 2015, the Tokyo Stock Exchange established the listed infrastructure market for funds that invest in infrastructure assets, which include concession rights.<sup>77</sup> An investment corporation, usually used in a Japanese REIT, is a tax-transparent vehicle that may, to the extent that it meets certain conditions, avail itself of tax deductions for dividends paid. As a vehicle investing in real property, it has gained broad acceptance among individual and institutional investors. In this regard, while the use of investment corporations may attract institutional investments in public infrastructure, current tax requirements limit an investment corporation’s investments in concession rights to less than half of its total assets. It is also questionable whether the authorities will allow an investment corporation, which is seen as engaging in passive investments, to actively operate an infrastructure business as concessionaire. Further considerations are required for investment by an investment corporation in concession rights.

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73 Contract Guidelines, Section 6-2.

74 PFI Act, Chapter 5.

75 Id., Article 53.

76 See the PFIPCJ website: [www.pfipcj.co.jp/activity/support\\_list.html](http://www.pfipcj.co.jp/activity/support_list.html).

77 See the Tokyo Stock Exchange press release issued on 30 April 2015, [www.jpx.co.jp/news/1070/20150430-01.html](http://www.jpx.co.jp/news/1070/20150430-01.html).



## **VII OUTLOOK**

As the government continues to demonstrate a proactive and encouraging support of PPPs, address remaining regulatory hurdles and incentivise governmental agencies and local governments to adopt PPP methods, PFI Act concessions and other PPP projects will keep growing and expanding while project schemes and finance arrangements of PPP projects are expected to become more diversified.

# MEXICO

*Federico Hernandez A and Julio Zugasti González<sup>1</sup>*

## I OVERVIEW

The implementation of a public-private partnership (PPP) framework at a federal level and therefore of PPP projects is recent in Mexico. Although various states in the country had regulated and promoted different PPP local projects, the federal government is determined to use this mechanism as a new measure to improve key infrastructure and services at a national level.

The initial step towards the use of PPPs was the publication of the Public-Private Partnership Law (the PPP Law) and the Regulations of the PPP Law (the Regulations) both in 2012. As detailed below, the PPP Law regulates the schemes for the development of the projects on a federal basis in accordance with the Mexican Political Constitution in order to create long-term relationships between public and private parties for, among others, the provision of services to the public sector and the use of infrastructure totally or partially provided to increase social welfare and private investment projects in Mexico.

In January 2012, former Mexican President Felipe Calderon Hinojosa enacted the PPP Law authorising the use of PPP projects on a federal basis. The Regulations were issued in November 2012. Notwithstanding the foregoing, the PPP Law and the Regulations were not really applied until the corresponding technical guidelines were issued on 31 December 2013 (although the current guidelines were published in February 2015). Since then, the federal authorities have commenced the implementation of such regulatory framework, considering that the PPP Law has been amended three times (two times in 2014 and the third in 2016) and the Regulations were only amended in 2014.

At a federal level, there have been different projects using PPP schemes mainly involving the health, communications and transportation sectors. Overall, there have been approximately 34 PPP federal projects during the past four years.<sup>2</sup> It is early to weigh the results of the PPP regulatory framework and the projects initiated, but we expect that the PPP regulatory framework will likely be applied in the long term, to continue attracting local and foreign investments in order to improve the welfare state and private interests.

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1 Federico Hernandez A is a partner and Julio Zugasti González is an associate at Hogan Lovells BSTL, SC. Special acknowledgement to Carlos Heredia and Carolina Castañeda, law clerks at Hogan Lovells, for their assistance in preparing this chapter.

2 For more information about the 34 PPP federal projects, please refer to Compranet at: <https://compranet.funcionpublica.gob.mx/web/login.html>.

## II THE YEAR IN REVIEW

In April 2016, several amendments to the PPP Law became effective. As part of such amendments, the Investment and Technological Development Fund (the Fund) was included in the PPP Law to support technological projects on different key areas in accordance with the applicable science and technological regulations. In general terms, the purpose of the Fund is, among others, to plan, develop and promote projects that will be developed by the private sector in technological areas. In 2014, the Fund was incorporated and received approximately US\$45.5 million of federal contributions. At all times, the Fund shall be used in accordance with the National Development Plan.

Likewise, in order to increase transparency on the bidding procedures of PPP projects, several changes were included on the manner to display the relevant projects through the government electronic public information system web page known as 'CompraNet'.<sup>3</sup> Now, all information regarding the use of PPP projects will be publicly available except as otherwise established by the applicable regulations.

The Regulations of the PPP Law include provisions regarding the use of the National Infrastructure Fund (FONADIN), as well as the scope to consider such funds by any entity.

In addition and as mentioned above, there are also state laws which regulate PPP projects on a local level. In general terms, the distinction between the state and federal level will depend on the origin of the funds that will be used for the PPP project. PPP projects that will use the expenditure of federal funds will be deemed of a federal nature. In this chapter we will focus only on federal PPPs.

In 2015, the Ministry of Public Function (MPA) issued the Code of Ethics for the public officials of the federal government, which makes reference to the obligation of public officials to perform their activities with honesty, legality, loyalty, impartiality and efficiency, so public officials should consider these principles when carrying out PPP procedures.

In 2016, there were eight PPP projects published on CompraNet. The most relevant projects related to the public health sector, road networks and fibre optic. As can be seen, PPPs have been used as a new mechanism not previously available for building new major infrastructure works in Mexico.

## III GENERAL FRAMEWORK

### i Types of public-private partnership

There could be different classifications of PPPs depending on the characteristics considered for such purposes. One useful classification refers to the subject matter of the PPP. The PPP Law distinguishes between PPPs carried out to develop productive investment projects, applied investigation and/or technological innovation (Technological PPPs) and the rest of the PPPs, which are the most common projects.

Technological PPPs have the purpose of financing projects for social welfare and technological development with the support of research centres and higher education entities. The Science and Technology Law is applicable to the Technological PPPs and the Fund will be used to promote these projects.

Another useful classification considers the type of federal resources used to fund a PPP. Considering the foregoing, there are three types of PPP: (1) budgetary funds; (2) funds of FONADIN or other federal non-budgetary funds; and (3) non-financial funds such as

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3 See <https://compranet.funcionpublica.gob.mx/web/login.html>.

contribution of authorisations (e.g., granting of authorisations for the execution of the works and for the provision of services; permits, licences, concessions or authorisations for the execution of the works as required by law; and permits, concessions or authorisations for the use or exploitation of public goods or the provision of services as required by law).

## **ii The authorities**

The PPP Law is applicable to the following promoting entities calling for or involved in a PPP project: (1) agencies and entities of the Public Federal Administration; (2) federal public trusts that are not deemed as state-owned entities; (3) constitutional autonomous bodies; and (4) any other entity whether municipal, local or federal that uses federal funds (or the majority of the funds are federal). For such reason, it would be deemed that more projects in the social sector might be developed based on the federal entity or the origin of the funds.

The Ministry of Finance and Public Credit (the Ministry of Finance) is in charge of interpreting the PPP Law and has a major role in controlling all the budgetary, investment and similar studies and procedures. On the other hand, the MPA is the authority in charge of the public goods, valuations, responsibilities of public officials, supervision and CompraNet, including the enforcement of the PPP contracts. The MPA is in charge of, among others, the administrative enforcement of the proper conduct of procurement processes and federal PPP projects. In accordance with the PPP Law, the MPA holds the authority to supervise the preparation, beginning and award of the PPP projects and the development of the projects, as well as any other process regulated by the applicable law.

Of course, other authorities will be involved with respect to the granting of authorisations applicable to the relevant project, such as, for example, the Ministry of Environment and Natural Resources. In the case of the allocation of federal budgetary funds, the corresponding approval shall be issued by the Chamber of Deputies. With respect to the Technological PPPs, the corresponding authorities will participate accordingly.

As an example of the promoting entities, the Mexican Social Security Institute and the Ministry of Communications and Transportation (MCT) played a significant role for the promotion of 2016 PPP projects. For instance, the former called for the construction of a hospital located at Bahía de Banderas, state of Nayarit and in Coatzacoalcos, state of Veracruz. The MCT developed a major PPP project in the telecommunications sector called 'Red Compartida' (wholesale shared wireless network in the 700MHz band), which is the biggest telecom project in Mexico's history.<sup>4</sup>

## **iii General requirements for PPP contracts**

Under the PPP Law, the PPP contract must include, among other information, relevant to the project, the following: (1) purpose (provision of the services and, if applicable, the execution of the infrastructure works needed for the provision of the services); (2) technical specifications and level service agreements; (3) properties, assets and rights to be used for the project; (4) financial regime and consideration to the developer; (5) the regime of distribution of risks and other terms and conditions applicable in case of force majeure and acts of God; (6) beginning of the operations, if applicable; (7) penalties and sanctions; (8) method of dispute resolution; and (9) date of issuance. The term of the contract and, if applicable, its extension may not exceed 40 years.

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<sup>4</sup> For more details about the project, please visit [www.sct.gob.mx/red-compartida/index.html](http://www.sct.gob.mx/red-compartida/index.html).

Administrative sanctions and penalties apply to PPP contracts in cases where the individual or company does not comply with its obligations under the contract and the PPP Law. Under specific scenarios (e.g., wilful misconduct or bad faith), the relevant individual or company may be subject to disbarment by the MPA.

In Mexico, information on awarded PPP contracts is publicly available, provided there are no national security reasons against making the information public, confidential information or third-party information infringements are involved in accordance with the General Transparency and Access to Public Information Act and the Personal Data Protection General Act. In that regard, the information publicly available regarding the execution of the PPP contract and the development of the contract can be found in CompraNet and through requests for information to the competent authority.

## **IV BIDDING AND AWARD PROCEDURE**

### **i Expressions of interest**

In accordance with the PPP Law, PPP projects are subject to transparent and publicly available tender procedures. In that regard, the public call for tender must be published on the website of the relevant entity and in the Federal Official Gazette, on CompraNet and in a national and regional newspaper. All local or foreign individuals or companies may participate in PPP calls, provided, however, that they fulfil the applicable requirements of the project. If applicable, local or foreign participants may participate individually or as a consortium (a joint proposal that is formed by two or more individuals or companies). If awarded, the consortium must incorporate a special purposes company only for the relevant project.

According to the PPP Law, any individual or entity is allowed to assist as an observer to the events of the PPP procedure. PPP procedures must have a social witness in order to verify, among others, that the relevant process is carried out impartially, ethically and independently.

The specific bidding rules of the project shall establish, among others, certain requirements such as (1) the name of the calling entity; (2) information for identification of the project; (3) a general description of the project; (4) applicable dates; (5) the authorisations required for the execution of the project; (6) legal and financial matters; (7) technical specifications; (8) standards for the performance of the project; (9) draft of the contract; (10) guarantees to be provided; and (11) any clarification or additional information requested by the entity. It is prohibited to establish requirements that may restrict free competition. In that regard, the calling entity must take into account the recommendations issued by the Federal Economic Competition Commission and the guarantees may not exceed 10 per cent of the estimated value of the investment.

In addition, the PPP procedure must have at least one Q&A meeting to clarify any doubts or concerns that the participants may have. The entity shall answer in writing the doubts and questions submitted by the participants. In the event that the calling entity intends to carry out a modification to the bidding rules, there should be enough time to prepare the relevant information to be submitted. Likewise, for the purposes of promoting participation in the procedures and avoiding being disqualified by a minor matter, previous reviews of the documentation are allowed to be performed by the relevant entity except with respect to the economic proposal. Between the last meeting of clarifications and the submission of the proposals, there must be enough time and if necessary, the date established for the submission and opening of proposals may be deferred.

## **ii Requests for proposals and unsolicited proposals**

Any individual or company interested in carrying out a PPP project may submit its unsolicited proposal of the project before the relevant entity or agency. For such purposes, the entities or agencies may publish a notice in the Federal Official Gazette and on their own web pages in order to determine the projects' proposals that are willing to receive, specifying the sectors, subsectors and geographical matters, type of projects, estimated dates and expected benefits. Unsolicited proposals must comply, among others, with: (1) a viability study that includes the description of the project; (2) social profitability; (3) legal viability; and (4) estimated investments. The relevant unsolicited proposal must also not have been submitted previously or have already been resolved by the relevant entity. If the relevant unsolicited proposal does not fulfil any of the requirements set forth in the PPP Law and its Regulations, the proposal will not be analysed.

In the event that the unsolicited proposal is feasible, the relevant participant is entitled to obtain an incentive in the evaluation of its offer, which will be no greater than 10 per cent of the evaluation method over the other participants. If the relevant participant is the only one in the process, the contract may be directly awarded if it complies with all of the requirements.

The estimated period for the competent entity to carry out the analysis and evaluation of the feasibility of the project is three months, which may be extended for an additional three-month period depending on the characteristics of the project. At this time, the public entity may request clarifications or additional information, and may even transfer the proposal to another public sector entity (e.g., municipality), as well as to invite said agencies to participate in the project.

Once the appropriate evaluation has been fulfilled, the relevant entity will express its opinion regarding the feasibility of the studies submitted. If applicable, this information will be sent to the applicant and will be published on the website of the entity and on CompraNet. Subsequently, a PPP procedure may be initiated.

On the other hand, the Ministry of Finance will be in charge of coordinating and publishing the relevant information about the unsolicited project, which will be public, except for, among others, confidential information. For such purposes, it will be published in the Transparency Portal Budget of the Ministry of Finance.

The Ministry of Finance must report the description of the authorised PPP projects, as well as the amounts disbursed or that will be disbursed in accordance with the estimates of the relevant case, the progress on the execution of the project, as well as the annual amount of the payments committed during the permanence of the contract.

## **iii Evaluation and grant**

For the purpose of making an assessment of the relevant project, the documents of the proposal must be submitted before the entity in sealed envelopes. In order to promote transparency, the envelopes will be publicly opened. On such meeting, participants are allowed to submit one proposal only, which is final and not subject to negotiation. Once the proposals are submitted, they are mandatory, so there is no opportunity to withdraw or invalidate them. For the purpose of making an evaluation of the proposals submitted, it is necessary to consider, among others, the following:

- a* the entity must verify that the requirements established in the bidding rules have been met;

- b* to follow up on the applicable evaluation method (e.g., cost-benefit criteria and point-rated criteria) to be used in accordance with the rules;
- c* to carry out a clear evaluation of the project; and
- d* to verify the technical, legal and financial capabilities of the awarded party.

As long as the applicable evaluation has been carried out, the relevant project will be awarded to the participant that has met the applicable requirements in accordance with, among others, the points established above. For such purposes, there must be grounded reasons to support the decision by the calling entity. However, in the event that more than one proposal meets the requirements set forth, the project will be awarded to the proposal that guarantees the best economic conditions for the Mexican government. If both proposals have equal conditions, the award of the project will be granted to the one that offers greater use of, among others, Mexican human resources, goods and services.

The relevant project will be awarded to the participant that filed a proposal that meets all applicable requirements. The relevant entity must issue a written decision based on the analysis of all proposals submitted including the legal, technical and financial grounds and the reasons the chosen entity provides the best conditions for the Mexican government.

For the purpose of making the evaluation and award of the project public, the calling entity shall hold a public meeting and shall also publish the award on its website and on CompraNet.

## **V THE CONTRACT**

### **i Payment**

The draft of the PPP contract should establish the payment in favour of the awarded party and the applicable mechanism to proceed with the payment. In the event that a participant is not in agreement with the payment scheme, said individual or company may ask for any applicable change during the Q&A meeting. At all times, the participant must take into consideration any applicable risk in accordance with the bidding rules. For instance, in June 2016, the Security and Social Services for State Workers Institute (ISSSTE) published a call for the provision of supplementary services on the health public sector by means of a PPP project. The bidding rules established an integral monthly net payment in favour of the awarded party, which was composed of various mandatory tariffs. In addition, the bidding rules included, among others, a maximum payment for the provision of services during the term of the contract.

### **ii State guarantees**

The Mexican government guarantees payment arising from the execution of a PPP contract through the corresponding annual Federal Expenditure Budget.<sup>5</sup> However, under the applicable regulation, it is not provided that specific guarantees will be issued in favour of awarded parties by the Mexican government. Therefore, in accordance with the applicable legal provisions, the Mexican government will ensure that sufficient funds exist to meet its payment obligations by providing them in the applicable Federal Expenditure Budget of the relevant year of multi-annual expenditure commitments.

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<sup>5</sup> For 2017, the maximum authorised amount is approximately US\$1.61 billion.

The PPP bidding rules must establish that the participant of the project should provide guarantees to evidence its capacity on the project. In such scenario, there are caps on the value of the infrastructure during the construction of the project, but additional guarantees and insurance may be requested by the relevant entity in accordance with the applicable regulation.

### **iii Distribution of risk**

PPP projects allow the parties to assume the risks related to the execution of the project. In accordance with the PPP Law, the draft of the contract will establish the distribution of risks of the project, so it may be understood that risks should not be unreasonable for one of the parties only. However, once the contract is signed, the parties may not make adjustments to the distribution of risks to the other party. In that regard, extensive analysis must be carried out by the PPP participants regarding the scope of risks.

In addition to the above, the risks regarding the operation, service provision and, if applicable, the construction of infrastructure and financing of the project will be assumed by the awarded party.

### **iv Adjustment and revision**

During the term of the PPP project, adjustments and modifications may be made to the terms originally established, in order to:

- a* improve infrastructure features, which may include additional works;
- b* increase the services or their performance level;
- c* have aspects related to environment protection, as well as to the preservation and conservation of natural resources; or
- d* restore the economic balance of the project.

Under such an event, other applicable documents should be modified accordingly. However, in order to restore the economic balance of the project, the awarded party will have the right to review the contract when the expenses and cost of the project substantially increase or the benefits of the awarded party decrease arising from an administrative, legislative or judicial activity. However, specific circumstances have to be met (e.g., unforeseeable change) to make any review of adjustment by the relevant entity.

### **v Ownership of underlying assets**

As a result of the execution of a PPP project, the relevant parties may acquire the property, assets and rights necessary in accordance with bidding rules or the relevant contract. The acquisition of such properties, goods or rights may be done through conventional means. In other words, a negotiation may be carried out with the owners of the property or through an expropriation proceeding due to public utility principles. In order to proceed with the acquisition through the conventional or expropriation means, an assessment needs to be requested from the relevant entity.

### **vi Early termination**

The entity may terminate the PPP contract early when there are reasons of general interest or if the need to request the services or goods no longer exists, considering justified causes and if the performance of the contract will cause an injury or damage. The early termination



must be supported by an opinion of the entity establishing the reasons and causes that make such decision. In case of early termination, the awarded party will be entitled to receive reimbursement of expenses and investments that proves it has invested, which are not recoverable and pending of payment. In any case, the expenses must be directly related to the project. The applicable payments have to be made within a period not exceeding 90 business days once the request has been made including the applicable information.

## VI FINANCE

The National Infrastructure Fund (FONADIN) was created by means of the National Works and Public Services Law in order to, among others, coordinate the development of infrastructure in different key areas in the country. The purpose of FONADIN is, among others, to plan, design, and build up infrastructure projects that will be developed by private individuals or companies with the help of the Mexican government.

In addition, according to the 2014–2018 National Infrastructure Program (the National Program), the Mexican government is determined to increase the existence of, among others, PPP projects.<sup>6</sup> Considering the foregoing, the Mexican government established an investment goal of approximately US\$338 trillion, which will be partially provided by the government and the private sector. Therefore, there is a clear determination to optimise funds and the public health sector will promote the use of PPP on its projects.

## VII RECENT DECISIONS

As previously set forth, in 2016, eight PPP projects were published on CompraNet. The results of said projects are basically addressed to the road networks and fibre optic. One project refers to the development of the ‘Red Compartida’ project to offer competition in the telecoms sector (provision of spectrum capacity), considering the high concentration levels in the Mexican telecoms market. The awarded party of the PPP project is a consortium of various Mexican and international investors, which will make large investments and will have access to spectrum as part of a 20-year contract. In addition, in 2016, four road network projects were published by the MCT on CompraNet. Another project refers to the maintenance and reconstruction of the Queretaro-San Luis Potosi road network, which is one of the most important highways in central Mexico.

In addition, in June 2016, the ISSSTE published a call for the provision of supplementary services by means of a PPP project for the design, construction, equipment and maintenance of a new hospital in Merida, state of Yucatan for an approximately 27-year term, which was awarded in favour of a local company.

## VIII OUTLOOK

During the past few years, PPP projects have been launched to promote Mexico’s economic growth. With projects such as the ‘Red Compartida’, it is fair to say that there are grounds for optimism. The PPP Law and its Regulations (as amended) strengthen the Mexican investment

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<sup>6</sup> For more details about the National Program please visit <http://cdn.presidencia.gob.mx/pni/programa-nacional-de-infraestructura-2014-2018.pdf?v=1>.

project legal framework. The biggest challenge for Mexico seems to lie on the enforcement side of strong and necessary projects for the welfare of the people. Therefore, the creation of PPP projects, with a specific scope, is essential to Mexico's success for both the public and private sector. One of the most important changes in the recent reforms is the transparency obligation on a federal basis, but it has not been replicated in all local regulations.

Even though the Mexican government has the major responsibility of attracting new investment, foreign and local individuals or companies could take advantage of using the PPP regulatory framework for the development of major infrastructure projects for the benefit of the country and the people.

# MOZAMBIQUE

*Taciana Peão Lopes*<sup>1</sup>

## I OVERVIEW

Law 15/2011 of 10 August and Decree 16/2012 of 4 July 2012 approved the Public-Private Partnerships (PPP) Law and PPP Law Regulations that set out the guiding rules for the process of contracting, implementing and monitoring undertakings of PPPs, mega projects and business concessions, and establish the general framework for private sector investments in Mozambique, focusing on investments in key infrastructure, natural resources and large-scale investment.

The first PPP undertaking approved under this framework was in the context of the Nacala Corridor Project and entailed an investment of US\$6 billion for the design, construction, ownership, operation, maintenance, financing, insurance and management of a railway and port in Nacala by the mining company Vale. In 2013, a power-generation project using natural gas in Ressano Garcia was also approved under the PPP regime.

## II THE YEAR IN REVIEW

During the past couple of years, the large majority of PPP undertakings negotiated and awarded in Mozambique have related to power-generation projects using natural gas, coal or water resources. Most recently, the government of Mozambique has been in the process of negotiating solar generation PPP projects. In addition, it is expected that, in the near future, more PPP projects will be implemented for infrastructure, since the government has announced its intention to launch tenders for concession contracts for certain bridges and roads throughout the country, and all the infrastructure projects connected with the development of the liquid natural gas project in the Rovuma Basin, northern Mozambique.

## III GENERAL FRAMEWORK

### i Types of public-private partnership

The PPP Law defines three different types of undertakings: straightforward PPPs, mega projects and business concessions.

A PPP is defined as a contract between the government and a special purpose vehicle, the object of which consists in the qualitative and quantitatively efficient provision of public goods to users, but there are other PPPs that are conceptualised as adding value to national resources, including the land required to carry out the project. This land is temporarily

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<sup>1</sup> Taciana Peão Lopes is the founding partner and manager at Taciana Peão Lopes e Advogados Associados.

transferred to the PPP via a right of use and development of land, but the resources remain the property of the state. Underlying the PPP concept is the 'user-pays' principle ensuring that the price paid for services provided, under the contractually agreed terms, compensates for the costs incurred and provides a profit margin.

A mega project corresponds to the undertaking of an investment, authorised or contracted by the government, the value of which, with reference to the date of 1 January 2009, exceeds the amount of 12.5 billion meticaís.

A business concession is aimed at the exploration, prospecting, production or use of natural resources, other resources or assets of the state.

PPP contracts can take various forms, from BOT (build–operate–transfer), DBOT (design–build–operate–transfer); BOOT (build–own–operate–transfer); DBOOT (design–build–possess–operate–transfer); ROT (rehabilitate–operate–transfer); and ROOT (rehabilitate–own–operate–transfer).

## **ii The authorities**

The PPP Law applies across a number of economic sectors and is based on a sectorial and institutional articulation. The competent government authority will be the competent authority in the economic sector to which the project relates (such as the Ministry of Energy for power projects and the Ministry of Transport and Communications for railway and port concessions). Notwithstanding, the Ministry of Finance plays a key role in ensuring that the PPP undertaking provides enough comfort in respect of the sharing of benefits and the allocation of risks.

## **iii General requirements for PPP contracts**

### ***Term***

The duration of the PPP undertaking depends on the type of project undertaken and shall not, in any case, exceed 30 years for greenfield projects (this may be extended by up to 10 years in the case of mega projects and if the long-life and technological or ecological requirements of the implementation or planning of the project so require); 20 years, for a concession contract and an operations contract for an existing undertaking requiring rehabilitation or expansion; and 10 years for a management contract for an operational undertaking.

Term extensions can also be granted if the government lowers the user fee, or after force majeure events. At the end of the project, and only if the infrastructure is sound, the original investor has a 5 per cent advantage over other bidders provided that it has shown good performance and results in the execution of the previous contract.

### ***Guarantees***

The holder of a PPP undertaking shall provide the following financial guarantees:

- a* at the negotiation phase, from the bid submission to the signature of the PPP contract, 0.1 per cent of the total estimated investment as per the project investment approval;
- b* during the construction phase, 10 per cent of the total estimated investment;
- c* during the operational phase, 5 per cent of total actual investment (subject to adjustment in case of depreciation in excess of 25 per cent due to inflation or exchange-rate fluctuations); and
- d* at the stage of transferring the asset to the state, 5 per cent of the total investment.

### ***Financial and socio-economic benefits***

A specialised unit established by the Ministry of Finance evaluates PPP projects from a financial and economic point of view, in coordination with the competent sectorial ministries.

When contracting a PPP the following factors should be considered: the specific policies and development plans of the sector; the contribution to adding value to national resources; creation, rehabilitation or expansion of infrastructure for production or provision of services, in connection or associated with the undertaking; the equitable division of the benefits of the undertaking; a commitment to reduce the risks inherent in each particular project; the removal of restrictions that compromise the viability of the projects; the creation and preservation of jobs and the transfer of skills to Mozambican workers and management; its potential contribution to the development of national capital markets; the inclusion of Mozambican partners in all undertakings; establishing partnerships between PPPs and small and medium-sized Mozambican firms, as well as the transfer of know-how to these firms; and the requirement that PPPs should establish programmes, projects or actions that promote social development in the local communities where they are located.

The law requires that the PPP contract makes express reference to the following specific matters:

- a* Local content requirements:
  - an obligation to list 5–20 per cent of the company implementing the project's share capital on the Mozambican stock exchange, within five years from the start of commercial operation of the project. Such shares must be offered at a nominal value per share to enable Mozambican nationals with limited economic means to participate in the offering; and
  - a commitment to give public or private Mozambican companies the opportunity to acquire an interest in the project on terms to be negotiated.
- b* If the project results in unexpected, exceptional direct profits for three consecutive financial years as a result of external market factors, resulting in the return on the investment exceeding contractually agreed rates of return, such profits must be retained in Mozambique or reinvested in Mozambique.
- c* A signing bonus – where established in the tender documents – of between 0.5 and 5 per cent of the value of the assets assigned by the state or other public partner.
- d* A concession fee to be paid on a monthly, quarterly, semi-annual or annual basis, as agreed between the parties.
- e* A minimum of 35 per cent of the annual taxable profit of a project to be remitted to the state via the state's participation in the special purpose vehicle and taxation.

### ***Transfers***

Any direct or indirect transfers of rights and obligations granted under the PPP contract, to an affiliate or to a third party, are subject to the government's approval. Furthermore, such assignments are subject to the payment of capital gains.

### ***Administrative Court visa***

Without prejudice to protection of the confidentiality of the undertaking's strategic commercial and competitive information, the main PPP contract concluded is subject to issuance of a prior review administrative ruling by the Administrative Court as well as to the publication of (1) the principal contract terms in the Official Gazette and the government portal; and (2) accounting balance sheet and reports related to the undertaking's activity.

### ***Interpretation***

The PPP Law expressly states that it will override sector-specific legislation in respect of the contracting regime, sharing of benefits (unless comparable benefit-sharing arrangements exist in sector-specific legislation) and the allocation of risks.

### ***Governing law and dispute resolution***

The law applicable to PPP contracts is the law of Mozambique. Mozambican law is also applicable to some key project agreements, such as the engineering, procurement and construction contract, unless otherwise expressly authorised by the government. The resolution of disputes emerging in any phase of a PPP undertaking is processed under the terms contractually defined between the parties, in compliance with the applicable legislation in force on the matter. To enable the speedy resolution of disputes and to preserve the dynamism of business and economic life, especially to meet collective needs, the PPP contract may establish that the resolution of any disputes arising therefrom should be through mediation and arbitration.

## **IV BIDDING AND AWARD PROCEDURE**

The awarding procedure can take three forms: (1) bidding by pre-qualified firms for simple projects; (2) a two-stage procedure for complex projects where pre-qualified firms participate in the final design, before the bidding stage; and (3), in special cases, and as a last resort where there are no bidders and subject to prior express approval by the government, the government can contract a firm by direct negotiation.

The PPP Law admits the possibility of unsolicited proposals and if they are accepted, the proponent has a 15 per cent advantage in [scoring at] the bidding stage, but no compensation for the costs incurred in preparing the proposal are applicable.

PPP undertakings are subject to public law principles of legality, finality, reasonableness, proportionality, pursuit of the public interest, transparency, publicity, equality, competition, impartiality, good faith, stability, motivation, integrity and reliability, good economic-financial management and promptness.

## **V THE CONTRACT**

### **i Payment**

Typical forms of remuneration include offtake agreements, common in power-generation projects where the principal offtaker is the national power utility, or via the collection of tariffs for the services provided, usually charged in railway, port and road projects.

### **ii State guarantees**

In the case of PPP projects that are of special socio-economic interest to the country but that are not independently profitable, the government may provide subsidies or guarantees, or facilitate access to multilateral agencies or donor countries. These guarantees or subsidies should be registered by the Finance Ministry, which should track both the individual and overall level of these commitments, and include them in the annual budget.

**iii Distribution of risk**

The PPP Law sets out detailed risk-allocation principles for PPPs. These broadly require the state to assume political risks (such as changes in law and matters relating to the grant of land rights) and require the company implementing the PPP to assume the financial, technical and operational risks relating to the project.

**iv Adjustment and revision**

The PPP Law requires the state to tailor the term of the PPP concession to the requirements of the economics of the project, rather than grant a concession for the maximum term in each case.

The PPP Law allows for the renewal of the initial term of PPPs in limited circumstances. For greenfield undertakings, the initial term can be renewed for up to 10 years if the project is a mega project and the economics of, and technology used in, the investment require it.

In other PPPs the state can extend the term of a PPP where (1) additional investments were made out at the request of the state and need to be recovered; (2) the PPP's revenues are based on a tariff determined by the state and the tariff level is insufficient to achieve the investor's required return; and (3) any force majeure events have occurred and additional time is required to achieve the investor's required return.<sup>2</sup>

**v Ownership of underlying assets**

The public property assets contractually granted remain the inalienable property of the state and cannot be given as security, without prejudice to enjoy the right of use and benefit that is contractually granted to the private party.

**vi Early termination**

The PPP contract must describe the specific conditions for termination of the contract and the mechanisms for compensation in case of termination. The law establishes some general conditions under which the contract can be terminated, including serious non-compliance with the contract, abandonment of the contract, transfer of the contract without consent, non-payment of taxes or other contracted sums, with the contractual conditions to be published in the Official Gazette.

Redemption of the contract by the state is only allowed for weighty reasons of public interest duly justified under the terms of the law and the contractual provisions agreed on the matter, which entitle the private investor to an indemnification to allow the recovery of its investments and to ensure the undertaking's profitability.

Termination compensation is usually paid taking into consideration several matters, such as the financial model, the formula agreed by the parties for calculating the purchase price, and senior debt and shareholder equity contributions.

**VI FINANCE**

PPP undertakings have been financed via a combination of equity-plus-debt on a recourse and non-recourse project-financing basis. Direct agreements entered into between the

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2 Recently the government of Mozambique agreed to extend the term of the Nacala Port and Railway Concession.

government and lenders are common and provide certain rights, such as (1) step-in rights in the event of violation of a PPP project contract by the entity that was awarded the relevant contract; (2) government confirmation of its support for the relevant PPP project, namely by supporting the undertaking to obtain some of the relevant licences and authorisations; and (3) government confirmation of its consent to security over the contract and commitment to pay amounts as directed by the lenders.

## **VII OUTLOOK**

Mozambique has massive investment needs in the infrastructure (energy, transportation, water and sanitation) and social (health and education) sectors and therefore PPP undertakings will need to increase and make more effective public investment, build human capital, sustain growth and ensure broad economic development.

Politicians and policymakers should look into alternative instruments to support investment in essential infrastructure, such as the resource-financed infrastructure model, which is a mechanism that may enable a government that does not have funds available to invest, and cannot borrow on a sovereign basis, to involve the private sector in the project – and also protect the national treasury from credit – by following a licensing process for development and production of natural resources to a private developer and to borrow against its expected revenue stream from the resource-development project.<sup>3</sup>

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3 For more details on this mechanism see the report ‘Resource Financed Infrastructure – A Discussion on a New Form of Infrastructure Financing’, prepared by the World Bank, Hunton & Williams and PPIAF, 2014.



# NIGERIA

*Fred Onuobia, Okechukwu J Okoro and Bibitayo Mimiko*<sup>1</sup>

## I OVERVIEW

The Federal Republic of Nigeria is made up of a central federal government, 36 state governments and 768 local governments. Each federating unit is, subject to some constitutional restrictions, responsible for infrastructural development within the territory over which it has or exercises control.<sup>2</sup> Theoretically therefore, there could be as many public private partnership (PPP) laws and frameworks as there are tiers of governments in Nigeria. However, in reality, PPP is still in its infancy in Nigeria, with only very few states such as Lagos State, the nation's commercial capital, having any form of formal legal framework for PPPs.

The late 1990s and beyond saw the federal government of Nigeria shedding some of its responsibility for infrastructural development by increasing private participation in critical sectors of the Nigerian economy through the privatisation and commercialisation of hitherto state-owned monopolies especially in the telecommunications, electricity and financial services sectors. Undoubtedly, privatisation had been the preferred vehicle for private sector participation in Nigeria's infrastructural development. There has, however, in recent years, been a gradual shift towards PPPs.

The Infrastructure Concession Regulatory Commission (Establishment, etc.) Act, 2005 (the ICRC Act) was enacted for 'the participation of the private sector in financing the construction, development, operation, or maintenance of infrastructure or development projects of the federal government through concession or contractual arrangements; and the establishment of the Infrastructure Concession Regulatory Commission to regulate, monitor and supervise the contracts on infrastructure or development projects'.<sup>3</sup> In Lagos State, the statutory regime for PPP has evolved from the Lagos State Roads, Bridges and Highway Infrastructure (Private Sector Participation) Development Board Law enacted in 2004<sup>4</sup> to the more streamlined Lagos State Roads (Private Sector Participation) Authority Law passed in 2007 and finally to the Lagos State Public Private Partnership Law, 2011 (the Lagos PPP Law), which is the law currently in force.<sup>5</sup>

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1 Fred Onuobia is the managing partner and Okechukwu J Okoro and Bibitayo Mimiko are associates at G Elias & Co.

2 Nigeria operates a federal system of government. Each tier of government has its constitutionally allocated responsibilities. See Constitution of the Federal Republic of Nigeria, 1999 (the Constitution) Sections 4, 5 and 8. Also Schedules 2 and 4 of the Constitution.

3 Explanatory Memorandum, ICRC Act, 2005.

4 This was widely recognised as a first of a kind in the Nigerian PPP sphere.

5 Other states such as Ekiti, Rivers, Kogi, and Cross River have their respective PPP laws.

## II THE YEAR IN REVIEW

In the course of 2016, the federal government of Nigeria set up committees to oversee and steer the concession of the aviation and railway sectors. The plan is to concession Nigeria's four major international airports (Lagos, Abuja, Port Harcourt and Kano international airports) and the eastern and western railway lines respectively. Within the year, the federal government of Nigeria also approved a 50-year concession for the Ibom Deep Sea Port in Akwa-Ibom State Nigeria. The Ibom Deep Sea Port project is being carried out by a special purpose vehicle, with equity participation conceived as follows: Akwa-Ibom State, 20 per cent; private sector, 60 per cent; and 20 per cent floating for interested private investors of other state governments. There are also other PPP projects at different stages, with values running into billions of dollars, being developed by the federal, state and local governments in Nigeria.

## III GENERAL FRAMEWORK

### i Types of public-private partnership

A wide range of PPP models are possible under existing legal frameworks in Nigeria. Provision is made for traditional models and there is latitude for innovation where needed. The ICRC Act provides that 'any Federal Government ministry, agency, corporation or body involved in the financing, construction, operation or maintenance of infrastructure, by whatever name called, may enter into a contract with or grant concession to any duly pre-qualified project proponent in the private sector...'<sup>6</sup> 'Concession' is broadly defined to include 'a contractual arrangement whereby the project proponent or contractor undertakes the construction, including financing of any infrastructure, facility and the operation and maintenance thereof...'<sup>7</sup>

In clarifying the law, the Supplementary Notes to the National Policy on Public Private Partnership (Supplementary Notes) explains that 'a wide range of contract forms- in turn represented by numerous acronyms (BOT, DBFO, BOOT, etc.) falls within the scope of the term "public private partnership". It can be said to include: outsourcing and partnering; performance-based contracting; design, build, finance and operate (or build operate transfer) contracts; and sometimes, concessions.'<sup>8</sup> Over the years, governments in Nigeria have undertaken different PPP projects under different models.<sup>9</sup> The Murtala Muhammed Domestic Airport Terminal 2 (MMA2), the domestic terminal of the international airport situated in Lagos and its ancillary facilities, were developed under a Build-Operate-Transfer (BOT) agreement among the federal government, represented by the Minister of Aviation, the Federal Airports Authority of Nigeria and Bi-Courtney Aviation Services Limited, as concessionaire. The Katampe District Infrastructure was undertaken under a design, build, finance and transfer PPP model, between, the federal government, represented by the Federal Capital Development Authority and a private partner, Deanshanger Project Ltd.

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6 Section 1(1) ICRC Act.

7 Section 36 ICRC Act.

8 See Part 4, paragraph 2 of the Supplementary Notes.

9 Among others, the Tinapa Free Trade Zone & Tourism Resort and the Akampa toll road project were all developed by the Cross River State Government using PPP models. Also the River State Government is developing the Greater Port Harcourt housing project scheme under a PPP.

On its part, the Lagos PPP Law defines a ‘concession agreement’ as ‘any agreement between the government and any person, firm, company or limited liability partnership for the construction, maintenance, operation or management of public infrastructure, assets and facilities over an agreed period of time including, but not limited to, the following types of agreements – (1) Design, Build, Operate and Transfer (DBOT); (2) Build, Own, Operate and Transfer (BOOT); (3) Rehabilitate, Operate and Transfer (ROT); (4) Joint Development Agreement (JDA); or (5) Operation and Maintenance (OM)’.<sup>10</sup> The Lekki-Epe toll road concession was executed on a BOT basis between the Lagos State Government (LASG) and a special purpose vehicle specifically established for the project, the Lekki Concession Company (LCC). The Lekki-Epe toll road concession agreement provided for the payment of a toll by users of the road to LCC, the concessionaire.<sup>11</sup>

## ii The regulators

There have been attempts to establish regulators or agencies with mandates that are specific to PPP. At the federal level, the Commission was established in 2008 pursuant to the ICRC Act as a body empowered to, among other things, ‘take custody of every concession agreement made under this Act and monitor compliance with the terms and conditions of such agreement; [and] ensure efficient execution of any concession agreement or contract entered into by the Government’.<sup>12</sup> For states with PPP-specific laws, such laws invariably establish a body with responsibility for PPPs in the state. In Lagos State, for instance,<sup>13</sup> the Office of Public Partnerships (the Office) has the power to grant concessions; negotiate with prospective private partners; inspect and monitor concessionaires to ensure compliance with the terms of any concession agreement; designate a public infrastructure or public asset as a service charge, user fee or toll paying public infrastructure or public asset and specify the condition for the use of such infrastructure or assets. Further, the Office is empowered to approve the amount of money that may be charged by a private or public operator with respect to any public infrastructure, public assets or amenities as toll or user fees, subject to the approval of the Lagos State House of Assembly.<sup>14</sup>

The Bureau of Public Enterprises (the BPE) established under the Public Enterprise (Privatisation & Commercialisation) Act, 1999 (the PE Act) is charged with the responsibility of effecting the privatisation or commercialisation of government enterprises identified under the First and Second Schedules of the PE Act. The BPE in the performance of this function has been seen to make use of traditional PPP models such as BOT or concessioning in some circumstances. For instance, the Nigerian Ports Authority currently has about 25 terminals operated under concession agreements with private entities with the concession terms ranging from 10 years to 15 years. There are also at least two ports operating on a BOT basis, namely, the Tin Can Island Port Complex and the Rivers Port Complex.

The Supplementary Notes outlines the roles and responsibilities of ministries, departments and agencies (MDAs) and other stakeholders in PPPs to avoid duplication,

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10 Section 35 Lagos PPP Law.

11 Control of LCC has since December 2014 being taken over by the LASG pursuant to a share purchase agreement between stakeholders of LCC and the LASG.

12 ICRC Act Section 20(a) and (b).

13 Other State also have similar ‘offices’ or ‘bodies’ under varying appellations, with powers similar to that of the Office, established under their respective PPP laws.

14 Section 10 Lagos State PPP Law.

reduce bureaucracy and promote consistency, clear responsibility and accountability. Apart from the Commission and the BPE, the key MDAs involved in PPPs are the National Planning Commission, the Federal Ministry of Finance, the Debt Management Office, Office of the Accountant-General of the Federation and the Bureau of Public Procurement (the BPP). There are also sector-specific regulators, such as the Nigerian Communications Commission (for telecommunications projects), the Nigerian Electricity Regulatory Commission (for power projects), the Nigerian Maritime Administration and Safety Agency, Nigerian Ports Authority and the National Inland Waterways Authority (for maritime projects) and so on.

### iii General requirements for PPP contracts

PPPs can be utilised for any project in Nigeria, except those that relate to matters on the 'negative list'.<sup>15</sup> The actual terms of a PPP contract will depend on the negotiation process of the parties involved and any special considerations surrounding the project. There is no standardised PPP agreement that must be adopted by the parties. There are, however, certain provisions that must be complied with as stipulated under the ICRC Act or the laws of the relevant states, including provisions for arbitration as the dispute resolution mechanism. Generally, it is required that the project company possess the financial capacity, relevant expertise and experience in undertaking the relevant infrastructure development or maintenance before it can contract with a relevant MDA.<sup>16</sup>

In addition, while the concession agreement might be executed only between the relevant government ministry or agency and the private entity, such an agreement would have been subjected to numerous consent requirements, depending on the peculiarities of the project. For instance, for prioritised projects under the ICRC Act, the approval of the Federal Executive Council<sup>17</sup> is required before the relevant ministry or agency can enter into a PPP agreement. Also, the approval of the Federal Executive Council is required for a government ministry, agency or corporation to give any form of guarantee, letter of comfort or undertaking in a concession agreement.<sup>18</sup>

The Executive Council and the Governor are the approving authorities in Lagos State.<sup>19</sup> However, the Lagos PPP Law further provides that 'any Concession Agreement to be entered into by the Office must be presented before the House of Assembly for ratification before implementation'.<sup>20</sup> This provision is peculiar to the Lagos PPP Law. There is no such consent requirement under the PPP laws of Ekiti and Rivers States, for example. The Ekiti State PPP Law provides instead that 'the award of a Concession by the Ekiti State Public Procurement Board is subject to the approval of the Governor as the approving authority'.<sup>21</sup> Finally, where a consortium is undertaking the project under a PPP, members would be jointly and severally

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15 Section 31 of the Nigerian Investment Promotion Commission Act, 1995 lists sectors to which investment is barred by both local and foreign investors. They are (1) production of arms, ammunition, etc.; (2) production of and dealing in narcotic drugs and psychotropic substances; (3) production of military and para-military wears and accoutrement, including those of the Police and the Customs, Immigration and Prison Services; and (4) such other items as the Federal Executive Council may, from time to time, determine. See also, Public Procurement Act, 2007 Section 15(2).

16 ICRC Act, Section 2(3).

17 This is the name of Nigeria's federal cabinet or council of ministers.

18 ICRC Act, Section 3.

19 Paragraph 8.19 Lagos State PPP Manual.

20 Section 26 Lagos PPP Law.

21 Section 8 Ekiti State Public Procurement Board, 2011.

liable under the contract and the withdrawal of any member of the consortium before or during the implementation of the project may be ground for review or possible cancellation of the contract.<sup>22</sup>

The duration of a PPP agreement will depend on the nature of the project. The ICRC Act does not limit the duration of PPP agreements.

## **IV BIDDING AND AWARD PROCEDURE**

### **i The federal government of Nigeria**

In addition to the ICRC Act, the Public Procurement Act, 2007 (the PPA) also plays a central role in the award of concessions at the level of the federal government. The PPA established the BPP and makes due process provisions applicable to procurements by the federal government and its agencies. Essentially, the PPA requires every procurement entity<sup>23</sup> to maintain a record of a comprehensive procurement procedure. Nevertheless, while the actual procurement process may differ from one entity to another, all procurement must comply with the principles and general framework laid down by the PPA. The principal feature of the PPA is that all procurement entities must obtain a 'Certificate of 'No Objection' to Contract Award' from the BPP for every procurement to be formalised<sup>24</sup>. The PPA establishes different procedures for the procurement of goods and works on one hand, and the procurement of services on the other hand. Central to both regimes is the general<sup>25</sup> need for public advertisement of invitation for bids in respect of the procurement with a view to encouraging 'open competitive bidding'.<sup>26</sup>

Also noteworthy is that the PPA expressly permits preferential treatment for domestic or local bidders in situations where an invitation to bid for goods and works is also extended to foreign bidders. Section 34(1) of the PPA states that 'a procuring entity may grant a margin of preference in the evaluation of tenders, when comparing tenders from domestic bidders with those from foreign bidders or when comparing tenders from domestic suppliers offering goods manufactured locally with those offering goods manufactured abroad'. The parameters of such domestic preference must be disclosed in the bidding document.

Finally, in determining the successful bid, the procurement entity must be mindful of the bid offering the most value for money as regards the requirements of the proposal for bid.

### **ii The state governments**

The bid and award process will differ from state to state depending on the specific regulatory framework in place. For Lagos State, it goes without question that the extant legislation on procurement applies to PPPs. The Lagos PPP Law expressly provides that 'the Office shall be a procuring entity for the purpose of the Lagos State Public Procurement Law and shall comply

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22 Section 4(3) ICRC Act.

23 Procurement Entities 'means any public body engaged in procurement and includes a Ministry, Extra-Ministerial office, government agency, parastatal and corporation' PPA section 60.

24 Section 16(1)(b) PPA.

25 Exceptions to the need to publicly advertise the invitation for bids include emergency, and the availability of goods, works or services from only a particular supplier.

26 Open competitive bidding is defined as 'the process by which a procuring entity based on previously defined criteria, effects public procurements by offering to every interested bidder equal simultaneous information and opportunity to offer the goods and works needed Section 24(2) PPA.

with the intendment of that Law'.<sup>27</sup> The provisions of the Lagos State Public Procurement Law, 2011 (the Lagos Procurement Law) are very similar to that of the PPA. A significant difference is that under the Lagos Procurement Law, there is no provision for the issuance of a Certificate of No-Objection by the Office. Moreover, unlike the PPA, the Lagos State Procurement Law makes provision for e-procurement.<sup>28</sup> Nevertheless, procurement by any procuring entity is governed by the same principles of open competitive bidding, promotion of competition, system of accountability and the likes.

### iii Unsolicited bids

The Commission's Guidance Notes on Unsolicited Proposals governs unsolicited proposals at the level of the federal government. The Commission's Guidance Notes encourage unsolicited proposals on the premise that they might contribute to the infrastructural development of the country. Unsolicited proposals are to be submitted directly to the relevant MDA. MDAs on their part are to review submitted unsolicited proposals against the following laid down criteria: (1) does the project serve a credible public interest?, (2) is the project in line with the national development goals of the relevant MDA?, (3) does the project fall under the category of critical infrastructure?, (4) is the project viable without need for Viability Gap Funding (VGF)?, and (5) does the project proponent possess the requisite competence and profile to implement the project?<sup>29</sup>

Upon completion of the MDA's review, the proposal is forwarded to the Commission for its review and issuance of 'No Objection' after a favourable technical and financial due diligence exercise. Thereafter, ministerial approval is sought and if obtained, the project proponent is issued a formal acknowledgment as the project author and the project proceeds to a competitive bidding stage. At the bidding stage, the Swiss Challenge System<sup>30</sup> will be applied to allow for submission of competing bids by other potential proponents via a transparent process. However, the investments made by the project proponent in preparing the proposal to the requisite OBC standard<sup>31</sup> is taken into consideration and as such the original proponent is granted the right to counter-match the best offer and secure the contract.<sup>32</sup> The successful bidder is determined on the basis of the most economically and financially viable submission.

For unsolicited bids, the approach of the Office in Lagos State is similar to that of the Commission outlined above. The Lagos State PPP Manual (the Manual) provides that 'in select cases, the project could be initiated by the private sector as an Unsolicited Proposal under a transparent, competitive process which will also be managed by a MDA.'<sup>33</sup> It appears, however, that Lagos State is less disposed to pursuing unsolicited proposals as the Manual

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27 Section 11 Lagos PPP Law.

28 Section 60(2) Lagos State Procurement Law provides that 'subject to the provisions of this Law and its Regulations, it shall be lawful for any procuring entity to consider any or all of its tenders by electronic auction and or simulation on its electronic portal, provided that the use of electronic system shall be transparent, efficient and economical.'

29 Paragraph 3.2.1 ICRC's Guidance Notes on Unsolicited Proposals.

30 This refers to the system where it is mandatory for a procurement entity that has received an unsolicited bid to request for competing bids from the public. The bid from the original project proponent is then assessed against the competing bids before a decision is reached.

31 This refers to the 'Outline Business Case' Standard provided under the Supplementary Notes.

32 Paragraph 8.6 ICRC's Guidance Notes on Unsolicited Proposals.

33 Paragraph 2.1.1 Lagos State PPP Manual.

further provides that ‘while all proposals will be treated on a case-by-case basis, consideration of unsolicited proposals will be the exception rather than the rule, limited mainly to projects that demonstrate genuine innovation and/or use of proprietary technology’.<sup>34</sup>

## V THE CONTRACT

There is no standard or model PPP agreement. Thus each PPP agreement will be unique to the project and parties involved.

### i Payment

The existing frameworks provide for both direct payment by the public procuring entity to the private entity and also for payment from the proceeds of the project. Under the ICRC Act, where payment is to flow directly from the government, such payment must be by way of amortised payments.<sup>35</sup> Unfortunately, the ICRC Act does not further provide for the rate or interval of payment of these amortised payments. Also, under the PPA,<sup>36</sup> mobilisation fees of up to 15 per cent may be paid to a contractor or supplier and future payments are subject to the issuance of an interim performance certificate. Payments must be settled promptly as payments that remain unpaid for more than 60 days after the date of the submission of an invoice, will attract a delayed payment interest. The PPA further provides that ‘all contracts shall include terms, specifying the interest for late payment of not more than sixty days’.<sup>37</sup>

While the Lagos Procurement Law provides that a performance guarantee may be required as determined by the Office, the PPA makes the provision of a performance guarantee mandatory. Section 36 PPA provides that ‘the provision of a Performance Guarantee shall be a precondition for the award of any procurement contract upon which any mobilisation fee is to be paid, provided, however, it shall not be less than 10 per cent of the contract value in any case or an amount equivalent to the mobilisation fee requested by the supplier or contractor whichever is higher’.

### ii Guarantees

MDAs are not permitted to give any guarantee, letter of comfort or undertaking in respect of any concession without the approval of the Federal Executive Council. On the other hand, in Lagos, it would appear that there is an outright prohibition on the provision by Lagos State or the Office of guarantees in support of PPPs. Section 17 of Lagos PPP Law states that ‘a public private partnership agreement must not contain provisions for any financial guarantee from the State, any Ministry, Department or Agency for the Public Private Partnership but may include provisions for indemnity or undertaking that would be given in the ordinary course of business.’ Considering Nigeria’s infrastructure deficit and the weakness of institutions of state, it may be prudent for government to incentivise private entities to enter into PPPs

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34 Paragraph 8.19 Lagos State PPP Manual.

35 Section 7(3) ICRC Act.

36 These provisions are mirrored in Sections 62 and 64 of the Lagos Procurement Law. The Lagos Procurement Law, however, sets a higher threshold of 20 per cent as mobilisation fee (called advancement payment under the Lagos State Procurement Law) and advance payment of more than 20 per cent may be paid upon submission of a written request by the supplier or contractor justifying the need for such payment.

37 Section 37(4) PPA.

by providing guarantees and other fiscal incentives. A total ban on state support is not recommended.

### **iii Distribution of risk**

The guiding principle for the distribution of risk is that risks will be allocated to the party best able to manage them. It is typical for the private entity to be completely or largely responsible for the design, development, finance and eventual completion of the project. Risks borne by government are thus restricted to matters such as those relating to the ownership and availability of the underlying assets and other matters that are completely within the control of the government or inappropriate for the private entity to bear. In all, the policy as provided under the Supplementary Notes is that the government will aim to optimise, rather than maximise, the transfer of project risks to the private entity.

It is not unusual for the PPP agreement to mandate the private entity to obtain insurance to cover the risks to be borne by the private entity under the PPP agreement.

### **iv Adjustment and revision**

Adjustment and revision of the PPP agreement can only be carried out as provided for under the relevant PPP agreement and this will vary with each PPP agreement. Suffice it to say, that there is no law conferring on the government the right to revise a PPP agreement, except as provided under such agreement.

To start with, the Nigerian Investment Promotion Commission Act, 1995 provides guarantees against nationalisation or expropriation of any enterprise and the compulsory surrender of interest in the capital of any enterprise. Moreover, on adjustment and revision in PPP agreements, ICRC Act, section 11 provides that 'no agreement reached in respect of this Act shall be arbitrarily suspended, stopped, cancelled or changed except in accordance with the provisions of this Act.' There are also constitutional guarantees against expropriation of assets. Where assets are expropriated, the Nigerian Constitution mandates the payment of adequate compensation to the affected party. Nigeria is also a signatory of the ICSID Treaty. All these provide some level of comfort to the private enterprise intent on executing a PPP project.

### **v Ownership of underlying assets**

The government usually owns the underlying assets involved in PPP projects and will also be responsible for the acquisition of such assets where the same is not readily available. The right granted to the private entity over the asset will depend on the project and the PPP model adopted. Ownership will invariably remain with the government or will be required to be re-assigned to the government at the expiration of the concession term. However, during the pendency of the concession term, the private entity may use such underlying asset as security for obtaining finance for the project.

### **vi Early termination**

The PPP agreement will typically make provisions for early termination by either party for default or force majeure reasons. Where early termination is as a result of default by a party, the defaulting party will be liable to pay compensation to the counterparty.



## VI FINANCE

Most often than not, the private enterprise participating in a PPP has the responsibility for financing a PPP venture but the government may provide guarantees that will assist in negotiations with lenders. Most PPP projects have been financed through syndicated loans sometimes involving international lenders. Also important to note is the role played by the World Bank in providing guarantees on certain projects.<sup>38</sup>

## VII RECENT DECISIONS

Given that PPP in Nigeria is still in its infancy, there are no significant recent case laws on PPP contracts. Most PPP-related cases before the courts and arbitral tribunals in Nigeria are still at the preliminary stages. The practice of Nigerian courts is to give effect to the terms of agreements freely entered into by parties. The courts are therefore more likely than not to uphold the terms of a duly executed PPP agreement.

In the case of *Maevis Ltd. v. Sita Telecommunication Nigeria Ltd. & Anor.*,<sup>39</sup> the Federal High Court in Nigeria upheld the right of a private entity under a PPP agreement to enforce its contractual rights without interference from any third party. In this case, Maevis Ltd., the plaintiff, signed a PPP contract with the Federal Airports Authority of Nigeria (FAAN) in 2007 for the provision of services to four airports in Nigeria. In 2010, dispute arose between Maevis Ltd. and FAAN in relation to the contract, following which the parties went to court but were referred to arbitration on the basis of the PPP agreement signed by the parties in 2007. The court also ordered the parties to maintain the status quo pending the outcome of the arbitration. However, on 24 March 2011, FAAN terminated the contract with Maevis Ltd. and went on to execute another contract with Sita Telecommunications Nigeria Ltd. and Société Internationale de Télécommunications Aéronautiques (SITA) (the defendants) on the same project. The Defendants were informed during negotiations with FAAN of the PPP contract between FAAN and Maevis Ltd., and the pending litigation and the order of court for the parties to maintain the status quo. The defendants ignored the warning and contracted with FAAN. Maevis Ltd. subsequently sued the defendants for inducing and/or procuring FAAN to breach its contract with Maevis Ltd. The court ruled that the defendants acted unlawfully by interfering with the contractual relations between Maevis Ltd. and FAAN, even though it had knowledge of the pending litigation.

## VIII OUTLOOK

Giant strides have been taken in relation to PPPs both at the federal and state levels. Weak legal frameworks, weak institutions, poor access to finance and lack of expertise have all contributed to the little role PPP has played in infrastructural development in Nigeria. Also instructive is the lack of continuity in government policies especially in the area of infrastructural development resulting in a myriad of abandoned or uncompleted infrastructure projects. This degree of uncertainty militates against the existence of a conducive environment which is needed for PPPs that are at their very core long-term in nature.

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38 An example is the World Bank Partial Risk Guarantee in the Azura-Edo Independent Power Plant project.

39 (2013) 10 CLRN 124.

The enactment of PPP laws both at the federal and state levels is a welcome development. With the decline in government revenues following the drop in crude oil prices, more PPP projects are expected in different sectors of the Nigerian economy in the coming year. Nigeria has a huge infrastructure deficit. Hospitals, roads, railways, the sea ports, airports and the power grid require huge investments. It is expected that investments and developments in these sectors would be achieved by the utilisation of the PPP model.

# PARAGUAY

*Javier Maria Parquet Villagra and Karin Basiliki Ioannidis Eder*<sup>1</sup>

## I OVERVIEW

In relation to public investments, national budget limitations have always been an obstacle for Paraguay. For political reasons, a large part of the annual budget of the Paraguayan government is diverted to fund essential expenses leaving little remaining for infrastructure development. In this context, public-private partnerships (PPPs) are a useful and novel tool for financing important infrastructure projects that would avoid these budgetary difficulties.

Regarding the implementation of PPPs, fortunately Paraguay has not been detached from the international experience in this matter and has incorporated modern and innovative provisions following international parameters aiming to promote investment and at the same time protect investors. Nevertheless, the law has also been mindful of local institutions and has made the necessary adjustments to the norms of the Paraguayan administrative system.

The regulation that establishes the PPP regime in Paraguay has been enacted through Law No. 5102 on the ‘investment promotion in public infrastructure and the expansion and improvement of goods and services provided by the state’ (the PPP Law), in force since the end of 2013. The implementation of several rules on PPPs was subject to Regulatory Decree No. 1350 (the Regulatory Decree), which was passed in March 2014. Since then, the administration has been focused on the task of developing institutions with the structure and functionality that this new legal instrument requires as well as identifying potential projects to be developed through the PPP regime.

The specialised public office in charge of following and coordinating PPP projects is the Public Private Participation Projects Unit (the PPP Unit) of the Technical Planning Bureau.

PPPs are definitely the instrument that will allow the creation of necessary infrastructure that is vital for the social and economic development of Paraguay by means of long-term contracts between the private and public sector and with the main goal of developing public infrastructure or rendering services complementary to that infrastructure.

## II THE YEAR IN REVIEW

The PPP Law has been in force since 2013 and the Regulatory Decree since March 2014, and therefore the law is in full force. Numerous developments have since been implemented – mostly at the administrative and organisational level – including the web page publishing the lists of PPP projects, both private and public initiatives ([www.stp.gov.py](http://www.stp.gov.py)), the appointment

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and training of specialised civil servants at different levels and establishing departments in charge of all the phases of the pre-contractual activities and contractual follow-up.

Numerous private-initiative projects filed by private companies (see Section II.i, *infra*) have been analysed by the PPP unit at a prefeasibility stage, some have been approved and others are still being considered under a strictly confidential process.

Two important public-initiative projects reached the international tender stage during 2016. The Route 2 & 7 highway roadwork, for US\$507 million, with 11 pre-qualified companies, was awarded in October 2016 in favour of a consortium integrated by one local company and two international construction companies; the works are currently in progress and this contract represents the first PPP project to be implemented in Paraguay. The second public-initiative project launched during 2016 was the airport infrastructure improvement, operation and management project for US\$135 million. This international tender has not yet been finalised since the award is still pending government approval.

Other important public-initiative projects have been approved and are undergoing feasibility studies such as the Route 1 & 6 highway roadwork, for US\$684 million, which has reached the prefeasibility stage, and the dredging and maintenance of the Paraguay River waterway.

Other public-initiative projects have been defined and are currently being analysed at a pre-feasibility level, these include: highway infrastructure; Ypacarai Lake basin sanitary and water treatment infrastructure; Asunción and metropolitan area sewage system and water treatment plant, operation and maintenance; the railway system; and the construction, operation and maintenance of prison facilities.

### III GENERAL FRAMEWORK

#### i Types of public-private partnership

There are two ways in which a PPP may originate. On the one hand, there are public initiative projects, in which the government proposes the project and then wholly or partially delegates its execution to a private participant. And on the other hand, there are private initiative projects, in which the private participants propose a project to the government and then they carry it out.

##### ***Public-initiative projects***

Public-initiative projects are those in which the relevant public institution prepares and follows up a project of its interest and submits it to the PPP Unit.

The public initiative must include a pre-feasibility report, with a project of contents of the feasibility report. The pre-feasibility report will be evaluated by the PPP Unit and Ministry of Finance. Once a favourable opinion is rendered by those authorities, the feasibility report must be presented. The PPP Unit must then issue a new opinion, as must the Ministry of Finance. Once the favourable opinions are issued, the executive power must then grant its approval through a decree.

After the decree is issued, the public bidding process begins for all interested parties. The minimum term to submit the offers is 60 days.

The terms and conditions of the bidding documents shall include the *pro forma* agreement approved by the PPP Unit as well as by the contracting administration.

The offers will include a 'technical offer' and an 'economic offer'. The government will also demand a warranty for the fulfilment of the offer, otherwise referred to as a 'bid security'.

After the opening of envelopes, the evaluation and comparison of the offers is carried out, the selection of the bidder is made and finally the bidder is awarded the contract.

To carry out the awarded PPP project, the bidder must incorporate a company with the sole corporate object of the accomplishment and development of the PPP project. The initial paid-in capital of the corporation must be at least 20 per cent of the project's official budget, as estimated by the contracting administration.

### ***Private-initiative projects***

The PPP Unit of the Technical Planning Bureau is the institution in charge of receiving all the private initiatives as long as: (1) the proposed project's goal is not similar to another that has already been submitted; and (2) either the contracting administration is performing studies for the project's presentation through the public initiative process, or the contracting administration has expressly identified the project and incorporated it in its future planning as a project that will be carried out *ex officio* or by a public initiative regime.

Projects that are rejected may not be resubmitted for three years after their rejection.

A private-initiative process comprises the following stages:

- a* Presentation: the proponent must demonstrate the technical, economical-financial and legal capacity for the development of the project. Besides, it must demonstrate the viability of the project at a pre-feasibility level. The PPP Unit will analyse the presentation within 10 days and forward it to the contracting administration for further analysis. The costs of the pre-feasibility study and preparation and presentation of the project are borne by the proponent.
- b* Evaluation: the PPP Unit and the contracting administration analyse the project for 60 days (which may be extended). Within this period, the Ministry of Finance will have to determine the viability of the project through the PPP regime. Acceptance at this stage implies a favourable opinion and a declaration of public interest.
- c* Feasibility report: once a declaration of public interest is issued, the feasibility report must be submitted. The deadline for its submission will be established by the contracting administration.
- d* Approval or modification: the PPP Unit has 120 days to approve or request modifications to the project. In the case of an approval, the Unit will pass the bid on to the executive branch for its approval and the preparation of the bidding documents and the terms and conditions.
- e* After this stage, the same provisions that apply to public bidding in a public-initiative project will be followed.

Unsuccessful bidders may be reimbursed for the costs of their feasibility studies.

Further, at the stage of evaluating the various bids, a 3–10 per cent bonus will be added on to the score of the original proponent's bid (see Section IV.ii, *infra*).

### **ii The authorities**

There are three main authorities involved in the PPP process; the contracting administration, the PPP Unit and the Ministry of Finance.

The contracting administrations are the government entities and government-owned corporations that are empowered to award PPP contracts. Because Paraguay's greatest deficit is infrastructure, the leading contracting administration is the Ministry of Public Works, which is by law in charge of the development and execution of all PPPs relating to

transportation, roads and highways, dredging river services, riverine communications and airport infrastructure.

The contracting administration, with the coordination of the PPP Unit, is responsible for structuring, awarding and executing the PPP contract as well as exercising control in the correct execution of the contracts and monitoring parties' compliance with their obligations.

The PPP Unit ([www.stp.gov.py](http://www.stp.gov.py)) has been created as a special unit in charge of promoting and coordinating all authorities, contracting administrations, agencies and other parties regarding the implementation of PPP projects.

The Ministry of Finance has the key role not only in evaluating proposals and risk assessments for PPPs, but also in provisioning future payments to be included in the national budget. Further, in a PPP project, a trust fund is created for the sole purpose of guaranteeing payment and liquidity in relation to the PPP contract, and the Ministry of Finance acts as trustor in that trust fund.

This fund is created to collect, safeguard, invest and manage the financial resources that are part of it, and to fulfil the obligations undertaken by the government and the costs involved in the dispute-resolution process in the PPP contracts. The trustee will be the Financial Agency for Development, the government will act as the trustor or settler of the trust through the Ministry of Finance.

### **iii General requirements for PPP contracts**

PPP contracts may involve a wide range of infrastructure and related service-provision projects, including but not limited to: road projects, railways, ports, airports, waterways and dredging and the maintenance of river navigability, social infrastructure, electric infrastructure, improvement supplying and urban development; drinking water supply and sanitary services; among other investment projects in infrastructure and services of public interest. PPP contracts may also relate to the production of goods and rendering of services that are intrinsic to government agencies and public companies in which the government holds an interest.

PPP contracts as defined by Law No. 5102 shall only be applicable to projects in which the estimated investment is equivalent or above 12,500 minimum monthly wages.

All contracts must contain specific provisions regarding the following:

- a* distribution of obligations and costs of the project to be borne by the parties, with risk to be assigned to the parties in a better position to assume each risk;
- b* the exact distribution of profit sharing;
- c* the distribution of the legal and financial risks and consequences for contingencies that may occur during the execution of the contract;
- d* the identification of the one-off payments, benefits and costs that third parties should assume;
- e* the determination or indication of the procedure and steps to take in case of any adverse events;
- f* determination of the risks relating to each contract, which will depend on the type of contract. To name a few: construction and engineering risks, operational risks, market risks, social conflicts and environmental risks, financial risks, and political risks; and
- g* the identification of all necessary authorisations, permits, licences and approvals to carry out the PPP contract, together with its costs and responsible party.

### ***Assignment of contract or shares***

The PPP contract will be executed by the contracting administration and the private party, who will operate by means of a local company incorporated with the sole corporate purpose of executing the PPP contract. The assignment of the contract or of the shares of the company requires the authorisation of the contracting administration, while the subcontracting of any type of activity will be allowed under the private law regime, except where expressly forbidden. During the execution of the contract the contracting administration will request the establishment of performance securities in each of the construction stages and operation, as well as insurances policies covering all types of risks including: third-party insurance, construction risks, insurance for work-related accidents and other types of insurance policies to be established in the bidding documents.

As for control, the contracting administration will have a wide range of powers to perform controls through, *inter alia*, external audits, performance and quality evaluations, inspections and expert testimonies in the technical, legal, economic, financial, accounting and environmental fields.

### ***Dispute resolution***

There are three levels of dispute resolution:

- a* at the first level, direct negotiations between the parties;
- b* an the second level, technical and economic issues will be discussed before a technical panel appointed by the parties upon signing the contract; and
- c* at the third level, the differences will be resolved by an arbitration procedure in accordance with the Law No. 1879/2002 on Arbitration and Mediation.

The Regulatory Decree allows the appointment of foreign arbitrators. Parties may also agree on the venue of the arbitration proceedings. Legal issues may only be dealt with by direct negotiations or an arbitration procedure.

## **IV BIDDING AND AWARD PROCEDURE**

### **i Expressions of interest**

As stated above, there two procedures by which the PPP process may begin: a public initiative or an unsolicited bid (private-initiative proposal). In the first case, the government has already identified its scope of interests and has already prepared a project for which it requests proposals. In the second instance, the PPP Unit receives a private initiative (up to the pre-feasibility level) that complies with the threshold for the invested amount, the corresponding authorities then analyse and evaluate the entire project proposal and eventually, if they approve, the government declares the project as being of public interest.

### **ii Requests for proposals and unsolicited proposals**

#### ***Content of a private-initiative proposal (unsolicited bid)***

The private-initiative proposal must be filed in compliance with the terms indicated in the application form for private initiative projects available on the PPP Unit's website ([www.stp.gov.py](http://www.stp.gov.py)).

Further, the project to be filed must contain comprehensive information up to a pre-feasibility level, including at least the following information:

- a* documents proving the legal, technical and financial capacity of the private party;
- b* designation of the relevant contracting administration for the project;
- c* a proposal identifying the need, the problem and the potential benefit that the project pretends to bring, including the benefits and costs, performance and quality indicators, and socio-economic indicators;
- d* a market analysis, technical, legal, competition, economic and financial risk assessment;
- e* an estimation of government support during the applicable fiscal years and the commitment to be assumed by the government; and
- f* social impact, environmental studies of the project identifying the affected population and setting forth the mitigation plan for possible damages during or as a result of the deployment and development of the project.

### ***Incentives granted to private initiative projects***

Private proponents of PPP projects shall benefit from the following preferences:

- a* reimbursement of the costs of feasibility studies if the project is deemed of interest but the proponent is not awarded the contract;
- b* an advantage of 3–10 per cent in the evaluation score assigned during the evaluation of the offer, depending on the size and complexity of the project; and
- c* a waiver of the costs of submitting bidding documents.

### **iii Evaluation and grant**

#### ***Private initiative***

Once the private party has filed the proposed project with the PPP Unit, the project will be evaluated by the Unit, the contracting administration and the Ministry of Finance within 60 days, which may be extended. If the proposal is accepted, a declaration of public interest is issued by the government and the private party must file the studies at a feasibility level in accordance with the recommendations issued by the PPP Unit and the contracting administration.

The feasibility studies shall be analysed within 120 days, which may be extended. If the analysis is positive the government shall approve the project and the bidding documents, terms and conditions shall be prepared for the public tender.

#### ***Public initiative***

The public initiative initiates with the contracting administration stating the intention to promote a PPP by public initiative and this must be informed to the PPP Unit together with a brief summary of the project.

The contracting administration then files the pre-feasibility studies for the first evaluation; at this stage the information contained must be similar to that for a private-initiative proposal set out in subsection ii, *supra*, including: a value-for-money evaluation, a fiscal and financial budgetary impact analysis, economic and social indicators of profitability and a proposal for the scope of the feasibility study.

The project will be studied by the PPP Unit and the Ministry of Finance within the terms set forth in the Regulatory Decree. If favourable opinions are issued, the contracting administration must file a feasibility study, which must contain additional, more comprehensive and updated studies, all of them provided for in the Regulatory Decree.



### ***The bidding process***

In both cases, the bidding process may consist of a standard international tender procedure with or without a pre-qualification of bidders.

In certain types of multifunctional projects that entail a high level of complexity and in projects in which the proponents need to file costly and complex studies, a pre-qualification stage will be implemented.

## **V THE CONTRACT**

### **i Payment**

Payment provisions shall be included in the bidding documents, identifying all contributions and costs, benefits, profits and remaining conditions. However, the PPP contract will contain in detail and with precision the exact composition of the public contributions and remunerations for the private party, in line with the principles of transparency.

The PPP Law and the Regulatory Decree do not contemplate a particular frequency or method of payments; this shall be proposed either by the private party in the project proposal or inserted in the bidding documents, depending mainly on the type of project to be rendered (infrastructure, services or both) and its complexity.

### **ii State guarantees**

#### ***Trust fund***

To guarantee payment, Paraguay has introduced the mandatory creation of a trust fund to facilitate payment and guarantee timely payment and liquidity on the part of the state. The trust will be administered by Financial Agency for Development, the sole second-floor banking institute in Paraguay.

The state shall act as the settlor of the trust through the Ministry of Finance, which is in charge of constituting the trust fund as a first step once the PPP contract is signed. Funds reserved for future PPP contract payments shall be transferred to the trust account and kept separated from remaining state liabilities. These funds shall not return to the state treasury and instead remain for the sole and exclusive purpose of honouring any future assumed liabilities.

#### ***Limitations to future indebtedness***

According to mandatory norms provided for in the PPP Law, the Ministry of Finance shall be responsible for assessing and registering the payment obligations and contingent liabilities the state assumes in the course of PPP contracts. The accumulated amounts of obligations and contingent liabilities, net of income, assumed in PPP contracts must not exceed 2 per cent of Paraguay's GDP for the previous year. Equally, the amount assumed for obligations and contingencies, calculated yearly, must not exceed 0.4 per cent of the GDP of the previous year.

#### ***Transparency, publicity and control of the PPP process***

The PPP Law sets forth numerous mechanisms of transparency, publicity and control of the PPP process. To this end a register of PPP projects has been created by the PPP Unit, which provides permanent and up-to-date information by electronic means. The register contains the following information:

- a* legal provisions applicable to PPP projects and process, current policies and approved plans;

- b* a list of approved public initiative projects;
- c* general and standard bidding documents;
- d* pre-feasibility studies and feasibility studies of PPP projects with the approval decrees and mandatory opinions;
- e* pre-qualification calls and documents setting out the terms for pre-qualification;
- f* decisions adopted in the pre-qualification process;
- g* bidding documents for tenders, records of opening offers and awarding decisions;
- h* PPP contracts and amendments;
- i* technical, financial and accounting information of PPP contracts; and
- j* pledges, trusts and constituted warranties.

With respect to mechanisms of control, the PPP Law provides the state with both the authority and the duty to carry out the planning, control, application of sanctions, regulatory supervision and monitoring of the execution of a PPP Contract. The contracting administration in coordination with the PPP Unit is in charge of controlling the correct execution and compliance with the obligations of the contracts.

Additional control and transparency mechanisms are:

- a* the annual public report to be prepared and filed by the PPP Unit including the performance indicators, goals, results and target achieved;
- b* external audits and an international audit shall be commissioned by the Ministry of Finance at least every four years covering the contingent liabilities and compliance with all obligations including an evaluation of quality of services;
- c* management audits to verify the legal compliance and contractual of both parties
- d* each December, performance indicators reflecting quality-of-service levels shall be released; and
- e* every semester, the contracting administration must release information regarding compliance with the terms of the PPP contract.

### **iii Distribution of risk**

In relation to the distribution of risk, the Regulatory Decree provides a non-exhaustive list of possible risks to be considered in PPP contracts on a case-by-case basis and according to the type of contract and the possibility of its occurrence:

- a* construction and engineering risks, such as cost overruns, project delays, defective construction, price increase, geological problems, insufficient management, logistical and transport problems and unavailability of land;
- b* operational risks, such as expected decrease in production, technical obsolescence, transport risks and risk management;
- c* market risks, including the supply of goods and services, risks in the quality of primary goods and risks in the level of demand;
- d* financial risks of the project, such as the unavailability of funds, insufficient shareholder capital to guarantee financial support, risks related to variations in interest rates, inflation risks and risks applicable to exchange rates;
- e* political risks, such as risks of currency convertibility, unavailability of land, local or regional authorities decisions obstructing the roll-out of the project, nationalisation risks, terrorism risks, contractual non-compliance, risk of international conflict affecting multilateral projects, risks during the compulsory-purchase process, risks associated with allocation of permits and authorisations; and
- f* risks derived from force majeure and fortuitous events.

#### **iv Adjustment and revision**

PPP contracts may be adjusted or amended by means of the following procedures.

##### ***Unilateral modifications***

A unilateral modification to a PPP contract may only be introduced if the contracting administration has the support of the technical opinion of the PPP Unit, the State Attorney General, the Ministry of Finance and a technical report taking into account public-interest considerations and an estimation of possible compensation. However, the contracting administration must compensate the private party for possible damages that may have occurred upon the alteration of the economic equation. The contracting administration may only introduce modifications that represent 15 per cent of the contract price (total investment). The private party must be compensated for any such modifications.

##### ***Mutually agreed modifications***

The contracting administration and the private party may agree to modify certain aspects of the contract, such as the quality-of-service levels and technical standards, trying at all times to abide by the original nature and object of the contract.

Both parties may only modify up to an amount that represents 30 per cent of the contract price (total investment).

The private party is entitled to corresponding compensation in case the agreed changes imply a less favourable economic result than in the original contract.

##### ***Modifications or amendments arising out of force majeure or fortuitous events***

Upon the occurrence of such events, the private party may request the suspension of the execution of the contract and upon verification of the damages incurred by the private party, the compensation for such damages, subject to the provisions and procedures provided for in the Regulatory Decree.

#### **v Ownership of underlying assets**

The PPP contract will determine the existing or future assets that are property of the contracting administration or other state agencies, which will be granted in favour of the private party with a right to use and with the obligation to return them to the contracting administration at the end of the contract.

Assets acquired by the private party that are directly related to the PPP contract may not be transferred separately, nor be subject to any pledge, lien or security except with consent of the contracting administration.

#### **vi Early termination**

The PPP contract may be terminated upon a material breach of contract by the private party according to a resolution reached through the dispute resolution mechanism.

In turn, the contracting administration may terminate the contract for public-interest reasons in accordance with the terms of the PPP contract and upon an agreed payment of compensation for damages. This may occur in case the work or service hired has become unnecessary for the satisfaction of public needs or requires a redesign or complementary work that exceeds 30 per cent of the contract price. In this case, the private party is entitled to compensation payment to be calculated upon criteria set forth in the Regulatory Decree.

Any discrepancy regarding the compensation amount or other aspects shall be resolved by means of the dispute resolution mechanism, which includes the opinion of a technical panel.

## **VI FINANCE**

According to the government's current investment plan, which includes major infrastructure projects, many of these projects already count on partial or complete financing either by international organisations such as the Inter-American Development Bank or the CAF – Development Bank of Latin America. In the case of road works, another source of financing would be the concession regime.

## **VII RECENT DECISIONS**

The Regulatory Decree, which sets out the specific rules and detailed provisions governing the PPP process and contracts has been in force since March 2014, therefore Paraguay is still in the initial stages of PPP implementation.

Nevertheless, the basis for implementation, including the enactment of the PPP Law, its Regulatory Decree, the appointment of selected specialised personnel in all levels, training of civil servants and the identification of the government's intended medium and long-term investment projects has been carried out in a serious and unprecedentedly transparent manner shown in the sharing, distribution and publication of all kinds of information regarding government plans.

The current government – now reaching the end of its five-year elected term – is facing several challenges which may have an effect on the future of the PPP projects mainly in terms of the quantity of projects per year. Also, National Congress has requested more accountability and issued Law No. 5567/2016 requiring the executive power to provide quarterly reports to Congress regarding the PPP projects being handled.

The government continues to handle an interesting avalanche of international companies, organisations, financial institutions and third parties demonstrating genuine interest in future projects and offering vital information and recommendations based on real international experience on PPP contracts.

## **VIII OUTLOOK**

In spite of upcoming political change the country must face and a probable status quo effect on all important decision-making, we still foresee positive implementation of PPP agreements due to the fact that the need for PPP projects is undeniable and the interest of both private and public parties is present. The roadmap for this has been shared and there is interest in PPPs in both the public and private sectors.

# PHILIPPINES

*Marivic G Ramos-Añonuevo and Arlene M Maneja*<sup>1</sup>

## I OVERVIEW

In line with the state policy set out in the Philippines Constitution to recognise the indispensable role of the private sector in national growth, encourage private enterprise and provide incentives to attract needed investment, the Philippine government has long resorted to public-private partnerships (PPPs) to address problems of national interest. Even before the enactment of specific legislation on PPP arrangements in 1990, the government entered into PPPs in the 1980s to respond to a power shortage. The first build–operate–transfer (BOT) agreement was executed in 1989 between the National Power Corporation and Hopewell Energy Management Ltd for the construction and operation of a power station in Navotas.<sup>2</sup>

In 1990, Republic Act No. 6957 (the BOT Law) was enacted to provide a legal framework for PPP arrangements, particularly, through BOT and build–transfer (BT) arrangements. Amendments to the BOT Law were introduced in 1994 through Republic Act No. 7718, which serves to broaden the types of PPP schemes and introduce provisions governing unsolicited proposals, direct negotiations and special incentives for certain registered projects.

With specific laws in place, PPPs have been used to boost the Philippines' infrastructure development programme, including the establishment of facilities for agri-business development, transportation and road development, water supply, telecommunication and information technology, environmental protection, property development, health and education, to name a few.<sup>3</sup> Of these, the transportation and road sectors have notably been attracting substantial private investment with contracts involving construction of highways, construction, operation and maintenance of railway systems, and the development and modernisation of ports.

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2 Maria Joy V Abrenica, 'Contracting for Power: The Philippine Case', available at [www.adbi.org/files/2004.12.6.cpp.case.philippines.pdf](http://www.adbi.org/files/2004.12.6.cpp.case.philippines.pdf) (last accessed 7 January 2015).

3 The Build–Operate–And–Transfer Center, 'The Philippine PPP Program', available at [www.philippineconsulatela.org/Trade/02b\\_Primer%20-%20The%20Philippine%20PPP%20Program.pdf](http://www.philippineconsulatela.org/Trade/02b_Primer%20-%20The%20Philippine%20PPP%20Program.pdf) (last accessed 7 January 2015).

## **II THE YEAR IN REVIEW**

In 2016, the government awarded the Civil Registry System Information Technology Project (Phase II) and the unsolicited proposal for the NLEx-SLEx Connector Road Project.<sup>4</sup>

The government, however, halted the procurement of the Light Rail Transit (LRT) Line 2 Operations and Maintenance Project and the LRT Line 6 Project; deferred the bidding for the Regional Prison Facilities PPP to 2017; and approved the unbundling of the bidding for the Regional Airports Project consisting of five regional airports.

In late 2016, the government approved the roll-out of, among others, the Ninoy Aquino International Airport (NAIA) PPP Project, the Metro Manila Bus Rapid Transit Project, the Plaridel Bypass Road Project, the New Cebu International Container Port Project, the North-South Railway – South Line Project and the New Nayong Pilipino at Entertainment City Project.<sup>5</sup>

The government also allocated for the Risk Management Program about 30 billion Philippine pesos in its 2016 budget, which is intended to answer for commitments made by, and obligations of, the government under the concession agreements in respect of PPP projects, subject to the fulfilment of certain conditions.<sup>6</sup> In 2017, the budget allocation decreased to 29 billion Philippine pesos.<sup>7</sup>

## **III GENERAL FRAMEWORK**

### **i Types of public-private partnership**

Under the BOT Law and its 2012 Revised Implementing Rules and Regulations (the BOT Regulations), the principal contractual arrangements for PPPs include BOT, BT, build–own–operate (BOO), build–lease–transfer (BLT), build–transfer–operate (BTO), contract–add–operate (CAO), develop–operate–transfer (DOT), rehabilitate–operate–transfer (ROT), rehabilitate–own–operate (ROO). Other contractual schemes may, however, be undertaken upon approval by the President.

### **ii The authorities**

The PPP Center,<sup>8</sup> an agency of the National Economic and Development Authority (NEDA), is a specialised body with particular focus on PPPs. It coordinates and monitors PPP projects implemented under the BOT Law, assists implementing agencies (IAs) and local government

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4 The PPP Center, 'Pipeline of Projects', available at [http://ppp.gov.ph/?page\\_id=26075](http://ppp.gov.ph/?page_id=26075) (last accessed 16 January 2017).

5 Id.

6 Special Provisions 4, Article XLI, Unprogrammed Fund, of Republic Act No. 10717, General Appropriations Act of 2016.

7 Special Provisions 5, Article XXXVII, Unprogrammed Fund, of Republic Act No. 10924, General Appropriations Act of 2017.

8 Section 1.3 (e), Rule 1, BOT Regulations. The PPP Center is the successor of the BOT Center and Coordinating Council of the Philippine Assistance Program, the agency mandated under Section 12 of the Act to coordinate and monitor projects implemented under the Act, pursuant to Administrative Order No. 105 (Section 1989), as amended by Administrative Order No. 67 (Section 1999), as amended by Administrative Order No. 103 (Section 2000), and Executive Order No. 144 (Section 2002), as amended by Executive Order No. 8 (Section 2010).

units (LGUs) in the preparation and development of projects and serves as a repository of information on the status of projects, copies of unsolicited proposals and other related documents received by IAs and LGUs.

PPP projects are also subject to approval by different bodies as follows: (1) NEDA's Investment Coordinating Committee (ICC) must approve national projects costing up to 300 million Philippine pesos; and (2) upon the recommendation of the ICC, the NEDA Board must approve national projects costing more than 300 million Philippine pesos and negotiated projects (regardless of the amount). For local projects, approval by the proper local legislative body is required.

The proposed PPP contract is subject to review by the Office of the Government Corporate Counsel, Office of the Solicitor General or any other entity prescribed by law as the statutory counsel of the procuring entity. The head of the IA or LGU concerned approves the reviewed PPP contract. If required, the Department of Finance (DOF) should also review the draft contract of projects of national government agencies, local projects involving funds of the national government and local projects requiring ICC approval.

### **iii General requirements for PPP contracts**

PPP projects eligible to be implemented under the BOT Law are those involving infrastructure or development projects, including, but not limited to, power plants, highways, ports, airports, canals, dams, hydropower projects, water supply, irrigation, telecommunications, railroads and railways, transport systems, land reclamation projects, industrial estates or townships, housing, government buildings, tourism projects, markets, slaughterhouses, warehouses, solid waste management, information technology networks and database infrastructure, education and health facilities, sewerage, drainage and dredging.

In general, PPPs implemented under the framework of the BOT Law and the BOT Regulations must comply with the requirements, processes and procedures thereunder. However, for PPPs involving public utilities, the Philippine Constitution requires that: (1) the franchise, certificate or authorisation to operate public utilities be held by Filipino citizens or corporations or associations organised under Philippine law with at least 60 per cent of its capital owned by Philippine citizens; (2) the participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in its capital; and (3) all the executive and managing officers of such corporation or association must be citizens of the Philippines. Moreover, such franchise, certificate or authorisation for operation of a public utility is limited to a period of 50 years.

While there are no value thresholds for PPP contracts, additional registration requirements or approvals are imposed on certain contractual schemes, such as presidential approval for BOO projects and contract arrangements other than those listed in Section 2 of the BOT Law.

## **IV BIDDING AND AWARD PROCEDURE**

Under the BOT Law, a PPP contract may be implemented through public bidding or by the submission of an unsolicited proposal.

### **i Expression of interest**

A public bidding may be initiated through pre-qualification or simultaneous qualification proceedings. In a pre-qualification proceeding, upon approval of the parameters and terms

of a PPP project, the IA or LGU shall publish a notice inviting prospective proponents to pre-qualify and bid. The invitation shall be: (1) published once every week for three consecutive weeks in at least two newspapers of general circulation and in at least one local newspaper of general circulation in the region, province, city or municipality in which the projects are to be implemented; and (2) continuously posted on the website of the IA or LGU concerned, if available, and the PPP Center during the period stated above. If the total project cost amounts to 500 million Philippine pesos or more, the invitation may also be published in at least one international publication and the IA or LGU concerned shall issue official notification of the same to registered proponents of a project. On the other hand, when exigencies of service so require, the IA or LGU may opt to conduct a simultaneous qualification whereby the invitation to bid calls for the submission of qualification requirements and bid proposals.<sup>9</sup>

In both pre-qualification and simultaneous qualification proceedings as well as with unsolicited proposals, a pre-bid conference shall be conducted at least 30 calendar days before the submission of bids for projects costing less than 300 million Philippine pesos and a maximum of 60 calendar days before the submission of bids for projects costing 300 million Philippine pesos and above.

## **ii Requests for proposals and unsolicited proposals**

In pre-qualification proceedings, prospective bidders have at least 15 calendar days from the last date of publication of the invitation to pre-qualify and bid to prepare their respective pre-qualification requirements, which include the legal requirements, experience or track record, and financial capability of prospective project proponents. These shall be evaluated by relevant pre-qualification, bids and awards committee (PBAC), which will determine the pre-qualified and disqualified project proponents within a period of 20 calendar days after the deadline for submission of the prequalification documents. The bidders shall then submit their bids on or before the deadline stipulated in the instruction to bidders. The bids shall be in at least two envelopes, the first containing the technical proposal and the second the financial proposal.

For simultaneous qualification proceedings, the qualification requirements and bid proposals are composed of three envelopes. The first envelope contains the qualification documents corresponding to the requirements; the second contains the technical proposal; and the third envelope contains the financial proposal.

In case of unsolicited proposals,<sup>10</sup> a private proponent submits a complete proposal to the relevant IA or LGU, which shall acknowledge receipt of the proposal within seven calendar days and shall advise the proponent within 30 calendar days whether or not the proposal is complete. Within 120 days receipt of the complete proposal by the IA or LGU, it shall evaluate the proposal and inform the proponent of whether it accepts or rejects the proposal. The IA or LGU may accept an unsolicited proposal from a project proponent, provided that

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<sup>9</sup> Annex A, Timelines for Publicly Bid/Solicited Projects under the Revised Implementing Regulations of RA No. 6957, the BOT Regulations (citing Section 5.7, Rule 5, BOT IRR) [the Timelines for Public Bidding].

<sup>10</sup> Section 1.3, Rule 1, BOT Regulations. 'Unsolicited proposals' refer to project proposals submitted by the private sector, not in response to a formal solicitation or request issued by an IA or LGU and not part of the list of priority projects as identified by the IAs or LGUs, to undertake infrastructure or development projects that may be entered into by an IA or LGU subject to the requirements or conditions set out in Rule 10 of the BOT Regulations.



all the following conditions are met: (1) such projects involve a new concept or technology<sup>11</sup> or are not part of the list of priority projects; (2) no direct government guarantee, subsidy or equity is required; and (3) the IA or LGU has invited by publication, for three consecutive weeks, in a newspaper of general circulation, comparative or competitive proposals and no other proposal is received for a period of 60 working days. However, in the event another proponent submits a lower price proposal, the original proponent shall have the right to match that price within 30 working days. We note that the PPP Center is currently drafting guidelines for Unsolicited Proposals which include a three-tiered assessment of the proponent to promote greater transparency.<sup>12</sup>

### **iii Evaluation and grant**

For public biddings, the first-stage evaluation involves the assessment of the technical, operational, environmental, and financing viability of the proposal as contained in the bidder's first envelopes with regard to the prescribed requirements and basic parameters prescribed in the bidding documents. The second stage evaluation shall involve the assessment and comparison of the financial proposals of the bidders. Following the evaluations, the PBAC submits its recommendation to the head of the IA or LGU. Upon approval of the recommendation, the head of the IA or LGU will issue a notice of award to a winning proponent. Subject to compliance with the post-award requirements in the notice of award, the PPP contract shall be executed and signed by the winning bidder and the head of the IA or LGU.

In the case of unsolicited proposals, the IA or LGU first evaluates the unsolicited proposal and will decide to accept or reject it. If the IA or LGU accepts the unsolicited proposal, a letter of acceptance shall be issued, and the proponent shall be granted 'original proponent' status. The head of the IA or LGU then endorses the same to the ICC, which shall determine the reasonable rate of return and other parameters for negotiation. The approving body shall evaluate the recommendation made by the ICC and shall formally advise the IA or LGU of its approval or denial of the proposal. Negotiations between the IA or LGU and the original proponent shall then commence with the IA or LGU being required to submit a report to the ICC and approving body of the results of its negotiation within seven calendar days after the negotiation period. After the issuance of a certification of successful negotiation, the PBAC shall publish the invitation for comparative proposals. Thereafter, the procedure for the award of the PPP project for an unsolicited proposal is the

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11 Pursuant to Section 10.2, Rule 10, BOT Regulations, to be considered a 'new technology,' the same must possess at least one of the following attributes:

- a* a recognised process, design, methodology or engineering concept that has demonstrated its ability to significantly reduce construction costs, accelerate project execution, improve safety, enhance project performance, extend economic life, reduce costs of facility maintenance and operations, or reduce negative environmental impact or social or economic disturbances or disruptions either during the project implementation and construction phase or the operation phase;
- b* a process for which the project proponent or any member of the proponent consortium possesses exclusive rights, either worldwide or regionally; or
- c* a design, methodology or engineering concept for which the proponent or a member of the proponent consortium or association possesses intellectual property rights.

12 The Public-Private Partnership Center, available at PPP Center <https://ppp.gov.ph/wp-content/uploads/2016/11/UnsolProp-A-General-Guidelines-for-Unsolicited-Proposals-Final-Draft.pdf> (last accessed 13 January 2017).

same as in a public bidding, except that in the event that a comparative proponent submits a price proposal better than that submitted by the original proponent, the latter shall have the right to match such price proposal.

## V THE CONTRACT

### i Payment

To facilitate payments under PPP contracts, the BOT Regulations prescribe specific repayment schemes for particular contractual arrangements as summarised below:

Contractual arrangement or scheme	Repayment scheme
BOT, CAO, DOT and ROT	Collection of reasonable tolls, fees, and charges for a fixed term, which shall not exceed 50 years.
BOO and ROO	Collection of reasonable tolls, fees, and charges for a fixed term.  Upon renewal of its franchise or contract with the IA or LGU, the proponent is allowed to continue collecting toll, fees, charges and rentals for the operation of the facility or the provision of the service.
BTO	Option 1: Appropriate amortisation and collection of reasonable tolls, rentals and charges while operating the facility on behalf of the IA or LGU, which may be directly applied to the amortisation. Moreover, the facility operator may be repaid by the IA or LGU through a management fee provided in the management contract.  Option 2: Directly collect tolls, rentals and charges for a fixed term.
BT and BLT	Repayment through amortisation.
NEDA Board approved/authorised contractual arrangements/schemes not enumerated under Section 2 of the BOT Law	Repayment through any of the schemes recommended by the ICC and approved by the NEDA Board.
Note: Where applicable, the proponent may likewise be repaid in the form of revenue sharing or other non-monetary payments (i.e., grant of commercial development rights, grant of a portion or percentage of the reclaimed land, subject to constitutional requirements or any other non-monetary payments).	

### ii State guarantees

The BOT Law and the BOT Regulations provide for the following guarantee structures in favour of proponents: direct government guarantees, government undertakings and investment incentives.

Direct government guarantees are agreements whereby the government or any of its IAs or LGUs guarantees to assume responsibility for the repayment of debt arising from a loan default directly incurred by the proponent during the implementing the project.

Government undertakings are forms of contribution or support extended to the proponent by the government or its IAs or LGUs, including but not limited to cost sharing, credit enhancements, direct government subsidies, direct government equity, performance undertakings, legal assistance and security assistance.

Investment incentives are contributions or support extended to the proponent by the government, IAs or LGUs as set forth under applicable law such as the Omnibus Investment Code of 1987, Renewable Energy Act of 2008, Tourism Act of 2009, Mini-Hydroelectric Power Incentives Act or Local Government Code.

**iii Distribution of risk**

In general, Philippine PPP projects follow the risk allocation principle that the risk should be assigned to the party best able to control or influence its occurrence or manage the consequences of the risks. Thus, commercial risks (e.g., demand risk, supply risk, operational risk, financing risk) are typically allocated to the private sector while legal, political or regulatory risk are allocated to the government (e.g., approval of rates or tariff adjustments, change in law, material adverse government action). In some instances, the parties may agree to share certain risks. For instance, PPP agreements may provide that the government will only be liable for certain risks (e.g., force majeure risk) after a particular monetary threshold has been reached.

**iv Adjustment and revision**

Changes to the PPP contract may be allowed before the submission of the bids provided the head of the relevant IA or LGU secures the approval of the approving body.<sup>13</sup> Changes after the bid submission and before the execution of the contract shall not be allowed except for changes to contract terms affected or decided by the winning bidder's bid.

During the implementation of the PPP contract, a contract may be varied upon approval by the head of the IA or LGU provided that: (1) there is no impact on the basic parameters and terms of the contract as approved by the approving body; (2) there is no increase in the agreed fees, tolls and charges or a decrease in the IA or the LGU's revenue or profit share derived from the project, except as may be allowed under a parametric formula in the contract itself; (3) there is no reduction in the scope of works or performance standards, or fundamental change in the contractual arrangement nor extension in the contract term, except in cases of breach on the part of the IA or LGU of its obligations under the contract; or (4) there is no additional government undertaking, or increase in the financial exposure of the government under the project. For contract variations that do not meet these requirements, approval by the approving body is required. Failure to observe this rule renders the contract variation void.

**v Ownership of underlying assets**

Generally, the government will obtain ownership of the underlying assets; however, the time of the transfer of ownership will depend on the contractual agreement between the parties. For example, in a BTO or BT scheme, transfer of ownership of the assets to the government occurs immediately after completion of the project, subject to later payments to the private party comprising its investment plus a reasonable rate of return. In contrast, in a BOT or BLT scheme, transfer will occur only after an agreed period, during which the private entity will be allowed to operate or lease the facility and charge its users the appropriate rentals, fees, or tolls.

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13 Section 2.8, Rule 2, BOT Regulations. Approval must be sought for the following:

(1) changes that reduce the service levels to the public; (2) changes that reduce the economic internal rate of return below the hurdle rate used in the original analysis of the project; (3) changes that increase the total government subsidy to a project by at least 5 per cent of the total project cost; and (4) changes in the risk profile that are detrimental to the best interest of the government.

**vi Early termination**

The BOT Law and the BOT Regulations recognise early termination or rescission of PPP contracts and provide for the consequences thereof:

- a* In cases where the IA or LGU terminates, cancels or revokes the contract through no fault of the project proponent; the parties terminate the contract by mutual agreement; or a court revokes or cancels the contract by final judgment through no fault of the proponent, the government shall compensate the proponent for its actual expenses incurred in the project as of termination including a reasonable rate of return thereon not exceeding that stated in the contract and subject to such reliefs available to it under the insurance provision of the contract.
- b* When the government defaults on certain major obligations in the PPP contract and such failure is not remediable or, if remediable, shall remain unremedied for an unreasonable length of time, the proponent shall be reasonably compensated by the government for the equivalent or proportionate contract cost as defined in the contract, subject to the reliefs available to the government under the insurance provision of the contract.

In both instances, the compensation shall be determined by an independent appraiser, mutually acceptable to the IA or LGU and the proponent. Unless the parties agree on a different payment period, the compensation shall be paid by the IA or LGU concerned within 90 calendar days from the independent appraiser's advice of such determination, subject to the enactment of a law or ordinance, as the case may be, appropriating such amount, if required.

Lastly, the IA or LGU concerned may rescind the contract when the proponent: (1) refuses or fails to perform any of the provisions of the technical and performance standards in the approved contract; (2) fails to satisfy any of the contract provisions including compliance with the prescribed or agreed milestone activities; or (3) commits any substantial breach of the approved contract. In these instances, aside from forfeiting the proponent's performance bond, an IA or LGU may either take over the facility or allow the proponent's lenders, creditors and banks to exercise their rights and interests under the loan and collateral documents with respect to the project.

**VI FINANCE**

Historically, financing of PPP projects in the Philippines required the participation of multilateral agencies like the Asian Development Bank and the International Finance Corporation. However, due to the weakening of the US dollar, the increasing financial muscle of Philippine banks and their improved capability to do cash-flow lending and project financing, financing for PPP projects may be tapped domestically and in Philippine pesos.

In contrast with traditional corporate loans that used to fund government infrastructure projects undertaken with the help of the private sector more than a decade ago, non-recourse project financing is now being made available to PPP proponents. It also helps that Philippine banking regulations have increased the applicable single-borrowing limits. Thus, PPP projects that used to be financed by Philippine banks for five years with a maximum loan of 3 billion Philippine pesos half a decade ago can now take advantage of project financing of 80 billion Philippine pesos with 15-year maturity.

In terms of financing structure, ongoing PPP projects are required to maintain a debt-to-equity ratio of 80:20. Thus, PPP proponents can obtain financing for as much as 80 per cent

of the project cost; however, their ability to tap into the resources of Philippine banks largely depends on the quality of the security offered. Where PPP projects involve the operation of public utilities or the construction of social infrastructure like schools and hospitals, the security package is usually limited. For instance, the relevant concession agreements relating to the Mactan Cebu International Airport Project (MCIA Project) and the Modernisation of the Philippine Orthopedic Center (MPOC Project) contain express prohibition on mortgaging, pledging or hypothecating the facilities constructed by the concessionaires.

Apart from hard security, loan collaterals usually take the following forms:

- a* Assignment of Revenues: PPP contracts generally allow concessionaires to assign, with the prior consent of the government, their revenues and receivables to the lender or, if the project loans are syndicated, to a common security trustee appointed by the syndicate of lenders to act for and on their behalf. To capture and ring-fence all project revenues, it is usual for lenders to require the establishment of a cash waterfall account charged in favour of the lenders.
- b* Lenders' step-in rights: Probably the most important security that can be given to the lenders are step-in rights, which vest on the lenders the ability to nominate a substitute or successor concessionaire for the project upon occurrence of an event of default under the concession agreement or the financing agreement. Step-in rights may vary in terms of procedure and length of cure and nomination periods across the concession agreements relating to the various PPP projects, but the exercise thereof is always subject to prior approval of the government. Government approval will typically be granted for as long as the government is satisfied that the substitute or successor concessionaire has the technical competence and financial resources needed to continue the project. Moreover, applicable nationality requirements must be complied with.
- c* Assignment of project documents: To ensure full implementation of the step-in rights assigned to the lenders, a corresponding assignment of its rights and remedies under all project documents is also made by the concessionaire in their favour. To fortify such assignment, it is not unusual for the lenders to require direct agreements with the concessionaire's counterparties under the project agreements to create a privity between them and the lenders and enable the latter to have direct access to the counterparties in the enforcement of the assigned rights and remedies.
- d* Pledge of shares: Since the creation of liens on project assets is generally prohibited, lenders may have indirect access to such assets through a pledge on all the shares of the concessionaire. With the prior consent of the government, a pledge by the sponsors of their shares in the concessionaire may be allowed. However, there is one peculiarity of Philippine law that easily makes a pledge the least attractive of all the types of security that can be provided to the lenders. Under Philippine law, any foreclosure of the pledge extinguishes the loan, and lenders do not have the right to recover any deficiency in case the proceeds from the foreclosure of the pledge are insufficient to fully pay the outstanding balance of the loan.
- e* Sponsors' support: Most, if not all, PPP projects are financed on a non- or limited recourse basis. However, PPP sponsors or proponents are typically mandated to bear the burden of any cost overruns or any shortfall in the applicable maintaining balances required under the cash waterfall accounts. Some financing agreements allow sponsors to fund their sponsor support obligations through cash, corporate guarantee or a standby letter of credit issued by a bank acceptable to the lenders.

In November 2016, the Philippine Securities and Exchange Commission (SEC) approved the proposed supplemental listing and disclosure rules (PPP Rules) proposed by the Philippine Stock Exchange that applicable to PPP companies. In support of the government's efforts to sustain the country's economic growth through sustainable partnership with the private sector for infrastructure development, the approved PPP Rules will allow PPP companies to raise funds from the capital market.<sup>14</sup>

## VII RECENT DECISIONS

In 2016, the Supreme Court in the case of *Osmeña v. Abaya et al.*<sup>15</sup> clarified that the mere partnership or common directorship or direct involvement in one bidder is not sufficient to disqualify a prospective bidder due to conflict of interest.

Additionally, the NEDA Board also adopted new policies to improve and streamline the government's approval processes of major public investment projects, as follows: (1) the economic hurdle rate was reduced from 15 per cent to 10 per cent to facilitate the economic justification for more projects; (2) the ICC project cost floor was raised from 1 billion to 5 billion Philippine pesos to de-clog the pipeline of projects for ICC approval; (3) the ICC review process for minor changes in scope, design, cost, and extension of implementation or loan/grant validity of projects has been streamlined so that it may be approved by the ICC, the DOF and/or the NEDA Secretariat, as applicable, based on existing laws, rules and regulations; and (4) the proposed ICC Guidelines on Processing China-assisted Projects detailing the guidelines and procedures to process projects require the availment of support from China to conduct pre-investment and investment activities has been approved.<sup>16</sup>

## VIII OUTLOOK

2016 proved to be a challenging year for PPPs since the May 2016 national elections seemed to have called a hiatus for the aggressive rollout and procurement of critical PPPs. However, PPP activities are expected to pick up in 2017 considering that the administration of President Rodrigo R Duterte is keen on shortening timelines for awarding PPPs<sup>17</sup> and approving more PPPs for rollout in the coming months.

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14 Securities and Exchange Commission, available at [www.sec.gov.ph/wp-content/uploads/2015/10/SEC-Approved-PPP-Listing-Rules-November-08-2016.pdf](http://www.sec.gov.ph/wp-content/uploads/2015/10/SEC-Approved-PPP-Listing-Rules-November-08-2016.pdf) (last accessed 17 January 2017).

15 G.R. No. 211737, 13 January 2016.

16 National Economic and Development Authority (NEDA), available at [www.neda.gov.ph/2016/09/15/neda-board-approves-nine-projects-in-first-meeting-changes-in-the-investment-coordination-committee-icc-review-policies-also-green-lighted/](http://www.neda.gov.ph/2016/09/15/neda-board-approves-nine-projects-in-first-meeting-changes-in-the-investment-coordination-committee-icc-review-policies-also-green-lighted/) (last accessed 17 January 2017); NEDA, available at [http://www.neda.gov.ph/wp-content/uploads/2016/11/Guidelines-for-Project-proposals-for-ICC-review-and-approval\\_availment-of-Chinese-support.pdf](http://www.neda.gov.ph/wp-content/uploads/2016/11/Guidelines-for-Project-proposals-for-ICC-review-and-approval_availment-of-Chinese-support.pdf) (last accessed 17 January 2017).

17 Presidential Communications Operations Office, 'Duterte administration to speed up infra projects, November 3, 2016', available at <http://pcoo.gov.ph/duterte-administration-to-speed-up-infra-projects-nov-03-2016/> (last accessed 13 January 2017).

# PORTUGAL

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## I OVERVIEW

During the 1990s and onwards the Portuguese public authorities launched and widely used the public-private partnership (PPP) model to provide the country with modern infrastructure and services. PPP contracts were deployed particularly in the road infrastructure sector, as well as in the health sector, with the innovative feature of placing clinical National Health Service (NHS) hospitals under private management with an aggressive risk allocation to the private sector. Such PPP activity was boosted further after the international financial crisis of 2008, with the purpose of enhancing the Portuguese economy's poor performance.

As a consequence of the sovereign debt crisis of 2011 and in the context of the bailout advanced by the European Union (EU) and the International Monetary Fund (IMF), the Portuguese government was forced to introduce an austerity programme. As a result, public funding for investing in public infrastructure was materially reduced and the government endeavoured to reduce the significant payments to be made by the Portuguese state under PPP contracts.

With this aim in mind, the government started a negotiation process with PPP concessionaires in January 2013. In several roads PPPs the negotiation process was successful and agreements were reached.

During this period, companies have also experienced difficult conditions mainly owing to liquidity constraints and to the slowdown of the Portuguese PPP and construction markets in connection with the economic crisis, leading many of those companies to search for new opportunities in foreign markets, in particular in the Portuguese-speaking countries in Africa.

In early 2014, the Portuguese government approved the Strategic Plan for Transport and Infrastructure, which selects some infrastructure projects that could bring positive economic effects to Portugal between 2014 and 2020. Priority projects include the modernisation of the Portuguese rail freight sector, the development and increase in capacity of major Portuguese ports, a few projects in the road sector deemed essential to complete the road network, as well as the increase of cargo capacity at Lisbon Airport.

Such investments – in a global amount exceeding €6 billion – and the improved performance of the Portuguese economy, are expected to give rise to many opportunities in the coming years. In line with the above-mentioned Strategic Plan for Transport and Infrastructure for 2014–2020 and taking into account the limitations of the new European

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funds framework, some of the infrastructure projects in the pipeline are likely to be launched and executed under a PPP model.

## **II THE YEAR IN REVIEW**

The PPP business in Portugal has been quiet in recent years with regard to new deals coming to the market. In this context, 2016 saw no relevant changes, and similarly to recent years, PPP activity was mainly focused on concluding the renegotiation process of the existing road PPP contracts whose process had already been initiated in previous years, in order to meet the conditions of the EU–IMF financial assistance programme and following the feasibility assessment of major PPP projects.

In a significant number of road concessions, the renegotiation process was almost completed in 2014, although lenders' approval and the formal amendment of the concession contracts were still pending.

The amendments to the concession contracts, taken together, represent a substantial modification to the original risk allocation between the contracting authority and the road project companies. In fact, some development projects were reduced in scope, permitting savings not only in the construction works and associated capital and financing costs, but also in operation and maintenance spending in the future.

In relation to the projects already completed, the renegotiation process covered the reduction of service requirements and availability payments and, in some road PPP contracts, the possible extension of the maximum duration of the concession contracts to three years, subject to certain contractual requirements. In one specific case, the parties agreed on the replacement of availability payments with a traffic risk-based regime together with a minimum revenue assured by the contracting authority to the extent required to service debt under the financing contracts. Renegotiated contracts will also contemplate a set-off mechanism against toll revenues for the benefit of the concessionaires and an upside-sharing mechanism to encourage concessionaires to promote traffic in their concessions.

The Portuguese government has also appointed negotiation commissions to renegotiate the urban rail PPP contracts and the port terminal concession contracts. However, amendments to the existing concession agreements have not yet been approved.

Greenfield projects on a PPP scheme were almost entirely suspended in the effort to materially reduce public expenditure.

This being said, Portugal is still one of the European countries with the highest costs assigned to PPP projects (mainly in the road sector), notwithstanding the slowdown in relation to new PPP-based projects over the past few years. In fact, according to the statistical information provided by the European Commission, Portugal recorded the highest ratio of PPP over total GFCF (gross fixed capital formation) between 2000 and 2014, which demonstrates the relative weight of PPP projects within the Portuguese economy.

## **III GENERAL FRAMEWORK**

### **i Types of public-private partnership**

Decree Law 111/2012, of 23 May 2012, revoked Decree Law 86/2003, of 26 April 2003, and establishes the general rules applicable to any PPP launched by the Portuguese state.

It introduces several amendments to the previous PPP regime, in particular regarding the preparation, launching, execution and modification of PPP.



Both institutional and contractual PPP structures are available in Portugal. However, institutional PPP structures are not commonly used. In fact, the majority of PPP projects closed to date in Portugal are based on project finance contractual structures and typically follow a build–operate–transfer or design–build–finance–operate model.

The underlying contractual framework of a PPP transaction in Portugal traditionally includes a concession contract giving the project company the right to carry out the project or the relevant activity, a shareholders' agreement to regulate the relationship between the sponsors or project company's shareholders and an equity subscription agreement, a set of finance documents and certain major commercial contracts. Among the major commercial contracts, there is typically a construction contract and an operation and maintenance contract in infrastructure PPP projects. Supply agreements or sales agreements or both may also be entered into in connection with the project.

In the vast majority of the Portuguese PPP transactions closed to date, the concession-based construction contracts used do not follow any standard form, such as those issued by the International Federation of Consulting Engineers, the Joint Contracts Tribunal, or the Institution of Civil Engineers. Hence, the form of construction contract used in each case has varied depending on the sector of industry at stake or the sponsors involved.

In relation to the infrastructure projects closed in Portugal in the 1990s and early 2000s, it was generally accepted that, given the need to adapt the legal structure of the facility agreements to international syndication, the whole financing package other than the security documents had to be governed by English law, while the project documents, notably the concession contract, were subject to Portuguese law. That ceased to be the case from the mid-2000s onwards, at which point the project financiers active in Portugal had become sufficiently comfortable with the Portuguese law and, therefore, most finance documents executed thereafter are governed by Portuguese law, notwithstanding closely following the structure of a typical English law project finance documentation package.

PPP major projects in the health sector, the second most relevant sector concerning PPP projects, also have some particularities in Portugal. The specific framework for PPPs in health sector, set out in Decree Law 185/2002, of 20 August 2002, is still in place. The Decree Law, as amended, governs the development of PPPs for the construction, financing, operation and maintenance of healthcare units forming part of the NHS. An important feature of these PPPs is that they may envisage the private partner not only managing the hospital facilities but also providing clinical services as part of the NHS. When both managing facilities and clinical services provision are foreseen, two separate project companies must be incorporated. In such case, both project companies are bound to comply with their own obligations under a sole concession agreement, and one concessionaire is liable before the other provided that the non-compliance of its own obligations may give cause to the other concessionaire's infringement under the concession agreement. The health sector concession agreements set out different contractual periods for each concessionaire (10 years for the clinical services providers – which may be extended for additional 10-year periods up to a maximum of 30 years – and 30 years for the concessionaires responsible for the design, construction and operation of the hospital buildings). In 2016, PPP projects in the health sector were subject to an evaluation by the Health Regulatory Authority (ERS), in order to assess the quality of healthcare provided under the mentioned projects. According to this study, the quality of clinic services provided by the private partner are similar to the services provided by the state-run public utilities. Notwithstanding the positive performance, the Portuguese government has set a target to reduce the public burden of PPP projects in the health sector.

Therefore, renegotiations with the private partners are ongoing to reduce public payments. In this context, the renegotiation of the PPPs regarding the hospitals of Cascais and Braga assumes a particular relevance, as these PPP contracts will be terminated in 2018 and 2019; at the moment, the maintenance of a PPP model in such hospitals or, conversely, the return of the hospitals to the public management, is under political discussion.

In the road sector, different solutions were put in place regarding the concessionaires' payment mechanism and risk matrices. Shadow toll systems were introduced in some road projects during the 90s and onwards but in all those projects such payment systems were replaced by road availability payments and real toll payment systems. An exception was made in Madeira and Azores, where the regional political authorities chose to maintain the shadow toll systems previously adopted in their respective road projects. More recently, real toll payment mechanisms were also substituted by road availability solutions under the recent renegotiation process on the PPP projects of the road sector. Such renegotiation process also brought some specific solutions, including a set-off mechanism against toll revenues for the benefit of the concessionaires and an upside-sharing mechanism to encourage concessionaires to promote traffic in their concessions. At a municipal level, PPP activity took place through the launch of several projects for municipal water supply, wastewater treatment and waste management; Decree Law 90/2009, of 9 April 2009, and Decree Law 194/2009, of 20 August 2009, as amended, established the rules applicable to PPPs in the mentioned sectors.

## **ii The authorities**

In general terms, the sector ministries (energy, infrastructure, transports, health, etc., and (when applicable) environment) are responsible for the launching, licensing and major regulation of the projects, either directly or through their governmental departments.

The approval of the Ministry of Finance is also required when the project involves public investment or, more generally, where the PPP legal framework applies.

Decree Law 111/2012 introduced several amendments to the previous legal regime, in particular regarding the preparation, launching, execution and modification of PPPs.

The main purpose of this new legal framework is to reinforce supervision, scrutiny and consistency of the decisions of the public partner and contemplates the creation of the Technical Unit for Monitoring Projects, which centralises and executes all main tasks related to the preparation and execution of PPP contracts.

Other PPP projects at a municipal or regional level are prepared and executed by the respective public structures and such projects are not subject to the Technical Unit for Monitoring Projects' control.

## **iii General requirements for PPP contracts**

The legal framework applicable to the PPP projects expressly foresees the need to accommodate the type of expenditure within budgetary regulations and requires the preparation of economic and financial surveys to confirm the figures for the public sector comparator, as well as establishes general procedure rules applied to any type of PPP contracts.

Projects that require a global public cost above €10 million and an investment not higher than €25 million for the entire contractual period are not subject to the legal regime of the Decree Law 111/2012, of 23 May 2012.

Since the previous PPP Decree Law dated 2003 (Decree Law 86/2003, of 26 April 2003), procurement procedures may only be launched and awarded after approval of the relevant

environmental impact declaration and once the relevant environmental and urban planning licences and permits have been obtained, in order to ensure an effective transfer of execution risks to the private partner.

The regime concerning environmental impact assessment for each project was approved by Decree Law 151-B/2013, of 31 October 2013, as amended, pursuant to which any application for an environmental approval must enclose a detailed environmental impact study, the procedure for granting the relevant environmental impact decision implying a coordinated effort between a different array of entities for better assessment of the environmental risks associated with each project.

Depending on the sector of industry in question, a project may also be subject to environmental licensing under the new integrated pollution prevention and control legal framework, approved by Decree Law 127/2013, of 30 August 2013. The environmental licence (which is required, in particular, for industrial projects) must be obtained before operation commences and must be successively renewed during the entire period of operation of the plant, although simplified licensing procedures may be in place in accordance with the scope of the activities carried out.

Furthermore, in the context of the EU emissions trading system, for projects in certain industrial sectors and meeting certain conditions or thresholds, the operators must hold a permit to emit greenhouse gases, and be the holder of emission allowances.

Other industrial and construction licences and permits may be required depending on the type and specific conditions of each project to be implemented.

Finally, it should be noted that compliance with all legal conditions and procedures is subject to validation by the Court of Auditors. After the execution of a PPP agreement by any public entity, the Court of Auditors will verify and confirm whether all legal requirements are fulfilled and payments under those contracts can only be made further to such validation.

#### **IV BIDDING AND AWARD PROCEDURE**

The Public Contracts Code (PCC) was published on 29 January 2008 by means of Decree Law 18/2008 and revoked, among other pieces of legislation, Decree Law 59/99, of 2 March 1999, which applied to public works and to public works concessions. Such statute implemented the Public Procurement Directives 2004/17/EC and 2004/18/EC of 31 March 2004.

The PCC applies to every public tender procedure launched by a public authority. The Code sets out different procedures for the procurement process applicable to administrative contracts, including those to be entered into in connection with PPP projects: the direct agreement, the public tender, the limited tender by pre-qualification, the negotiation procedure and the competitive dialogue. Unsolicited bid mechanisms are not foreseen in Portuguese law. Differently from the former legal framework for public procurement, the PCC does not automatically require a public tender for public works concessions or public services concessions, the awarding entity being entitled to choose between the launch of a public tender, limited tender by pre-qualification or a negotiated procedure.

In each procedure allowed by the PCC, administrative principles of equal treatment, legality, transparency and competition are duly reflected in the respective regulation. Moreover, such principles are directly applicable to each procedure and may be invoked by any interested party. If an interested party considers that an act under the procurement procedure does not comply with applicable regulation and principles, it may claim directly to the awarding entity but also to a court. In such case, the interested party may ask the court

to declare the suspension of all subsequent acts in the procurement procedure by means of a temporary injunction, in order to ensure that its rights are not irreversibly threatened.

Substantive provisions dealing with public works and the public services concessions are included in the PCC, some of which are mandatory in nature. These mandatory provisions refer to relevant features of a PPP, such as termination by the contracting authority and sequestration/step in. Other substantive provisions of the PCC will only apply in the absence of express provision in the relevant contract.

The granting of the approval by the Court of Auditors is a condition for the contracting authority to make any payments under the contract; the contract may, however, enter into force prior to the validation and all rights and obligations contained therein may be performed, except for public payments.

In February 2014, the European Parliament and the Council adopted Directive 2014/25/EU (procurement in the water, energy, transport and postal services sectors), Directive 2014/24/EU (public works, supply and service contracts) and Directive 2014/23/EU (concession contracts). The new Public Procurement Directives were published in the Official Journal of the European Union on 28 March 2014 and entered into force on 17 April 2014.

The recent economic crisis in Europe has made it necessary to reform public procurement rules: first to make them simpler and more efficient for public purchasers and companies and second to provide the best value for money for public purchases, while respecting the principles of transparency and competition. The Directives comprise major changes to the European public procurement regime with the aim of:

- a* promoting environmental policies, as well as those governing social integration and innovation;
- b* improving the access of small and medium-sized businesses to public procurement markets;
- c* implementing stronger measures preventing conflicts of interest and corruption; and
- d* new simplified arrangements for social, cultural and health services listed in the Directives.

The deadline to incorporate the new rules into Portuguese law expired in April 2016. Portugal failed to transpose the Directives within the legal deadline due to the change of government at the end of 2015 and the intention to implement wide-ranging reforms in the public procurement legal regime. In this context, a draft law was submitted in September 2016 for public consultation.

Additionally, a specific new legal framework of electronic platforms for public procurement (e-procurement), the transposition deadline of which ends in September 2018, is currently under discussion.

## **V THE CONTRACT**

### **i Payment**

Remuneration mechanisms diverge considering the different sectors of activity and the different PPP projects.

In the road sector, different solutions were put in place regarding the concessionaires' payment mechanism. Real toll systems and shadow toll systems coexisted under different projects but the shadow toll systems were generally replaced by road availability payments and real toll payment systems. In addition, some real toll payment mechanisms were

substituted by road availability solutions under the recent renegotiation process on the PPP projects of the road sector. Upside-sharing mechanisms were set out thereunder to encourage concessionaires to promote traffic in their concessions.

Payments due under the PPP projects in the health sector are linked to the clinical services provided in accordance with a list of medical acts and complexity levels, and also to the availability of the hospital facilities. Both concessionaires are subject to payment deductions if any contractual requirements are not totally fulfilled, and additional revenues can be obtained through the performance in the hospital facilities of other related activities (the revenues of which are to be shared with the awarding entity).

Water supply concessions are generally paid by consumers – both at bulk and retail level – in accordance with the water consumption, the applicable tariff being determined in accordance with the concession agreement.

## **ii State guarantees**

The law establishes a type of sovereign guarantee which may be granted by the Portuguese government to secure payments by the state and related parties, such as state-owned companies or government departments. The maximum amount of the guarantees that may be provided in any given year must be approved and set out in the relevant state budget. However, PPP projects in Portugal usually do not include any type of sovereign guarantee to secure payments from the government or other public entities.

## **iii Distribution of risk**

According to Decree Law 111/2012, of 23 May 2012, project risks are to be shared between the public and private partners according to their capacity to manage such risks. Moreover, a PPP project should imply an effective and significant transfer of risks to the private partner. The concession contract allocates the relevant project risks between the contracting authority and the project company. The risks that remain with the contracting authority are usually covered by the financial rebalance mechanism, which is a key concept in all concession-based transactions in Portugal.

Typical financial balance events include unilateral variations by the contracting authority, force majeure events, specific change of law and construction delays caused by the contracting authority.

Traditionally, archaeological and ground risks were borne by the public partner. That was, however, not the case in the PPP1 Poceirão-Caia high-speed rail project closed in May 2010, (which was cancelled as part as the austerity-led review of PPP projects) and in the PPP hospital projects, where that risk was partially assumed by the project company and transferred by the latter to the contractor.

Nationalisation, expropriation or requisition of private property can only take place on the grounds of public interest and provided that private entities are duly compensated. Public interest may also constitute grounds for termination of the concession contract by the contracting authority, in which case the contracting authority shall compensate the project company for all the damages caused (which may include loss of profit). Some concession contracts set out the method for calculating the damages incurred by the project company in case of termination by reason of public interest. Such calculation usually takes into account the status of construction.

Other political risks, such as war, civil disturbance or strikes may be considered as events of force majeure and, therefore, the project company shall be relieved from its obligations

under the concession contract to the extent affected by the relevant event of force majeure. Force majeure events may trigger the financial balance mechanism and, hence, the project company (and consequently, the construction contractor) shall be compensated. In the case of prolonged force majeure or if the restoration of the financial balance of the concession proves too onerous, the concession contract may be terminated.

Changes in law may also be treated as a political risk. Only a specific change in law entitles the project company to financial rebalance. The risk of change in general law is typically assumed by the project company.

In water concession projects additional events may give cause to apply the financial rebalance mechanism, as it is the case of water consumption levels below certain limits or additional infrastructure investment requirements.

The project company generally passes on to the contractor all design and construction obligations, liabilities and risks under a construction contract which is fully back-to-back with the concession contract.

The contractor usually undertakes to perform the design and construction obligations on a turnkey and fixed-price basis and, hence, it bears the risk of price escalation of the material, equipment or workers. In some cases, the contractor is allowed to revise the price annually to reflect inflation.

Other risks that are transferred by the project company to the contractor under a classic concession-based construction contract include the delay in the completion of the works, approval risk, the risk of damage to the works and defects during the defects liability period.

The risks generally covered by the financial balance under the concession contract do not entitle the contractor to suspend the works or in any way relieve the contractor of its obligations under the construction contract. The contractor shall, however, be entitled to compensation in accordance with the 'back-to-back, if and when' principle, (i.e., the contractor will only receive compensation for any of the relevant events to the extent the project company is compensated for those same events under the concession contract).

With regard to limitation of liability, under general Portuguese law, any party is liable before the other for the breach of its obligations under the relevant contract. All damages caused by such breach must be compensated, including all direct damages and loss of profit but excluding indirect or consequential damages. Portuguese law expressly forbids prior general waivers of the right to compensation, although specific waivers after the occurrence of the fact giving rise to the right to compensation are permitted. It is possible, however, for the parties to agree an amount of liquidated damages for breach of obligations, provided that it represents a reasonable estimate of the damages that may result from such breach. Caps on liability are also generally admitted.

Portuguese project concessionaires usually have unlimited liability under the respective contracts. In recent years, the subcontracts executed by concessionaires with construction and operation and maintenance contractors set out liability caps in line with the commercial practices in other countries.

In contracts where a liability cap is foreseen, the same is often equivalent to the contract price and, since no restrictions are made to the type of damages that are considered for compensation purposes, the relevant legal provisions will apply. In recent projects, contractors have successfully demanded the introduction of tighter liability caps and the exclusion of loss of profit suffered by the project company.

**iv Adjustment and revision**

The risks that remain with the contracting authority are usually covered by the above-mentioned financial rebalance mechanism. If a financial balance event arises causing a deterioration in the levels of the project ratios, the contracting authority agrees to compensate the project company with a view to restoring the financial balance of the concession.

In general, any amendments to the PPP concession contracts should be subject to the procedures set out in Decree Law 111/2012, of 23 May 2012. Such procedures include the creation of a negotiation committee to prepare and execute the negotiations with the private partner in order to reach a new agreement, which will be subject to a final report and approval process by the relevant government members. Other adjustment mechanisms not focused particularly on the payments are also set out, as is the geographic area the clinical services should encompass under hospital PPP projects. In fact, subject to certain constraints, the public health authority can modify the reference area for each type of medical treatment merely by a decision to be notified to the private partner.

**v Ownership of underlying assets**

Other than assets in the public domain (e.g., the hydric domain, mineral resources, roads, railways) which may not be appropriated by private entities, the ownership of land or other assets may be acquired by the private partner.

However, the exercise of a specific economic activity by use or operation of such assets may require a licence and, in the case of an asset of public domain, the attribution of a right of use (of the relevant asset, normally through a concession regime).

It is usual to set out that the private partner should deliver any assets at the term of the contract, even though such assets are owned by the private partner, provided that the same are required to perform the relevant activity under the agreement.

**vi Early termination**

Concession agreements may be terminated by either party owing to the infringement of the other party's obligations. Also, concession agreements usually foresee the possibility of redemption or early termination on grounds of public interest.

Some concession contracts set out the method for calculating the damages incurred by the project company in such situations, which calculation usually takes into account the status of construction and in some circumstances the financing agreements entered into between the private partner for the purposes of implementing the project.

Termination owing to one party's failure to comply with its obligations usually does not entitle the non-compliant party to any compensation rights. However, in some PPP projects – as is the case of the hospital PPP projects – compensation may be due in such situations taking into consideration the significant investments made by the private partner that should revert to the public partner.

**VI FINANCE**

Most the PPP projects in Portugal are financed pursuant to the project finance structure. The use of project bonds or monoline structures to finance projects was not common until recently, as these instruments have now started to be considered as an alternative or complementary financing tool to traditional project finance.

The finance package usually comprises a commercial bank credit agreement (as well as a European Investment Bank (EIB) credit agreement and an intercreditor agreement whenever the EIB is also providing finance to the project), an accounts agreement, a forecasting agreement, security documents and direct agreements between the lenders and the contracting authority or the major project parties, all in a form consistent with international market standards.

The two main types of security that can be created under Portuguese law are mortgages and pledges. Mortgages will entitle the beneficiary, in the event of a default, to be paid with preference to non-secured creditors from the proceeds of the sale of immovable assets or rights relating thereto or of moveable assets subject to registration (such as automobiles, ships or planes). Pledges will confer similar rights to those created by the mortgages, but are created in respect of moveable (non-registered) assets or credits. Portuguese law does not recognise the concept of a floating charge. Also it does not permit the creation of security over future assets and, therefore, promissory agreements and assignments in security are entered into to overcome this hurdle. However, since Portuguese law does not recognise the concept of assignment by way of security as existing in most (if not all) common law jurisdictions, the instrument used is a true assignment of rights, with the occurrence of an event of default being either a condition precedent to the assignment or a termination event, depending on the bargaining power of the borrower and sponsors (as applicable). It also should be noted that Portuguese law does not foresee the concept of a security trustee, therefore there is some uncertainty as to whether a Portuguese court would immediately recognise the authority of a security agent to enforce security interests on behalf of the secured creditors (the collateral takers), on terms similar to those accepted in a common law context.

Also, Portuguese law does not allow for remedies other than outright sale, other than in the case of financial pledges where appropriation of financial collateral is permitted on enforcement of the pledge, provided that the parties have agreed a commercially reasonable mechanism for evaluating the price. Financial pledges may be granted over cash on bank accounts or financial instruments (including shares but not quotas in Portuguese limited liability companies) and, more recently, credits over third parties.

Portuguese project finance documentation generally includes direct agreements between the lenders and the contracting authority and the lenders and any major contractors. All direct agreements contemplate step-in rights in favour of lenders, which may be exercised upon the occurrence of certain events: default of the concessionaire under the underlying contracts and, in certain cases, default of the concessionaire under the finance documents.

Shareholders are generally required to provide on-demand bank guarantees in order to guarantee their equity subscription and other funding obligations. Standby equity commitments to fund general investment, operational costs overruns or loss of revenues are often also supported by on-demand bank guarantees.

In health sector PPPs, the shareholders have been requested to provide a corporate guarantee to guarantee, in the proportion of their shareholding in each project company (the ClinicCo and the InfraCo) and up to a certain amount, any lack of funds in the project and breach of the obligations of the project company.

## **VII RECENT DECISIONS**

No significant dispute under the existing PPP procurement procedures has been registered recently. However, some relevant disputes arose from the performance of those contracts.



The main reasons evoked by the concessionaires included the variations imposed by the contracting authorities which were not settled by negotiation under the financial rebalance mechanism. There is one dispute that has not yet been decided related to the impact of the international financial crisis and the applicability of change of circumstances legal provisions in that context. In Portugal, PPP concession agreements frequently set out arbitration as the applicable dispute resolution mechanism. In 2016, the Portuguese state was sentenced to pay a considerable amount within a concessionaire's claim under the financial rebalance mechanism. The concessionaire claimed an adjustment under the financial rebalance mechanism following a specific change of law (a change of law that had a direct impact on the project), establishing the introduction of real tolls on an SCUT road project, which resulted in a loss of revenues of the project.

## **VIII OUTLOOK**

The Portuguese economy is recovering, after the conclusion of the three-year EU-IMF adjustment programme in May 2014. There is, however, some uncertainty associated with political pressure – from left-wing parties supporting the government – to avoid PPP schemes, at least in areas of greater social sensitivity, such as health and public transport. Public investment in several infrastructure projects – mainly in the freight rail and port sectors, as stated in the Strategic Plan for Transport and Infrastructure 2104–2020 – is still expected. Whether or not under a PPP model, these investments should have a significant positive impact on the Portuguese economy and create many business opportunities for all stakeholders in the relevant sectors. Other opportunities may arise from the recent focus of the Portuguese government in developing the Green Economy and Green Growth in Portugal, in relevant areas such as climate and energy, water and waste management, biodiversity and sustainable cities.

It should also be noted that the Lisboa-Oriental Hospital Project, originally launched in 2008 and put on hold during the last phase of the tender procedure in 2010, is expected to be re-launched in 2017, as foreseen in the 2017 State Budget Law. The 2017 State Budget Law also foresees the allocation of funds for the construction of another two hospitals. The use of a PPP model for these transactions has not yet been decided on.

# SPAIN

*Manuel Vélez Fraga and Ana María Sabiote Ortiz<sup>1</sup>*

## I OVERVIEW

According to the Spanish National Association of Construction Companies, between 2003 and 2011, Spain generated over 500 public-private partnership (PPP) transactions worth approximately €50 billion. However, since 2012, the PPP market has fallen to 2005 levels mainly due to budget cuts by the Spanish governments. The economic crisis and changes in financial markets affected ongoing PPP projects, those under construction and those recently awarded.

In view of the budget restrictions and the tight levels of public debt, PPP projects are again an opportunity to foster investment in public infrastructures as the financing is mainly assumed by the sponsor and the public expense is prorated along the project life. In short, PPP can help the authorities overcome short-term budget constraints by making the most of the PPP advantages available, such as whole-life cost management and payment tied to service delivery, not asset provision.

There is a general conviction that infrastructure development contributes towards economic growth, and privately financed PPPs could be an option to deliver key infrastructure as they limit short-term pressure on both debt and deficit.

According to a report by AT Kearney regarding priority areas for sustainable investment in infrastructures in Spain, the country is in a good position with regard to certain infrastructures (namely high-capacity roads, high-speed railways, airports and ports), but it has deficiencies in the maintenance of current infrastructures, the transport of goods, accessibility and urban mobility, as well as secondary nets. In its analysis, AT Kearney recommends investment in eight priority areas: water, energy, social care, transport, environment, IT, urban nets, and infrastructure maintenance. PPP schemes are a way of obtaining that investment in view of the limited public funds.

## II THE YEAR IN REVIEW

2016 has been a politically uncertain year because of the deadlocks in the Spanish elections. This uncertainty has influenced both political initiatives and private investment. The formation of the Spanish government and the recovery of the economy will likely bring about new actions in public and private investments that may foster PPP as a way to improve infrastructures in the areas identified above.

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With the formation of the new government, a new bill on public sector contracts was submitted to and is currently being reviewed by the Spanish parliament. The new bill will transpose into Spanish law both Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repeal Directive 2004/18/EC and Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the award of concession contracts. The new bill will likely be enacted in the first half of 2017.

### III GENERAL FRAMEWORK

#### i Types of public-private partnership

In the Spanish market, PPP is not a legal concept strictly speaking, but a type of public policy or management method that entails collaboration between a public entity and a private partner. This collaboration aims to implement, finance and manage public infrastructures in broad terms, including facilities, services or utilities. This clarification serves to avoid misidentifying PPP in general with a specific and single contract form under the Spanish Public Procurement Law.

Under the Spanish Public Procurement Law,<sup>2</sup> there are three main types of PPP contracts: (1) public works concession contracts; (2) public service management contracts; and (3) partnership agreements between the public and the private sector.

#### *Public works concession contracts*

Traditionally, public works concession contracts are conceived under Spanish law as a contract under which the concessionaire develops a public works project and is remunerated for it through the right to operate the project (by collecting a fee or toll from users), at its own risk, during the term of the concession.

This type of contract is the most commonly used in practice for new categories of projects such as (1) projects that require the involvement of the private contractor in defining the project; (2) projects in which the contractor does not manage the public infrastructure or facility directly for private individuals, but for the public entity, which uses the infrastructure as a physical base for the provision of public services to citizens, which are provided by the public authority itself (using its own resources); or (3) projects in which the contractor is not remunerated directly by users, but by the public entity (either based on the number of users using the infrastructure – payment for demand, or on the conditions under which it is made available to the public authority – payment for availability).

This broad concept of public works concession is firmly accepted under Spanish law. Currently, public works concession contracts can be executed for the following reasons according to Spanish law:

- a* the concessionaire may also be in charge of preparing the relevant project, on the basis of the preliminary plan or study approved by the contracting government department;
- b* the purpose of the public works concession contract includes not only the construction of new infrastructure, but also the renovation and repair of existing constructions, as well as the preservation and maintenance of the constructed elements. This broadens

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2 Namely, Royal Legislative Decree 3/2011 of 14 November approving the Consolidated Public Sector Contracts Law. Royal Legislative Decree 3/2011 is currently under review in the Spanish parliament. The new bill will likely be enacted in the first half of 2017 and will derogate Royal Legislative Decree 3/2011.

the potential use of this contract, which can now cover not only new infrastructures but also the operation of existing ones that require a significant investment with regard to renovation or maintenance; and

- c they also include agreements under which the concessionaire uses the public infrastructure to make it available to the public entity (or to an indirect operator), so that it can use it to provide a public service. In the latter case, use consists of operating the infrastructure. The operation must be undertaken in accordance with its particular nature and purpose. Since the concession involves a public infrastructure, its nature determines that it must be established as an instrumental support to perform different activities and services of public interest, or for general use or enjoyment, in exchange for remuneration fixed through one of the mechanisms provided by law.

### ***Public service management contracts***

The public service management contract is an agreement under which the public entity entrusts a third party to manage a public service on its behalf. The standard public service management contract is generally classified as follows:<sup>3</sup>

- a Public service management concession. A contract under which the public authority – responsible for a public service – awards the management of such service to a private entity to operate it at its own risk. The private entity may be paid by the users, the public entity, or both.
- b Special agreement. This is another subcategory of the public service management contract. It is characterised by the fact that the public entity awards the management of the service to an individual or legal entity that already provides similar services to the relevant public service. It is common in the education and health sectors.
- c Public service management by a semi-public company. The semi-public company is a type of institutionalised PPP under which a company is incorporated through a contract between private and public capital, to then become a public contractor with the characteristic rights and obligations of a concessionaire. Semi-public companies have a long tradition under Spanish law in managing local public services.
- d There is also a fourth subcategory of public service management contract under the Spanish Public Procurement Law: stakeholder management, under which the public entity and the company share the operating profits of the service in the proportion agreed in the contract.

### ***Partnership agreements between the public and the private sector***

Partnership agreements between the public and private sector were implemented in Spain in 2007.

The main characteristics of this partnership agreement are the combination of two elements:

- a the execution by the contractor of a complex operation, which includes one or more of the following activities: (1) the execution of complex works, equipment, systems

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3 The new draft bill on public procurement being prepared by the Spanish parliament envisages important changes to the public service management contract. According to the current draft, the public service management contract will be mainly to reduce the public service concession, although certain forms of the traditional public service management contract remain for local entities. This issue must be further analysed in view of the final bill.

- and utilities, as well as the maintenance, updating or integrated operation; (2) the integrated management of complex facilities; and (3) the provision of other complex services associated with the public authority's performance of its specific responsibilities; and
- b* the initial financing by the contractor of the tangible or intangible investments required for the services that constitute the first of the elements.

Very few examples of this type of contract can be found in practice at national, regional or local level. Some examples can be found in areas such as energy efficiency. In general, public entities have seldom used partnership agreements between the public and private sector.

It is probably for this reason that the draft bill currently under review by the Spanish parliament foresees eliminating this type of agreement.

## **ii The authorities**

Spain is a regional state, which means it is a decentralised state formed by 17 regions with their corresponding regional authorities. In addition to the national and regional governments, the Spanish Constitution gives local authorities some administrative authority.

Therefore, Spanish authorities are mainly arranged at three institutional levels: national government and its corresponding public entities, regional governments and their corresponding public entities, and local governments and their corresponding public entities.

The three levels have different or partially concurrent powers. Each authority level can exercise these powers through PPP projects. For instance, the national government has authority over transport and can exercise its powers through PPP on transport infrastructures. Regional governments have authority over health and social care and may develop hospital infrastructures through PPP. Local governments have authority over local services such as water and waste collection, and may implement these services through PPP projects.

Any department of the public authority in these three levels may enter into PPP contracts in their specific field. For instance, the Environment Department may call a procedure for the construction of water infrastructures under a PPP project. However, at national level, there are two main ministries involved in PPP projects: the Ministry of Infrastructure, as it has authority over all transports involving public works; and the Ministry of Finance and Public Administration, which administers the state budget and expenses and that plays an important role due to public debt restrictions and analyses the impact of PPP projects on public accounting.

There is currently no specific authority in charge of PPP projects in Spain. In October 2015, the national government created the National Evaluation Office to improve the quality of the investments made by public authorities. The National Office assesses the feasibility of public projects under public contracts taking into account the rules governing budgetary balance. The National Office may also assist regional and local governments. However, the ruling officially implementing this National Office has not yet been issued, thus it is not yet operative, and, for now, is not regulated by law as a real PPP unit to foster PPP benefits or collect and improve PPP practices.

Apart from the national, regional and local authorities strictly speaking, there are other public entities mainly governed by private law, such as the Railway Infrastructure Administrator (ADIF), or the Port Authorities. These entities often enter into contracts to construct and operate public infrastructures and facilities that include some of the characteristics set out for the types of PPP contracts described in subsection i, *supra*. However, although their names

and legal frameworks may coincide, totally or in part, with the provisions for PPP contracts governed by the Public Procurement Law, the effects and termination of these contracts are governed by private law. The general regime for PPP described in this chapter only applies to contracts entered into by other public entities when such entities so decide in the contract in question.

### **iii General requirements for PPP contracts**

Public authorities must meet a series of internal requirements and approvals to enter into a specific PPP contract. Mainly, public authorities must evidence the need for which the PPP is to be executed, and must prove the advantages of using a PPP contract to cover that need over other types of contracts or over the public authority implementing it directly. In addition, the public entity must make sure that there are sufficient funds to pay for the PPP contract before calling a public tender under a specific procedure. Likewise, the new National Evaluation Office must analyse the financial sustainability of the public works and public service, for example, whenever the price will be assumed totally or partially by the contracting authorities, not by the users.

In addition, prior to calling the public tender, the contracting authority must undertake to carry out a feasibility study which analyses the economic-financial basis for the contract. This study must provide an estimate of use demands and profitability of the contract, operational and technological risks in the construction and operation phases, as well as an estimate of investment costs and the potential financing system to perform the work. This feasibility study constitutes the value for money assessment by the public authority.

Once the feasibility study has been prepared, and at all times prior to calling the public tender, the contracting authority must prepare the administrative and technical bidding terms that will govern the relationship with the awardee. These terms must be approved by the legal and technical advisers of the contracting body.

Once the internal requirements have been met and the bidding terms have been approved, the public entity can start the tender procedure.

Public works and public services concessions are subject to temporal limits established by law. Therefore, the term of the contract must be justified in the contract itself, taking into account the need to be satisfied and the recovery of the investment but at all times in accordance with statutory limits, which are (1) 40 years for public work concessions; or (2) for public services concessions, 50 years if it includes construction work, 25 years for other cases, and 10 years if the public services rendered are healthcare services which involve no construction works.

In principle there are no other general restrictions on the use of PPP to cover a public need. In any case, the services that involve exercising public powers cannot be managed by third parties and therefore cannot be entrusted to a contractor through a PPP project. They must be exercised by the public authority directly.

## **IV BIDDING AND AWARD PROCEDURE**

The Public Procurement Law in force mainly regulates four types of procedures to select and award the contracts included under the PPP category (see Section III.i, *supra*): open procedure, restricted procedure, negotiated procedure (with and without publicity) and competitive dialogue.

The open and the restricted procedures are called ordinary procedures, because they can be generally used by the contracting authorities. Negotiated and competitive dialogue procedures can only be used under certain circumstances, such as if the matter is especially complex, in the case of competitive dialogue, or if the preliminary open or restricted procedure has been declared null, in the case of negotiated procedure.

In practice, the two main PPP contracts (public works and public works service concessions) are awarded through open procedures and, rarely, through restricted procedures. The preference for open procedures is due to the restrictions existing for using other procedures, the higher complexity of the other procedures and the aim of allowing as many participants as possible.

The open procedure results in mainly standardised PPP contracts, as the rights and obligations under the contract are mainly governed by standardised administrative and bidding terms. The bidding terms are not negotiable so they cannot be modified by the tenderers.

Our observations in the following subsections refer to the two most commonly used procedures (open and restricted) in PPP contracting in Spain.

### **i Expressions of interest**

The Public Procurement Law provides no specific procedure for the awarding body to request information from interested parties. However, this request and assessment of interest can be channelled through the public hearings in preparing the PPP contract: in particular, the public hearing of the feasibility study, which must last a minimum of one month, and the public hearing that may take place in certain complex public projects regarding the construction project. The law does not prevent public entities from organising other hearings or consultations to obtain feedback from the market before calling a public tender.

Additionally, according to Spanish law, private third parties may submit feasibility studies on themselves, in order to invite the public entity to cover a specific need through a public concession. Once the feasibility study has been submitted, the authority decides whether to proceed. If a public tender is called following a feasibility study, and the contract is awarded to another private party, the promoter of the feasibility study must be compensated for the expenses it incurred to promote such study plus 5 per cent. Despite this legal provision, private initiative in submitting feasibility studies has been practically non-existent in Spain.

### **ii Requests for proposals and unsolicited proposals**

Once the public entities approve the file to enter into a specific PPP, they can launch the public tender procedure. The procedure starts with an advertisement in the Official State Gazette and the Official Journal of the European Union, or in the Official Gazette of the autonomous community or municipality in question. This advertisement is particularly important because it is the start of the term to submit offers.

Under the open procedure, any third party may submit an offer. Submitting an offer implies the unconditional acceptance of the bidding terms, and the terms of the contract cannot be negotiated.

Between the call and the submission of offers, any interested party may request clarifications from the awarding authority. The queries made and answers provided during this phase must be generally available to all interested parties.

Unlike the open procedure, the restricted procedure is structured in two phases during which a shortlist of offers is made. The existence of a preliminary selection phase means that,

when preparing the contract (before its tendering), the contracting body defines the objective criteria of solvency in accordance with which it will choose the candidates (generally no fewer than five) which it will invite to submit proposals. These criteria are available from the moment the tender is announced. Only the pre-selected candidates may submit proposals.

### **iii Assessment of the offer and granting of the award**

Beyond the preliminary contract preparation phase during which the content of the contract is defined, its content cannot be altered or specified by negotiation under either the open procedure or the restricted procedure. Submitting a proposal entails that the tenderer accepts the bidding terms in full.

Once the proposals have been filed, the Public Procurement Law establishes the procedure to open and analyse the proposals under transparency and parity criteria. The awarding criteria in PPP projects usually include both economic and technical assessment and must be previously defined in the bidding terms in accordance with the purpose of the contract. The criteria that cannot be assessed using an automatic formula will be scored before those subject to automatic criteria to ensure parity.

The contract will be awarded to the bidder with the highest score, and will come into force once both parties enter into the formal agreement. This formal agreement is usually short and merely restates the main obligations which are defined in the bidding terms and in the bidder's proposal.

## **V THE CONTRACT**

### **i Payment**

The standard two methods of payment are suitable for PPP projects: by the contracting authority itself, or by the users. However, payment can also be a combination of both methods. Therefore, the difference between the types of PPP contracts does not depend on who pays for the service provided by the sponsor. Direct payment by the users is usually regulated and capped by the contracting authority.

Likewise, payments made by the public entity may depend on the demand or level of use of the infrastructures (as in the case of shadow tolls), or on the availability of the infrastructure for the public entity measured in view of certain service standards or indicators.

There has been some debate over whether payment based on the availability of the public infrastructure to the public entity (payment for availability) is compatible with the existence of a risk for the concessionaire. Whenever the formulas for availability are defined in a clearly aggressive way to ensure that the concessionaire actually assumes the effects of inadequate performance of the contract, it can be said that the concessionaire assumes a real risk.

In practice in Spain, the misgivings regarding payment for availability have been precisely due to the establishment of insufficiently sensitive parameters of availability, which, as a result, significantly reduce the risk for the concessionaire.

The remuneration resulting from the operation of the infrastructure may be accompanied by a price paid by the public entity, and by other public contributions to the construction and operation of the infrastructure, making the system of concessionaire remuneration quite flexible.



## **ii State guarantees**

Traditionally, public entities have been considered trustworthy and guarantees have not been required to secure payment. Because of the recent economic crisis, some public entities have had payment problems. This situation has been addressed by tightening the regulations to control public expenses and investments. Likewise, the state has implemented measures to support regional and local authorities in their obligations, but the Public Procurement Law has not been modified to introduce a scheme of guarantees to ensure payments by public contractors. The amendments have focused on a stricter control of the existence of funds and the economic feasibility of the contract before it is executed.

In connection with the above, the Public Procurement Law has been amended to introduce the following limits to public contributions and securities: (1) public contributions and any type of security, guarantee and other measures to finance the project must necessarily be stipulated in the bidding terms and their amount must be determined in the award procedure. This amendment does away with the possibility of contributions being made at the end of the concession and the contribution being increased after the award resolution; (2) bidders will determine the exact amount of public contributions in their offers within the maximums established in the bidding terms; and (3) the bidding terms must state any reduction of the public contributions as an evaluation criterion for awarding the contract.

## **iii Distribution of risk**

A key element in public concessions is the construction and/or operation of infrastructures by the concessionaire at its own risk. According to this principle, the concessionaire must assume the consequences, in financial terms, that may arise from performing the contract.

Under Spanish law, the principle that the contractor assumes its own risk is compatible with the guarantee to restore the financial-economic balance when the contract's economic imbalance is caused by the public authorities, either by exercising their prerogative to modify the contract, or due to decisions of the contracting administration or other public authorities (including regulatory risk in general).

The risk principle is also compatible with restoring the concession's economic balance when that balance is disrupted by risks unrelated to actions not only of the concessionaire, but also of the public authorities. This is the case of force majeure events and unexpected risk. The Public Procurement Law expressly regulates the former (force majeure). If force majeure has a significant disruptive effect on the economic side of the contract, it gives rise to a right to restore its economic balance and, if the contract can no longer be performed, to its termination in such a way that the recovery of the concessionaire's investment is guaranteed. However, the concept of force majeure under Spanish law is applied very restrictively and has traditionally been complemented with the concept of 'unexpected risk'. Under unexpected risk, economic imbalances arising during the performance of a contract due to the emergence of a risk that could not have been foreseen when the contract was executed can be corrected. This is the case if the risk in question significantly disrupts the conditions to perform the contract, to the extent that providing the agreed service has become much more burdensome than anticipated for one of the parties. Although the doctrine of unexpected risk is currently quite prevalent, it is not actually referred to in legislation.

In addition to those described above, there is another group of risks which must be determined in the bidding terms as they are not established by either legislation or case law.

In the specific case of financing, the risk known as financial closure risk is particularly important. This risk is assumed by the concessionaire and worsens in times of credit market crisis.

Financial closure risk can be defined as the fluctuation in the cost of financing required by the concessionaire to perform the contract, from the time the bid is awarded to the time when the financing is definitively confirmed after being awarded the contract. Generally, unless the bidding terms state otherwise, the tenderers assume the financial closure risk, in such a way that any differences between the financing conditions foreseen when the bid is submitted and the conditions secured when the financing is finalised after the contract is awarded, are assumed by the tenderer, who is not allowed to pass on a higher financing cost than that offered in the financial-economic plan. In practice, the tenderers have attempted to cover this risk by negotiating derivatives of the main financing contract in order to cover exchange and interest rates. However, the coverage only comes into effect once the contract is awarded, and thus, until then, the risk continues to be assumed entirely by the tenderer.

#### **iv Adjustment and revision**

Public authorities have special prerogatives over the contractor, basically consisting of the power to: (1) construe the terms and conditions of the contract; (2) unilaterally modify the contract for public interest reasons; (3) impose penalties; and (4) unilaterally terminate the contract under certain circumstances set out by law and in the contract, and establish the effects of this termination.

Therefore, according to these prerogatives, the contracting authority will retain its right to modify aspects of the contract for new and compelling public interest reasons, provided that the contractor is paid compensation. This legal prerogative can be challenged in court when it does not fulfil the relevant mandatory provisions.

The grantor modifying the concession is one of the events that triggers the contractor's right to rebalance the financial terms of a contract, provided that the amendment affects the economic balance of the contract when it was awarded to the detriment of the concessionaire (beyond a mere reduction in the expected profits). The concessionaire can request the grantor to rebalance the financial situation by evidencing the unbalancing event and its actual effects on the existing financial plan approved as part of the contract. The rebalancing can be implemented by modifying any financial condition of the contract. The terms of the tender may limit when this financial rebalancing can be done.

The compensation to the concessionaire must be paid within the term set out in the bidding terms, which must not exceed the maximum legal term established by law, which is currently 30 days following the grantor's approval of the service rendered. Late payment triggers default interest. When late payment exceeds a joint period, the contractor may suspend the contract, or even request its termination as explained in subsection vi, *infra*.

The review or update of the compensation under public contracts also depends on the bidding terms that cannot be contrary to the legal requirements. The review of the price in public contracts has recently been modified by Law 2/2015 of 30 March and further implemented for public contracts by Royal Decree 55/2017 of 3 February. Under these new regulations, the review can only take place when the investment return exceeds five years and subject to the strict conditions set out in the regulations.

## v Ownership of underlying assets

Assets in PPP contracts are owned by the public authority. Due to its connection to a public work or service, the public entity does not lose its right *in rem* over the assets during the contract, but the concessionaire is empowered to use them for the proper rendering of the service or the operation of the public works. At the end of concession contracts, the facilities must be returned to the grantor in adequate working condition to continue providing the services. To this end, the grantor may inspect the facilities to make sure that the grantor is complying with its obligations under the contracts.

Empowerment to use the assets to properly render the service or operation of the public works implies that the contractor can dispose of the assets with the assistance of the public entity, when necessary, to that end, and that the contractor may mortgage the concession itself in accordance with the mortgage legislation, and with the prior authorisation of the contracting authority. The mortgage cannot be used to secure obligations under contracts other than the relevant PPP.

According to the Public Procurement Law, the contract itself cannot be assigned without the grantor's prior authorisation. Spanish public procurement law has traditionally regulated the assignment of the contract, but not the transfer of the contractor's shares.

Therefore, when the contract is silent in this respect, the transfer of the contractor's shares does not require the grantor's prior authorisation, except when the transfer may be considered equivalent to assigning the contract. Transferring shares may be considered an assignment when it only relates to a company whose sole object is to operate public concessions and the transfer of shares entails a change in the person who controls the holder of the concession.

## vi Early termination

The public authority can terminate the concession early under certain circumstances set out by law and in the contract, and establish the effects of this termination. The effects (compensation) of early termination vary depending on the specific termination event.

The Public Procurement Law currently establishes the following main early-termination events for public concessions:

- a* the concessionaire loses its legal personality;
- b* the contractor enters into a creditors' agreement or files for insolvency;
- c* foreclosing the concession mortgage is unfeasible;
- d* by mutual agreement between the public authority and the contractor;
- e* the concession has been seized by the authority for longer than the agreed maximum term;
- f* payment delays by the public authority for over six months;
- g* the contract is revoked by the public authorities at their discretion (this unilateral termination is not connected to the concessionaire's management);
- h* the exploitation of the public infrastructure or the public service is cancelled for public interest reasons;
- i* the infrastructure cannot be operated due to the contracting authority's decisions after the contract was executed; or
- j* the concessionaire fails to comply with essential contractual obligations.

If the concession is terminated for public interest reasons, adequate compensation must be paid. According to case law, 'public interest' is an abstract notion that can only be

determined and defined on a case-by-case basis and taking into account the characteristics and circumstances of a particular contract as a whole, such as its subject matter, purpose, nature, etc. The grantor must justify its decision on public interest reasons, which can be challenged in court.

Among other consequences, rights arising for the contractor from an early termination event include the equity value of the investment, usually, albeit inappropriately, referred to as the pecuniary liability of the public authority (RPA).

The method of calculating RPA was modified in 2015, and it may be further modified by the new draft bill on public procurement under review by the Spanish parliament.

Following the modification of 2015, the provisions on RPA distinguish two calculation methods: (1) for cases involving a termination not attributable to the public authority, the RPA is determined in a new award process for the concession; and (2) in cases of termination not attributable to the concessionaire, the regulation on compensation for investments is similar, but specifies that straight-line depreciation will be used.

Termination is not automatic. The contracting authority must undergo a procedure in which the concessionaire is heard.

## **VI FINANCE**

The private funds involved in a PPP project may come from two sources: tenderers (usually as capital of the special purpose vehicle responsible for carrying out the project) or third-party financiers.

Financing PPP contracts in Spain usually follows the traditional scheme of bank financing. This scheme relies chiefly on pledges, and, in some cases, assignment to the financier both of the credit rights arising from the normal operation of the infrastructure (periodic cash inflows from the operation of the public works or services), and of the credit rights arising from the early termination of the contract (the equity value of the investment or RPA, as explained above).

The financing is normally granted in the form of credit, which the concessionaire can obtain upon completing the project phases. The syndication mechanism is a response to the need to distribute the operating risks when they are too high to be assumed by a single entity. In the past few years we have seen the growth in particular of uninsured or 'club deal' syndicated loans, under which each institution of the syndicate guarantees only its share, as opposed to other types where one or more institutions undertake to contribute all of the financing if they are unable to find enough institutions that wish to participate in the financing project.

Syndication of financing involves the execution of a contract by creditors including all the institutions in the syndicate which regulates, among other matters, the majorities required to adopt decisions related to financing and the rules to distribute the amounts obtained from the concessionaire company. Unless other debt and creditors' seniority is established, loan repayments are usually distributed in proportion to each institution's share in the financing.

To facilitate the operational management of the financing, one of the financial institutions assumes the role of agent bank. As such, it is responsible for delivering the funds to the company, distributing the repayments among all the financial institutions and channelling communications in each direction.

We note that, given that the tendering procedure generally adopted to award concessions is a standardised one (open or restricted), negotiations with financial institutions begin in

the phase prior to the contract, since the tenderer has to include the main characteristics of the financing that it will be able to secure in its financial bid. However, credit negotiations are only finalised *a posteriori*, once the tenderer is awarded the contract. At this time, the concessionaire's negotiating position is very much influenced by the urgency of the financing to fulfil the contractual obligations it has assumed vis-à-vis the public authority. Moreover, the added cost with which the financing may be finally secured will generally, but not always, be assumed by the concessionaire, who has little chance of passing it on to the public authority.

Guarantees play a fundamental role in bank financing. In fact, the granting of financing is generally conditional upon the prior or simultaneous granting of guarantees over the different assets, goods and rights that constitute the equity of the concessionaire company.

On the other hand, the Public Procurement Law expressly regulates the issue of bonds by concessionaires, as well as the securitisation of credit rights arising from the concession. Given that the concessionaire generally has no revenue other than these credit rights, the bonds and securities that could potentially be issued would essentially be those resulting from securitisation. The issue of these securities will require prior administrative authorisation from the contracting authority, which can only be denied if this is justified by the successful outcome of the concession or another factor of public interest.

## VII RECENT DECISIONS

The main recent relevant jurisprudence relating to PPP has concerned public concessions for the construction and operation of ring roads in Madrid. However, this jurisprudence, mainly related to expropriation costs and calculation of damages for early termination events, is very casuistic and limited to exceptional circumstances that may not apply on a general basis. There has not been an established line of jurisprudence to strengthen or weaken the PPP model, which is, in any event, a popular scheme Spain, through the concession model.

## VIII OUTLOOK

Traditionally, investing in infrastructures has contributed to fostering the economy due to the improvement of the country's competitiveness and to citizens' welfare. Despite the high level of transport infrastructures (see Section I, *supra*), there is still a significant investment deficit in Spain in other priority sectors such as infrastructure maintenance, transportation of goods, social care (health and education), water, etc., compared with other European countries.

Alternative financing schemes are required due to public budget restrictions. In this scenario, PPPs are a perfect channel for private investment in infrastructures.

This situation, together with the acceptance of the PPP model in Spain, the existence of brownfield opportunities and a new full political cycle ahead, provides an ideal setting for PPP projects in Spain in the coming years.

# TANZANIA

*Nicholas Zervos*<sup>1</sup>

## I OVERVIEW

The Tanzanian legal system has evolved largely on the basis of English common law because of British presence in the country from 1919 until independence in 1961. In Zanzibar, the legal system has evolved from both English common law and Islamic law. The legal framework in Tanzania comprises statutes, rules and regulations enacted by Parliament as well as those formulated by other statutory and professional bodies. The Constitution is the fundamental law prevailing over all other legislation and includes a Bill of Rights.

The government of Tanzania published a National PPP Policy in 2009 that recognises the role of the private sector to bring about socio-economic development through investments and to ensure efficiency, effectiveness, accountability, quality and outreach of services.

The projects relevant for PPPs are in 'productive and social sectors' and include:

- a* agriculture;
- b* infrastructure;
- c* industry and manufacturing;
- d* exploration and mining;
- e* education;
- f* health;
- g* environment and waste management;
- h* information and communication technology (ICT);
- i* trade and marketing;
- j* sports, entertainment and recreation;
- k* natural resources and tourism; and
- l* energy.

## II THE YEAR IN REVIEW

The PPP legislation was amended in December 2014 to rationalise the PPP framework by merging the two original PPP Units into one PPP Centre, by setting up a PPP Technical Committee, a National Investment Steering Committee and a PPP Facilitation Fund. Also by clarifying that all PPPs shall be procured through an open and competitive bidding process, for both solicited and unsolicited proposals, and that the Minister for Investment shall prepare specific regulations for unsolicited proposals.

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The PPP Regulations were revised in 2015, thereby replacing the Public Procurement Regulations 2013 which had previously applied. PPPs have been identified as a key tool in aiding development. Major undertakings include the Dar es Salaam Rapid Transit project and the construction of a standard gauge railway from Dar es Salaam to Kigoma, as well as the Liganga iron ore and Mchuchuma coal mining and power projects.

### III GENERAL FRAMEWORK

The PPP Act came into effect in 2010 with PPP Regulations in 2011. There have been various subsequent amendments to the legislation, the latest in 2014, while the PPP Regulations were revised in 2015.

The PPP Act and regulations provide for the institutional framework for the implementation of public private partnership agreements between the public sector and private sector entities; and set rules, guidelines and procedures governing public private partnership procurement, development and implementation of public private partnerships and provides for other related matters.

Under the amended PPP Act:

- a* the PPP Centre shall administer PPPs;
- b* the PPP Technical Committee shall consider and approve PPP projects and agreements; and
- c* the National Investment Steering Committee shall scrutinise all PPP projects.

Each project requires a feasibility study to demonstrate the PPP shall, among other things, be affordable to the contracting authority, shall provide value for money, shall transfer appropriate technical, operational or financial risks to the private party.

Procurement Act and Regulations shall not apply to PPPs and the new PPP Regulations shall govern the procurement procedures.

A Facilitation Fund shall be set up (see Section VI.i, *infra* for more details).

The PPP Centre functions include to:

- a* mobilise resources;
- b* ensure that government departments integrate PPP plans;
- c* implement a fair, transparent, competitive and cost-effective procurement process;
- d* deal with fiscal risk allocation;
- e* monitor and evaluate the performance of the PPP projects; and
- f* undertake research on PPP matters.

The PPP Technical Committee functions include:

- a* reviewing policy, legislation, plans and strategies pertaining to the promotion, facilitation and development of PPPs and to advise the Minister accordingly;
- b* advising the Minister on matters relating to implementation of the PPP Programme;
- c* considering and approving PPP projects, agreements and any amendment to the agreements;
- d* approving allocation of project development funds from the Facilitation Fund or the Treasury;
- e* assigning to contracting authorities terms and conditions for utilisation of the Facilitation Fund; and
- f* subject to the recommendation made by the PPP Centre, approving feasibility studies, selection of preferred bidder agreements and amendment to agreements.

Both solicited projects (i.e., competitively tendered initiated by the public sector) and unsolicited projects (i.e., initiated by a written proposal from a private party to a contracting authority) are permitted.

PPPs in the energy sector have additional requirements which we set out in some more detail in Section IV, *infra*.

PPPs must endeavour to provide opportunity for empowerment of the citizens of Tanzania. The government has resolved to take measures designed to promote and facilitate economic initiatives aimed at empowering Tanzanians; and has agreed in terms of the National Economic Empowerment Policy that natural resources, trade, agriculture, industry and other economic opportunities must generate wealth, boost the small and medium enterprise sector, in order to bring about a sustainable affirmative action and facilitate genuine and positive economic empowerment to the population of Tanzania. Also that economic empowerment is a central means for bringing about economic growth and social justice among Tanzanians that is necessary for the promotion of peace, tranquility and social stability.

#### **IV BIDDING AND AWARD PROCEDURE**

All PPP projects shall be procured through an open and competitive bidding process.

All solicited and unsolicited projects shall be procured through an open and competitive bidding process and in a manner prescribed in the PPP Regulations. The current PPP Regulations 2015 specify that for solicited projects, at least two months before the beginning of the budget cycle, each contracting authority will submit to the PPP Centre a list of potential projects to be undertaken in partnership with the private sector. Based on the recommendation of the PPP Centre, the contracting authority may then proceed to conduct a full feasibility study of the project.

For unsolicited projects, the private party is required to put forward a project concept to the proposed contracting authority, which may then be forwarded to the PPP Centre for review. The winning bidder is to reimburse the original proponent of any reasonable and verifiable costs incurred in undertaking the feasibility study.

The PPP Regulations 2015 provide for the involvement of local government authorities in small-scale PPPs, these being PPPs whose total project value does not exceed US\$70 million and which entail an agreement not exceeding a maximum duration of 15 years.

- There are additional requirements in respect of PPPs in the energy sector, which include:
- a* the electricity utility, TANESCO, must obtain approval first of the regulator, the Energy and Water Utilities Regulatory Authority (EWURA), before initiation of procurement of any power project;
  - b* the application to EWURA must be made for solicited proposals, before releasing the tender and for unsolicited proposals, after TANESCO has accepted the proposer's project concept but before commencing any formal negotiations for a power purchase agreement;
  - c* EWURA will evaluate compliance with all required legislation, including the PPP legislation; and
  - d* EWURA may nominate a representative to observe the procurement process to be followed by TANESCO.

There are special regulations and a standard power purchase agreement (SPPA) for energy projects of less than 10MW under the recently enacted Electricity (Development of Small Power Projects) Rules 2016.



Wind and solar projects must be solicited proposals (i.e., competitively bid) approved by EWURA. Hydro and biomass projects shall be procured through a letter of intent with an SPPA power buyer.

There are further special rules for mini projects of less than 1MW (called 'very small power projects'/VSPP), such as no requirement for EWURA approval of the retail tariff but EWURA may review the tariff if petitioned to do so by 15 per cent of affected households.

## V THE CONTRACT

A contracting authority can enter into an agreement with the private sector for the performance of functions of the contracting authority.

The contracting authority shall form a multi-disciplinary negotiating team with knowledge, skills and experience on the subject matter of the project.

The contract shall cover the following items:

- a* specify the responsibilities and the private party;
- b* specify the relevant financial terms;
- c* ensure for the management of performance of the private party;
- d* provide for undertaking by the contracting authority to the private party in obtaining licences and which may be necessary for the implementation of the project;
- e* provide for the return of assets, if any, to the contracting authority, at the termination or expiry of the contract;
- f* specify the roles and risks undertaken by either party;
- g* provide for the payment to the private party, by way of compensation from a revenue fund charges or fees, collected by the private party from users or customers of the service provided by it;
- h* specify payment of the private party to the contracting authority;
- i* provide for remedies in the event of default by either party;
- j* impose financial management duties on part of the private party, including procedures relating to internal financial control, budgeting, transparency, accountability and reporting;
- k* provide for the termination of the contract in case of breach of terms and conditions by either party;
- l* provide for the conditions for the provision of service, where necessary;
- m* provide for the period of execution; and
- n* contain such other information as may be necessary.

The contract shall ensure that:

- a* the private party undertakes to perform a contracting authority's function on behalf of the contracting authority for a specified period;
- b* the private party is liable for the risks arising from the performance of its functions;
- c* the environmental impact assessment certificate has been issued in respect of the project;
- d* government facilities, equipment or other state resources which are necessary for the project and are transferred or made available to the private party on a timely basis; and
- e* the public and private assets are clearly specified.

The rights, obligation and controlling interests of the private party in the project shall not be transferred or assigned to a third party without the prior written consent of the contracting authority.

The duration of a contract shall be provided for in the contract and shall not be extended unless:

- a* there is a delay in completion or interruption of operations owing to circumstances beyond any party's control;
- b* there was an increase in costs arising from requirements of the PPP Centre or contracting authority which were not foreseen or included in the contract; and
- c* the service is required and the contracting authority has no capacity or immediate intention to take over and run the project.

A violation of these provisions by either of the parties shall render a defaulting party liable for any pecuniary loss incurred by the other party.

### **i Termination of the agreement**

Under the PPP Regulations 2015, parties shall have a right terminate the project if it fails to fulfil the conditions set out under the project agreement. Any such reasons and resultant compensation are required to be included as provisions in the agreement. Upon such termination, the contracting authority may, pursuant to the PPP Act and Regulations, engage another party.

### **ii Contract approval**

The contracting authority shall ensure that the contract is executed under procedures stipulated and through institutions specified under the PPP Act.

The contract shall be signed by the accounting officer of the contracting authority after it has been considered and approved by, among others, the Office of the Attorney General. The accounting officer shall sign the contract upon fully satisfying him or herself that the contract has complied with the provisions of this Act and any other relevant laws. Any person who contravenes these requirements commits an offence.

The accounting officer who has entered into a contract shall take all necessary and reasonable steps to ensure that:

- a* the outsourced activity is effectively and efficiently carried out in accordance with the contract;
- b* any public property which is placed under the control of the private party, in terms of the contract, is appropriately protected against forfeiture, theft, loss, wastage and misuse; and
- c* the contracting authority has adequate contract management and monitoring capacity.

The contract shall be submitted to the Office of the Attorney General for a legal opinion.

### **iii Contract dispute resolution**

The contract shall be governed and construed in accordance with the laws of mainland Tanzania.

Any dispute arising during the course of the, contract shall be resolved through negotiation, mediation or arbitration.

**iv Offences**

Any person who commits an offence under:

The PPP Act may be liable to a fine not exceeding 5 million Tanzanian shillings, or imprisonment for term up to three years.

Electricity (Initiation Power Procurement) Rules 2014 may be liable to a fine from 10 million Tanzanian shillings to 100 million Tanzanian shillings, or imprisonment for term up to three years, and this applies to directors, managers or officers of the utility in breach.

**VI FINANCE**

**i Project development**

The Facilitation Fund shall be set up with:

- a* moneys allocated by Parliament and from development partners, public entities, parastatal organisations and social security funds and funds previously advanced to contracting authorities; and
- b* approval by the PPP Technical Committee.

It will be used for:

- a* financing wholly or partly feasibility studies and other project preparation costs as may be required by a contracting authority;
- b* providing resources to enhance the viability of projects which have high economics benefits that have demonstrated to be of limited financial viability; and
- c* any such other purposes as may be prescribed in the regulations.

**ii PPP fees**

A PPP contract enables the private party to receive a benefit for performing on behalf of contracting authority function or from utilising the public property, either by way of:

- a* consideration to be paid by the contracting authority which derives from a revenue fund, or where the contracting authority is a central government or local government authority, from revenues of such authority;
- b* charges or fees to be collected by a private party or its agent from users or customers; or
- c* a combination of such consideration and such charges or fees.

**iii Government support**

The PPP Centre shall mobilise government support to PPP projects.

There is a definition of ‘contingent liability’ of government in the PPP Act but it is not used in the present PPP Act.

For unsolicited projects, a contracting authority shall not conduct a procurement process proposal which requires government financial support.

There is specific legislation relating to the government guarantee of loans, but not for the guarantee of contractual obligations of a contracting authority.

**iv Security for lenders**

Collateral available in Tanzania includes mortgages over land, fixed charges over assets (including cash at bank), share charges and pledges, assignment by way of security, (including

the benefit of contracts and receivables) liens and floating charges (together with security interests) and guarantees.

Generally, there is no restriction of foreign ownership or management of companies established in Tanzania. Foreign ownership of title to land is not permitted unless the foreign-owned company has a certificate of incentives from the Tanzania Investment Centre, which has approved the project for investment purposes.

Generally, inter-creditor agreements are used by local banks in Tanzania to subordinate debts and to adjust the ranking of secured creditors by way of contractual agreement. The enforceability and operation of these inter-creditor agreements have not to our knowledge been challenged in the courts in Tanzania.

In the case of a company insolvency, preferential debts will be paid as a priority. Preferential debts include specified taxes, specified government rents and specified wages or salaries.

Generally, a security interest is perfected by registration at the Business Licensing Regulatory Authority (BRELA) within 42 days of the date of its creation, otherwise it will be void on the insolvency of the company against the liquidator or administrator, or any creditor of the company. Mortgages must also be registered at the relevant land registry, and some documents should also be registered at the registry of documents. The priority of security interests is generally determined by the date of the document, and the priority of mortgages is generally determined by the date of registration at the relevant land registry, in each case provided it is registered in time and there is no agreement to the contrary.

## **VII RECENT DECISIONS**

Steps are under way to assist PPPs by, for instance, capacity building, more project preparation, viability gap funding and covering other costs necessary for the government to develop PPP projects.

Despite various amendments and revisions to the current PPP legislation and regulations, there remain some gaps and areas that need to be improved to create a solid basis on which the PPP programme can be developed.

## **VIII OUTLOOK**

PPP is recognised as an important instrument for the government to attract private investment with a view to providing better public services.

The outlook for PPPs in Tanzania is improving quickly as steps are taken to clarify and improve the processes and formal relationships between public and private sectors in a clear regulatory framework.

# THAILAND

*Weerawong Chittmittrapap and Jirapat Thammavaranucupt<sup>1</sup>*

## I OVERVIEW

Variations of public-private partnerships (PPPs) have been customarily practised in Thailand for many decades prior to any official promulgations detailing such ventures. As early as the 1900s, engagements between the sovereign and individuals emulating the underlying principles of PPPs can be observed.

A contract awarded to construct the Second Stage Highway in late 1988 marked the very first documented instance of a state enterprise, the Express and Rapid Transit Authority of Thailand, granting a concessionary right to a private juristic entity. A few more projects concentrated in rudimentary infrastructural developments were launched up until the promulgation of the Private Participation in State Undertakings Act BE 2535 (1992) (the PPSU Act). The same is seen in the PPP projects seen today: sectors such as transportation, telecommunications and other public utilities dominate the percentage of PPP investments in Thailand.

Although for two decades the PPSU Act served as the foundational piece of legislation administering PPPs in Thailand, the increasing demand and need for socioeconomic growth pushed for renewed legislation that could remove certain ambiguities that arose when applying the PPSU Act. Because the PPSU Act was mainly drafted to facilitate these types of concessionary projects that were already under way in Thailand in the early 1990s, it lacked clear-cut criteria addressing matters of scope, duration and authority with regard to initiating and implementing PPPs.

Through what could be interpreted as an official recognition of this need, the government enacted the Private Investments in State Undertakings Act BE 2556 (2013) (the PISU Act). The PISU Act explicitly remarks that Thailand is in need of infrastructure constructions and various other forms of public services. The same imperative is echoed in many other state publications addressing the state policy stated in the Constitution, development goals and plans. The state definitively intends to rely on PPP as the main mechanism in achieving these objectives and maximising state resources. Drafted from this vantage point, the PISU Act promotes private participation and attracts private investors by offering transparent, streamlined accountable procedures in relation to PPPs to be taken into account in any risk-benefit analyses.

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## II THE YEAR IN REVIEW

The PISU Act is composed in a way that a series of ancillary laws could ensue after its enactment. These can manifest in the form of a Notification issued by the State Enterprise Policy Office (the Office), a Notification issued by the Public-Private Partnerships Policy Committee (the Committee), or a Ministerial Regulation. When prescribed to applicable areas of the PISU Act, these notifications and regulations serve to clarify some of the rules governing certain procedures in relation to PPPs.

Since the PISU Act's enactment, there have been a number of significant ancillary laws to this effect. These include, but are not limited to:

- a* Notification of the Office regarding Standard Contract Terms for Public-Private Partnership BE 2558 (2015);
- b* Notification of the Office regarding Information for Invitation for Bids, Requests for Proposals, Procedures for Invitation for Bids, Selection Procedures of the Selection Committee, Determination of Bid Security and Performance Security BE 2558 (2015) (the Selection Procedures Notification);
- c* Notification of the Committee regarding Material Amendments to Public-Private Partnership Contracts BE 2558 (2015);
- d* Notification of the Committee regarding Rules and Procedures for Calculating the Value of Investment Projects; and
- e* Notification of the Committee regarding Rules and Procedures for Private Investment in Projects with a Value of less than the Amount Prescribed in Section 23 of the Private Investments in State Undertakings Act BE 2556 (2013), BE 2559 (2016) (the Notification regarding Projects with a Value of less than the Amount Prescribed in Section 23).

In addition, related to the above, the Cabinet issued a resolution on 3 November 2015 approving a means to fast-track PPPs. Termed the 'PPP Fast Track', once implemented, the system would expedite the project introduction phase from two years to a mere nine months. Many PPPs, particularly in the transportation sector, have experienced acceleration this way and have since been completed.

Perhaps most notably, pursuant to Chapter 3 of the PISU Act the first Strategic Plan for the years 2015–2019 was published by the Committee (the PPP Strategic Plan). The total private investment value is projected at 1.41 trillion baht (approximately US\$40.2 billion). The systematic, five-year plan titled 'Project Pipeline' comprehensively identifies all development focus areas and the respective state agencies responsible for its implementation, otherwise known as host agencies. PPP projects under the newly developed Fast Track regime enable the government to productively use innovative PPP instruments as mechanisms in carrying out various infrastructural projects in Thailand.

## III GENERAL FRAMEWORK

### **i Public-private partnership applicability criteria**

The PISU Act very loosely defines projects that fall under the PPP purview as the state intends for PPPs to serve as a mechanism to develop infrastructure in Thailand indefinitely. According to the PISU Act, any project that falls under the criteria of being both (1) a state undertaking and (2) a public-private joint investment will be eligible for PPP procurement.

State undertakings can take the form of (1) an undertaking which a government agency, state enterprise, other state agency or local administrative organisation, either individually or collectively, has a legal obligation to perform; or (2) an undertaking which requires the utilisation of natural resources or properties of one or several government agencies, state enterprises, other state agency or local administrative organisation, either individually or collectively.

In addition, the approved PPP project will be implemented by virtue of a public-private joint investment or designation of a unilateral private investment through the granting of a licence, concession or any kind of rights. However, the definition of a public-private joint investment still remains unclear as to what business activities it consists of since the PISU Act defines investment as a public-private joint investment undertaken by any means. Despite this, the PISU Act explicitly excludes the granting of concessions for petroleum and mining as they are regulated and governed by respective statutes.

As mentioned above, projects for PPP procurement shall be state undertakings that are implemented through a public-private joint investment. Nevertheless, the approval process of the project proposal is different depending on whether the project's value is small, medium-sized or large.

A project with a total investment value of 1 billion baht will be classified as a small project. The detailed approval procedure of a small project is specified in the Notification regarding Projects with a Value of less than the Amount Prescribed in Section 23. The authority to approve the project lies with the minister of the respective host agency, or other state agencies as specified for different circumstances.

A project with a total investment value that is not lower than 1 billion baht but does not exceed 5 billion baht will be classified as a medium-sized project. The detailed approval procedure for a medium-sized project is specified in the Notification regarding Projects with a Value of less than the Amount Prescribed in Section 23. The approval authority depends on whether the medium-sized project adheres to the conditions set out in the Notification or the PISU Act. The authority to approve the former lies with the ministry of the host agency, and the latter with the Cabinet.

Lastly, a project with a total investment value exceeding 5 billion baht will be classified as a large project. The approval procedure for a large project is prescribed in the PISU Act, and the Cabinet is the final approving authority.

## **ii Types of public-private partnership**

As mentioned above, PPPs in Thailand can take many forms, because under the PISU Act there is no classification for the types of investment undertakings. The type of PPP project is chosen based on the specific conditions of each project and the business or political requirements of the parties.

Nevertheless, most PPP projects in Thailand have used the following contractual structures: (1) build-own-operate (BOO), where a private organisation builds, owns and operates some facility with some degree of encouragement from the government; (2) build-transfer-operate (BTO), where a contract is signed between an authorised state agency and investors to build an infrastructure facility completely, and then the investors shall transfer such facilities to the authorised state agency and obtain the right to operate such facility commercially for a fixed term; and (3) build-operate-transfer (BOT), whereby the investor shall transfer the facilities at the end of the concession. As such, the investors are able to finance, design, construct and operate a facility stated in the concession contract and this

enables the project proponent to recover its investment, operating and maintenance expenses in the project.

### **iii The authorities**

There are two main authorities involved in the PPP process: the Committee and the Office. According to Section 8 of the PISU Act, the Committee is composed of the Prime Minister as chairman, the Minister of Finance as vice-chairman and the Director-General of the Office as a member and secretary. The Committee has powers and duties mainly to: (1) prepare a strategic plan; (2) give approval in principle to a project involving a private investment and the operation of a project; (3) prescribe rules and regulations under the PISU Act; and (4) give decisions on issues pertaining to the implementation of this Act.

In addition, the Office serves as an ancillary body to the Committee, responsible for carrying out secretarial tasks (i.e., supporting the Committee in the implementation of PPP projects). According to Section 18 of the Act, the Office shall have the following powers and duties to: (1) prepare a draft strategic plan for submission to the Committee; (2) study and analyse projects and submit opinions to the Committee for consideration and approval; (3) study, research and prepare a database relating to private investment in state enterprises for dissemination, provision of education and advice to state agencies and the general public in order to promote and build an undertaking of private investments in state undertakings; and (4) report problems and obstacles arising from the implementation of the PISU Act to the Committee.

### **iv General requirements for PPP contracts**

In general, PPP contracts must conform to the framework of the 2013 PISU Act and the requirements of the Notification of the Office regarding Standard Contract Terms for Public-Private Partnership Contracts BE 2558 (2015) (the SC Notification). A draft PPP contract must contain the standard contract terms for investment contracts as prescribed by the SC Notification with the approval of the Committee. Generally, PPP contracts must at least contain the following clauses:

- a* duration, provision of services and the implementation of the project;
- b* rights and duties of each party;
- c* the ownership of the project assets and their valuation. If state assets are utilised in implementing the project, the right and duty of each party in relation to the utilisation and maintenance of the aforementioned assets shall also be specified;
- d* changes to the nature of the provision of services under the project; changes to a contracting party, contractor, subcontractor, and the assignment of claims;
- e* force majeure events and actions in the case of a force majeure event, including payment of compensation;
- f* causes for termination of the contract, methods of termination, consequences of termination other than termination due to expiry, as well as information relating to actions to be undertaken in order to continue the provision of services in the case of the suspension of the project, and payment of damages arising from the termination of the contract;
- g* the host agency shall not be bound to settle a dispute by arbitration unless the host agency demonstrates the reasons and necessity for doing so due to this being the general practice for that particular type of PPP contract; and



- b* the governing law of the PPP contract and the implementation of the project shall be Thai law.

Besides the main requirements listed above, it is prohibited for the PPP contract to contain any provisions allowing a unilateral renewal or extension of the duration of the project under the PPP. The SC Notification reiterates the same principle and prohibits granting the private party the unilateral right to adjust or amend any contractual conditions in a manner that will have an impact on the provision of public services or the benefits to the public sector.

Furthermore, PPP contracts and other documents integral to the implementation of a PPP must be prepared in Thai. If any part of a PPP contract is prepared in English, a provision indicating that in the event of any conflict or discrepancy between the two, the parties will comply with the original Thai document, must be included in the PPP contract.

In terms of the procedure of contract approval, there are three main authorities playing a significant role: the Selection Committee, the Office and the Cabinet. Pursuant to Section 35 together with Section 36 of the PISU Act, the Selection Committee is made up of the host state agency as chairman, representatives of the Office and the Office of the Attorney-General as members. The Selection Committee plays a significant role in the project implementation to negotiate and select the private investor.

Once the private entity selection and negotiation results have been obtained, and a draft investment contract has been prepared, the Selection Committee will submit the draft to the Office and the Office of the Attorney-General for their review of those submissions. Those reviews are then submitted to the responsible minister for his or her review, who will then submit them to the Cabinet for its consideration and approval.

#### **IV BIDDING AND AWARD PROCEDURE**

There are two main regulations governing the bidding and award procedure in Thailand: the PISU Act and the Selection Procedures Notification. Generally speaking, the procedure is jointly conducted by the host agency and the Selection Committee with the oversight of the Office and the Committee.

##### **i Expressions of interest**

In Thailand, the selection of the private investor commences at the level of the host agency, who plays a key role in publishing relevant notices. Thus, virtually all expressions of interest are implied by the submission of a proposal by the bidder, and all proposals must be solicited by these notices.

The process begins with the host agency's drafting of the invitation for bids. The document must contain, among others, the terms of reference detailing the background, objectives, scope of work and commitment duration of the project, a statement declaring that the bidder must have not been granted privileges or immunities from the courts, the required qualifications of the private investor, information related to the request for proposal and its fee, and the selection criteria.

The host agency then establishes a Selection Committee and appoints its members in accordance with Section 35 of the PISU Act. The Selection Committee is granted the authority to approve the draft invitation for bids as well as the discretion in selecting the private investors. Once the Selection Committee is established the actual bidding and award procedure begins.

The Selection Committee may also, when it deems appropriate to narrow down the number of applicants, shortlist a pool of qualified bidders before publishing the invitation for bids. In such a case, only the selected investors will receive the invitation for bids.

It is important to note that the Selection Committee and the host agency can jointly decide to opt out of the bidding procedure in selecting the pool of private investors. If the Office concurs, the Office may petition the Committee for its approval. Where there are disagreements between the Selection Committee and the host agency, the Office will petition the Committee for its approval only when the Office also deems opting out to be more appropriate to the case at hand. If the Committee approves, the host agency has to provide the rationale behind such decision, and disclose the names of the chosen investor or investors along with supporting justifications.

## **ii Requests for proposals and unsolicited proposals**

Pursuant to Clause 6 of the Selection Procedures Notification, once approved, the host agency must publish the invitation for bids at least 60 days prior to the submission deadline of the proposals in three different mediums. Thereafter, it is the responsibility of the interested party to purchase the request for proposals at the designated place, time and date as specified in the invitation for bids.

The request for proposals solicits the following information to be provided by the interested party: the qualifications of the bidder related to the nature of work, a business plan which also details financial aspects, and an implementation plan stating its benefits proposed to the state.

The submitted proposals must contain all the information requested in both the invitation for bids and the request for proposals at a minimum. Any foreign entities and foreign individuals who wish to participate in the bid may submit their proposals in the same manner.

As mentioned above, there are no procedures that would allow private investors to submit unsolicited bids.

## **iii Evaluation and grant**

Once all of the proposals have been collected, all bidders or their representatives gather for the opening of the proposal envelopes. Strict evaluations of the submitted proposals are then conducted, at which stage the Selection Committee may request additional information from the bidders, but any bidder who wishes to amend or provide any unsolicited content is prohibited from doing so.

After a negotiation with the selected party is concluded, the Office and the Office of the Attorney General jointly will submit their opinion to the responsible minister for consideration and approval. The final grant is approved by the Cabinet. Therefore, although the Selection Committee is allowed to enter into negotiations with the bidders having passed the evaluation, the project implementation must be approved by the Cabinet.

# **V THE CONTRACT**

## **i Payment**

No specific regulations impose restrictions or limitations on the way in which private parties in PPP contracts are remunerated in Thailand. As such, the parties are free to determine all

variables, such as the frequency of payment and rates of payment, through the PPP contract. In general, however, two forms are prevalent.

The first is PPP net cost, where the private investor collects and allocates the revenue according to the agreed terms in the contract. Any increase in the amount of profit will be reflected in the amount of remuneration. Because of the nature of the payment, it is most frequently paired with PPPs that involve commercial development projects.

The second is PPP gross cost, where the state assumes the responsibility for collecting revenue, and makes a fixed payment to the private investor. Because of the nature of the payment, it is most frequently paired with PPPs that involve social development projects.

## **ii State guarantees**

No separate regulation regarding state guarantees exists in Thailand. Nonetheless, the PISU Act stipulates that private investments in state undertakings must be granted with consideration to financial and monetary discipline. Thus, state guarantees are considered in the same manner.

There have been no clear state policies regarding state guarantees in the past, but since the enactment of the PISU Act, policies have leaned favourably towards state guarantees to private entities of PPPs. For instance, the state issued a policy granting state guarantees to private investors of PPPs in the form of aid to be used in the project.

## **iii Distribution of risk**

Section 6(5) of the PISU Act stipulates, as a general rule, that a private investment in a state undertaking shall have regard to suitable risk allocation in the project between the state and private entity. However, the PISU Act does not incorporate the detailed risk-allocation rules and regulatory provisions for the PPP projects. Hence, there is no allocation of risk principles or a risk-mitigation mechanism specified in the laws regarding PPPs. Typically, the distribution of the risks associated with a project is determined on a case-by-case basis and the parties usually provide details of the risk allocation in the PPP contract.

Various types of risk are found in carrying out a PPP project. In practice, the risks related to expropriation or assistance in securing land necessary for the execution of PPPs customarily rests with the contracting authority. Although force majeure risks are shared by both parties, other risks associated with the project are, in almost all cases, borne by the private entity.

## **iv Adjustment and revision**

The PPP regulatory framework sets out specific rules concerning adjustments and revisions of the PPP contract. Therefore, any amendments to the PPP contract can only be made through following the procedure for amendments stipulated in the PPP Act.

Pursuant to Section 47 of the PISU Act, in the event a contract amendment is necessary, the host agency shall submit the rationale and necessity for requesting the amendment to the Supervisory Committee for consideration. According to Section 43 of the PISU Act, the Supervisory Committee is composed of a representative of the responsible ministry who is an official of the responsible ministry holding a higher level executive office.

Where the Supervisory Committee finds that the amendment is insubstantial, the Supervisory Committee shall consider the proposed amendment and notify the responsible minister. On the other hand, where the Supervisory Committee finds that the amendment of an investment contract is material in nature, the host agency shall also submit the proposed

amendment issues, the impact of the investment contract amendment and other relevant details to the Supervisory Committee for consideration. If the Supervisory Committee agrees to the amendment, the host agency shall submit the draft amendment to the Office of the Attorney-General for review before forwarding the Supervisory Committee's opinion along with the amendment as reviewed by the Office of the Attorney-General to the responsible minister for submission to the Cabinet for approval.

In determining whether an amendment to the PPP contract is a material amendment in nature, Clause 3 of the Notification of the Committee regarding Material Amendments to Public-Private Partnership Contracts BE 2558 (2015) provides that material amendments to PPP contracts mean changes to any of the following characteristics:

- a* amendments to the nature of a project, scope of work, provision of services or implementation of a project;
- b* amendments relating to the benefits that the state will receive, of any kind, including amendments to benefits in monetary form or in the form of revenue sharing, amendments to the ownership of project assets, and amendments relating to dispute resolution;
- c* changes to a contractual party or a change in corporate structure that renders the implementation of a project impossible;
- d* amendments to the term of the PPP contract;
- e* amendments to the performance security; and
- f* amendments to the rate of the service fee or quality of services provided.

#### **v Ownership of underlying assets**

Under the PISU Act, there is no provision stipulating clearly which contractual party has ownership of the underlying assets. Nevertheless, the PISU Act rules that a standard PPP contract must contain a clause indicating the content of the transferring and holding of ownership of the project. The transfer of ownership of the underlying assets depends on the type of PPP contract used. In practice, ownership of project assets is usually provisioned under the PPP contract to be transferred to the public sector. If state assets are utilised in implementing the project, the rights and duties of each party in relation to the utilisation and maintenance of the aforementioned assets will also be specified.

#### **vi Early termination**

The PISU Act does not specify any consequences for early termination, but rather, together with applicable ancillary regulation, mandates that the standard PPP contract contain a clause that specifies a mechanism for early termination. Therefore, the PPP contract will typically contain provisions for early termination. The result of early termination is different in the following three main situations: (1) in a contract breached by the host agency; if by the state's non-fulfilment the private entity incurs damages, such private entity can claim compensation in the amount of actual damages; (2) in a contract breached by the private entity; in the case of his or her non-fulfilment the state must provide appropriate compensation (i.e., the state will make a payment proportional to the actual contracted income calculated up until the date of termination). However, the state is entitled to recover its loss arising out of such breach from the private entity; and (3) in the case of force majeure, the state and the private party as contractual parties must mutually absorb the risk; both parties cannot refer to force majeure in order not to make a payment in accordance with their contractual obligations.

Regardless, the state will make a payment proportional to the actual contracted income calculated up until the date of termination.

## **VI FINANCE**

In Thailand, PPPs are generally financed via capital markets or financial institutions. One option is for the concessionaire to list its company with the Stock Exchange of Thailand and to offer its shares to the general public as a means of raising capital (initial public offering). Second, it could be privately financed by setting up an infrastructure fund and offering its fund units to the general public. To mention a few examples of infrastructure funds established in the past, the BTS Rail Mass Transit Growth Infrastructure Fund (BTSGIF) and Jasmine Broadband Internet Infrastructure Fund (JASIF) were established in 2013 and 2015, respectively, to finance their respective PPP projects. These options do pose some limitations to PPP transactions in that the concessionaires must receive the prior approval of the grantor to be listed on the stock exchange. In addition, any transfer of concessionary rights must also receive the prior approval of the grantor even when it becomes inevitable as a result of changes to the company's shareholding structure.

Project financing via financial institutions also imposes similar limitations to those mentioned above. Generally, project funding requirements must contain a step-in clause; in case of critical situations the financial institution, as a creditor of the project, shall have rights to step in and take control of the PPP project granted in favour of the financial institution. Thus, the possibility of the financial institution exercising its step-in rights remains open at all times throughout the venture, which, if petitioned, must receive prior approval from the relevant state authority.

There is no restriction under Thai law for seeking cross-border financing; therefore, so far it has been freely employed. BTSGIF and JASIF were open for sale indiscriminate of borders.

## **VII RECENT DECISIONS**

A look at recent court judgments indicates a strict adherence to the rules and regulations governing PPPs and suggests a failure to do so would warrant legal and binding consequences.

An example is the judgment of the Highest Administrative Court No. Aor. 349/2549, where the Court ruled that the latest amendment to a PPP contract made by the relevant state agency and ITV Public Company Limited was non-binding as it failed to comply with the PPSU Act in relation to the procedure of amendment to the PPP contract. The legal consequences of the court judgment in relation to non-binding PPP contracts remain unclear, meaning that unlawful amendments to a PPP contract should be void or voidable or automatically terminated or still valid until it is terminated by the relevant state agency.

## **VIII OUTLOOK**

As a growing nation, Thailand has tremendous need for investments in infrastructure development and public services to promote the nation's economy, support the fast-paced urbanisation and enhance the quality of life of the general public. Thailand's latest development plans, the 12th National Economic and Social Development Plan (2017–2021) and Thailand 4.0 Policy, explicitly place an emphasis on infrastructure development and logistics systems.

However, the capacity of the government to provide funds directly to infrastructure and public services projects is limited. Therefore, the government recognises the innovative PPP mechanism as a prominent instrument in the implementation of projects in Thailand, as evidenced by the amount of PPP projects successfully implemented or currently undergoing bidding and procurement procedures. According to the PPP Strategic Plan, the total estimated investment cost of projects included in the Public Private Partnership Strategic Plan is 1.4 trillion baht, and, currently, there are 66 projects in the PPP Project Pipeline. In light of the robust trend in public sector investment projects and the fact that a number of PPP undertakings are being rolled out, it is anticipated that the implementation of PPP projects in Thailand will continue to be in significant demand. Accordingly, the PPP market in Thailand will continue to grow in the subsequent years.

# UNITED KINGDOM

*Adrian Clough, David Wyles and Paul Butcher*<sup>1</sup>

## I OVERVIEW

### i Early history

The UK was one of the pioneers of public-private partnerships (PPPs) in the early 1990s.

The private financing of infrastructure development had occurred before this. In particular, the Thatcher governments in the 1980s had embarked on an extensive privatisation programme of publicly owned utilities, including telecoms, gas, electricity, water/waste, airports and railways. These privatisations were in part driven by the need for extensive new capital investment and constraints on public sector investment. The privatised utilities, overseen by new independent regulators, were allowed to include in their charges to end users a return on capital employed. The regulators periodically review the need for new investment and the return permitted on approved investment.

One of the consequences of the privatisation programme is that PPP has not been an appropriate model for funding new infrastructure in many sectors where it might otherwise have been used.

In addition to privatisation, there were a small number of free-standing transport infrastructure concessions, where the concessionaire relied on end user revenue for its return rather than payments from the public sector.

The Private Finance Initiative (PFI – the term PPP was not used in the UK until the late 1990s) was launched in 1992. PFIs are design-build-finance-operate (DBFO) projects structured as the purchase of ongoing services, rather than capital assets, by the public sector, with the services being defined as outputs.<sup>2</sup> Service payments are principally met from public funds rather than end user charges.

PFI was a means of introducing private sector capital into sectors that were not considered suitable for privatisation. The original justification for PFI was that it would enable more capital investment in public services to take place, tackling historic capital underinvestment.<sup>3</sup> Subsequent policy has tended to focus on PFI generating better value for money than the public provision of infrastructure, with the benefits of private sector management and expertise, performance incentivisation and optimised risk allocation outweighing the higher cost of capital.

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2 What is to be achieved, rather than how it is to be achieved.

3 HM Treasury, 'PFI: Strengthening Long Term Partnerships', March 2006.

PFI got off to a slow start. Less than £1 billion of capital investment had been agreed with private companies by the end of 1995<sup>4</sup> but, following an initial reappraisal, the Blair government elected in 1997 gave it increasing impetus, including the creation of a government taskforce to drive delivery of projects and encourage standardisation. PFI established itself as the main delivery method for public infrastructure within both central and local government. In the decade between 1998 and 2008 there was only one year in which fewer than 50 projects closed<sup>5</sup> (the highest being 64 in 2003/4).<sup>6</sup>

The term PPP is used in the UK to describe a variety of different forms of public- private sector cooperation (see Section III.i, *infra*). This chapter, however, focuses principally on PFI, since it is to date the model that has been used for most privately financed infrastructure and the only form of general application to have developed a standardised framework.

## ii Recent history

After 2008, with the global financial crisis, the value and volume of PFI projects closing in the UK fell to the lowest levels in a decade and following a partial rebound in 2009 have fallen each subsequent year until a small value increase in the year to April 2016.<sup>7</sup>

The use of PFI has also been heavily affected by changing political sentiment. Concerns have developed that the ongoing charges associated with PFI projects, particularly in respect of ‘soft’ facilities management services, are not good value for money and provide investor windfalls. There is also concern that PFI fixed costs have reduced flexibility to manage within available overall budgets, particularly in hospitals. It has been acknowledged that a desire to keep capital costs outside official government borrowing figures in the early years of PFI provided an inappropriate incentive – the government now publishes ‘Whole of Government Accounts’, which provide a comprehensive picture of the government’s assets and liabilities, including off-balance sheet PFI liabilities.<sup>8</sup>

Additionally, policy focus has increasingly been on the requirement for new investment in economic (rather than social) infrastructure – particularly power generation, transport and broadband – where the relevant activities are in many cases already in the private sector and PFI is therefore an inappropriate model.

## iii A new approach to PFI: PF2

In 2012, the government launched a revised PFI model, called PF2.<sup>9</sup> Despite previous suggestions from within government that the PFI model might be scrapped, it was left broadly intact but with some important changes.

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4 National Audit Office, ‘Private Finance Projects’, October 2009.

5 Ibid.

6 HM Treasury, ‘Private Finance Initiative and Private Finance 2 projects 2016’.

7 Ibid. Comparable figures for the period from April 2016 are not yet available.

8 The introduction of international financial reporting standards in 2009–10 resulted in nearly all PFI debt being included in the financial accounts of government departments for financial reporting purposes. However, PFI debt is still left off the most politically sensitive measure of the public sector balance sheet (public sector net debt).

9 HM Treasury, ‘A new approach to public private partnerships’, December 2012.



The reforms introduced by PF2 were designed to increase transparency, promote efficiency, ensure projects were good value for money and encourage alternative sources of institutional capital (such as infrastructure and pension funds). The principal reforms were:

- a* Provided the project meets its investment criteria, government will take a minority equity stake in the project vehicle, with the investment being managed by a new PF2 equity unit.
- b* Equity funding competitions will be encouraged. Bidders will be required to develop a long-term financing solution that is not reliant solely on bank debt.
- c* Private sector equity return information will be published. A 'project approvals tracker' will be available on the government's website, showing the status of each stage in the government approvals process (including pre-procurement). A running control total for off-balance sheet PF2 commitments has been introduced.
- d* Departments with a PF2 pipeline are encouraged to establish a central procurement unit. A maximum 18 months from tender issue to selecting preferred bidder has been introduced, with the procurement process being streamlined in line with the government's 'lean sourcing' principles.<sup>10</sup> HM Treasury will undertake greater scrutiny of business cases during the approvals process.
- e* 'Soft' services such as cleaning and catering will be removed from PF2 to focus the contractor on provision of the asset and long-term maintenance. Underspend on anticipated life-cycle costs is to be shared equally between public and private sectors.
- f* The allocation of certain unmanageable risks to the private sector, such as unforeseen changes in law and site contamination, will cease.

To date PF2 remains little used against the backdrop of a very significant decline in the number of projects in the UK market.

#### **iv Regional variations**

The UK Parliament has devolved certain powers to the parliaments and assemblies of Scotland, Wales and Northern Ireland. In addition, the system of law applying in Scotland and to some extent in Northern Ireland is different from that in England and Wales. There are therefore variations for PPPs in those regions.

The Scottish government has been particularly active in modifying the structure of Scottish PPPs, introducing the non-profit-distributing (NPD) model<sup>11</sup> to replace standard UK PFI. This involves enhanced stakeholder involvement in the management of the projects, no dividend bearing equity and capped private sector returns. It is not a 'not for profit' model – contractors and funders are expected to earn a normal market rate of return. However, the NPD model aims to eliminate the uncapped equity returns associated with the traditional PFI model and limit such returns to a reasonable rate fixed in competition. The NPD model is now also being used in Wales. Northern Ireland has developed a model called 3PD, under which a facility is built and operated by the private sector, which provides the up-front capital, and then leased on a long-term arrangement to the public sector.

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10 Crown Commercial Service, 'Lean sourcing: guidance for public sector buyers', updated 29 June 2015.

11 Scottish Futures Trust, 'NPD Model Explanatory Note', December 2011.

However, new EU guidance<sup>12</sup> on the application of EU rules<sup>13</sup> to the accounting treatment of PPPs suggests that the NPD model will need to be adapted if it is to allow projects to stay off the public sector net debt balance sheet. For example, it states Eurostat's view that a cap on the private sector partner's profits 'automatically leads to the PPP being on balance sheet for government'.<sup>14</sup>

## II THE YEAR IN REVIEW

### i Brexit

The biggest UK event in 2016 was of course the June 2016 referendum in favour of the UK leaving the European Union, known as Brexit. In legal terms this has no immediate impact. The UK is currently expected to give the required notice of its intention to leave the EU<sup>15</sup> by the end of March 2017. The UK will remain a Member State of the EU with all its existing rights and obligations during the notice period, which is set at two years, unless it were to be agreed with all 27 other Member States that its membership should cease sooner or continue for a longer period. At the end of the notice period, the UK will automatically leave the EU, even if the exit terms have not been agreed.

The UK government has announced it will table a 'Great Repeal Bill', which, despite its name, will seek as a transitional measure to preserve most EU law currently applicable in the UK as UK law after Brexit, with change thereafter being gradual. This chapter can only touch on a couple of the many issues and options that Brexit raises (see Section III.ii.a, and Section VI.ii, *infra*).

The new government under Theresa May has been quick to offer assurances about Britain remaining 'open for business', with green lights for large-scale infrastructure projects including the Hinkley Point C nuclear power station, the full High Speed 2 railway route and a third runway at London Heathrow Airport. In its November 2016 Autumn Statement the government also signalled that it would set course to a permanently higher share of GDP being spent on strategic economic infrastructure (see subsection ii, *infra*).

### ii National Infrastructure and Construction Pipeline 2016

In December 2016, the government published the National Infrastructure and Construction Pipeline,<sup>16</sup> bringing together and updating the previous separate infrastructure and construction pipelines. It provides a forward-looking assessment of planned investment in infrastructure across the public and private sectors, containing over 700 projects and programmes with a total value of more than £500 billion, of which more than £300 billion is for investment by 2020/21. As with the National Infrastructure Plans published each year between 2010 and 2016,<sup>17</sup> this document makes clear that much of the proposed investment (over 50 per cent of the pipeline to 2020/21) is to be financed and delivered by the private sector of which 60 per cent is in the regulated utilities sector (recovered through end-user

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12 Eurostat, A Guide to the Statistical Treatment of PPPs, September 2016.

13 Council Regulation (EC) 549/13 of 21 May 2013 on the European system of national and regional accounts in the European Union (OJ L 174/1, 26.06.2013, p. 1).

14 Ibid.

15 Under Article 50 of the Treaty on European Union.

16 HM Treasury, National Infrastructure and Construction Pipeline, December 2016.

17 Renamed the National Infrastructure Delivery Plan 2016 to 2021 in its April 2016 version.

charges). The anticipated pipeline of projects to be structured using the PF2 model remains extremely limited. However, the greater appetite for government-funded infrastructure investment under the new government is reflected in its exploration of a new pipeline of projects suitable for delivery through the PF2 scheme, due to be published in early 2017.

### **iii Other developments**

The government also recently shelved its previous plans to make the National Infrastructure Commission, which offers recommendations for priority infrastructure projects, statutorily independent. It had been hoped that such independence would reduce the impact of the electoral cycle on long-term infrastructure development decisions.<sup>18</sup>

#### ***Green Investment Bank (GIB)***

Since the government set up GIB in 2012 and funded it to support, on a for-profit basis, investment in the UK's green infrastructure, it has committed £2.7 billion to 85 green infrastructure projects worth £11.3 billion, including helping to finance first-of-a-kind projects that use innovative technologies in waste management and offshore wind power.<sup>19</sup> In March 2016, the UK government launched the process to move GIB into private ownership in a privatisation worth about £2 billion.<sup>20</sup> The sale process is ongoing as at January 2017.

#### ***Strong secondary market***

There continued to be an active market for the sale and purchase of developed UK infrastructure assets, including PPP assets. Examples include the M6 toll road auction and the sale of interests in the M25 motorway PPP.

## **III GENERAL FRAMEWORK**

### **i Types of public-private partnership**

The predominant form of PPP in the UK has been the PFI (now PF2) project, with nearly 700 projects having achieved financial close and still under contract.<sup>21</sup> Other less common forms of PPP used in the UK are also described below.

#### ***PF2***

Project financed structures where a public sector procurer awards a contract through competitive tender for the DBFO of a piece of public infrastructure. The contractor is a special purpose vehicle (SPV) formed by the successful bidder, or more often consortium of bidders, for the purpose of the project. The construction and subsequent service provision are subcontracted by the SPV on the basis of a full flow-down of the risk from its contract with the procuring body. The principal subcontractors are usually related entities of the bidders.

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18 House of Commons Library, National Infrastructure Commission Briefing Paper, November 2016

19 Green Investment Bank, Summary of transactions, updated 22 December 2016.

20 Green Investment Bank, press release, 2 March 2016.

21 Footnote 6, *supra*.

### ***Strategic infrastructure partnerships***

These involve the appointment of a contractor (or contractors) to deliver a flow of PF2 projects, bundling together projects which would otherwise be too small to justify use of PF2.<sup>22</sup>

### ***Concessions***

Project-financed structures similar to PF2, and awarded by the public sector, but with the contractor's revenue coming from user charges rather than charges to the procuring body. These exist in UK public infrastructure, for example, several tolled river crossings,<sup>23</sup> but they are relatively rare.

### ***'Regulated asset base' structures***

These build on the privatisation structures described in Section 1, *supra*. The relevant activity is made a licensable activity and a competition is held for the award of a licence. The licence permits the successful licensee to recover an agreed return on expenditure efficiently employed in developing and operating the project assets, subject to independent regulation.<sup>24</sup>

### ***Delivery partner or integrator***

A contractor is appointed to manage the delivery of a project on behalf of the public sector through pre-procurement, procurement, construction and into operation. The delivery partner integrates the underlying procurements so that they deliver an overall asset or service to the procuring body. The delivery partner does not (generally) deliver the underlying assets and services itself, but rather adopts a 'client-side' role.

### ***Public/private joint ventures***

These can be either corporate, where a new corporate vehicle is established, jointly owned by public and private sectors or contractual, where there is no separate entity and the public and private sector cooperate under the terms of a commercial contract. The joint venture structure is usually used to progress commercial activities formerly carried out in the public sector for mutual benefit, or to realise the commercial development potential of publicly owned real estate, rather than to create new public infrastructure assets, and is sometimes done with a view to a subsequent sale. A more recent development is the 'mutual' joint venture, where the employees also own part of the joint venture company. Although there is guidance on joint ventures,<sup>25</sup> structures tend to be largely bespoke.

### ***Government-owned, contractor-operated companies***

This involves putting a commercial activity into a new corporate entity, transferring it temporarily to an appointed services contractor for the duration of the services, and then returning it to the public sector. Government may hold a special share to ensure the ultimate control of a strategic asset, but it does not have an economic interest.

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22 Bundling is currently in use for the PF2 element of the Priority School Building Programme.

23 For example, the Second Severn Crossing and the QE2 Bridge at Dartford.

24 These are currently in use for the development of offshore electricity transmission networks (OFTOs) and the Thames Tideway Tunnel.

25 HM Treasury, 'Joint Ventures: a guidance note for public sector bodies forming joint ventures with the private sector', March 2010.

### ***Flexible or hybrid projects***

These are specially designed one-off structures for particularly large or complex projects, where a procuring body requires a tailored approach; for example, where a long-term PPP relationship is desired but it is not possible to define the service requirement or pricing for the full period. They can borrow elements from several of the above structures.

### ***Bespoke structures***

These are standardised PPP structures for use in specific activities where PF2 is inappropriate.<sup>26</sup>

## **ii The authorities**

The principal public bodies that play a role in the UK PPP market are:

- a* European Commission: sets the public procurement regulatory framework for the EU and regulates the provision of state aid to private sector entities. Post-Brexit, and subject to any transitional agreement, the continued application of such EU rules will likely depend on the degree of EU internal market access that the UK and the EU agree as part of any trade agreement.
- b* HM Treasury: sets and oversees fiscal policy and general policy on PPPs and approves project business cases.
- c* Cabinet Office: oversees the efficiency of government functions and procurement, sets the policy framework for government procurement and approves individual procurement routes and structures.
- d* Infrastructure and Projects Authority (IPA): this provides expertise in infrastructure and the financing, delivery and assurance of major projects to the whole of government.
- e* Procuring bodies: departments and executive agencies of central government, local government authorities and other public bodies. Procuring bodies structure and procure projects, enter into and manage the PPP contracts and pay for the services.
- f* Independent regulators: different regulators regulate particular areas of activity (for example environment, health and safety and data protection) and particular sectors (such as gas and electricity, water, rail and communications).
- g* Planning authorities: grant development consent for projects. Their identity differs by location and type of project (with a special streamlined regime for nationally significant infrastructure projects).
- h* Comptroller and Auditor General/National Audit Office: scrutinises public spending on behalf of Parliament.

## **iii General requirements for PPP contracts**

PPP projects in the UK are for the most part promoted under the general legislative and common law powers of government and other public bodies. Unlike in many other jurisdictions, there is no PPP framework enabling legislation.

Central government departments may act under the Crown's common law powers, which broadly confer unfettered legal power except where expressly or impliedly limited

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26 Good examples are (1) the 'contract for differences' and 'capacity market' structures developed as part of the reform of the electricity market, which support essential private investment in low carbon generation projects, including new nuclear power stations; and (2) the passenger rail franchising system, under which private sector contractors are appointed to operate UK rail services.

or restricted by legislation. The powers of local government and other public bodies are limited to those conferred by legislation (and powers reasonably incidental to those express powers), but these have generally proved adequate to promote PPPs. The powers of local government have been considerably enhanced by the Localism Act 2011. Where necessary, minor legislation has been enacted to remedy specific deficiencies in powers.<sup>27</sup>

The general EU and UK legal framework applies to PPP projects in the usual way – for instance, the law of contract, company law, competition and public procurement law, employment law and tax law.

Given the broad range of PPP projects described in subsection i, *supra*, there is no single standard approach to PPP contracts. However the approach to PFI/PF2 projects is largely standardised and is set out in HM Treasury’s ‘Standardisation of PF2 Contracts’ document (SoPC)<sup>28</sup> and the standard equity investment documentation.<sup>29</sup>

There are no specific guidelines on when a PPP (or a particular PPP model) should be used – these are policy decisions taken on a case-by-case basis by procuring bodies under the oversight of the Cabinet Office and HM Treasury.

All PPP projects are subject to various government approval processes, which differ depending on which public body is procuring the project and which evolve over time. In outline, the current framework is:

- a approval of the procurement route is required from the Cabinet Office before procurement. The project must proceed through a staged assurance process as the procurement proceeds, operated by the IPA; and
- b approval of the strategic outline case (SOC), outline business case (OBC) and final business case (FBC) is required from HM Treasury. The SOC is generally required at project initiation, the OBC at pre-market stage and the FBC before final negotiations. Treasury approvals take account of the IPA reviews.

The procuring body will need to follow its own approval processes, including sign off by the nominated accounting officer (usually the head of the relevant body). Local government bodies, and other non-departmental public bodies, will need to obtain approval from their sponsoring department.

These approvals are obtained by the procuring body and not the successful bidder. The successful bidder needs to obtain only the licences and consents that would be required by any business undertaking the relevant activity, such as planning (development) consents and environmental permits; there are no PPP-specific consent requirements.

#### IV BIDDING AND AWARD PROCEDURE

Procurement of works, goods and services by public sector bodies is governed by the EU Directives (see Section III.ii.a, *supra*) on public procurement and the UK Regulations that implement those Directives into UK law. Updated Directives came into force on 17 April 2014 and EU Member States had two years to implement them into national law.

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27 For example, the National Health Service (Private Finance) Act 1997.

28 The current version of which is Standardisation of PF2 Contracts, HM Treasury, December 2012. However, note that Infrastructure and Projects Authority has indicated that it currently finalising a refresh of the SoPC, due during the first half of 2017.

29 Published by HM Treasury in July 2013.

The principal Directive (2014/24/EU) was implemented in the UK via the Public Contracts Regulations 2015, which govern all relevant procurement procedures commenced after 26 February 2015.<sup>30</sup> These Regulations were supplemented by the Concession Contracts Regulations 2016, which entered into force in April 2016.<sup>31</sup>

EU law imposes general requirements for equal treatment of bidders and transparency. The Directives and Regulations, with limited exceptions,<sup>32</sup> require public bodies to follow one of a number of specified competitive procurement procedures. These specify minimum timescales for particular elements of the process, for example the time allowed to respond to an invitation to tender (ITT), with an expedited procedure for urgent requirements.

Before 2006, the procedure usually adopted for UK PFI procurements was the ‘negotiated’ procedure. This is a flexible procedure, suitable for complex procurements as it allows the procuring authority to negotiate the contract with one or more shortlisted bidders. However, since 2006 government policy has been to use the ‘competitive dialogue’ procedure introduced by the 2006 Regulations.

The competitive dialogue procedure involves the procuring body engaging in dialogue with shortlisted bidders to develop specified areas of the contract so that they meet its requirements. Once dialogue has concluded and a successful bidder has been selected, only very limited further changes to the contract are allowed. Although competitive dialogue has generally proved adequate for PFI, the revised EU Directive of 2014 has relaxed the previous restrictions on the use of the negotiated procedure (renamed the competitive procedure with negotiation) and aligned them with those applying to competitive dialogue. It will be interesting to see whether this new form of negotiated procedure becomes the process of choice again.

There has been a significant government policy focus on shortening procurement timescales. As part of this, the government promotes extensive pre-procurement market engagement, which is expressly permitted under the EU Directive of 2014 and the UK Regulations.

Procuring bodies generally retain the right to alter or cancel the procurement process as it proceeds, though the process would need to remain within the constraints of the EU Directives and UK Regulations, including the principles of equal treatment and transparency.

Public consultation is not usually a feature of the PPP process. Procuring authorities are, however, subject to freedom of information laws and concluded contracts are also published (usually with redactions of particularly sensitive information).

Whether the competitive dialogue or (renamed) negotiated procedure is used, the procurement process essentially follows the same steps. Procurement processes are now generally run through secure web-based applications such as Bravo.

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30 These 2015 Regulations replaced the Public Contracts Regulations 2006. Other Directives and UK Regulations are concerned with procurement in the fields of defence and security and utility activities (i.e., water, energy, transport and postal services), including by public bodies.

31 These Regulations implement EU Directive 2014/23, which is a new instrument governing the award of concessions for works or services.

32 Public bodies may be exempt from the general requirement to hold a competitive procurement procedure in a range of narrowly construed circumstances, which include: (1) where for technical reasons, or reasons connected with exclusive rights, only one contractor can perform the contract; (2) where there is extreme urgency due to unforeseeable events; and (3) where additional works or services become necessary due to unforeseeable circumstances (in each case, subject to conditions).

### **i Expressions of interest**

The procuring body is obliged to advertise openly by publishing a contract notice in the Official Journal of the European Union. The notice is usually accompanied by a prequalification questionnaire seeking information about bidders and a guide to the prequalification process.<sup>33</sup>

There are limitations on the criteria through which the shortlist of prequalified bidders is selected. Essentially the prequalification evaluation should assess only the technical or professional ability and economic or financial standing of bidders. There are also various grounds for mandatory or discretionary exclusion, covering matters such as criminal convictions, insolvency and professional misconduct. The EU Directive and UK Regulations expressly allow poor performance on previous public contracts to be considered as a discretionary ground for exclusion.

### **ii Requests for proposals and unsolicited proposals**

Once pre-qualified bidders have been selected, the procuring body will issue them with an invitation to tender (or invitation to negotiate), together with supporting information (including a proposed contract). The invitation to tender/negotiate will contain detailed instructions on the bid process, content and format of bids and a submission deadline. Bidders may ask clarification questions up to a specified deadline, and structured dialogue or negotiations may take place before the submission of bids.

Bidders are generally required to confirm acceptance of the proposed contract terms, or to mark up those parts of the contract they are not able to accept (with explanations). Deviations from the proposed terms are strongly discouraged, and may be expressed to be non-compliance entitling the procuring body to exclude the bidder from the competition. They are, however, usually taken into account by risk-adjusting the bid price. The dialogue or negotiation procedure helps to minimise bidders' issues with the contract by the time of bid submission.

Awards based on unsolicited proposals are generally not consistent with procurement law. If a public body wished to procure a project proposed in an unsolicited proposal, it would still be required to run an advertised competitive tender unless one of the limited exemptions applied.

### **iii Evaluation and award**

The procuring body's evaluation of bids is required to identify which bid is the 'most economically advantageous'.<sup>34</sup> The detailed criteria for such evaluation and the weightings to be applied must be clearly stated in the ITT/ITN and then carefully applied. Further dialogue or negotiation may take place after the submission of initial bids.

An additional bid stage, usually called a 'best and final offer', may be employed if it is not possible to conclude the award process on the basis of the initial bids.

Once the procuring body has taken the decision to award a contract, it must inform all bidders (with reasons) and allow a 'standstill' period of at least 10 days to elapse before

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33 The EU Directive includes, at Article 53(1), a requirement that the procurement documents are made available to candidates as from the date of publication of the contract notice in the EU Official Journal. The extent of this relatively new requirement is unclear, but it may be interpreted as requiring the authority to make available the invitation to tender and draft contract as from that publication date.

34 This enables the evaluation of the financial impact of risk allocation in addition to the bid price.



the contract is signed. This is designed to give dissatisfied parties the chance to challenge the award legally, on the grounds that the process has been defective.<sup>35</sup> The number of procurement challenges by dissatisfied bidders in the UK courts has steadily increased over recent years but remains relatively low compared to other European jurisdictions.

The PPP contract and associated consortium, financing, construction and services subcontracts are signed at the same time, as part of the overall process of ‘financial close’.

#### **iv Subsequent amendments to the PPP agreements**

Where a PPP project falls within the EU Directive and UK Regulations and has been awarded pursuant to those rules, there are limitations on the extent to which the project agreements may subsequently be amended without triggering a requirement to hold a new competition. The legislation specifies that any ‘substantial modification’ has to be treated as giving rise to a new contract which must be put back out to tender, unless a specific exemption applies. A modification will be considered substantial if it renders the contract ‘materially different in character’, changes its economic balance or extends its scope considerably, or if the changed parameters would have attracted different bidders or led to a different successful bidder in the original competition. However, the Directive and Regulations do allow for exemptions, *inter alia*, where the modifications were provided for in precise review clauses in the initial procurement documents or where the need for those changes has arisen from circumstances which a diligent authority could not have foreseen.

The parties to a PPP agreement falling within the scope of the procurement legislation should therefore consider carefully at the outset how to cater for the potential need to introduce amendments during the term of the PPP project.

## **V THE CONTRACT**

This section focuses on the current guidance for PF2 contracts, which is set out in SoPC.<sup>36</sup> Some procuring bodies have developed their own template documents based on SoPC.<sup>37</sup> In some cases, the guidance provides detailed drafting to be incorporated into the contract, either on a ‘required’ basis or a ‘recommended’ basis. Contracts for other types of PPP differ significantly, but often use the PF2 approach as a starting point.

### **i Payment**

There should be a single unitary charge for the services, which generally comprise making facilities available, provision of maintenance and related services. The unitary charge may be indexed and subject to periodic benchmarking. Some limited capital expenses for the project may be covered by capital contributions.

Payment of the unitary charge does not begin until service commencement. Payments are subject to deductions for non-availability or failure to meet required service standards. An uneven or irregular payment profile over the life of a project is not recommended.

There may be limited usage risk.

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35 This is a statutory requirement introduced in response to the ECJ’s judgments in the Alcatel case (Case C81/98) and *Commission v. Austria* (C212/02).

36 Footnote 28, *supra*.

37 For example, the Education Funding Agency and the Ministry of Defence.

## ii State guarantees

PPP projects procured by central government may carry a state credit rating. State guarantees of non-departmental public bodies are not common but have sometimes been provided on the most complex projects. The government introduced the UK Guarantee Scheme (see Section VI, *infra*) to support major projects (now managed by the IPA).

## iii Distribution of risk

PF2 involves an extensive risk-allocation framework. The most significant risks are discussed below.

The contractor is protected against three categories of supervening events:

- a Compensation events: primarily circumstances of contract breach by the procuring body, where the contractor receives compensation and relief from its obligations.
- b Relief events: events outside the contractor's control but which the contractor is best placed to manage, where the contractor receives relief from default termination.
- c Force majeure: events outside the contractor's control which the contractor cannot manage, where the affected obligations are suspended.

Additionally the contractor is protected against discriminatory changes in law (those affecting only the contractor or the specific project) and specific changes in law (those affecting only the relevant category of services or businesses). The contractor is not protected against other changes in law unless they require further capital expenditure.

The contractor is required to indemnify the procuring body against death and personal injury, physical damage, third-party liability, breach of intellectual property rights and statutory claims arising from the contractor's operations. The contractor is also required to effect specified insurances for the services and project assets, with some protection where risks become uninsurable.

The procuring body has the right to step into the services in certain circumstances such as emergencies. The extent to which the contractor is protected financially depends on whether the step-in was caused by contractor default.

The sponsors do not usually guarantee the contractor's obligations, but may be required to provide guarantees to the funders.

## iv Adjustment and revision

There is flexibility to make changes to the services and contract, provided that the changes do not amount to a 'substantial modification' under the procurement rules. According to the procurement legislation,<sup>38</sup> amendments shall be considered substantial when they render the original contract 'materially different', for instance because they shift the economic balance in favour of the contractor or extend the contract's scope considerably.

Within this rule, the procuring body can require service changes subject to limited contractor veto rights, for example, where the proposed change is illegal, impossible, or

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38 Article 72 of Directive 2014/23 and Regulation 72 of the Public Contracts Regulations 2015, which build upon principles initially laid down by the European Court of Justice in *Presstext Nachrichtenagentur GmbH v. Austria* (C-454/06). Where there is a substantial modification, the procuring body must undertake a new competitive tender process, unless an exemption applies. However, no such obligation arises if the modifications were provided for in the initial procurement documents in 'clear, precise and unequivocal review clauses'.

materially changes the risk profile of the project. Contract amendments other than service changes usually require mutual agreement.

The contractor can only make service changes with mutual agreement. The consent of the procuring body is also generally required for amendment, termination or replacement of the contractor's supporting project contracts.

The contract contains a detailed protocol for specifying, pricing and agreeing service changes, with independent determination in the event of disagreement.

#### **v Ownership of underlying assets**

Project assets may be owned by the contractor, or be owned by the procuring body and made available to the contractor for the duration of the project. In the former case, the contractor may or may not bear residual asset risk. The latter approach is often used where the assets are 'strategic', such as defence facilities and highways. The asset ownership structure may be partly tax driven.

#### **vi Early termination**

The procuring body may terminate early for contractor default, which includes, for example, material or persistent breach, insolvency and breach of certain key provisions, subject to the contractor's right to rectify the breaches (if capable of being rectified) within a specific period. The procuring body may also have a right to terminate 'for convenience' on notice.

The procuring body's rights to terminate early for default are subject to the funders' right to step in to the project.

The contractor's rights to terminate early for procuring body default are usually limited to non-payment, expropriation, breach that frustrates the contractor's performance of its obligations and non-permitted assignment of the contract.

Either party may terminate early for long-term force majeure.

Provisions for compensation on termination are complex. In essence:

- a* On termination by the contractor for procuring body default, or 'for convenience' by the procuring body, compensation is designed to put the contractor and funders in the position they would have been in had the contract continued.
- b* On termination for force majeure, there will be compensation for the initial investment but not for expected return.
- c* On termination by the procuring body for corrupt gifts, or breach of the refinancing provisions, compensation will cover the outstanding senior debt only (including breakage costs).
- d* On termination by the procuring body for contractor default, compensation is limited and is calculated by reference to the market value of the project, through a retender to a new contractor (where there is a liquid market) or a calculation of market value by an independent expert (if not). This compensation, in broad terms, is the sole remedy for losses arising from early termination.

There are usually detailed hand-back obligations on the contractor on termination, including in relation to the condition of the assets.

## **VI FINANCE**

The prevailing model for the financing of PFI/PF2 projects in the UK has been to use project finance, with debt and equity being provided by funders on a limited recourse basis. Typically debt has funded around 90 per cent of project costs, while equity has provided the remaining 10 per cent. Funders' recourse has been limited to the cash flows of the project and to the project assets. While this model became the norm for standard PFI projects in the UK, there were, of course, variants. The global financial crisis also led to innovation as traditional sources of funding dried up. Government and the private sector have risen to the challenge and delivered new financing solutions to the market.

### **i Equity**

Equity finance for UK PFI/PF2 projects is provided in the form of share subscription monies and subordinated debt lent by shareholders. At the outset, the equity providers were the contractors that were bidding for the project and the underlying subcontracts. As the market grew, capital constraints for the contractors led to the development of third-party investor funds that invest in greenfield projects as a financial investor. In turn, the contractors developed fund offshoots that would purchase completed projects from the contractor enabling them to recycle capital back into projects. A wider market in secondary transactions has also developed with the same effect.

The PF2 model means that government will fund a proportion of the equity requirement for a project, albeit only a minority interest. The development of a deeper equity market has also enabled government to stipulate that PF2 projects should include equity funding competitions. It remains to be seen how the market responds to this – there are some obvious disincentives for bidders to spend time and money bidding for a project only to be undercut on the cost of equity at a later stage.

A further recent trend has been various attempts to harness pension fund or insurance company money into direct investment in projects. The Pension Infrastructure Platform (PiP), the Insurers' Infrastructure Investment Forum and the collaboration between the London, Greater Manchester, Lancashire, Merseyside and West Yorkshire local government pension schemes now all have funds or members that are able to invest equity into projects, whether in the primary or secondary markets. The Thames Tideway Tunnel, one of the largest projects in Europe, which reached financial close in 2015, attracted significant equity financing from PiP.

### **ii Debt**

The majority of the finance for UK PFI/PPP projects is provided by way of senior debt. The first transactions were funded with bank debt and a deep market of project finance banks developed, many of them international, providing debt on increasingly competitive terms. Alongside the banks, the debt capital markets responded with bond finance products, initially to refinance completed projects with cheaper, longer term debt and later, with the support of monoline insurers providing guarantees, to finance projects during the construction phase.

The UK PFI/PF2 market has benefited too from significant debt provision by the European Investment Bank (EIB), providing up to half of the debt requirement for projects whether alongside commercial banks or bond holders. Brexit may remove the EIB as a source of funding for UK infrastructure projects which do not contribute to the EU internal market. However, this sort of funding would generally be compliant with WTO rules, to which the

UK, the EU and its continuing Member States are subject, so similar funding on similar criteria from the UK or a UK government-owned infrastructure investment bank should be possible post-Brexit. UK funding is likely to be more expensive than the EIB due to the relative credit ratings.

A combination of the global financial crisis and new regulatory requirements for banks in particular has brought change. The banks have been capital constrained and less inclined to issue long-term loans. The monoline insurers and their 'wrapped' bond product are largely defunct. The consequential funding gap has given rise to innovation as government and the private sector have responded.

First, institutional investors (pension funds and insurance companies) have stepped up, both through the PiP and through direct investment to provide long-term debt to projects. Separately, infrastructure debt funds, often associated with infrastructure equity funds, have come to market with the aim of lending to greenfield projects or, more often, to refinance those projects once constructed. Meanwhile the banks have returned to market, although in smaller numbers and with less capacity than previously.

Secondly, government has responded both through PF2 and with the provision of guarantees through the UK Guarantee Scheme.

PF2 actively seeks to encourage bidders to develop long-term financing solutions using a greater range of debt finance sources. This is intended to encourage institutional investors to lend alongside the banks. An example of innovation in the context of PF2 has been the Department for Education's procurement of financing for five batches of schools through an aggregator vehicle owned by the private sector. The objective is to allow relatively small projects to gain access to long-term finance in the debt capital markets via the aggregator.

The UK Guarantee Scheme aims to provide government support to projects where the risk profile would otherwise be too great for the market. The support can take various forms but the most frequently used to date have been the provision of guarantees (for example for the financing of the Mersey Gateway bridge or Hinkley Point C nuclear power station) or the provision of standby facilities (for example, for London Underground's Northern Line extension). The Thames Tideway Tunnel benefits from a government support package in respect of certain risks, again through the UK Guarantee Scheme.

In November 2016 the government announced in its Autumn Statement that the UK Guarantee Scheme will continue until at least 2026. It may, after consultation with industry, develop a form of construction-only guarantee, de-risking the construction phase of infrastructure investment. This is likely to make infrastructure investment more attractive to institutional investors.

Under SoPC, the procuring body is entitled to request project refinancing every two years if it considers more favourable terms are available in the market. Refinancing gain is shared between public and private sectors on a sliding scale.

The newly formed UK Municipal Bonds Agency plans to issue new municipal bonds for Britain's local authorities for the purpose of funnelling investment in infrastructure, housing and other assets. The first bonds, expected in 2017, are backed jointly by the Local Government Association and 56 local councils across the UK.<sup>39</sup>

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39 Municipal Bonds Authority, 'In the media', November 2016.

## VII RECENT DECISIONS

Although, as always, there have been a number of general contract cases over the past year dealing with relatively narrow points of law that are applicable to PPP contracts in the same way as other contracts, the only case to be of particular interest to the PPP market in the UK is summarised below.

### i Contracting authority's transparency and equal treatment obligations

In *EnergySolutions EU Limited v. Nuclear Decommissioning Authority*,<sup>40</sup> EnergySolutions was part of an unsuccessful bidding consortium in a public procurement competition run by the Nuclear Decommissioning Authority (NDA) for the decommissioning of 12 nuclear facilities in the UK. EnergySolutions sought compensation for the loss it alleged it had suffered as a result of what it claimed was the NDA's improper conduct of the tender process.

The High Court found that the NDA committed serious breaches of the Public Contracts Regulations 2006, in particular that if the results of the procurement competition were adjusted to correct mistakes made by the NDA, EnergySolutions' consortium scores were higher than those of the winning bidder. This would have made their bid the 'most economically advantageous' (see Section IV. iii, *supra*). The Court also found that the winning bidder should have been disqualified from the competition.

The Court noted that there is a 'margin of appreciation' allowed to the contracting authority in matters of judgement and assessment, that is, the Court will not substitute its own view for what the score should have been merely because that score might be different to the view that the NDA had. However, manifest errors were found in numerous scores and the reasons given by the NDA. The NDA was found to have 'fudged' the evaluation to achieve and support its preferred outcome. The NDA therefore failed to evaluate its tender responses in accordance with the rules of the competition and to comply with its transparency and equal treatment obligations.

## VIII OUTLOOK

The use of the PFI model has probably passed its high water mark in the UK. However, following the Brexit vote, the new government has indicated some changes in its approach to UK infrastructure.

First, although the Autumn Statement disappointed those who had hoped for radically increased government funding for economic and social infrastructure, limited spending increases were announced and the government signalled that it would set a course to a permanently higher share of GDP being spent on strategic economic infrastructure.

Secondly, while expectations remain limited in advance of the government's announcement of a new pipeline of PF2 projects in early 2017, the Infrastructure and Projects Authority has indicated that it expects the pipeline to include both social and economic infrastructure and also that it is currently finalising a refresh of the SoPC standardised PF2 documents.

Thirdly, the government is due to announce a new 'industrial strategy' in early 2017, which is anticipated to focus on critical national infrastructure.

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40 [2016] EWHC 1988.

This means that while some changes are expected, the details of the government's new approach are not yet known and it will be some time before it will be possible to judge how significant or successful any of the changes will be. Furthermore, all this is set against the backdrop of the government's Brexit negotiations, which will inevitably take up much of its focus in the short term.

Notwithstanding the imminent PF2 announcement, it is still likely that most large and complex projects in the short to medium term will be directly publicly funded or use bespoke financing structures. Other forms of PPP will continue to be increasingly important (and undergo some standardisation).

In any event, the UK seems likely to continue looking for new ways to get private finance into large infrastructure projects, particularly given continuing fiscal challenges. Innovation is therefore likely to continue.

# UNITED STATES

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## I OVERVIEW

2016 saw continued developing interest in public-private partnerships (P3s) at both federal and state levels of funding. At the federal level, the trend toward P3 made more progress along avenues the Obama administration had previously paved in implementing the Transportation Infrastructure Finance and Innovation Act (TIFIA), the Fixing America's Surface Transportation (FAST) Act and the Water Infrastructure Finance and Innovation Act (WIFIA). In addition, the Obama administration oversaw a set of amendments to WIFIA as well as the Water Infrastructure Improvements for the Nation (WIIN) Act. Federal agencies in 2016 made progress establishing and expanding programmes to administer federal funding for critical road and water infrastructure projects. At this time, the federal government's commitment to P3 remains limited to 'horizontal' initiatives involving water systems and highways.

States have been more receptive to innovative P3 applications. Roughly two-thirds of states with P3 enabling legislation leave open the possibility of extending P3s from highway projects to transportation facilities such as airports and 'vertical' projects such as hospitals and schools. As significant vertical projects such as the University of California's 'Merced 2020 Project' and the City of Long Beach, California's Civic Center reach successful completion, we expect to see an increase in the number of single-purpose vertical projects built with shared risk and shared funding. We expect to continue to witness P3 agreements that rely on a combination of private and public funding of capital expenditures (utilising tax-exempt sources such as capital bonds) and long-term operate and maintain concessions. Early indications from the incoming Trump administration suggest that tax credits may become a meaningful incentive to increase private investment in P3 projects.

2016 was less active than anticipated in the P3 clean energy sector, with no identified major P3 projects reaching financial close in 2016. Clean energy P3 projects remain a minority within the US P3 portfolio, while transportation, aviation and healthcare facilities continue to dominate the P3 landscape. We believe that clean energy as well as other high-tech projects will increase their P3 footprint in the US as the financial uncertainties of the election season subside and the underlying technologies mature and de-risk. Nevertheless, as elaborated hereunder, President Trump's rhetoric and executive actions taken thus far suggest that clean

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1 Robert H Edwards, Jr and Mark J Riedy are partners and co-head the energy team; Ariel I Oseasohn is a member of energy team; Randall F Hafer is a senior partner and head of the construction and infrastructure team; and Christian F Henel and Daniel P Broderick are members of the construction and infrastructure team at Kilpatrick Townsend & Stockton LLP.



energy projects may enjoy somewhat diminished federal support relative to recent years, which may impede the clean energy P3 presence in the US in 2017.

We anticipate 2017 to usher in the launch of several significant P3 projects. It also will see the early impacts of a new presidential administration that has simultaneously extolled the need for dynamic private investment in public projects while hinting at changes to the legislative and regulatory framework that could significantly alter traditional assumptions regarding the financial incentives, financing structures and divisions of scope and labour that public and private partners typically ascribe to P3s.

The following addresses the 2016 year in review and provides some additional discussion of what 2017 might hold for P3 in the United States.

## II THE YEAR IN REVIEW

Below are some of the most notable regulatory and policy changes that took place in 2016, followed by noteworthy P3 projects to reach financial close in 2016.

### i Policy, legislative and regulatory update (excluding clean energy projects)

The Obama administration closed 2016 with a series of modest updates to existing P3 laws, regulations and related programmes.

The Department of Transportation established the ‘Build America Bureau’ to administer federal credit programmes issuing credit to P3 participants (and others) under the FAST Act.<sup>2</sup> The Build America Bureau establishes a Public-Private Partnerships Office, and its web page focuses on P3 and P3 tools and informs the public that ‘The Build America Bureau encourages the consideration of P3 in the development of transportation improvements. Early involvement of the private sector can bring creativity, efficiency, and capital to address complex transportation problems facing State and local governments.’<sup>3</sup> The Build America Bureau also now makes available a Credit Programs Guide, Notice of Funding Availability (NOFA) for credit assistance for infrastructure projects, and updated information on TIFIA and FAST projects.<sup>4</sup> The NOFA has authorised upwards of US\$275 billion per year through to fiscal year 2020.<sup>5</sup>

On 11 March 2016, the Department of Transportation issued a NOFA for critical infrastructure projects pursuant to the FAST Act.<sup>6</sup> On 22 December 2016, the Build America Bureau announced a new infrastructure financing tool for up to four Seattle area transit projects.<sup>7</sup>

On 16 December 2016, President Obama signed the WIIN Act with strong bipartisan support.<sup>8</sup> The Act authorises nearly US\$10 billion in federal investment in a host of water

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2 [www.transportation.gov/buildamerica](http://www.transportation.gov/buildamerica).

3 Ibid.

4 [www.transportation.gov/buildamerica/programs-services/tifia](http://www.transportation.gov/buildamerica/programs-services/tifia).

5 Ibid.

6 81 Fed. Reg. 13031 (11 March 2016); see also [www.fhwa.dot.gov/fastact/factsheets/tifiafs.cfm](http://www.fhwa.dot.gov/fastact/factsheets/tifiafs.cfm).

7 ‘USDOT Launches Innovative Infrastructure Financing Tool to Provide up to Nearly \$2 Billion to Seattle Transit Projects,’ available at [www.transportation.gov/briefing-room/usdot-launches-innovative-infrastructure-financing-tool-provide-nearly-2-billion](http://www.transportation.gov/briefing-room/usdot-launches-innovative-infrastructure-financing-tool-provide-nearly-2-billion).

8 WIIN Act, S.612, Pub. Law No. 114-322 (16 December 2016); see also [www.govtrack.us/congress/votes/114-2016/s163](http://www.govtrack.us/congress/votes/114-2016/s163).

initiatives, including water infrastructure and services. The WIIN Act also tasks the White House Office of Science and Technology with promoting the use of P3 to develop a framework for planning and building ocean desalination projects.<sup>9</sup>

On 19 December 2016, the Environmental Protection Agency (EPA) signed its interim rule implementing WIFIA, 'Credit Assistance for Water Infrastructure Projects.'<sup>10</sup> The interim final rule notes the EPA's role in promoting the use of P3 by reducing the cost of private investment with 'limited impact on the municipal bond market'.<sup>11</sup> According to the EPA, US\$1 billion in annual WIFIA assistance is expected to account for approximately 3 per cent of the market for water infrastructure bonds.<sup>12</sup>

On 10 January 2017, the EPA went to work issuing credit assistance under WIFIA and the WIIN Act. The EPA announced it will make available approximately US\$1 billion in credit assistance for water infrastructure projects under the WIFIA programme.<sup>13</sup> Through WIFIA, the loans will be available to partnerships, including P3 participants. The new credit assistance programme is geared towards large infrastructure projects with an investment value of at least US\$20 million. The EPA praised WIFIA for providing it with the authority and funding for up to US\$2 billion in water infrastructure.<sup>14</sup>

P3 continues to gain acceptance at the state level. Several state legislatures adopted or expanded P3 in 2016. New to adopt P3 in 2016 were Kentucky,<sup>15</sup> Tennessee (transportation projects),<sup>16</sup> and New Hampshire (transportation projects).<sup>17</sup> Louisiana extended P3 to its Department of Transportation and Development<sup>18</sup> and New Jersey extended P3 to certain hospital projects.<sup>19</sup>

According to a survey performed by the National Council for Public-Private Partnerships, as of 7 February 2017, a total of 36 states and the District of Columbia have adopted legislation enabling some form of P3.<sup>20</sup> Of those, 11 limit P3 to 'horizontal' projects, such as highways and similar transportation projects. Another two states limit P3 to 'vertical' projects such as hospitals, schools and other social infrastructure. Twenty-four states and the District of Columbia are fully open to P3 business.

State laws vary in terms of how they enable, or, alternatively, how they restrict, P3. For example, Kentucky H.B. 309 establishes a Local Government Public-Private Partnership Board with approval rights over any P3 agreement with a total contractual value exceeding 30 per cent of the general fund revenues received by the local government in the immediately

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9 Id. at Section 3801(d).

10 81 Fed. Reg. 91822 (19 December 2016).

11 Id. at 91824.

12 Ibid.

13 EPA.gov News Release, 'EPA Launches New Program With \$1 Billion in Loans Available for Water Infrastructure Projects,' available at: [www.epa.gov/newsreleases/epa-launches-new-program-1-billion-loans-available-water-infrastructure-projects](http://www.epa.gov/newsreleases/epa-launches-new-program-1-billion-loans-available-water-infrastructure-projects).

14 Ibid.

15 Kentucky H.B. 309 (8 April 2016).

16 Tennessee S.B. 2093 (27 April 2016) (effective 1 October 2016).

17 New Hampshire, S.B. 549 (16 June 2016) (effective 15 August 2016).

18 Louisiana Act 519 (13 June 2016). Louisiana extended pre-existing P3 from its Transportation Authority to its Department of Transportation and Development. [www.ncppp.org/new-laws-pave-the-way-for-transportation-p3s/](http://www.ncppp.org/new-laws-pave-the-way-for-transportation-p3s/).

19 New Jersey S.B. 2361 (27 September 2016).

20 [www.ncppp.org/resources/research-information/state-legislation/](http://www.ncppp.org/resources/research-information/state-legislation/).

preceding fiscal year.<sup>21</sup> In another example, New Hampshire S.B. 549 restricts P3 to design–build–finance–operate–maintain (DBFOM) and design–build–operate–maintain (DBOM). Additionally, states have passed legislation authorising venture-specific P3, such as California’s S.B. 562 targeting a DBFOM/lease-leaseback arrangement for the City of Long Beach California’s Civic Center project.<sup>22</sup>

## ii Policy, legislative and regulatory update – clean energy

In his last year in office, former President Obama and his administration continued to support the clean energy sector, as they did in 2015. New regulations were set in place focused on cleaner operating standards for the fossil fuel sector as well as strengthening financial opportunities for the renewable energy market.

Notable among such regulations are the (first-ever) Standards to Cut Methane Emissions from the Oil and Gas Sector issued by the EPA in May 2016.<sup>23</sup> For new, modified or reconstructed sources of pollution, the EPA is finalising a set of standards that will reduce methane, volatile organic compounds and toxic air emissions in the oil and natural gas industry. For existing resources, the EPA issued for public comment an Information Collection Request that requires companies to provide information that will be necessary for the EPA to reduce methane emissions from existing oil and gas sources.<sup>24</sup>

New fuel-economy standards for medium-duty as well as large trucks, buses and other heavy-duty vehicles were finalised by the Obama administration in August 2016.<sup>25</sup> Although such vehicles represent approximately 5 per cent of total volume of traffic, they account for over 20 per cent of transportation-related fuel consumption and greenhouse gas emissions, making these standards highly impactful.

In December 2016, the administration issued an executive order banning oil drilling in large areas of the Atlantic and Arctic oceans.<sup>26</sup> This step followed a number of cancellations by the Department of the Interior of federal land lease contracts in Montana and Colorado with oil and gas entities.<sup>27</sup> The administration also placed halts on new mining claims on 30,000 acres near Yellowstone National Park.<sup>28</sup>

On the energy procurement front, the Obama administration in October 2016 set a new goal for civilian agencies in the federal government to procure and facilitate development

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21 Kentucky H.B. 309 (8 April 2016) at Section 5(12)(a).

22 California S.B. 562 (11 August 2015).

23 EPA.gov News Release, EPA Releases First-Ever Standards to Cut Methane Emissions from the Oil and Gas Sector, available at [www.epa.gov/newsreleases/epa-releases-first-ever-standards-cut-methane-emissions-oil-and-gas-sector](http://www.epa.gov/newsreleases/epa-releases-first-ever-standards-cut-methane-emissions-oil-and-gas-sector).

24 See EPA, Final Information Collection Request (ICR) for the Oil and Natural Gas Industry (10 November 2016), available at [www.epa.gov/controlling-air-pollution-oil-and-natural-gas-industry/oil-and-gas-industry-information-requests](http://www.epa.gov/controlling-air-pollution-oil-and-natural-gas-industry/oil-and-gas-industry-information-requests).

25 For links to the standards, see EPA News Release, EPA and DOT Finalize Greenhouse Gas and Fuel Efficiency Standards for Heavy-Duty Trucks (16 August 2016), available at [www.epa.gov/newsreleases/epa-and-dot-finalize-greenhouse-gas-and-fuel-efficiency-standards-heavy-duty-trucks-0](http://www.epa.gov/newsreleases/epa-and-dot-finalize-greenhouse-gas-and-fuel-efficiency-standards-heavy-duty-trucks-0).

26 Exec. Order No. 13,754, 81 Fed. Reg. 89,669 (9 December 2016).

27 [www.doi.gov/pressreleases/secretary-jewell-senator-tester-blackfeet-nation-and-devon-energy-announce](http://www.doi.gov/pressreleases/secretary-jewell-senator-tester-blackfeet-nation-and-devon-energy-announce).

28 See Dep’t of Int. Press Release, Obama Administration Protects 30,000 Acres from New Mining Claims near Yellowstone Park (11 November 2016), available at [www.doi.gov/pressreleases/obama-administration-protects-30000-acres-new-mining-claims-near-yellowstone-national](http://www.doi.gov/pressreleases/obama-administration-protects-30000-acres-new-mining-claims-near-yellowstone-national).

of 1 gigawatt of new renewable electricity by 2021.<sup>29</sup> This target builds on executive action taken by President Obama in 2015 according to which 30 per cent of electricity used by the federal government will come from renewable sources by 2025.<sup>30</sup>

### **iii P3 projects reaching financial close in 2016**

In November 2016, the Vista Ridge project reached financial close.<sup>31</sup> This San Antonio, Texas project is the largest P3 water project to reach close to date in the United States. The project includes a 142-mile water pipeline infrastructure that will result in a 20 per cent increase to San Antonio's water capacity by 2020. The Vista Ridge project will supply enough water for 162,000 families and will help to protect endangered species in the Edwards Aquifer during droughts. Sumitomo Mitsui Banking Corporation arranged and led the project financing in the form of US\$875 million in a non-recourse loan.

The Port Authority of New York and New Jersey announced closing on the financing arrangements for the US\$4 billion renovation of the LaGuardia Airport. The project is the largest airport financing and greenfield P3 project in the United States to date. LaGuardia Gateway Partners (Vantage Airport Group, Skanska and Meridiam) entered into a 34-year lease, which includes responsibilities for the team to provide, design, build, operate and maintain services.<sup>32</sup> The financing includes US\$2 billion in long-term fixed rate special facility bonds, including a US\$2.35 billion tax-exempt tranche and US\$150 million in taxable municipal bonds.

On 16 December 2016, Natixis Infrastructures announced financial close of the construction of a cross-continental subsea and terrestrial fibre optic cable network connecting northern and western territories in Alaska.<sup>33</sup> The project involves a partnership between Alaska-based telecom operator Quintillion Subsea Holdings LLC and French telecom conglomerate Alcatel Lucent Submarine Networks utilising a US\$1.4 million grant from the US Department of Agriculture's Community-Oriented Connectivity Broadband Grant Program.<sup>34</sup> Phase I of the project is expected to be completed in 2017.

## **III POLICY AND FINANCIAL CLOSING OUTLOOK**

### **i P3-related policy priorities for 2017**

Although the United States has historically been slow to embrace P3 as commonplace project financing and execution vehicles, recent changes in the US political climate suggest that the tide may be rising. The recently elected Trump administration campaigned, in part, on the theme that private industry can solve problems at a faster and more efficient rate

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29 See Dan Utech & Christine Harada, Continuing the Administration's Commitment to Deploying Clean Energy on Federal Facilities (14 October 2016), <https://obamawhitehouse.archives.gov/blog/2016/10/14/continuing-administrations-commitment-deploying-clean-energy-federal-facilities>.

30 Exec. Order No. 13,693, 80 Fed. Reg. 15,871 (26 March 2015).

31 Garney Reaches Financial Close on Vista Ridge Water Supply Project, [www.garney.com/garney-reaches-financial-close-vista-ridge-water-supply-project/](http://www.garney.com/garney-reaches-financial-close-vista-ridge-water-supply-project/).

32 LaGuardia Airport Reaches Financial Close, [www.ncppp.org/laguardia-airport-reaches-financial-close/](http://www.ncppp.org/laguardia-airport-reaches-financial-close/), <http://qexpressnet.com/system/>.

34 'Quintillion partners with Alcatel-Lucent for Arctic fiber', *Alaska Journal*, 6 August 2015, available at [www.alaskajournal.com/business-and-finance/2015-08-06/quintillion-partners-alcatel-lucent-arctic-fiber#WJqIFE1lipo](http://www.alaskajournal.com/business-and-finance/2015-08-06/quintillion-partners-alcatel-lucent-arctic-fiber#WJqIFE1lipo).

than government. Specifically with respect to P3, the Trump administration cited the US's 'crumbling' infrastructure as a 'golden opportunity for accelerated economic growth and more rapid productivity gains', through a 'deficit-neutral' plan.<sup>35</sup> Key characteristics in the President's plan from a P3 perspective include:

- a providing maximum flexibility to the states;
- b leveraging new revenues and work with financing authorities, P3, and other prudent funding opportunities;
- c harnessing market forces to help attract new private infrastructure investments through a deficit-neutral system of infrastructure tax credits;
- d linking increased investments with positive reforms to infrastructure programmes that reduce waste and cut costs; and
- e completing projects faster and at lower cost through significant regulatory reform and ending needless red tape.<sup>36</sup>

It remains unclear at this point what specific administration programme, legislation or regulatory framework will emerge to accomplish these goals. However, both parties in Congress have cited the need to fix America's ailing critical infrastructure and proposed programmes valued at upwards of US\$1 trillion.<sup>37</sup> The primary difference between the trillion-dollar plan floated by Democrats in Congress and the administration's plan comes down to financing: Democrats would fund infrastructure using federal dollars exclusively, while the administration's approach is acutely focused on private investment and contribution, such as P3.<sup>38</sup>

To move forward with such a plan, the federal government will need to meaningfully reform its current approach to infrastructure financing and spending. The administration intends to implement tax reform, including an across-the-board corporate income tax reduction to reduce offshoring and new tax credits under the theory that it would allow developers to pour private funding into new infrastructure.<sup>39</sup> These tax credits, sometimes referred to as the 'Navarro-Ross' credits,<sup>40</sup> are designed to serve as an 'equity cushion' that will

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35 'Donald J. Trump's Vision', Donald J. Trump for President, Inc., campaign website, available at [www.donaldjtrump.com/policies/an-americas-infrastructure-first-plan](http://www.donaldjtrump.com/policies/an-americas-infrastructure-first-plan).

36 Ibid.

37 'Senate Democrats unveil a Trump-size' infrastructure plan', *The Washington Post*, 24 January 2017, available at [www.washingtonpost.com/politics/democrats-set-to-unveil-a-trump-style-infrastructure-plan/2017/01/23/332be2dc-e1b3-11e6-a547-5fb9411d332c\\_story.html?utm\\_term=.f8d4a457eab7](http://www.washingtonpost.com/politics/democrats-set-to-unveil-a-trump-style-infrastructure-plan/2017/01/23/332be2dc-e1b3-11e6-a547-5fb9411d332c_story.html?utm_term=.f8d4a457eab7).

38 Ibid. The Democrat-proposed 'Blueprint to Rebuild America's Infrastructure' would rely on direct taxpayer funding as administered through existing infrastructure stimulus programmes such as the TIFIA, the FAST Act and the WIFIA. 'A Blueprint to Rebuild America's Infrastructure,' Democratic Policy & Communications Center, available at [www.dpcc.senate.gov/?q=blueprint&p=search&site=dpcc&num=10&filter=0&x=0&y=0](http://www.dpcc.senate.gov/?q=blueprint&p=search&site=dpcc&num=10&filter=0&x=0&y=0).

39 'Trump's Tax, Infrastructure Plans Jeopardize Exemption for Munis', *The Bond Buyer*, 7 February 2017, available at [www.bondbuyer.com/news/washington-infrastructure/trumps-tax-infrastructure-plans-jeopardize-exemption-for-munis-1117786-1.html](http://www.bondbuyer.com/news/washington-infrastructure/trumps-tax-infrastructure-plans-jeopardize-exemption-for-munis-1117786-1.html).

40 The Navarro-Ross tax credits are named after Trump administration senior policy advisers Peter Navarro, Professor of Economics and Public Policy, University of California Irvine Paul Merage School of Business, and Wilbur Ross, international private equity investor. They outline their complete plan in a 27 October 2016 White Paper: 'Trump Versus Clinton On Infrastructure', available at [www.donaldjtrump.com/press-releases/white-paper-on-djt-econ-plan](http://www.donaldjtrump.com/press-releases/white-paper-on-djt-econ-plan).

allow investors to infuse more capital into projects, even risky ones.<sup>41</sup> The credits are designed to become refunded incrementally as developers and contractors pay tax on recognised profits and labour wages, making the approach revenue-neutral.<sup>42</sup>

Despite its promise for generating interest and infusing capital, it remains unclear how the administration intends for federal, state, or local governments to participate in the resulting public infrastructure projects. The administration's plan does not call for abolishing tax-exempt bonds as P3 financing tools, but the authors of the Navarro-Ross plan suggest that tax credits should replace bonds, which they decry as inefficient and unreliable.<sup>43</sup> These kinds of claims have caused some in the bond industry to question the future of tax-exempt bonds in P3.<sup>44</sup> Further, the administration has not yet indicated what impacts, if any, tax credits in lieu of tax-exempt bonds may affect the willingness or feasibility of government actors to enter into the types of long-term financial incentives, such as concession contracts, that have long served as a catalyst for private investment. Adding to the debate is whether tax credits will adequately incentivise private investment and whether the plan will actually be deficit-neutral.

In addition, while the new tax credits and other initiatives continue to emerge in the context of 'horizontal' P3 projects – infrastructure, rail, water and energy – the administration has also given little indication of what plan it has, if any, for 'vertical' P3 – social innovations such as hospitals and schools. The US has hesitated to use P3 for these types of projects; of the 37 states whose legislation authorises P3, 11 limit the vehicle exclusively to horizontal P3 projects.<sup>45</sup>

Finally, and parallel to infrastructure and tax reform, the new administration has issued an executive order aimed at eliminating new regulations and reducing existing regulations promulgated by the federal government.<sup>46</sup> Specifically, the order requires that any agency proposing a new regulation for public comment must identify at least two existing regulations for repeal.<sup>47</sup> The order further requires the agency proposing a new regulation to offset the cost associated with the new regulation by eliminating costs associated with at least two prior regulations.<sup>48</sup> The impacts of this executive order on P3 are unclear at best.

## ii Clean energy P3-related policy priorities for 2017

At this point in 2017, it is too early to make confident predictions on the new administration's clean energy policies. However, based on the presidential campaign rhetoric, actions already taken by the Trump administration and publicly announced plans for the forthcoming year,

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41 Id. at 4.

42 Ibid.

43 Id. at 6.

44 'Trump's Tax, Infrastructure Plans Jeopardize Exemption for Munis', *The Bond Buyer*, 7 February 2017, available at [www.bondbuyer.com/news/washington-infrastructure/trumps-tax-infrastructure-plans-jeopardize-exemption-for-munis-1117786-1.html](http://www.bondbuyer.com/news/washington-infrastructure/trumps-tax-infrastructure-plans-jeopardize-exemption-for-munis-1117786-1.html).

45 Infographic, 'State Legislation', The National Council for Public-Private Partnerships, [www.ncppp.org/resources/research-information/state-legislation/](http://www.ncppp.org/resources/research-information/state-legislation/). For example, Maine Revised Statutes, Title 23, Section 4521 limits the definition of 'project' to 'the initial capital development of a transportation facility'.

46 Executive Order on Reducing Regulation and Controlling Regulatory Costs, 30 January 2017, available at [www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling](http://www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling).

47 Id., Section 2(a).

48 Id., Section 2(c).

it seems safe to assume that the clean and renewable energy industries will not enjoy the same level of federal backing enjoyed during the past eight years.

It is expected that the Trump administration will focus on dismantling a number of clean energy-related regulatory and policy policies and actions taken by the Obama administration.

Most notable among such policies is the former administration's signature climate change policy – the Clean Power Plan (CPP) rule. As detailed in last year's edition of this publication,<sup>49</sup> this rule, administered by the EPA, is a federal programme for the regulation of greenhouse gas emissions from existing power plants. The CPP has been under legal challenges since its promulgation and its enforcement was stayed by the Supreme Court in 9 February 2016, pending consummation of the judicial review. President Trump has vowed to repeal the CPP, but has not yet formally explained how this will be done. Declining to defend the CPP in court or ordering the EPA to craft a substitute rule are possible steps the administration may take. Nominating a Supreme Court justice averse to broad regulatory outreach may be yet one more course of action for the incumbent President. The President has further signalled his intent to undermine the CPP by appointing Scott Pruitt as head of the EPA. Mr Pruitt, a former attorney general for the state of Oklahoma, led the legal challenges against the CPP prior to his appointment and is expected to steer the EPA's policies accordingly.

Another major policy change concerns the United States' commitments under the 21st Conference of the Parties to the United Nations Framework Convention on Climate Change, also known as the Paris Agreement.<sup>50</sup> 188 nations have joined hands in pledging to reduce greenhouse gas emissions, each pursuant to a nation-specific action plan. The action plan adopted by the United States calls for a reduction of 26–28 per cent on 2005 levels of greenhouse gas emissions by 2025. No formal announcement or steps have been taken by the current administration to date, but according to the head of President Trump's EPA transition team, the United States will 'pull out of the Paris Agreement'.<sup>51</sup>

The Trump administration has also voiced its intention to repeal former President Obama's Climate Action Plan<sup>52</sup> – a national plan issued in 2013 outlining principal ways to cut carbon pollution, prepare the United States for climate change impacts and garner international support for global initiatives to combat anthropogenic climate change and its impacts.

In addition to repealing regulations, parts of the Trump First 100 Day Plan as well as statements made since taking office, including his inaugural speech, suggest that the current administration intends on taking affirmative regulatory steps to spur investments in infrastructure by utilising, among other means, P3 arrangements.<sup>53</sup>

On 22 October 2016, during an address in Gettysburg, Pennsylvania, then-Presidential nominee Trump announced that if he were elected he would work with Congress to introduce

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49 Robert H Edwards Jr, Randall F Hafer, Mark J Riedy, Benjamin P Deninger and Ariel I Oseasohn, Chapter 21 – United States in *The Public-Private Partnership Law Review*, p. 255 (Bruno Werneck & Mario Saadi eds., 2016).

50 Paris Agreement, 12 December 2015, available at [http://unfccc.int/files/essential\\_background/convention/application/pdf/english\\_paris\\_agreement.pdf](http://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf).

51 Nina Chestney, US will change course on climate policy, says former EPA transition head, REUTERS (30 January 2017), available at [www.reuters.com/article/us-usa-trump-epa-idUSKBN15E1MM](http://www.reuters.com/article/us-usa-trump-epa-idUSKBN15E1MM).

52 See An America First Energy Plan, [www.whitehouse.gov/america-first-energy](http://www.whitehouse.gov/america-first-energy).

53 See footnotes 34–36, *supra*.

the American Energy & Infrastructure Act, to '[l]everage public-private partnerships, and private investments through tax incentives, to spur \$1 trillion in infrastructure investment over 10 years.'

On 24 January 2017 President Trump went beyond statements, issuing an executive order titled 'Expediting Environmental Reviews and Approvals for High Priority Infrastructure Projects'. The order made specific reference to the 'US electric grid' among infrastructure deemed 'high priority'.<sup>54</sup> Although not the focal point, clean energy infrastructure and projects will ineluctably benefit from grid modernisation.

In April 2016, with large bipartisan support, the first comprehensive energy legislation was approved by the US Senate. The bill, titled 'Energy Policy Modernization Act of 2016', is designed to modernise the electric grid, catalyse investments in renewable energy and usher new clean energy jobs.<sup>55</sup> Building on Trump's surprise win and the larger Republican majority in both chambers of Congress, Republican lawmakers have expressed change in their previous support, in an effort to reshape the bill to better embody their agenda. It remains to be seen what role the Trump administration will play with respect to this bill in 2017.

It also remains unclear whether the current administration will keep in place certain federal regulations that have had a significant impact on spurring clean energy growth in the United States in recent years, such as federal grants, direct loans and loan guarantees issued by a host of governmental agencies such as the Department of Energy, Department of Agriculture, Small Business Administration and the EPA. Given the by-and-large successful record of these programmes, it seems unlikely that the President will materially undercut their budget or scope.

### iii P3 anticipated to reach financial close in 2017 (excluding clean energy projects)

Transform 66, a US\$2.5 billion multi-modal expansion of interstate 66 outside the beltway surrounding Washington, DC in northern Virginia, is set to reach financial close in July 2017.<sup>56</sup> In December 2016, the Commonwealth signed an agreement with Express Mobility Partners, a private sector consortium, to finance, design, build, maintain and operate the project under Virginia's Public-Private Transportation Act.<sup>57</sup> The project is expected to result in US\$2.5 billion in construction, US\$800 million in net present value for transit capital and operating improvements over the term, US\$350 million in net present value for other corridor improvements over the term, and US\$500 million for other corridor improvements at financial close next year.<sup>58</sup>

Phase I construction is under way on the University of California at Merced's 'Merced 2020 Project'.<sup>59</sup> The 1.2 million gross-square-foot expansion has a design and construction budget of US\$1.3 billion composed of roughly US\$600 million in UC external funding,

54 Executive Order Expediting Environmental Reviews and Approvals for High Priority Infrastructure Projects, 24 January 2017, available at [www.whitehouse.gov/the-press-office/2017/01/24/executive-order-expediting-environmental-reviews-and-approvals-high](http://www.whitehouse.gov/the-press-office/2017/01/24/executive-order-expediting-environmental-reviews-and-approvals-high).

55 S. 2012, 104th Cong. (2016), available at [www.congress.gov/congressional-report/114th-congress/senate-report/138/1](http://www.congress.gov/congressional-report/114th-congress/senate-report/138/1).

56 Transform 66, available at [www.p3virginia.org/projects/interstate-66-corridor-improvements/](http://www.p3virginia.org/projects/interstate-66-corridor-improvements/).

57 News Release, 'Governor McAuliffe Announces Selection of Private Sector Team to Finance and Deliver I-66 Outside the Beltway Project in Northern Virginia', available at: [http://outside.transform66.org/news\\_information/default.asp](http://outside.transform66.org/news_information/default.asp).

58 <http://outside.transform66.org/procurement/default.asp>.

59 <http://merced2020.ucmerced.edu/>.



US\$590.35 million in developer investment and US\$148.13 million in campus funds.<sup>60</sup> The P3 structure utilises an ‘availability payment concession’ model wherein the private developer initially finances construction up until the building is ready for use, receiving progress payments during the construction period. Once the building is ready for use, the public owner begins making payments to cover remaining capital costs, operations and maintenance costs for the balance of the agreement’s 39-year life cycle.<sup>61</sup>

A further initiative to watch in 2017 is the proposed ‘Measure M’ transportation upgrades by the Los Angeles County Metropolitan Transportation Authority (LA Metro). LA Metro has received a series of unsolicited P3 proposals to address needs identified by LA county voters in a November 2016 ballot initiative.<sup>62</sup>

#### **iv Clean energy P3 anticipated to reach financial close in 2017**

Connecticut State Colleges & Universities issued a request for proposals to finance, design, install, operate and maintain solar photovoltaic (PV) systems on building roofs and/or ground mount locations at Southern Connecticut State University (SCSU), and sell the electricity output to SCSU. The power purchase agreement will be for 20 years. Any awards arising from this request for proposal (RFP) may also be extended to other constituent units of higher education, for the installation of similarly sized PV systems at other campus locations at the rates proposed, if mutually agreed upon by both parties.<sup>63</sup>

The Chicago Infrastructure Trust initiated the Smart Lighting Project to modernise the quality and reliability of Chicago’s outdoor lighting. In addition to a large-scale conversion of the city’s existing sodium lighting to light emitting diode (LED) technology, the project will include a lighting management system and targeted repair and/or replacement of poles and wiring to enhance system reliability. The RFP was issued in April 2016, with the latest submission deadline being December 2016. Selecting a winner and financial close are expected in 2017.<sup>64</sup>

A project to create a modern streetlight system was launched in the District of Columbia on 24 January 2016, with an industry forum that attracted hundreds of potential bidders. The event marks the first significant step in a procurement by the Office of Public-Private Partnerships. The project is a joint effort with the District Department of Transportation and the Office of the Chief Technology Officer to convert the district’s streetlights to more reliable and sustainable LED technology, deploy smart city technology such as free broadband WiFi and remote monitoring of the lights, and to transfer the system maintenance to a new private sector partner through a performance-based contract for greater accountability. If progressed

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60 Ibid.

61 Ibid.

62 ‘Metro receives Unsolicited Proposal that could accelerate several Measure M projects; four additional mega project proposals under review,’ in *The Source*, 11 October 2016, available at <http://thesource.metro.net/2016/10/11/metro-receives-unsolicited-proposal-that-could-accelerate-several-measure-m-projects-four-additional-mega-project-proposals-under-review/>. For additional information on Measure M, visit <http://theplan.metro.net/>.

63 Bd. Of Regents for Higher Educ., Conn. State Colls. & Univs., Request for Proposals RFP BOR-1605 (4 April 2016), available at [www.ct.edu/files/rfp/SCSU\\_Solar\\_Photovoltaic\\_RFP.pdf](http://www.ct.edu/files/rfp/SCSU_Solar_Photovoltaic_RFP.pdf).

64 Chicago Infrastructure Tr., Mayor Emanuel Announces New Street Lights; Requests Public Feedback Before Installation (13 December 2016), available at <http://chicagoinfrastructure.org/press/>.

swiftly, winner selection and financial close could take place in 2017 or the first half of 2018.<sup>65</sup>

Massachusetts, Connecticut and Rhode Island completed the selection of winners in six request for proposal processes for the procurement of renewable energy projects. The winning projects include onshore wind projects totalling approximately 150MW and solar plants totalling approximately 300MW. The foregoing states are requiring local distribution utilities to sign power purchase agreements (PPAs) with the winners and have them submitted for approval by March 2017. Financial close of some of these projects is expected concurrently or shortly after PPA executions.<sup>66</sup>

## IV BIDDING AND AWARD PROCEDURE

### i Expressions of interest

While each state has specific procedures for P3 bidding, the Federal Highway Administration (FHWA) has created a 'P3 toolkit' containing exemplary procedures and recommendations for public entities modelled around highway projects. While not binding on any state, the FHWA recommends that the public partner solicit bids by using: 'a multi-stage "best value" procurement process. This approach initially includes a public request for qualifications, followed by a selection of qualified bidders and the issuance of a request for proposals.' Thereafter, the public entity selects a bid and negotiates with the private entity with the winning bid.

### ii Requests for proposals and unsolicited proposals

A common approach for a public entity seeking a private sector partner for a P3 is 'the 'two-step request for qualification' and 'request for proposals' to obtain a qualified pool of candidates'. Many public entities also conduct interviews with potential private partners. Some public entities even receive unsolicited bids for P3s depending on applicable regulations. For instance, Miami-Dade County allows potential private partners to submit unsolicited proposals containing specified information, as well as a fee, to contract for public works over US\$15 million. The county has a specified period of time to consider such proposals and, if selected, issues a competitive solicitation asking for proposals for the same project.

### iii Evaluation and grant

Regardless of solicitation methodology, selection of a preferred bid also can occur based on criteria 'such as the lowest net present value of gross revenues required, the shortest proposed length of the concession term, the lowest subsidy or availability payment required, or the dollar value of the offer'. Evaluation and selection of P3 bids are typically governed by procedures that achieve transparency in procurement due to the public nature of the public partner. For instance, some states require an independent review panel comprised of members from stakeholder groups to review P3 project proposals. The financial stability of all partners

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65 Off. Of Pub.-Private P'ships, Gov't of D.C., District launches Smart Lighting Project, available at [https://op3.dc.gov/sites/default/files/dc/sites/op3/release\\_content/attachments/2017.01.24%20Smart%20Lighting%20Industry%20Forum%20Press%20Release%20FINAL.pdf](https://op3.dc.gov/sites/default/files/dc/sites/op3/release_content/attachments/2017.01.24%20Smart%20Lighting%20Industry%20Forum%20Press%20Release%20FINAL.pdf).

66 See, e.g., Mass. Clean Energy website, 83D Documents, available at <https://macleanenergy.com/83d/child-page/>.

is also of great importance and ‘complete due diligence [confirming] the potential private partner’s resources and its financial viability’ is common. Most states also require contractors to maintain various levels of insurance or bonds for P3s.

## **V THE CONTRACT**

### **i Payment**

A variety of payment models have been implemented in US transportation P3s including: (1) ‘toll concessions’ whereby the private partner takes on a project in exchange for receiving tolls (the public party usually limits the rate of toll increase in some manner); (2) ‘shadow toll concessions’ whereby the private partner receives payment for each vehicle that uses the facility (sometimes payment is adjusted based on safety, congestion, or pre-established floors and ceilings); and (3) ‘availability payments’ whereby the private partner receives payment based on the availability of the facility at a specified performance level.

Two of the most important payment mechanisms are revenue-based payments and availability payments. Under revenue-based payments P3 contracts, the private entity recoups its development and construction costs from user fees generated by the asset. For example, if the asset is a road, the user fee would be the toll charged for usage. The P3 agreement typically details the structure of the toll and the extent to which the private entity can modify the toll. The contract often limits the profit of the private entity by establishing a cost-sharing structure with the government when a certain threshold is reached. On the other hand, if toll revenues are below a certain threshold, the government may be contractually required to cover the difference.

Owing to the private sector’s limited appetite to take on this market risk, availability payments have become increasingly popular. Availability payments are a means of compensating a private concessionaire for its responsibility to variously design, construct, operate and maintain a tolled or non-tolled roadway for a set period. They are made by a public project sponsor based on project milestones such as facility completion or facility performance standards such as lane closures or snow removal. Availability payments are often used for toll facilities not expected to generate adequate revenues to pay for their own construction and operation, and the public sponsor retains the underlying revenue risk associated with the toll facility.

Because availability payments also carry less overall risk to the private entity than does a full concession, a concessionaire also can rely on the public agency’s credit to secure financing or rather than unpredictable toll revenue. In a typical availability payment model, the government makes periodic payments, often contingent on the achievement of project milestones, to the private contractor over an extended period of time (often 20 to 30 years). Owing to the potential burden of availability payments on the public sector entity, should usage fall below the predicated base case model, certain states may place limits on the scope and size of availability payments.

### **ii State guarantees**

In general, US states do not offer state guarantees. Unlike P3 projects in developing countries, the solvency of the government has not historically been a serious consideration. In addition, financing for many US P3 projects is obtained through the TIFIA and similarly federally guaranteed funds.

Most state guarantees to the private entity are contractually based. The most common such guarantee is a revenue guarantee. A revenue guarantee assures a certain level of usage or revenue for a project. For example, it may guarantee the revenue generated by a toll road per year. If the actual revenue falls below this amount, the state makes up the difference. In support of the state P3s, the federal government offers various credit enhancements and in some cases guarantees.

**iii Distribution of risk**

The table below provides a comprehensive summary of the various risk sharing approaches implemented under US P3 arrangements. For each project delivery model, various functional responsibilities are shifted to the private sector. The risk transfer to the private sector increases along a spectrum ranging from the design–build project delivery model to the build–own–operate–transfer model.

<b>P3</b>	Project delivery models	Functional responsibilities and project risks
	Design–build	Final design, construction and construction inspection
	Design–build with warranty	Final design, construction, construction inspection and long-term preservation
	Operate and maintain	Maintenance and operations
	Construction management at risk	Preliminary design, final design, construction and construction inspection
	Design–build–operate–maintain	Finance, final design, construction, construction inspection, maintenance, operations and traffic revenue
	Design–build–finance–operate	Finance, final design, construction, construction inspection, maintenance, operations and traffic revenue
	Brownfield concession	Finance, maintenance, operations, long-term preservation and traffic revenue
	Greenfield concession	Finance, final design, construction, construction inspection, maintenance, operations, long-term preservation and traffic revenue
	Build–transfer–operate	Finance, preliminary design, final design, construction, construction inspection, maintenance, operations, long-term preservation and traffic revenue
	Build–own–operate–transfer	Planning, environmental clearance, land acquisition, finance, preliminary design, final design, construction, construction inspection, maintenance, operations, long-term preservation, traffic revenue and asset ownership
<b>Non-P3</b>	Traditional design–bid–build	Final design and construction
	Build–own–operate	Planning, environmental clearance, land acquisition, finance, preliminary design, final design, construction, construction inspection, maintenance, operations, long term preservation, traffic revenue and asset ownership
	Asset sale	Finance, maintenance, operations, long-term preservation, traffic revenue and asset ownership

**iv Adjustment and revision**

P3 contracts are carefully calibrated to help balance the ability of the private party to make its return on investment while simultaneously ensuring that the public service is delivered in an efficient and cost-effective manner. Accordingly, P3 contracts frequently contain adjustment of payment levels including floors to help ensure a minimum return for the private sector and ceilings designed to protect the public and avoid excess profits or over compensation to the private party. Further, in many toll P3s, there are sharing mechanisms that may be triggered by revenue or return targets.

P3 contracts frequently contain adjustment provisions for unforeseen circumstances, force majeure, change of law and other events that were beyond the reasonable contemplation

of the contracting authority and the private sector participant. Adjustment provisions also may be included and allow the public entity to request changes to the scope or timing of services or adjustments to the design of the delivered systems. When market conditions change dramatically making the assumptions underlying the original contract unworkable, it is helpful if the P3 contract itself provides mechanisms for the parties to orderly make acceptable contractual amendments.

#### **v Ownership of underlying assets**

The public sponsor generally has control of the underlying asset in US P3s:

In a P3, the public agency retains ownership of the asset or enterprise, oversight of the operations and management of the asset, and controls the amount of private involvement. Through a P3, the public sector sets the parameters and expectations for the partnership and the private sector uses access to capital markets to address the public agency's needs. If the P3 does not live up to the contractual expectations of the partnership, the public agency can regain complete control of the asset or enterprise system.

#### **vi Early termination**

With respect to early termination, most US P3 contract provisions address the following key issues: termination for public entity default; termination for developer default; termination for extended force majeure events; and termination for convenience by the public entity. P3 contracts must anticipate default, compensation for default and orderly unwinding of the P3 in the event of termination.

## **VI FINANCE**

In the US P3s are frequently financed through a combination of private (debt and equity) and public funds including federal, state and local funds. Under many P3 structures, the public entity requires that the private sector place equity at risk. In the event that the private sector fails to perform on time and or on budget, the entity may lose part or all of its equity investment.

At the centre of a P3 project is a special purpose vehicle formed to undertake the P3. Under many typical P3 arrangements, the equity investments from the investors, along with bonds and/or loans benefiting from various federal and state enhancements are used to fund the initial design, development, procurement and construction of the P3 project. That is, the necessary up-front investments required to enable the project to reach commercial operation.

Historically, there have been varied sources of equity in P3s. A recent survey determined that the sources of equity investments in P3s in the US from 2008–2013 are as follows: contractor–developer 37 per cent, fund manager 32 per cent, operator 19 per cent, and institutional direct investor 12 per cent. The funding from 'lenders' described as bonds and/or loans are usually supported by federal programmes, or benefit from tax-exempt status.

## **VII OUTLOOK**

The market for P3 projects in the US is expanding steadily in both new and traditional fields due to both diverse public infrastructure needs; and constrained public budgets (State and Federal) nationwide. As concisely stated by one commentator:

*After decades of underinvestment and an increasing population, today's infrastructure needs are large and continue to grow. Federal, state and local governments are finding it difficult to finance new projects on their own due to decreased tax revenue and shrinking budgets. These two factors have increased the political will and desire to seek alternatives to the traditional 'design-bid-build' procurement methodology. Many states and the federal government agree the P3 model maximizes value for their constituents, delivers a lower total cost, and can be delivered quicker.<sup>67</sup>*

Despite the potential of the US P3 market, the extent of its actual growth depends on the following:

- a* political cycles, particularly the implications of gubernatorial elections;
- b* the federal government's continued ability to offer loans and other forms of financial assistance in P3 transactions; and
- c* the extent to which other funding sources (e.g., gas taxes) grow and lessen the catalysts for P3.<sup>68</sup>

While the need for infrastructure development and investment in the United States remains strong – and will likely continue to be for many years – both the trend of expanding uses of the P3 model as well as the adoption of P3 enabling legislation must continue. If public owner's ability to use the P3 model grows along with their confidence in the model's success and private sector cooperation remains strong then the US P3 market will continue to grow. Based on the trends presented and analysed in this chapter it is anticipated that the US P3 market will continue to grow as the potential to do so is large.

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67 Dan McNichol, The United States: The World's Largest Emerging P3 Market (30 January 2016, 1:45 PM), [www.aig.com/Chartis/internet/US/en/FINAL%20P3%20AIG%20Whitepaper\\_tcm3171-664767.pdf](http://www.aig.com/Chartis/internet/US/en/FINAL%20P3%20AIG%20Whitepaper_tcm3171-664767.pdf).

68 Andrew Deye, US Infrastructure Public-Private Partnerships: Ready for Takeoff?, *Kennedy School Review* (27 January 2016, 10:59 AM), <http://harvardkennedyschoolreview.com/us-infrastructure-public-private-partnerships-ready-for-takeoff/>.

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Ms Añonuevo worked on the equity financing for the acquisition by the National Grid Corporation of the Philippines of the concession to operate and rehabilitate the national transmission grid and sub-transmission assets of the National Transmission Corporation. This is said to be the biggest and most significant privatisation ever to be conducted by the Republic of the Philippines.

She is currently representing the various lending syndicates that have extended or committed to extend financing for the ongoing Metro Manila Skyway – Stage 3 Project (31 billion Philippine pesos), the MCIA Project (23.3 billion Philippine pesos), the NAIA Expressway Project (7.5 billion Philippine pesos), and the MPOC Project (2.9 billion Philippine pesos) under the public-private partnership programme of the Philippine government.

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Marjolein Beynsberger holds a master's in law from the University of Leuven (2003), a master's in tax law from the same university of Leuven (2004), a master's in corporate law from the Hogeschool-Universiteit Brussel (2005) and a postgraduate degree in corporate finance from the University of Leuven (2014). She joined Liedekerke in 2004 and is a counsel mainly active in the corporate and finance practice group as she specialises in corporate law, particularly in mergers and acquisitions, private equity investments, company reorganisations, capital operations, setting up of management structures, etc., but she also provides general corporate advice to all types of companies (major listed companies, multinationals, SMEs, etc.). She has also developed an extensive practice in project financed transactions, PPP and complex projects.

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Jan Bonhage specialises in EU, constitutional and public law, as well as public procurement and state aid. He advises and represents domestic and international companies, and the public sector. Jan's practice covers major projects especially in the EU energy sector (including conventional, nuclear, offshore, renewables, networks), as well as in transport and infrastructure (including German toll collect scheme/PPP, EU subsidies for roads and infrastructure), defence and security (including military procurement), finance and healthcare areas. Recent highlights include representation in proceedings before the courts of the European Union, of the European Commission and of the German Federal Ministries. Jan has broad experience as an expert in legislative procedures, both at the federal and state level. He has been involved in a range of internal investigations, including advising on self-cleaning measures.

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Paul's experience includes advising on the introduction of new regulatory regimes, sector privatisations, restructurings, infrastructure projects and other complex government procurements. He has worked on numerous PPP projects.

Paul has expertise in the electricity market reform structures that have been developed to underpin the development of low-carbon generation in the UK, and in the IUK guarantee scheme, both derived from his work on the new nuclear power programme.

Paul has been deeply involved in Brexit-related work since the EU referendum. As well as advising clients on the implications of Brexit, he is participating in detailed discussions with various arms of the UK government charged with handling Brexit. He also sits on the 'sherpa' committee which assists the work of the Department of Business, Energy and Industrial Strategy's Professional & Business Services Council (PBSC).

He graduated with a degree in philosophy, politics and economics from Oxford University and qualified as a solicitor in England and Wales in 2003.

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Adrian spent two years inside government on secondment as a senior official during the UK rail privatisation.

He has worked in a wide variety of sectors including power, nuclear, renewables, rail, roads, aviation, telecoms, defence, technology and social infrastructure. He advised on several of the earliest UK PFI projects, helping to develop the structures which are now regarded as standard, and has gone on to develop a number of bespoke PPP and public sector procurement frameworks.

Adrian graduated with a degree in jurisprudence from Oxford University and qualified as a solicitor in England and Wales in 1988.

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Ms Corrá is a partner in the international arbitration, economic regulation and administrative law departments at M & M Bomchil. Her work focuses on regulatory practice, complex litigation and international arbitration. She regularly advises and represents foreign and domestic clients in energy matters, including assisting as counsel in deals, public procurement and conflicts related to the construction, operation and maintenance of infrastructure for public utilities, among others.

Ms Corrá has a master's degree in administrative law from Universidad Austral and is a professor of administrative law at the School of Law of Universidad de Buenos Aires and a professor of economic regulation in the master's and specialisation courses at Universidad Católica Argentina. She is also a member of the Energy Law Committee at the Bar Association of the City of Buenos Aires and member and secretary of the Investment Arbitration Committee of the Latin American Arbitration Association (ALArb).

Ms Corrá has received the distinction of several well-regarded international publications such as *Latin Lawyer* and she has been lauded by *Chambers and Partners*, *LACCA*, *Best Lawyers*, *Lawyer Monthly* and *Corporate INTL* magazine, among others, for her practice in public law and arbitration.

## **DAVID DONNELLY**

*Allens*

David is one of Australia's leading infrastructure lawyers. He also has significant experience advising on resource development projects and project financing transactions.

David's practice includes: advising on the origination of new infrastructure (including PPPs and other competitive bid processes); ongoing advisory roles on the delivery and operational aspects of successfully closed PPPs and major infrastructure projects; and advising on secondary market investments and acquisitions.

David's infrastructure experience covers rail, roads, health, justice and prisons, mining and resources, telecoms, water, education, defence, energy and entertainment.

## **MARY DUNNE**

*Maples and Calder*

Mary Dunne is a partner in the Dublin office of Maples and Calder, and has specialised in public procurement law and infrastructure projects for over 20 years in both the public and private sectors. She acts as an expert to the OECD and World Bank on public procurement and PPPs and has advised many governments in that role, including most recently the governments of Ukraine, Jamaica, Morocco, Turkey and Montenegro.

## **ROBERT H EDWARDS JR**

*Kilpatrick Townsend & Stockton LLP*

Robert H Edwards Jr is a partner at Kilpatrick Townsend & Stockton LLP resident in Washington, DC. Mr Edwards is co-head of the energy, project finance and clean technologies practice. In this role he collaborates with colleagues to bring innovative structuring and financing solutions to technology and energy companies clients of the firm.

During his more than 25-year career as a practising attorney, senior presidential appointee in the US Department of Energy, and as an executive with the JP Morgan Global Commodities Group in New York City, Mr Edwards has closed more than US\$10 billion in energy, infrastructure and auto industry project financings. His clients include developers, contractors, utilities, equity investors and other project participants. He counsels a wide range of energy-storage, solar and smart grid companies. He played a leading role in the deployment of more than US\$35 billion into the US clean-energy sector during the American Recovery and Reinvestment Act (2009–2011). He is recognised as a leader in clean and renewable energy finance and policy.

In 2015, Mr Edwards was one of 20 professionals nationwide selected to participate in the National Renewable Energy Executive Program (NREL EnergyExecs). In 2016, Mr Edwards was selected as a Washington, DC Super Lawyer in the areas of energy and natural resources and utilities.

Mr Edwards received his JD from Stanford Law School where he was an associate managing editor of the *Stanford Journal of International Law*, an MBA from the Stanford Graduate School of Business, and an AB *magna cum laude* in economics from Harvard University where he was a John Harvard Scholar for all semesters during his undergraduate career.

## **RANDALL F HAFER**

*Kilpatrick Townsend & Stockton LLP*

Randall F Hafer is a senior partner and leader of Kilpatrick Townsend's construction & infrastructure projects team. The team was named 2015 Construction Team of the Year by *Chambers USA*, 2012 Team of the Year by *US News – Best Lawyers*, and is consistently ranked Tier 1 nationally by *Chambers*, *Best Lawyers* and *The Legal 500*. Throughout his entire career Mr Hafer has focused his practice exclusively on issues related to the construction industry. He has been involved in matters in most of the 50 states and internationally on a wide variety of construction projects, including tunnels, wastewater treatment plants, airports, power plants,

mass transit systems, mining facilities, bridges and highways, hospitals, office buildings, sports arenas, resort condominiums, universities and schools, manufacturing and processing facilities and military facilities. He is a panel member on the AAA's roster of arbitrators and mediators, a fellow of the American College of Construction Lawyers (ACCL), a member of the International Institute for Conflict Prevention and Resolution (CPR) Construction Advisory Committee, and the primary author of *Dispute Review Boards and Other Standing Neutrals, Achieving 'Real-Time' Resolution and Prevention of Disputes* for CPR.

### **CHRISTIAN F HENEL**

*Kilpatrick Townsend & Stockton LLP*

Chris Henel advises and assists government contractors regarding a wide array of issues including front-end compliance questions and reviews, proposal preparation, bid protests, claims, disputes, and appeals. He works with contractors across several industries, including construction, infrastructure, aerospace and defence, healthcare, and information technology. Mr Henel's regulatory compliance experience includes advising government contractors on how to comply with various contractual obligations, federal laws, regulations, policies, and standards that govern their relationship with federal, state and local governments. He counsels clients on ethics, small business issues, socioeconomic regulations, and labour and employment matters as they affect government contractors. Mr Henel's transactional practice includes counselling clients on P3 legislation, regulations, and development opportunities.

### **FEDERICO HERNANDEZ A**

*Hogan Lovells BSTL, SC*

Federico Hernández has extensive experience counselling clients on administrative, government contracts, public-private partnerships (PPPs), telecommunications, infrastructure, and commercial matters. Clients in industries including transportation, infrastructure, technology, media and telecoms, and non-governmental organisations turn to Federico for his creative approaches and his ability to put together the right legal team.

In addition to handling government contracts and PPP projects, Federico has worked in-house at Mexico's former telecoms commission, so he has first-hand knowledge of complex regulatory issues for, among others, telecommunications and the administrative sector. Therefore, he helps clients with regulatory, commercial, public procurement and administrative transactions.

Nowadays, Federico represents procurement companies, resellers, infrastructure, and equipment providers before regulators on various matters, so he is able to advise major local and foreign companies in their daily operations in Mexico. He has also actively participated with various clients in obtaining public contracts published under local or federal regulations.

Federico also has an exceptionally strong experience in obtaining regulatory authorisations for, among others, allowing foreign air carriers making flights to Mexico and operation of unmanned aircraft systems. Likewise, he has developed a strong reputation of defending his clients' interests and is willing to face the most challenging issues with public and private situations.

National and international companies call on Federico to help them navigate the regulatory, administrative and public procurement procedures challenges and other hurdles involved in establishing and maintaining operations in Mexico. His unique perspective and experience in working with both public and private clients allows him to provide practical

and efficient solutions to legal and business problems. He is focused on collaborating with clients to understand the public sector and get favourable business results.

### **KARIN BASILIKI IOANNIDIS EDER**

*Parquet & Asociados*

Ms Ioannidis Eder studied law in England and graduated from the University of East Anglia, Norwich in 1996 with an LLB (Hons) in law and European legal systems. In Paraguay, she graduated from the Faculty of Law of the National University of Asuncion in 1999, obtaining a degree as a practising lawyer.

Her professional experience includes working for two prestigious law firms in Asuncion. From 2000–2010 Ms Ioannidis Eder worked as internal legal telecommunications counsel, legal manager and institutional relations manager for a local telecom company wholly owned by the world-leading telecom company Hutchison Telecommunications Limited and later acquired by America Movil SA de CV – AMX, thus specialising in telecommunications, corporate law and administrative law.

In 2012 Ms Ioannidis Eder joined Parquet & Asociados in charge of telecoms and national and international corporate clients. She participated in the drafting of the recent Antitrust Law and Law No. 5102/2013 on ‘Investment promotion in public infrastructure and the expansion and improvement of goods and services provided by the state’ – the law regulating public-private partnerships – and its Regulatory Decree.

### **FRANK JUDO**

*Liedekerke*

Frank Judo is a partner in the regulatory practice group, where he regularly advises private businesses and public authorities on various aspects of public procurement law, both preventive and curative. He also assists business and private individuals in their legal relations with government in the broad framework of constitutional and administrative law, particularly in the field of administrative economic law and public law. His practice encompasses both advisory work and litigation, before both the Constitutional Court and the Council of State, while focusing on prevention through in-depth advice. Frank holds a law degree from the University of Leuven (KU Leuven 1998), where he also studied philosophy, modern history and canon law. He is still a voluntary academic assistant at the Institute for Constitutional Law at the KU Leuven, having been a lecturer between 1998 and 2004.

### **LENE LANGE**

*LETT Law Firm P/S*

Partner Lene Lange has for several years now worked with Henrik Puggaard on PPP projects and to date she has been a central legal adviser to bidding consortiums on approximately 20 Danish PPP projects. Lene is specialised in complex contracts, including PPP contracts, consortium agreements, construction contracts and plant agreements.

## **XIMENA DARACT LASPIUR**

*M & M Bomchil*

Ximena Daract Laspiur graduated with honours from the Universidad Católica Argentina School of Law in 2015 and she is a member of the arbitration and administrative and regulation law departments at M & M Bomchil.

## **OLIVIER LE BARS**

*White & Case*

Olivier Le Bars is an associate in the energy, infrastructure and project finance group of the Paris office. His principal field of expertise is project finance in particular in relation to public procurement law, energy law and construction law.

## **TIMOTHY LESCHKE**

*Allens*

Timothy has advised government and private sector clients throughout the life cycle of major infrastructure and transport projects – from advising on procurement issues, to drafting and negotiating various contract models (including PPPs), and through to delivery, contract administration, claims management and dispute resolution. He has worked on a broad range of major infrastructure projects across Australia, including the New Generation Rollingstock PPP, the Gold Coast Rapid Transit light rail PPP, the ACT Capital Metro light rail PPP, the Legacy Way tunnel, the Forrestfield-Airport Link, the WestConnex Motorway and the A\$10.25 billion long-term lease of TransGrid.

## **ARLENE M MANEJA**

*SyCip Salazar Hernandez & Gatmaitan*

Arlene M Maneja is a member of the firm's special projects, banking, finance and securities and alternative dispute resolution departments. She has been involved in rendering regulatory, transaction and business advice, conducting due diligence and documenting high-value deals involving investments, acquisitions and divestments, capital/corporate restructuring, commercial lending and project financing in, among others, public infrastructure, power/energy, oil and gas, and mining.

She has been active in the bidding, implementation and financing of Philippine PPP projects and her projects include the bidding and financing of the Manila LRT1 Extension, Operations and Maintenance Project, the bidding of the MCI Project, the LRT2 Operations and Maintenance Project, the Bulacan Bulk Water Supply Project and the Regional Airports Project. She has also advised leading Philippine conglomerates on their involvement in other PPP projects, including the Metro Rail Transit Line 3 and the NLEx-SLEx Connector Road Project.

Aside from her legal practice, Ms Maneja has acted as consultant to a number of firms in relation to industry studies, feasibility and business plans, marketing and branding strategy, as well as business model formulation in the telecommunications, outsourcing, retail and technology industries.

## **BIBITAYO MIMIKO**

*G Elias & Co*

Bibitayo Mimiko is an associate in G Elias & Co. She holds a master of law degree from the London School of Economics. She is a member of G Elias & Co's corporate team.

## **NICHOLAS NG**

*Allens*

Nicholas specialises in the procurement, delivery and operation of major infrastructure projects. He acts for project owners, financiers, sponsors and contractors across a broad range of sectors and delivery models, with a particular emphasis on public-private partnerships and other major outsourcing transactions. He has advised clients on many of the country's largest and most significant infrastructure projects.

## **SHIGEKI OKATANI**

*Mori Hamada & Matsumoto*

Shigeki Okatani has expertise in public-private partnerships, particularly airport, toll road and water concessions, renewable energy projects, real estate law and financial regulations. He has advised domestic and foreign investors and banks on renewable energy projects, and sponsors and banks in PPP projects. He is a core member of the firm's energy and infrastructure practice group. Shigeki Okatani was educated at the University of Tokyo and Virginia University Law School, and was previously seconded to the Ministry of Economy, Trade and Industry of Japan.

## **OKECHUKWU J OKORO**

*G Elias & Co*

Okechukwu J Okoro is an associate in G Elias & Co. He holds a degree in law from Ebonyi State University, Abakaliki. He is a member of G Elias & Co's project finance team.

## **FRED ONUOBIA**

*G Elias & Co*

Fred Onuobia is the managing partner of G Elias & Co. He holds a master of law degree from University College, London. His areas of practice include securities, banking and project finance law. He's recognised as a leading lawyer by *IFLR 1000*, *Chambers Global* and *The Legal 500*. Among other transactions, Fred Onuobia led the G Elias & Co team that advised the lenders on the Lekki-Epe Toll Road Project financing and the syndicated financing for the development of MMA2 airport terminal (Nigeria's first private airport terminal).

## **ARIEL I OSEASOHN**

*Kilpatrick Townsend & Stockton LLP*

Ariel Oseasohn is an energy transactions analyst in the firm's energy, project finance and technology team. His practice focuses on the development and financing of projects in the clean and renewable fields, including solar-thermal, photovoltaics, biofuel, bio-chemicals and natural gas fired facilities.

Prior to joining the firm, Mr Oseasohn worked as an associate for Yigal Arnon & Co in Jerusalem, Israel, where he counselled governmental, regulatory, and private sector actors in the renewable energy and infrastructure spaces. Ariel has extensive experience in advising on all facets of renewable energy projects, from the procurement through the development and financing (including within a public-private-partnership setting) stages thereof. Ariel received his LLB from the Hebrew University of Jerusalem, is an LLM candidate at Georgetown University Law Center and is a member of the Israeli and New York Bar Associations. Ariel is also licensed as a special legal consultant in the District of Columbia.

## **JAVIER MARIA PARQUET VILLAGRA**

### *Parquet & Asociados*

Dr Javier Parquet graduated with honours from the Faculty of Law of the National University of Asuncion in 1987. Then, in 1989 he obtained a master of laws (LLM) at Harvard Law School, USA. Dr Parquet is senior partner of Parquet & Asociados and he is currently a professor of administrative law at the National University of Asuncion.

Dr Parquet has provided legal counselling to a number of international companies in different fields including: Time Warner Entertainment Company LP, Twentieth Century Fox Film Corporation, Twentieth Century Fox Home Entertainment, Inc, Disney Enterprises, Inc, Paramount Pictures Corporation y Universal City Studios, Inc, Fox Latin American Channel, Inc, Turner Broadcasting System Latina America, Inc and HBO Ole Partners.

As a specialised external legal consultant, Dr Parquet has advised in numerous technical and financial assistance projects in favour of the Paraguayan government, under international cooperation agreements celebrated with the Inter-American Development Bank, World Bank, USAID, United Nations Development Program, the government of Japan and EU representatives in Paraguay.

Dr Parquet provides legal services to government agencies such as the Central Bank of Paraguay, the presidency or executive branch, the Ministry of the Treasury and the Social Welfare Institute. As an external consultant he has participated in drafting several laws and regulatory decrees and most recently Law No. 5102 on 'Investment promotion in public infrastructure and the expansion and improvement of goods and services provided by the state' and its Regulatory Decree.

## **TACIANA PEÃO LOPES**

### *Taciana Peão Lopes e Advogados Associados*

Taciana Peão Lopes has 17 years of experience providing legal and regulatory advice to private companies, government agencies and state-owned corporations throughout Mozambique. She has a solid understanding of PPP laws in Mozambique, which experience includes initiatives such as BOT, BOOT, DBOOT, foreign investment, project financing, and public tenders in the areas of mining, energy, oil and gas, transport, port, rail, tourism and commercial infrastructure.

Her main areas of work are oil and gas, energy, mining and infrastructures legislation and she is an expert on concession matters related to these sectors.

Taciana has been involved in major infrastructure projects in Mozambique, namely public infrastructure projects and other forms of public-private collaboration and private finance initiatives, having advised the two first PPP concessions in the country after the



approval of the PPP Law and the PPP Regulations (with an investment amount of more than US\$3 billion).

Sources describe Taciana Peão Lopes as a Mozambican regulatory expert who is ‘smart and reasonable. She knows how to get deals done.’

Taciana has been involved, as a legal adviser, in several infrastructure, energy, oil and gas, and mining projects, including railway and port concessions, road concessions, IPPS, and more recently in the discussion and drafting of the legal regime applicable to the LNG Project in Northern Mozambique.

Taciana Peão Lopes has also a strong academic background providing training in arbitration and commercial law and as a researcher with several publications related to the judicial reforms and policies and the drafting of legislation.

## **DANA PORTER**

*Stikeman Elliott LLP*

Dana Porter is a Toronto-based partner in Stikeman Elliott’s commercial real estate practice. He is a member of the firm’s project development and finance, structured finance and financial products, and bankruptcy and insolvency groups, and is a former member of the management committee of the firm’s Toronto office. Dana’s practice encompasses most aspects of commercial real estate, with an emphasis on acquisition and financing of income properties, structured and project finance, public-private partnerships and other public sector transactions. He represents a number of institutional investors, lenders and advisers – both domestic and international – as well as public-sector entities and private-sector suppliers of services and materials to the public sector.

Dana has been recognised as a leading practitioner by *Best Lawyers in Canada* (for real estate law), in Lexpert’s special edition on *Canada’s Leading Infrastructure Lawyers*, and by *The Canadian Legal Lexpert Directory* (for property leasing). He has also been recognised as a leading lawyer in Legal Media Group’s *Expert Guides: Real Estate*, and in *Chambers Global: The World’s Leading Lawyers for Business*.

## **MANUEL PROTÁSIO**

*VdA Vieira de Almeida*

Manuel Protásio was born in Lisbon and graduated in law in 1984 from the College of Law of the Portuguese Catholic University in Lisbon.

He worked on secondment at a Deutsche Bank investment bank subsidiary in Lisbon for approximately one year and has been involved in project finance matters since 1992.

He joined VdA in 1991 and is currently one of the partners in charge of the projects – infrastructure, energy and natural resources practice group. In such capacity he has participated and/or led the teams involved in the most relevant transactions carried out in Portugal to date on the power (including the renewable energies), oil and gas, road, transport, water and wastes sectors. He has also been actively working in regulation and public procurement procedures of those sectors.

Manuel Protásio is admitted to the Portuguese Bar Association.

## **HENRIK PUGGAARD**

*LETT Law Firm P/S*

Partner Henrik Puggaard is specialised in PPP and has been engaged in this industry from its very beginning in Denmark back in the early noughties and has been a central person in the development of the PPP-model and contract templates. Henrik is primarily adviser to private bidding consortiums, including pension funds, major construction companies and operators, and as such he has been involved in almost all Danish PPP projects. As a result, he is among the most experienced legal advisers within the PPP areas, both when it comes to financing agreements and handling of contractual risk management and risk allocation towards the public party and within the bidding consortium. In addition, Henrik Puggaard has advised and assisted some of the largest pension funds in Denmark in connection with setting up an investment cooperation agreement concerning future building-related projects within PPP. The agreement implies that up to 5 billion kroner may be invested in building-related PPP projects within the coming years.

Henrik Puggaard has been recommended as a leading lawyer by one of the major international ranking institutes, *Chambers and Partners*, which says: 'Henrik Puggaard is acknowledged for his comprehensive knowledge of PPP projects and public procurement. He is noted for his work in sizeable infrastructure projects in recent years.' (2010) 'Henrik Puggaard [...] is "a switched-on, fast and commercial lawyer", and is known as "one of the foremost experts on PPP projects.'" (2011). 'Sources agree that key partner Henrik Puggaard is highly skilled in conflict resolution and case preparation, and single him out as "one of the best PPP lawyers here in Denmark".' (2012).

## **FREDERICO QUINTELA**

*VdA Vieira de Almeida*

Frederico Quintela was born in Lisbon and graduated in law in 2001 from the College of Law of Lisbon University.

He became a postgraduate in corporate law in 2004 from the College of Law of the Portuguese Catholic University in Lisbon, and in 2012 he completed an LLM in international business law at the Global School of Law of the Portuguese Catholic University, in Lisbon.

He joined VdA as a trainee in September 2001 and currently he is a managing associate in the oil and gas and projects – infrastructure, energy and natural resources practice groups. At VdA, he has been actively involved in or led several transactions, mainly focused on the infrastructure, healthcare or energy sectors and acting either as legal adviser to the grantor, the sponsors or the lenders. Between 2012 and 2013 he was seconded to Pinheiro Neto Advogados, in Brazil.

Frederico Quintela is admitted to the Portuguese Bar Association and to the Brazilian Bar Association.

## **VASANTH RAJASEKARAN**

*Seth Dua & Associates*

Vasanth Rajasekaran is a partner at Seth Dua & Associates. He has considerable expertise in relation to international arbitration, infrastructure projects (roads, power, airports, ports, railways, water and sanitation), defence, aerospace and aviation, PPP projects, procurement law and general litigation. He has advised many foreign companies on Indian procurement

law and policies in several key infrastructure PPP projects across various sectors. He recently advised the Indian government's Ministry of Finance on the procurement process, and has also drafted the procurement manual for their *sui generis* socio-economic PPP. He has recently been retained by the Indian government's Ministry of Housing to draft a model concession agreement for various PPP models to implement the prime minister's affordable housing scheme.

## **ERIK RICHER LA FLÈCHE**

*Stikeman Elliott LLP*

Erik Richer La Flèche is a transaction lawyer, based in Stikeman Elliott's Montreal office, who is qualified to practise in Quebec (1979) and Ontario (1987), Canada. He has advised corporations, lenders and governments on M&A transactions and large capital projects (e.g., infrastructure, mining, electricity, and oil and gas) in more than 35 countries. Erik has worked on most Quebec PPPs, including the first (the award-winning A25 toll road and bridge) and the largest (the award-winning CHUM hospital PPP). He also assisted Infrastructure Ontario in connection with its first road PPP, the Honourable Herb Gray Parkway. Erik is recognised in the following publications: *Chambers Canada: Canada's Leading Lawyers for Business 2017* in Projects: PPP & Infrastructure, International Financial Law Review's *IFLR1000: The Guide to the World's Leading Financial Law Firms 2017*, in project finance, *The Best Lawyers in Canada 2017* in project finance law, energy law and energy regulatory law, *The Canadian Legal Expert Directory 2016* in project finance, infrastructure, mining and energy (electricity), *Expert Special Edition – Canada's Leading Energy Lawyers*, November 2016, *Expert Leading Canadian Lawyers in Global Mining*, special edition, October 2016, Legal Media Group's *Expert Guide to the World's Leading Banking Finance and Transactional Lawyers 2016* in the project finance sector, *Chambers Global: The World's Leading Lawyers for Business 2016* as a recommended lawyer in Projects: PPP & Infrastructure, *Who's Who Legal: Government Contracts 2016* and *Expert Canada's Leading Infrastructure Lawyers*, special edition, September 2016.

## **MARK J RIEDY**

*Kilpatrick Townsend & Stockton LLP*

Mark J Riedy is a partner at Kilpatrick Townsend & Stockton LLP in Washington, DC and co-leads its energy, project finance and clean technologies practice team. For more than 37 years, he has focused his practice on complex project development and finance, private placement, M&A, investment fund structuring and related investments, and regulatory and legislative compliance representation in more than 60 countries worldwide for renewable and conventional energy and chemicals, clean energy technology, energy storage, data centre, environmental and infrastructure clients. His clients represent developers, lenders, EPCs, O&Ms, equipment providers, private equity, venture capital and infrastructure funds.

Mr Riedy received his JD from the Georgetown University Law Center and graduated Phi Beta Kappa and *summa cum laude* from the University of Michigan with a BA. He has received numerous awards over his career including Biofuels Digest as a Top 100 World Bioenergy Leader (#42 in 2015–2017, #49 in 2014–2015, #56 in 2013–2014, #50 in 2012–2013 and #67 in 2011–2012), Legal Leaders as one of Washington, DC & Baltimore's Top Rated Lawyers for Business and Commercial Law (2011–2016) and Martindale-Hubbell as an AV Pre-eminent rated attorney (past 20 years). Mr Riedy also is one of the five founders

and General Counsel of the American Council On Renewable Energy (2001–present) and is the Vice Chairman of the American Bar Association’s Project Finance and Program Committees in the Energy, Environment and Natural Resources Section (2010–present).

## **MARC ROBERTS**

*Hengeler Mueller Partnerschaft von Rechtsanwälten mbB*

Marc Roberts has a broad public law practice with a particular focus on regulated industries. He advises and represents investors, companies and entities of the public sector in all public law and regulatory matters. Marc advises in public procurement and state aid procedures, including EU law. Marc’s practice covers internal investigations, including advice on self-cleaning measures, projects especially in the energy sector as well as in transport and infrastructure (including German toll collect scheme/PPP and inner-city advertisement contracts), finance and healthcare areas. Marc is an experienced litigator representing clients in administrative proceedings and legal disputes in all instances before specialised courts.

Marc studied in Greifswald (*Dr iur*) and Montreal. He was admitted to the German Bar in 2011 and joined Hengeler Mueller in that same year. In 2016, Marc was seconded to the New York law firm Cravath Swaine & Moore.

## **FERGAL RUANE**

*Maples and Calder*

Fergal Ruane is a senior associate in the Dublin office of Maples and Calder. He has spent over 15 years advising both private and public clients on public procurement, construction, infrastructure and commercial projects.

## **MÁRIO SAADI**

*Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados*

Mário Saadi received a law degree from Fundação Getúlio Vargas and a master’s degree in administrative law from Pontifícia Universidade Católica de São Paulo. Mr Saadi is currently working towards his doctorate degree in administrative law at Universidade de São Paulo.

Mr Saadi has broad experience with concessions, PPPs and other infrastructure projects, and financing, focusing his practice on the logistics sector, including ports, airports, roads, railways, and underground transportation.

He is also a member of the Federal Council for Infrastructure of the Brazilian Bar Association, an arbitrator in the Chamber of Arbitration and Mediation for the Paraná Industries Federation and author of the book *Private Initiative Procedures in the Brazilian Legal System*.

## **ANA MARÍA SABIOTE ORTIZ**

*Uría Menéndez*

Ana Sabiote is an associate in the Madrid office of Uría Menéndez. She joined the firm in 2007 and is a member of the public and environmental law practice areas. Ms Sabiote focuses her practice on administrative litigation, public procurement law, mining, subsidies and expropriation. She advises domestic and foreign clients and regularly participates in

M&A projects involving dealing with infrastructure issues. She has been involved in advising sectorial associations in the developing of new projects with regard to PPP.

### **MASANORI SATO**

*Mori Hamada & Matsumoto*

Masanori Sato is the head of MHM's banking and structured financing practice group. He advises across the board on international and domestic structured finance transactions, including PFIs, project finance, REITs and syndicated loans. He has led MHM teams on a number of high-profile transactions, including the first Japanese publicly offered CMBS transaction, the securitisation of public loans originated by the Japanese government and whole business securitisations in a number of sectors. Masanori Sato was educated at the University of Tokyo and the University of Chicago Law School.

### **SUNIL SETH**

*Seth Dua & Associates*

Sunil Seth is a co-founder and senior partner at Seth Dua & Associates with professional experience that spans over 25 years of advising multinational and Indian corporations in setting up business operations in India as joint ventures or wholly-owned subsidiaries, either as greenfield projects or through the M&A route. He has advised clients in sectors as diverse as aerospace, defence, automotive, industrial, engineering, consumer goods, infrastructure, construction, real estate, hospitality, healthcare, power, oil and gas, water, roads and transport. He has extensive experience in PPP projects across various infrastructure sectors. He regularly advises clients on procurement laws, policies and regulations across various sectors. He has delivered papers at various international conferences and has contributed articles to leading international publications and journals.

### **YUSUKE SUEHIRO**

*Mori Hamada & Matsumoto*

Yusuke Suehiro is a senior associate active in the finance practice group of Mori Hamada & Matsumoto. He is also a core member of the firm's energy and infrastructure practice group. He focuses on PPPs/PFIs, project finance, leveraged finance, securitisation and other bespoke structured finance transactions. He has advised a wide range of borrowers and issuers, as well as major banks and securities companies as lenders or arrangers in both domestic and cross-border transactions. Yusuke Suehiro was educated at the University of Tokyo and the University of Chicago Law School.

### **HUI SUN**

*Zhong Lun Law Firm*

Hui Sun is a partner at Zhong Lun Law Firm. She has provided legal services in the area of infrastructure and public utilities for 20 years and has particular experience in projects applying the PPP model. She has provided legal services in a number of important, large-scale projects. Her legal practice covers water, sewage treatment, solid waste, gas, roads and bridges, undersea tunnels, smart cities, new city development, fire power, clean energy, etc. She mainly provides legal services to domestic and foreign investors and also represents the

government in some other cases. Ms Sun has an in-depth understanding of the requirements of each party in all stages of infrastructure and public utility projects and cultivates providing one-stop legal services in this field.

She is listed as a leading individual for projects and infrastructure in *Chambers Global* and *Chambers Asia-Pacific* and is listed as one of the China's top 100 lawyers by *China Business Law Journal*.

Ms Sun received her LLB (1992) and LLM (1995) from Peking University. She is a member of the Beijing Lawyers Association.

## **JAMIE TEMPLETON**

*Stikeman Elliott LLP*

Jamie Templeton is a partner in Stikeman Elliott's Vancouver office with a practice in the areas of project finance, public-private partnerships (PPPs) and banking. Since 2001, he has advised on PPP transactions in the UK, Europe, Australia and Canada. He has extensive experience advising procuring authorities, sponsors and funders in PPP projects and also regularly advises lenders and borrowers in connection with loan financings and secured transactions. Jamie is recognised by the 2017 *Chambers Canada* guide in the area of Projects: PPP & Infrastructure. He is also recognised in the International Financial Law Review's IFLR100: The Guide to the World's Leading Financial Law Firms 2017 as a Rising Star in Banking. Prior to moving to Canada, Jamie was a lawyer in Scotland and Australia.

## **JIRAPAT THAMMAVARANUCUPT**

*Weerawong, Chinnavat & Peangpanor Ltd*

Jirapat Thammavaranucupt is an associate in the mergers and acquisitions practice group at Weerawong C&P. He has substantial experience advising domestic and international clients on capital markets, mergers, acquisitions and public-private partnerships (PPPs). He recently advised the Asian Development Bank on public procurement and the Ministry of Finance on PPPs in Thailand. He is a regular speaker at training sessions on PPPs, corporate governance and anti-corruption law arranged by the Thai Institute of Directors and national law schools.

## **FRANÇOIS-GUILHEM VAISSIER**

*White & Case*

François-Guilhem Vaissier is a partner in the Paris office's energy, infrastructure and project finance team. His practice mainly includes private sector participation and all aspects of the structuring, procurement and financing of energy, infrastructure and industrial projects.

An expert in public and construction law, François-Guilhem Vaissier has managed the negotiation and drafting of project documentation relating to large transactions in France (railways, motorways, road tunnels, airport operations, co-generation plants, wind farms), Europe (underwater tunnels, water and wastewater concessions), Africa (hydro-power plants and aluminium smelter projects, coal-fired power plants, cement plants, motorway concessions, mining concessions, free-zone areas, oil production sharing agreements and privatisation of a national air carrier), Asia (first public-private partnership for a metro project in India) and the Middle East (airport BOT, real estate financing).

## **AURÉLIEN VANDEBURIE**

### *Liedekerke*

Aurélien Vandeburie holds a PhD in law from Namur University (2013) and is a lecturer at the University of Brussels for the administrative law course and for the public health law course. He is also a teacher on the introduction to public law course at the ICHEC Brussels Management School. His PhD thesis was on public property and state lands. He specialises in administrative law, with particular emphasis on public tenders, public contracts, PPPs, public assets and economic public law.

## **CHRISTEL VAN DEN EYNDEN**

### *Liedekerke*

Christel Van den Eynden is a partner in the corporate and finance practice group and is a member of the board of Liedekerke. She specialises in mergers and acquisitions, project finance and complex projects (including PPPs). Christel's recent PPP expertise includes, among others, the A11 project, Livan I (closed December 2012), Bus Depots Cluster II projects (closed in January 2015), the Haren Prison project (ongoing), Spartacus (ongoing), Brussels Stadium (UEFA 2020) (ongoing), etc. In addition to her law degree from the University of Antwerp (1987), Christel has a master of arts in international relations from the Johns Hopkins University Paul H Nitze School of Advanced International Studies (Bologna, Italy, and Washington, DC) for which she was awarded a Fulbright Scholarship.

## **MANUEL VÉLEZ FRAGA**

### *Uría Menéndez*

Manuel Vélez is a partner in the Madrid office of Uría Menéndez. He joined the firm in March 2003 and is a member of the public and environmental law practice areas.

He regularly advises public and private entities on all aspects of public law (sanctioning procedures, public procurement, payment management before public authorities, energy, public infrastructures, telecommunications, authorisations and permits, liability of public authorities, subsidies, public property, constitutional law, anti-money laundering, etc.). He regularly appears before Spain's contentious-administrative courts and the Constitutional Court. In the 2015 edition of *Iberian Lawyer* he was named one of the top 40 lawyers under the age of 40 in Spain and Portugal.

## **BRUNO WERNECK**

### *Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados*

Bruno Werneck received a bachelor's degree in law from the Universidade de São Paulo and an LLM degree from Columbia University, where he was a Fulbright Scholar.

He previously served as an assistant to the President of the Brazilian antitrust agency, CADE; a consultant for OECD; an international associate with Cleary Gottlieb Steen & Hamilton in New York; and a partner at Mayer & Brown in São Paulo. He has taught public law and corporate law at Universidade Federal do Rio de Janeiro, Instituto Brasileiro de Mercado de Capitais and Fundação Getulio Vargas in São Paulo. He is a member of the São Paulo Bar Commission on Corporate Governance and Infrastructure and the author of many articles on regulatory issues and government procurement.

Mr Werneck focuses his practice on the infrastructure, mining and energy sectors. He advises domestic and foreign clients in project development, concessions, public-private partnerships, joint ventures and mergers and acquisitions in the infrastructure, mining and energy sectors. He has in-depth knowledge and experience representing clients in their negotiation of construction, supply, take or pay and other complex agreements. His practice includes negotiating with regulatory agencies and government authorities to obtain permits and approvals and to obtain tax benefits and with Brazil's Development Bank (BNDES), multilateral development banks and commercial banks to obtain financing. He has been involved in leading privatisations, concessions and PPP structures in Brazil.

## **DAVID WYLES**

*Herbert Smith Freehills LLP*

David is a senior partner at Herbert Smith Freehills in London. He has over 25 years of experience acting for banks and sponsors on projects and financings.

He advises on financings across a wide range of infrastructure and energy assets, including roads, rail, airports, renewables, gas and electricity transmission and distribution, telecoms, water and PFI/PPP.

He is listed as a leading individual for Infrastructure (UK) (*Chambers 2017*). David graduated with a degree in Anglo-French law from King's College London and a *Maitrise in droit privé* from the Sorbonne-Pantheon Paris and qualified as a solicitor in England and Wales in 1989.

## **NICHOLAS ZERVOS**

*VELMA Law*

Nicholas Zervos is a partner at VELMA Law and a senior commercial transactional lawyer with expertise in international corporate matters and project and structured finance, particularly in East Africa, the United Kingdom and central and eastern Europe.

Nicholas has lived and worked as a lawyer in Dar es Salaam since November 2006. Before then he was a senior partner with a major firm in London (and Hong Kong), advising sponsors and banks on commercial and financing agreements for infrastructure projects in developed and emerging markets. His areas of specialism include commercial law, project finance, finance and corporate law.

Nicholas has a law degree from the University of Nottingham, and is admitted to the English, Tanzanian and Hong Kong bars. Nicholas is a member of the Law Society of Tanganyika and the Law Society of England and Wales.

## **JULIO ZUGASTI GONZÁLEZ**

*Hogan Lovells BSTL, SC*

Julio Zugasti advises on government contracts, helping clients look for opportunities in both state and federal public procurement matters including PPP projects. He has represented foreign and national clients involved with extensive public bids and direct awards at all levels of government. He has worked with companies in the preparation of public bid proposals through to the awarding of the contract, so he is able to assist clients on the challenges regarding public bid guidelines and public procurement awards.



Julio has experience working on corporate matters, which helps him to understand opportunities for clients within government contracts and administrative matters. Julio sees how government contracts, anti-corruption issues, and general business matters affect one another. Julio has helped clients resolve contract enforcement problems as painlessly as possible, and has been able to improve relationships between clients and public entities.

Julio has advised a worldwide IT company on a major government contract procedure with the Ministry of Finance for a long-term relationship. He has represented various companies in the public procurement procedures regarding Mexico City New International Airport and rail transportation.

Julio is dedicated to giving back to his community and has participated in activities in support of the Community Investment Program of the Mexico City office.

## Appendix 2

# CONTRIBUTING LAW FIRMS' CONTACT DETAILS

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