Middle Eastern Telecommunications Deal of the Year 2008 (Al Yah Satellite)  
Project Finance 2009

Middle Eastern PPP Deal of the Year 2009 (Zayed University)  
Project Finance 2010

Middle Eastern PPP Deal of the Year 2008 (Paris-Sorbonne Abu Dhabi)  
Project Finance 2009

Middle East Water Deal of the Year 2009 (Disi Mudawarra)  
Project Finance 2010

Americas Infrastructure Deal of the Year 2008 (São Paulo Subway)  
PFI Awards 2009

European Roads Deal of the Year 2008 (A1 Autobahn)  
Project Finance 2009

European Rail Deal of the Year 2008 (Liefkenshoek Rail)  
Project Finance 2009

European Acquisition Deal of the Year 2008 (Angel Trains)  
Project Finance 2009

European Leisure Deal of the Year 2008 (Wembley)  
Project Finance 2009

European Infrastructure Deal of the Year 2008 (Liefkenshoek Rail)  
PFI Awards 2009

PPP Deal of the Year 2007 (Diabolo Rail)  
Project Finance 2008

Top Legal Advisor, Global PPP 2007 (Al Ain University)  
Dealogic 2008

Legal Adviser of the Year 2009  
IJ Awards 2010

Global Law Firm of the Year 2008  
PFI Awards 2009

Middle Eastern PPP Deal of the Year 2009 (ITE College)  
PFI Awards 2009
Foreword

It was with great pleasure that I accepted, on behalf of the European Investment Bank (EIB and the Bank), Allen & Overy LLP’s invitation to write the Foreword to the Global Guide to Public-Private Partnerships (the Guide). I particularly welcome the global scope of the Guide, which reflects on both the regional advance and the increasing importance of PPP models around the world.

The European Investment Bank is a leading source of debt finance for infrastructure projects in the European Union (EU) and Candidate Countries. The Bank also makes significant investments in its countries of operation outside Europe. From this standpoint, the Bank has both witnessed, and supported, the growth of PPP as an important additional policy option for governments both to finance essential infrastructure and promote the modernisation of strategic public services.

By the end of 2009, EIB had lent and/or invested around EUR 25 billion in approximately 120 PPP projects. In many cases, EIB structures its participation in a way designed to optimise the public sector’s ability to meet EU policy objectives. The Bank’s support for the Trans European Transport Network (TEN-T) is a case in point. Where TEN-T projects have been structured as PPPs, EIB has shown its willingness to develop and deploy a range of financial instruments, often meeting a significant proportion of the projects’ debt requirements but also promoting co-funding from other private sector sources. The A5 Autobahn project in Germany, which closed in 2009 at the height of the difficulties facing much of the European funding market, is a particular example. The Bank provided not only a significant proportion of the project’s senior debt, but also promoted the ability of other senior lenders to participate through the Loan Guarantee for TEN Transport. Finally, the Bank was an indirect provider of equity for the project through its investment in the Meridiam Infrastructure Fund.

Looking forward, 2010 will see the first operations of the 2020 European Fund for Energy, Climate Change and Infrastructure (the Marguerite Fund), developed by EIB and a number of partners. The Marguerite Fund (which is targeted for EUR 1.5 billion by final closing in 2011) will provide equity and quasi-equity for privately financed projects in TEN infrastructure as well as renewable energy. The partner institutions working with EIB, which include Caisse des Dépôts (France), Cassa Depositi e Prestiti (Italy), KfW (Germany), Instituto de Crédito Oficial (Spain) and PKO Bank Polski (Poland), intend to establish a EUR 5 billion associated Debt Co-financing Initiative. Taken together, these promise significant additional liquidity for Europe’s PPP market.

Whilst the difficulties that have faced the European PPP market since late 2008 are undeniable, the additional role taken on by EIB is not alone in demonstrating that innovative funding solutions have helped a number of important deals to close in 2009. The Guide points to a number of examples. More important still, the Guide clearly indicates that many countries have retained their commitments to ambitious PPP programmes, in some cases putting in place imaginative mechanisms (such as guarantee or co-lending facilities) to support these. A number of other European
countries have announced their intentions to develop new PPP programmes or to reinforce existing ones. Whilst the distressed state of many public finances has undoubtedly played a role in renewed interest in PPP structures within these countries, the growing body of evidence on the effectiveness of, and potential value for money from, well-planned and executed PPPs has also been important.

As the Guide indicates, these benefits of PPPs are also being recognised globally. As EIB has lending mandates in parts of Africa, Asia, Latin America and the Caribbean, as well as the EU's Mediterranean partner countries, the Bank will be following PPP developments in these regions with particular interest. Where appropriate, the Bank will develop partnerships with other International Financial Institutions working in these regions with a particular view to finding means of sharing EIB's expertise and experience of structuring and financing PPP projects.

By establishing the European PPP Expertise Centre (EPEC) in late 2008, EIB took an important step in developing its role to support the diffusion of best practice in PPP planning and delivery throughout the European Union. This initiative, established in conjunction with the European Commission and Member States, has been welcomed by both the public and private sectors and its activities will be developed further in 2010. The analysis of support measures for PPPs taken by Member States, including the impact of these on the accounting treatment of the underlying projects, will continue to be an important focus of EPEC's work, as will new initiatives to promote the use of capital markets as a means of funding PPPs. EPEC will also work with Member States and European Commission on the implementation of the important policy initiative in support of PPPs announced in the Commission's Communication on PPP published in November 2009.

In conclusion, whilst 2010 will remain challenging for the markets – the European economies are clearly not yet “out of the woods” – and continued innovation will be needed to securing the funding required to meet Europe's investment needs, we can be confident that governments are increasingly recognising the role that PPP can play as a complement to other sources of finance. The diversity of financial structures for PPP that has been evident across Europe is an increasingly significant source of strength. This offers governments not only the opportunity to learn from each other, but also to identify the models that best fit national needs and priorities.

This Guide, together with the Allen & Overy LLP Infrastructure Survey 2009, clearly demonstrates the diversity and innovation in global practice – for this reason, I particularly welcome its publication.

Thomas C. Barrett
Director
European Investment Bank
Introduction

Public-private partnerships (PPP) began as a purely domestic solution to a domestic problem. In the United Kingdom successive governments became aware that the benefits of privatisation of certain public sector services (improved service, long-term investment decision-making and separation from political interference as well as the obvious mobilisation of private (rather than public) capital) could be largely replicated with a contractual structure. The architects of PPP borrowed heavily from international project finance risk allocations to establish a workable structure for PPP projects.

PPP in the UK

From the early days of PPP, the model was used as a way of delivering specific UK government priorities. Initially, roads and prisons were the sectors towards which urgent investment needed to be directed. After 1997, priorities moved to education and health, with enormous investment being made in UK infrastructure over the subsequent decade. Throughout this period, the privatised industries and, in particular, the liberalised energy markets were seen as distinct and successful sectors that worked well without any cause for concern.

More recently, however, with the publication of Malcolm Wickes’ report on Energy Security, the Low Carbon Transition Plan, the Cave Report on Water and the various Competition Commission reviews of the airport sector, it has become clear that there is a growing need for direct government intervention to ensure investment is targeted towards particular industries. Whether or not such intervention will involve PPP is still to be determined, but it is certainly the case that at the very least the PPP model offers a useful reference point for those industries to consider when structuring a suitable investment opportunity for the private sector.

PPP in its traditional setting in the UK continues to work successfully to deliver the well-documented benefits of new, well maintained infrastructure.

PPP internationally

Over the last decade, governments across the globe have become aware of the benefits of PPP and PPP policies have been implemented in countries throughout Europe, the Middle East, the Americas, Australasia and Asia. Each jurisdiction that has implemented a PPP strategy shares a common recognition that infrastructure development is vital for economic growth – and moreover that infrastructure development can be accelerated through the use of PPP.

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Governments in both the developed and developing world have significant constraints on their ability to spend or invest in capital assets to improve public services; so involving the private sector in the provision of these public services is one solution to the conundrum of how to improve public services without raising taxes or increasing public borrowing. Since the start of the credit crisis in 2007, governments have also seen the benefits that infrastructure development can bring by way of overall economic stimulus. As a result, and given the even greater constraints on public budgets in this climate, PPP has become all the more appealing as a means of delivering such much-needed stimulus. Governments around the world have introduced a variety of measures to shore up the PPP market to ensure that vital infrastructure continues to be delivered. Financing methods are adapting to the economic climate and the involvement of multilateral agencies and export credit agencies has become more key, with their ability to provide cheaper and, importantly, available finance.

Whilst different countries have developed different accounting rules to analyse PPP deals, it is beyond debate now that structured correctly for the right service and in the right competitive environment, PPP can and does deliver value for money and enables governments to control their balance sheets.

In terms of available funding, the sub-prime loan market collapse has had a knock-on effect on the viability of monoline insurers and unwrapped bonds are currently no longer a feature of the PPP funding landscape. Despite the financial downturn, however, PPP still holds attractions for investors, and there are signs that the typical investor profile may change to include more institutions such as pension funds as they look for opportunities for long-term stable returns, particularly in relation to assets with existing cash flows. In the US, for example, a different type of investor may be attracted to PPP in response to moves by several US cities to evaluate whether to raise funds by concessioning non-core public infrastructure to private operators in an effort to mitigate substantial declines in tax revenue driven by the “Great Recession”.

In the US, parking assets are receiving the most attention in this regard. In 2010 alone, five US cities have issued solicitations of interest and requests for qualifications in connection with the long-term leasing of their parking systems. Three further cities are expected to tender their parking systems to market this year as well.

**Purpose of this Global Guide to Public-Private Partnerships**

The purpose of this Guide is to raise readers’ awareness of the issues to be addressed in implementing successful PPP projects around the world and to show areas of common ground as well as areas of difference in the jurisdictions covered. The Guide highlights the key issues private sector participants need to be aware of when engaging in PPP in the countries addressed, provides governmental bodies with an invaluable insight into how and to what extent PPPs are run in other countries and explains the role export credit agencies and multilateral agencies can play in PPP projects.

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5 Hartford, Indianapolis, Las Vegas and Pittsburgh are investigating transactions involving both metered on-street and off-street parking assets and Los Angeles is looking at public garages only.

6 Harrisburg, New Haven and Worcester.
In particular, the intention of the Guide is to provide a starting point for those interested in delivering or investing in PPP projects in the jurisdictions concerned by highlighting the sorts of issues that are likely to crop up early on in the procurement and investment decision process (such as the existence of or need for enabling legislation), as well as those which may appear later in the negotiation process.

Detailed questions may arise in relation to certain points highlighted in this Guide. While the answers to some of these may be straightforward, others may well involve more detailed consideration of the applicable laws and project concerned. Allen & Overy has first-hand detailed knowledge of the applicable laws of the jurisdictions in the Guide, as well as specific expertise in a wide range of sectors, and can draw on a wide range of experience of PPPs in these and other countries. Contact details for each jurisdiction’s Allen & Overy office are set out at the start of the relevant chapter and information regarding our experience and “best friend” firms in other jurisdictions can be supplied on request (a full list of our 34 offices is set out in Allen & Overy: an Overview).

Commonalities in PPP

The common themes that apply to PPP programmes across the globe are:

- the need for the public sector to save money without negatively impacting on the quality of public sector services;
- the availability to government/public sector bodies of advantageous accounting treatment for PPP projects; and
- the need to improve delivery times for greenfield infrastructure.

There are, however, nearly as many differences as similarities in individual countries’ approaches to PPP. Reasons for this range from there being differing priorities for public service improvement to there being differing regulatory environments. It is interesting to note that private sector provision of certain public services is still considered to be unthinkable in some countries, while in others the same services have a history of being delivered by the private sector without objection.

Whatever the reason, the main sector in which PPP is currently used across the globe is transport. This reflects not only how vital the need is for this infrastructure – how it is seen as essential to economic development – but also that transport projects (particularly roads) are in many ways considered to be relatively straightforward in comparison with other sectors.

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7 As at February 2010. A current list of our offices is available on our website: http://www.allenovery.com/AOWEB/PeopleOffices/PeopleOfficesHome.aspx?prefLangID=410
PPP activity across Europe

The UK has closed the most number of projects in virtually all sectors. This catalogue of projects is unrivalled and has enabled the UK to position itself at the forefront of PPP. Most countries with a PPP programme have therefore, at some point, relied on the UK experience. There can be no other explanation, for example, for the drafting in a Texan road to match word for word the drafting in a Slovakian road PPP, which also happens to follow drafting from the Standardisation of PFI Contracts Version 4 (or SOPC4). This international, cross-sector consistency can, however, only benefit public bodies, making investments and loans easier and quicker to make.

The level of PPP activity across Europe varies significantly. Some parts of Europe are not showing any real interest in PPP and other parts (particularly in Southeastern and Eastern Europe) may come to PPP in their own time. As the chapters in this Guide show, of those countries which are interested in PPP, some have a very active PPP market (eg France and Portugal), while others are either just beginning to grapple with the concept (eg Poland) or have made some early attempts which have not yet come to any real fruition (eg the Czech Republic).

It may be that the UK’s common law system, on top of prevailing political will, has facilitated its implementation of PPP as a procurement method. The legal and regulatory approach has varied across other European countries – some have implemented specific legislation to facilitate PPP (but may have yet to develop any projects under it), while others have simply proceeded with a PPP programme without introducing any PPP-specific legislation.

Member states have also had to take into account certain EU public procurement legislation aimed at improving transparent and effective competition. The effect of the “Remedies Directive”8 remains to be seen, with its standstill period between contract award decision and contract award to allow unsuccessful bidders an opportunity to challenge the decision and the introduction of ineffectiveness as a remedy for certain serious breaches of procurement rules. While not yet widely used outside the UK, the competitive dialogue procedure introduced by the “Classic Directive”9 (aimed at improving competitive tension and fair competition when procuring “particularly complex projects”), has, however, had the unwelcome effect of significantly increasing bid costs due to the financial, commercial and technical certainty required of all bidders in the competitive phase. A number of bodies (including the UK Treasury and the European PPP Expertise Centre) have been looking at this issue. The impact on defence PPP of the recent “New Directive”10 will also need to be assessed, with its new procurement rules specifically adapted to the defence and security sectors, aimed

9 Directive 2004/18/EC on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts (for implementation by most member states by 31 January 2006).
10 Directive 2009/81/EC on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security, and amending Directives 2004/17/EC (the “Utilities Directive”) and 2004/18/EC (for implementation by member states by 20 August 2011).
at opening up the European defence and security market to greater transparency and competition (the implementation of which is currently under consultation in the UK).

While this Guide focuses on jurisdictions where we have offices, there are of course other European jurisdictions with active PPP markets. Ireland, for example, has embarked on a significant number of PPP projects with early deals focusing particularly on the roads sector during a time when Ireland enjoyed considerable EU funding support. Ireland’s PPP dealflow remains relatively healthy and has expanded further into the transport sector (eg Dublin Metro and DART underground PPP), accommodation (eg Dublin Central Courts), education (eg Irish Schools Bundle 1 and 2) and health (eg Irish Oncology Hospital). In contrast, despite its potential for infrastructure investment, Greece is unlikely to see much PPP activity (unless internally financed) until its financial situation becomes clearer.

**PPP activity outside Europe**

Outside Europe, a number of countries have embraced PPP. The UAE (and in particular Abu Dhabi) have implemented a large number of projects in a short space of time. Japan has an extensive repertoire of projects that have closed, most notably in the airport, port and prison sectors. While Canada enjoys a relatively mature PPP market, it is mainly in the last five years that the US has begun to turn more towards PPP and, as our 2009 Global Survey results show, it is potentially a very attractive market to investors. The rest of the Americas have not yet embraced PPP, but Brazil looks to be leading the way.

Africa (if it can be described as a single block) is awakening to the benefits of infrastructure expenditure. The 53 countries comprising the African continent are aware of the infrastructure shortfall and the benefits, for economic growth, of funding the (approximately) USD 31 billion annual gap between needs and existing expenditure. Africa is urbanising faster than any other continent which can only increase the strain on existing infrastructure.

To date, investments have been concentrated in the telecoms sector, although there have been a number of notable transactions closed. Picking a few examples, Egypt is working on road and hospital PPPs, Nigeria has a strong pipeline of deals at state level, Senegal has a successful road project in Dakar, South Africa has implemented prison PPP and road PPP projects and Tunisia the Enfidha International Airport. Critical to the development of PPPs in Africa will be the role of the African Development Bank and other multilateral bodies referred to in Chapter 23.

Australia has a mature PPP market with State and federal governments required to consider using PPPs to fund and deliver infrastructure projects with a capital cost in excess of AUD50 million. In Australia, the federal, State, Territory and local governments are each tasked with the provision and operation of infrastructure in their jurisdiction and, as a result, the Australian PPP market faces significant challenges in populating and progressing a clear pipeline of projects and in implementing uniform contractual arrangements for PPP projects. To assist in coordination across the various levels of government, in 2008 the federal government formed Infrastructure Australia to audit Australia’s infrastructure requirements, develop a national infrastructure priority list for
consideration by the Council of Australian Governments (COAG) and produce National Public Private Partnership Policy and Guidelines (which were endorsed by COAG in November 2008). More than a year after the guidelines were released, most market participants are sceptical that the national guidelines will result in true consistency, in part because of the inclusion of a menu of options which enable governments to continue to use their own risk allocation principles in respect of a number of issues.

As was the case globally, the PPP market in Australia suffered from late 2008 and in 2009 as a result of the shock to the debt and equity markets after the collapse of Lehman Brothers and the downgrade of a number of financial guarantors. Funding from the debt capital markets, which was heavily utilised in Australian PPPs, disappeared overnight and the constraints on liquidity generally led to the deferral or cancellation of a number of PPP projects, including the South Australia prisons PPP which was withdrawn three days after the submission of final bids. However, despite the global financial crisis, six PPP projects reached financial close in the year from September 2008 to September 2009. The highlights included the use in the Queensland schools PPP project of an innovative, if somewhat controversial, co-funding model called the Supported Debt Model and financial close in relation to the AUD3.5 billion desalination plant PPP project in Victoria. The Victorian Government is credited with ensuring that AUD1.8 billion of the financing for the desalination plant PPP was successfully syndicated by agreeing to a range of measures, including sharing market disruption and refinancing risk and a funding guarantee in respect of any shortfall in syndication (which was not called on).

It remains to be seen which measures implemented in the wake of the global financial crisis will be features of Australian PPP projects in the future. Governments are reviewing whether and if so how best to contribute financially to PPP deals, whether by equity, debt or by last resort offer if the markets do not step up, and some of the larger projects have been broken up into publicly funded and PPP projects (eg Sydney Metro and the Gold Coast Rapid Transit project). Governments are also considering reallocating project risks in the wake of the uncertainties that persist in relation to financing economic infrastructure, with the Victorian government leading the way with its tender for the first Australian availability (as opposed to actual toll) road PPP.11

With the exception of Japan, Singapore and Korea, Asia has been slow off the mark in developing genuine PPP frameworks. There have been recent renewed interests from several ASEAN countries, driven perhaps by the urgency to build clean transportation infrastructure with support from the multilateral agencies. For example, in an effort to address its need for significant infrastructure investment, Vietnam has recently drafted a PPP financing framework which is due to be approved in the latter half of 2010. The proposed framework envisages public competitive bidding, pre-bid feasibility studies and the government sharing risk with the private sector (with the ability to fund up to 50% of certain projects).

In contrast to much of Asia, the PPP market in Singapore remains active, with new deals continuing to trickle to market notwithstanding the global financial crisis. Whilst many

11 With thanks to Erin Wakelin at Freehills (http://www.freehills.com.au/).
jurisdictions in South-East Asia continue to discuss their desire to develop a functioning PPP model to aid the development of much needed infrastructure, Singapore continues to lead the way with transactions based on the PPP Handbook produced by the Singapore Ministry of Finance in 2004 and with project agreements modelled on UK and Australian precedents. There has, since the closing of the award winning ITE College West project in August 2008, been some apparent cooling in the Government's eagerness to use the PPP procurement route. However, with the iconic Sports Hub project coming back to the lending market in recent times, and a continuing utilisation of the PPP structure by the Ministry of Defence on various projects, the market remains alive and well.

Having sustainable and workable PPP programmes in Asia is long overdue. We look forward to, and are actively participating in, promoting PPP programmes in several Asian jurisdictions.

**Allen & Overy Global Survey**

Conducted in the second half of March 2009, our Allen & Overy LLP Infrastructure Survey 2009 amongst our infrastructure clients was designed to provide some insights into what leading market participants see as the key markets and sectors for infrastructure investment and what governments can do to attract investors in an increasingly global and competitive infrastructure market. The results represent responses from just under 300 of the leading players in the global infrastructure market, ranging from CEOs and Chairmen to General Counsel, Heads of M&A and Directors in Asia, Continental Europe, the Middle East, UK and the US. The full survey results are available on our website.¹²

One of the overriding messages coming out of the survey responses is that if infrastructure investors are to make sound investment decisions, they must be able to draw comparators and flag up differences between various approaches adopted in different jurisdictions or sectors to assess the attractiveness or otherwise of a jurisdiction for infrastructure investment purposes. With the diversity of investment opportunities available (in both “greenfield” and “brownfield” infrastructure) and the multiplicity of interests shown, today’s infrastructure investors need to understand the underlying complexities of the legal and regulatory framework in which they are working.

We hope this Guide is a valuable tool in this process and we look forward to advising existing and new clients in this exciting and challenging market.

Allen & Overy LLP is one of a small group of truly international and integrated law firms with approximately 5,000 staff, including some 450 partners. We have offices in 34 major centres worldwide, on four continents, including our new offices in Sydney and Doha, and serve businesses, financial institutions and governments.

This network of offices includes local lawyers, English solicitors and US attorneys and combines local expertise and experience with international transaction management skills, ensuring our clients receive consistent global advice of the highest standard.

Allen & Overy has acquired a reputation for excellence and quality of service across the broad range of commercial practice areas in which we advise corporate and financial clients. This service includes commercially focused documentation, a “solutions-orientated” approach, fee transparency and highly effective, technology-driven transaction management.

“Global Law Firm of the Year”

Project Finance International Magazine Awards, 2009
Allen & Overy’s award winning international PPP practice within its Projects, Energy & Infrastructure practice has established an unrivalled reputation for providing advice to public sector, private sector and banking clients on the key issues in PPP transactions.

The increasing involvement of the private sector in the delivery of public services throughout the world has created a strong demand for the type of expertise our PPP practice offers. Our lawyers provide robust and commercial legal advice relating to the transfer of risks and responsibilities from the public to the private sector and our experience acting on all sides of PPP projects means we understand issues from a variety of perspectives and can apply these insights to anticipate and avoid potential problems, thereby saving our clients time and money.

We have a wealth of experience in PPP, having advised on many first-of-a-kind projects to be developed in both different countries and sectors, as well as on most of the major innovations in the market to date. Our expertise extends beyond the countries where we have offices, as shown by our involvement in key projects such as the first PPP road in Austria (the A5), the first Portuguese PPP toll road (Western Concession Toll Highway), Konkan Railway project in India, Calgary Ring Road in Alberta, Canada, New Quito International Airport in Ecuador, São Paulo Metro Line IV in Brazil, Autopista Central Toll Road in Chile and FARAC I Toll Road in Mexico. Together with our diverse client base, long track record and cutting edge know-how, our cross-sector experience gives us an in-depth understanding of commercial realities and how best to tackle issues which affect our clients’ commercial objectives. Clients are reassured by our understanding of their markets as we help them achieve their business aims rather than simply solve legal problems.

Our involvement on some of the largest and most complex deals in the market to date and the depth of our know-how accumulated not only from some 200 PPP/PFI transactions, but also from PPP-related client and industry secondments, means that members of our team at all levels, whether partner or associate, are able to draw on extensive market experience to provide high level strategic advice to our clients.

Our role on many of the first PPP projects to close in various countries means we can genuinely claim to have an intimate understanding of the fundamentals of PPPs and to have been there “from the beginning” in numerous PPP markets and sectors. This first-hand expertise gives us and our clients a significant advantage not only when addressing the challenges involved in introducing PPP as a new procurement and financing method in a particular sector or jurisdiction, but also when engaged in developing and expanding more established markets.
United Kingdom

To one who has faith, no explanation is necessary. To one without faith, no explanation is possible.

Saint Thomas Aquinas
(Ca. 1225-1274)
1. Introduction

The Private Finance Initiative (PFI) first appeared in the United Kingdom\(^1\) in 1992 under the then Conservative Government. Despite initial opposition, when the next Labour Government came to power it seized on PFI as a means to procure much-needed public infrastructure and services using private sector finance instead of increasing borrowing or taxation.

The two most significant sectors which were in need of PFI investment were the local government and health sectors. This was particularly relevant for two reasons: first, a significant backlog of maintenance needed to be addressed in almost all state-owned accommodation and facilities, particularly social housing and schools, which are both generally managed and operated by local government. Secondly, capital expenditure incurred by local authorities counts as Government expenditure and therefore at certain stages in the economic cycle will score against the various statistical measures of Government borrowing. Accordingly, from the central government perspective, PFI was a credible alternative to conventional procurement for any public sector body looking to make a capital investment as it would not count on the Government’s balance sheet.

With over 900\(^2\) signed PFI deals to its credit across all major sectors including highways, rail, health, defence, education and prisons, the UK has managed to resolve, or find acceptable solutions to, most (if not all) of those legal issues that vexed the PFI industry in the early days of the initiative. As the PFI has gained momentum, its success has both influenced and been accommodated within the developing framework through which the Government performs its functions and exercises its powers. By way of example, the UK’s National Health Service is in many respects quite different today to when the Labour Government came to power in 1997 and, in particular, responsibility for the delivery of a number of core health services has been devolved to a series of autonomous, localised public sector bodies that (amongst other things) manage their own budgets and sit outside direct central government control. Most of the PFI deals signed have been in England, with a number in Scotland, Northern Ireland and Wales, although PFI has met with more political resistance in Scotland and there has not been much PFI activity in recent years.

Despite some initial pockets of moral and political resistance (particularly from the trade unions), PFI has become a key method for successive UK governments to procure value for money public services and infrastructure in times when they could not otherwise afford to do so. In the current economic crisis, where availability of funding for projects is more scarce, the Government has been developing ways to maintain investment in infrastructure and keep the PPP programme afloat.

However, with the UK Government agreeing for prudential reasons (that it may now regret) that PFI deals involving central government counterparties are on the UK’s balance sheet (ie count towards certain measures of borrowing), the UK has disadvantaged itself as compared to other countries in the Eurozone undertaking PPP because, if it procures PPP projects at central government level, government borrowing will increase at a time when the UK is looking to reduce its debt close to Eurozone stability criteria.

Over time the term “PFI” has become less frequently used in the UK market, being replaced with “PPP” or “Public-Private Partnerships”, a term now commonplace internationally when referring to any Government sponsored initiative or scheme which involves the use of private finance to facilitate the provision of public services or social infrastructure. With such a volume of signed deals, it is important to recognise that some statements about PPP will involve generalisations. Despite this, there are a number of key points that can be drawn from the large body of PPP transactions signed in the UK.

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1. England, Wales, Scotland and Northern Ireland – see later for discussion of certain differences in PPP procurement.
2. See [www.partnershipsuk.org.uk/PUK-Projects-Database.aspx](http://www.partnershipsuk.org.uk/PUK-Projects-Database.aspx)
2. Legal and regulatory framework

2.1 Capacity to contract

The procuring authority (Authority) in UK PPP contracts may be central government (via a Secretary of State as agent of the Crown), local government (such as a town, borough, district or county council) or a public sector body which sits outside direct central government control but relies on an associated Government department for its funding (such as NHS Primary Care and Mental Health Trusts in the health sector, Passenger Transport Executives in the transport sector, the Youth Justice Board in the custodial services sector and Transport for London).

From a legal perspective, it is generally accepted under English law that (unless restricted by any Act of Parliament\(^3\)) the Crown has the capacity to enter into such contracts as it may require and it is not generally restricted by any capacity constraints, in the manner that, for example, local authorities would be. The Crown enters into contractual arrangements through its Secretaries of State, whose responsibilities are co-extensive\(^4\) (ie any one of them can execute the duties of all) so that in any statute, the expression Secretary of State means “one of Her Majesty's Principal Secretaries of State” unless a contrary intention appears\(^5\).

In other words, one of the benefits of the introduction of the PFI in the UK (in comparison to other jurisdictions) was that no enabling legislation was required to ensure that central government departments procuring a PFI project had the requisite powers to enter into the PFI Contract. Provided that a PFI Contract is properly executed by the relevant central government department, it should be a relatively straightforward exercise to establish that a PFI Contract is valid and enforceable against the relevant central government department (subject to the qualifications set out above).

As a general rule bodies outside the central government framework (such as those mentioned above) are established under statute and do not act as agents of the Crown (unlike the Highways Agency, for example, which is an agent of the Crown and contracts in the name of the Secretary of State for Transport). The statute normally addresses the capacity to contract (eg in the health sector the establishment of NHS Trusts\(^6\) involved (eventually) the enactment of legislation which specifically recognised and provided for NHS Trusts to enter into PFI Contracts).

By 1996, the majority of PFI Contracts that had closed were in the central government sector and there can be no doubt that one of the principal reasons for this was that the private sector had concerns related to the vires and/or financial standing of other public sector bodies seeking to procure PFI projects.

In the local government sector, a number of relatively high-profile financial transactions entered into by local authorities with financial institutions had (in the recent past) been set aside by the English courts. This had caused a general nervousness in the private sector (especially the financial community) that there was an over-reliance being placed by local authorities on incidental powers granted to them under legislation. In the absence of any specific powers being granted to local authorities to enter into long-term service or PFI Contracts, it was recognised that a successful PFI programme in the local government community looked unlikely so the Government took steps to address this.

2.2 Specific Enabling Legislation

Interestingly, enabling legislation was required in the local government and health sectors to address different concerns.

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\(^3\) This has always been the principal difficulty for those contracting with the Crown, in that identifying specific statutory exceptions is very difficult.


\(^5\) Interpretation Act 1978, s.5 and Sch.1.

\(^6\) An NHS Trust is a local public sector body that has responsibility for, amongst other things, the provision of hospital accommodation within a defined geographical area.
The Local Government (Contracts) Act, 1997 was the main enactment which addressed the private sector’s concerns regarding local authorities’ capacity to contract.

Ironically, although the legislation introduced to establish NHS Trusts had addressed the capacity concerns that were troubling the local government sector, the changes to the framework had given rise to other concerns. The private sector felt that the legal and financial autonomy of NHS Trusts presented problems related to their financial standing as the Authority under health PFI Contracts and the absence of central government support and/or guarantees. Particular concerns included the ability of NHS Trusts to fund ongoing commitments under PFI Contracts (and in the worst case, termination compensation) and the lack of any statutory requirement for intervention from central government in the event of an NHS Trust becoming insolvent. Again, the Government took steps to address these concerns and The NHS Residual Liabilities Act, 1996 was the principal legislation that enabled PFI to progress in the health sector.

As the number of PPP projects successfully procured in these sectors highlights, it has been generally accepted in the market for some time now that these statutory changes provide an acceptable position for the private sector.

### 2.3 Covenant Issues for Regional Authorities

A large percentage of PFI projects that have now closed in the UK have been procured by public bodies that sit outside central government. The current framework through which public services in the UK are now delivered involves (in a number of circumstances) responsibility for the delivery of services resting with localised, autonomous bodies that rely on an associated Government department for their funding (see examples in paragraph 2.1 above). As these bodies do not as a general rule act as agents of the Crown, where they wish to enter into PFI transactions the underlying covenant of the contracting Authority needs to be assessed. To the extent that potential investors do not believe that the proposed Authority sits comfortably within the government framework or there is no long-established history of this type of Authority being supported by central government, it may be necessary to obtain some form of support for the project from central government.

By way of example, in the late 1990s a number of PFI transactions were closing in the local government and health sectors, which were largely being procured by Local Education Authorities and NHS Trusts respectively. At such time there was a long-standing relationship between local and central government, whereas NHS Trusts were a relatively recent creation. Investors into schools PFI projects took comfort from the fact that in the past central government had intervened to ensure that local governments met all of their liabilities in the event that they entered into financial difficulties; with regard to NHS Trusts there was no analogous position to provide comfort to investors in health projects.

For that reason, and because no deals had closed in the health market until 1997, on each of the early PFI hospital projects in the UK, preferred bidders were able to negotiate a position whereby the Secretary of State for Health issued a letter of comfort in respect of each PFI project. Since May 1997, more than 50 PFI hospital schemes have reached financial close (with over 40 now operational) and on the basis that there is now an established market for hospital PFI projects and an established track record of the financial performance of NHS Trusts and central government intervention, investors will now invest in hospital PFI projects without requiring any such comfort from the Secretary of State for Health.

### 2.4 Differences in England, Wales, Scotland and Northern Ireland

Central government has devolved certain functions to the Scottish Parliament, the National Assembly for Wales and the Northern Ireland Assembly, including certain budgetary responsibilities. Each has its own plan for infrastructure investment and while overall budgetary responsibility remains with HM Treasury, each government is able to follow its own path as regards PPP policy. Primary legislative powers rest with the UK Parliament at Westminster and UK parliamentary legislation applies to all four home nations, with particular provisions applicable to Scotland and Northern Ireland as relevant. Each of the devolved assemblies has certain powers to enact secondary legislation.

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7 http://www.scotland.gov.uk/Topics/Government/Finance/18232
http://www.pfgbudgetni.gov.uk/index.htm
http://wales.gov.uk/about/civilservice-departments/finance1/assemblybudgets/?lang=en
For PPP contracts procured in Scotland, Wales and Northern Ireland the capacity to contract analysis remains broadly the same as regards the contracting Authority who will usually be a local government body. Differences will need to be taken into account, however, when considering governing law and jurisdiction clauses under PPP contracts, because projects in England and Wales will be subject to English common law and the courts of England and Wales, whereas projects in Scotland will be subject to Scots law and the courts of Scotland and projects in Northern Ireland law and courts.

2.5 PFI/PPP Bodies

(a) HM Treasury Taskforce

In 1997, HM Treasury set up a Taskforce to help reinvigorate the PFI process. The Treasury Taskforce members brought with them public sector experience as well as private sector legal, financial and commercial expertise (and Allen & Overy’s David Lee was transferred there for two years as one of the original members). One of the aims of the Taskforce was to provide guidance and support to public sector authorities on how to procure PFI projects and to navigate the various Treasury accounting and other requirements. Following extensive consultation with all sectors, in 1999 the Taskforce published its Standardisation of PFI Contracts (SOPC) which quickly became a reference bible for both the public and private sector in relation to standardising and understanding contractual terms and led to different government departments producing their own extensive standardised documentation. It is now on its fourth edition (SOPC4) and a raft of other guidance has been published.

(b) Partnerships UK

The Treasury Taskforce essentially became Partnerships UK (PUK) and in 2001 PUK was launched as a public-private partnership with an arm’s length relationship with HM Treasury, operational independence, and 51% private sector equity ownership, with the balance owned by HM Treasury and the Scottish Executive. It took on a broader remit including investing in projects itself. It has worked with the devolved governments and is a partner in Building Schools for the Future LLP with the Department for Children, Schools and Families (DCSF) which invests in the risk capital of Local Education Partnerships and schools projects (see below). It has also created Local Partnerships (incorporating the previous local government advisory body, the 4ps), which is a joint venture with the Local Government Association supporting public bodies in the delivery of improved services and infrastructure. Allen & Overy’s Andy Fraiser went on a period of secondment to PUK.

(c) Infrastructure Finance Unit

In 2009, in response to the economic climate and recognising a need to maintain investment in infrastructure, HM Treasury decided to build a professional lending capability to lend to PFI projects that cannot raise sufficient debt finance on acceptable terms. The Treasury’s intention is to lend alongside commercial lenders and the European Investment Bank and, if necessary, provide the full amount of senior debt required by a project. Treasury lending is intended to be a temporary and reversible intervention and the Treasury envisages selling the loans it makes prior to their maturity when favourable market conditions return. In order to effect this, it established The Infrastructure Finance Unit (TIFU). TIFU will operate at arm’s length from procuring authorities and consider applications for loans to PFI projects, negotiate the terms of any such loans and monitor and manage loans once made. TIFU completed its first loan facility on 8 April 2009, providing a GBP120 million loan for the Greater Manchester Waste Disposal Authority’s PFI project alongside the European Investment Bank and a syndicate of commercial banks.

(d) Infrastructure UK

As part of the Pre-Budget Report delivered on 9 December 2009, the Chancellor of the Exchequer announced the establishment of Infrastructure UK (IUK) to develop a strategy for the UK’s
infrastructure over the next five to 50 years (to be published at Budget 2010); identify and attract new sources of private sector investment in infrastructure; manage the Government’s investment in the 2020 European Fund for Energy, Climate Change and Infrastructure; support HM Treasury in prioritising the Government’s investment in infrastructure; and actively support the delivery of major infrastructure projects and programmes and help build stronger infrastructure delivery capability across government. IUK is intended to bring together HM Treasury’s PPP Policy Team (which is responsible for managing the PPP/PFI programme, market and guidance) and TIFU, and, subject to agreement, the capabilities within PUK that support the delivery of major projects and programmes.

(e) Sector and national bodies

Other government departments also have dedicated PFI units (such as the Ministry of Defence and NHS Private Finance Units) and there are other relevant bodies, such as Local Partnerships9 which provides a variety of assistance across the local government sector. On the education front, Partnerships for Schools was established in 2004 by the now DCSF as both a company and an executive non-departmental public body to deliver the Building Schools for the Future programme across England. Community Health Partnerships (previously known as Partnerships for Health until Autumn 2007) is an independent company, wholly owned by the Department of Health whose main activity has been to deliver the Local Improvement Finance Trust (LIFT) Initiative10.

In Scotland, The Scottish Futures Trust11 was established in September 2008. It is a government-owned company set up to improve public infrastructure investment. In Northern Ireland, the Office of the First Minister and Deputy First Minister has responsibility, in conjunction with the Department of Finance and Personnel, for the development and co-ordination of PPP policy in the public sector in Northern Ireland and the evaluation of its implementation. It is working with government departments and the Strategic Investment Board12 to develop knowledge and skills and identify new PPP models required to deliver investment in the Northern Ireland infrastructure. The Welsh Assembly Government closed its Private Finance Unit in April 2004.

3. Active sectors

The use of PPP and PFI is well established across a range of different sectors. As shown below, the main sectors to have used PPP to date are in the education, health, defence and transport sectors.

### Breakdown by Department

<table>
<thead>
<tr>
<th>Department</th>
<th>Number of Signed Projects</th>
<th>Capital Value (GBPm)</th>
<th>Number of Projects in Procurement</th>
<th>Capital Value (GBPm)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cabinet Office</td>
<td>1</td>
<td>12</td>
<td>0</td>
<td>N/A</td>
</tr>
<tr>
<td>Ministry of Justice</td>
<td>26</td>
<td>697</td>
<td>2</td>
<td>201</td>
</tr>
<tr>
<td>Culture, Media &amp; Sport</td>
<td>14</td>
<td>238</td>
<td>3</td>
<td>115</td>
</tr>
<tr>
<td>Environment, Food &amp; Rural Affairs</td>
<td>21</td>
<td>2,687</td>
<td>18</td>
<td>2,985</td>
</tr>
<tr>
<td>Transport</td>
<td>50</td>
<td>11,763</td>
<td>12</td>
<td>1,890</td>
</tr>
<tr>
<td>Department for Children, Schools &amp; Families</td>
<td>135</td>
<td>6,075</td>
<td>53</td>
<td>2,511</td>
</tr>
<tr>
<td>Health</td>
<td>114</td>
<td>11,367</td>
<td>4</td>
<td>473</td>
</tr>
</tbody>
</table>

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10 NHS LIFT is a programme for capital investment in front line primary and community care facilities (such as GP surgeries).
4. Likely future active sectors

The Government has made clear that where PFI has demonstrated that it can deliver value for money then it should be used as an important tool to deliver the Government’s significant increases in public investment. Consequently, the Government expects a significant number of major new capital investment projects to continue to be procured using PFI in the next few years in the sectors referred to below.

4.1 Education

The DCSF (then the Department for Education and Skills) announced its Building Schools for the Future (BSF) programme in 2004. BSF is a capital investment programme which aims to rebuild or refurbish every secondary school in England (approximately 3,500 schools) and will account for approximately two fifths of the capital investment in school buildings. BSF includes both conventional and PFI funding and of the estimated GBP2.2 billion to be spent per annum over the initial 10-15 year programme, GBP1.2 billion per annum was expected to come from PFI credits. Today, BSF has GBP2.5-3 billion capital investment per year and the Comprehensive Spending Review settlement for 2008-11 gives the BSF programme GBP9.3 billion over three years. The programme is well underway and to date there have been at least 49 BSF deals signed, with a capital value of approximately GBP5 billion – as a result 146 schools (including Academies) have already benefitted from BSF investment. Some 96 local authorities are involved in the BSF programme, with 12 more projects involving ten new authorities new to BSF announced on 30 November 2009. In early 2009, the National Audit Office estimated the total cost of renewing the school estate as between GBP52-55 billion, and that 250 schools would need to be built each year to include all schools by 2020 as planned.

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13 A PFI credit is a measure of the private sector investment which will be supported by central government sponsoring departments. Issuing a PFI credit letter is a promise that a PFI revenue grant can be claimed once the project is operational. The level of PFI credits determines the amount of grant.

14 Academies are publicly funded independently managed schools. PfS is responsible for delivering the Academies programme.

15 See the National Audit Office’s 12 February 2009 report entitled “The Building Schools for the Future Programme – Renewing the secondary school estate.”
Northern Ireland does not have a BSF-style programme and its education project procurement follows a more traditional PFI approach. It has not seen many projects in procurement to date. Similarly, there has been little recent activity in the education sector in Scotland although there was a commitment to procuring certain PPP schools projects under the Infrastructure Investment Plan 2008.

In May 2009 the Welsh Assembly announced its 21st Century Schools Capital Programme. This is a long-term, strategic capital investment plan which seeks to rebuild or refurbish every school in Wales to a 21st Century Schools standard. A 21st Century Schools Capital Programme team is to be established to support local authorities and provide expert advice to the Assembly Government, and Welsh Local Government Association.

4.2 Transport

The transition to a low-carbon economy is a key priority of the Government. The UK Low Carbon Transition Plan, published in July 2009 by the Government, recommends a national strategy for climate and energy and for the use of low-carbon alternatives. The strategy intends to provide support to the low carbon vehicles and fuels of the future.

Development of a lower carbon rail system through energy efficiency improvements and greater electrification is one way that the Government is showing its commitment to the objectives of the Low Carbon Transition Plan. Over GBP10 billion will be invested in enhancing rail capacity, with overall government support totalling GBP15 billion.

In addition to the Government’s commitment to a lower carbon rail system, it is dedicated in other ways to encouraging alternatives to road use. In this context, there has been both national and local support for Crossrail, the country’s biggest rail infrastructure project. This rail project is intended to provide a high frequency and accessible form of rail transport for London and the South East. When Crossrail opens in 2017 it will increase London’s public transport network capacity by 10%, support regeneration across the capital and help secure London’s position as a world leading financial centre. The estimated benefit of Crossrail to the UK economy is at least GBP36 billion.

4.3 Defence

Ministry of Defence (MOD) declared policy is that “the Private Finance Initiative is an important part of the Government’s efficiency policy, in conjunction with other forms of PPP,” and that for all projects the MOD will only consider using its own capital funding resources if PFI has been demonstrated to be unworkable, inappropriate or uneconomic.

There is a smaller volume of defence projects in comparison to the volume of projects in some other sectors. Projects can take a significant time to achieve close, but the project size can be immense. Examples of this include the GBP13 billion project to supply a fleet of air-to-air refuelling tankers to the UK’s Royal Air Force which closed last year and the Armoured Vehicle Training Service project, which has an estimated life value of GBP1 billion.

We currently anticipate further changes in the UK PPP market, both to improve the process, but also to widen the range of projects that qualify as PPPs.

With a general election due in May 2010, a change of government may affect attitudes towards PPP, but with current budgetary constraints it is unlikely that any new government will either be able to afford to abandon the PPP model or have the political will to leave it untouched.
5. General structure of concessions

5.1 Scope of Service

The key point to make here is that services are specified and contracted for on the basis of outputs. This means that the Contractor’s obligations are expressed by reference to the service being delivered (e.g., heat, light, and access) rather than through detailed specifications for any assets being designed and built in order to deliver that service.

5.2 Payment mechanisms

With a few notable exceptions, the UK PPP payment mechanisms generally focus on availability as being the basis for payment with separate performance-related deductions also possible. Few deals have closed where the private sector has been asked to take usage risk (toll roads, shadow toll roads, and bridges being the main exceptions).

This reflects both the practical point that the Government is in fact largely responsible for most of the patronage, as well as the macro-economic point that the Government should not be procuring long-term contracts for services unless it is confident that there will be demand for the services concerned for the full term.

5.3 Changes

Any Authority will be concerned to retain for itself maximum flexibility at all times. This concern remains when entering into a long-term service contract with a Contractor, but historically (even before PFI) there has been a reluctance to accept or value accurately the cost of obtaining that flexibility. There is now, however, increasingly an acceptance that flexibility in a long-term relationship comes at a price. A Contractor, its investors, and its lenders will be keen to ensure either that the flexibility required is part of the negotiation and is factored in to the project at financial close, or that the scope of the project cannot (either incrementally over time or in a single event) change in such a manner that changes the risk profile of the project to the detriment of the Contractor.

The typical position reached in UK PFI projects is for the Contractor to be obliged to carry out any change requested by the Authority, provided that the Contractor should have the ability to prevent change requests in certain circumstances (e.g., where the risk profile of the project would change adversely as a result). If the Contractor is required to carry out a change to the Project, the recommended approach is that the Contractor should be left in a neutral financial position as a result of effecting such change, so the Contractor is usually entitled to seek compensation from the Authority, together with temporary relief from its performance under the Contract as it implements the change.

5.4 Supervening Events

Due to the absence of any general legislation in the UK that specifically permits or regulates PPP contracts, it is a matter of contractual negotiations to establish the level of relief or compensation that a Contractor should be granted following the occurrence (and during the subsistence) of certain events. The commercial parties are free, therefore, to set out and agree in the PFI Contract how and when any relief mechanisms should apply, although many sectors now have firmly established terms which do not allow for much deviation. The approaches taken in SOPC4 and the individual sectors follow closely other, longer standing, project finance sectors.

There is now a well-established range of terminology in the UK for describing and dealing with supervening events that delay either construction or delivery of the relevant services under PFI Contracts. Broadly speaking, supervening events for which some form of relief should be provided to the Contractor are divided into five categories (although not all categories are used in all sectors):
(a) Compensation Events

Compensation Events are events at the Authority's risk that give rise to relief for the Contractor through both time (ie extension of construction long-stop dates though not usually the contract end date) and money (ie increased costs and loss of revenue), broadly reflecting all the losses of the Contractor. Not surprisingly, the scope of Compensation Events is typically extremely narrow and (save for project specific reasons) is typically restricted to breaches of the Authority's obligations and certain categories of change in law;

(b) Relief Events

Relief Events are events, the cost consequences of which the Contractor is expected to manage, but in relation to which relief from termination is granted to the Contractor;

(c) Delay Events

Delay Events are events that give an extension to any time limit for construction, but not a right to additional compensation (and so are usually construction specific);

(d) Excusing Causes

Excusing Causes are events at the Authority's risk that give rise to relief for the Contractor to the extent that payment is made as if the service concerned was being performed in full (but any loss arising from such an event that is in excess of the unitary charge payments will be borne by the Contractor); and

(e) Force Majeure Events

Force Majeure Events are a discrete set of events which the Contractor is expected to manage but in relation to which relief from termination is granted to the Contractor. Specific to Force Majeure events (as opposed to Relief Events) is that the extended subsistence of Force Majeure can lead to a termination of the PFI Contract by either party. It is also important to note that the recommended approach in UK PFI (unlike in some other jurisdictions) is that the subsistence of Force Majeure should not result in a proportionate suspension of the payment mechanism during the period of Force Majeure.

To the extent that any other event arises during the term of the project that is neither a Compensation Event, Relief Event, Delay Event, Excusing Cause or Force Majeure Event, such event will typically be a risk borne by the Contractor (ie one for which the Contractor does not benefit from any form of relief) under the terms of the PFI Contract.

Different approaches have been taken in each sector in the UK in relation to the scope of Compensation Events, Relief Events, Delay Events and Excusing Causes, but the scope of Force Majeure is well standardised and fairly consistently applied. It is worth noting that unlike in some jurisdictions and areas of project finance in the UK, the relationship between the scope of Relief Events and Force Majeure is such that not all Relief Events will be insurable and uninsurable events per se are not included within the scope of Force Majeure. Force Majeure under UK PFI is restricted to extreme events such as war, terrorism and biological contamination. In other words, PFI in the UK has achieved a position whereby the issue of categorising events as Relief Events or Force Majeure events is treated separately from the issue of whether or not insurance is available.

5.5 Change in law

The extent to which the Contractor is protected against change in law will typically be dictated by the nature of the project; for example, if the Contractor has the ability to pass on to the users of the Project any increases in cost arising out of a change in law (eg in a toll road project) the extent to which the Contractor can absorb such risk will be greater than in, for example, an accommodation project where the Contractor is paid an annual charge linked to the fixed price bid during the procurement of the project. The approach recommended to authorities in the UK is based largely on an assumption that the project is
an accommodation project (eg hospital or school) and involves the provision of soft services (eg catering and cleaning) that are benchmarked or market tested on a periodic basis. A summary of the UK recommended approach is set out below:

(a) **Types of Change in Law**

Change in Law risk is typically divided into three categories:

(i) **Specific Change in Law** – changes in law which relate to companies providing similar services to those being provided under the PFI Contract (eg the provision of cleaning services in health accommodation);

(ii) **Discriminatory Change in Law** – changes in law which are (broadly) targeted at the project, the Contractor or PFI generally (eg a windfall tax on Contractors); and

(iii) **General Change in Law** – any change in law which is not a Specific Change in Law or a Discriminatory Change in Law.

(b) **Available Compensation**

The Contractor may claim compensation (in terms of time and money) under the PFI Contract in respect of any Specific Change in Law or Discriminatory Change in Law. However, the Contractor will typically take the risk of General Change in Law during the construction phase of the project (assuming that the construction phase is not extraordinarily long). During the operational phase of the project the impact of any General Change in Law on the Contractor’s operating costs will be for the account of the Contractor, but a mechanism will typically be agreed in relation to any increase in capital costs which will require the parties to share the risk up to a pre-agreed limit, beyond which the costs are for the account of the Authority.

The reasoning behind the Contractor bearing the risk of any increase in operating costs caused by General Changes in Law is that the risk is typically only borne for a discrete period (ie because the soft services are to be benchmarked or market tested on a periodic basis, such as every five years from the start of operations) and the service payments under the PFI Contract are typically indexed. Accordingly, the agreement of any indexation mechanism and the frequency of benchmarking should take account of the Contractor’s exposure to General Change in Law risk.

5.6 **Termination and compensation**

The approach taken in the UK on termination and compensation under PFI Contracts is now well-established, particularly for accommodation deals, and has remained largely unchanged for over a decade. The typical approach distinguishes between termination events that are caused by the Authority (such as non-payment or interference with the delivery of the project), those that are caused by the Contractor (principally relating to poor delivery of the service, but also credit-related events) and those that are not attributable to either party (for example, force majeure and certain occurrences of unavailability in the insurance market that cannot be resolved through negotiation).

The typical position under a PFI Contract is that termination compensation[^20] is paid on the following basis.

(a) **Contractor default**

An assessment is done of the market value of the remaining cashflows under the project, less costs to be incurred (being costs to deliver the service and to complete construction and/or restore the service to the contracted level). This is done in one of two ways: first, if there is a liquid market[^21] for projects of a similar nature, then the Authority may conduct a competition to find a replacement project company and pass on any payment made by the winner of that competition (the value of the

[^20]: The foregoing ignores the rules on “Permitted Borrowing” for ease of explanation, the essence of which is to provide a limit to which further debt can be included as additions to the senior debt component of termination compensation unless specific Authority approval is given.

[^21]: The extent to which the Authority can opt for retendering is set out in Section 21.2.7 (Retendering Election and Liquid Market) of SOPC4. See [http://www.hm-treasury.gov.uk/d/pfi_sopc4pu101_210307.pdf](http://www.hm-treasury.gov.uk/d/pfi_sopc4pu101_210307.pdf)
(b) Authority default

The Contractor is paid any senior debt outstanding and redundancy costs. In addition the Contractor receives an amount that compensates it for loss of its future equity return. For this amount, it is asked to bid, as part of the original competition, on which of three approaches it would prefer: first, compensation to reflect the original IRR in the original bid for the duration of the contract; secondly, compensation to reflect the market value of the equity and subordinated debt immediately prior to the termination; or thirdly, to reflect the original IRR in the original bid for the remainder of the term of the contract.

(c) Force majeure

The Contractor is paid an amount equal to the senior debt outstanding and any redundancy costs. In addition, the Contractor is paid the nominal amount of equity and subordinated debt initially invested in the project, less any equity return paid up to the date of termination.

(d) Corrupt gifts and fraud

The Contractor is paid an amount equal to the senior debt outstanding.

(e) Breach of refinancing provisions

The Contractor is paid an amount equal to the senior debt outstanding.

There are still regular detailed discussions when negotiating a project on certain specific aspects of the termination compensation provisions, but these principally relate to refinements of the well-established principles to deal with post-refinancing changes to the financial structure and how to incentivise funders to support projects in difficulty.

It is worth noting that to date no projects have been terminated, so these provisions have yet to be implemented in practice.

5.7 Remedies

It is now generally accepted in UK PFI transactions that the operation of the payment mechanism should be the Authority's sole remedy in relation to a failure by the Contractor to provide the services under the PFI Contract and it is often said that this is the fundamental principle of PFI transactions. This principle has become generally acceptable for the following reasons:

(a) the combination of the calibration of the payment mechanism and the Authority's ability to terminate the PFI Contract for systemic poor performance should sufficiently incentivise the Contractor to perform the services to the standard required by the Authority; and

(b) to the extent that the Authority believes that a failure to provide the services could give rise to other concerns or liabilities that the payment mechanism and the Authority's termination rights do not address, the Authority should seek to include a specific remedy in the PFI Contract to address that concern (eg by including appropriate indemnities in the PFI Contract).

Ensuring that the sole remedy principle is not compromised requires a complex legal analysis of the Authority's rights under the PFI Contract and rights available as a matter of law (eg the right to claim damages). The consequences of not protecting this principle can be to expose the Contractor to risks that have been neither priced nor passed down to the sub-contractors.
5.8 Refinancing

In its simplest form, the UK Government's stated policy objective from 2001 to 2008 in relation to the refinancing of all future PFI projects was that, to the extent that any increase or acceleration of equity-related returns arose as a result of a change in the terms of the underlying senior debt for the project, the incremental increase should be shared 50:50 between the public and private sector. In October 2008, the allocation was changed, principally due to the widening of credit spreads so that now the split is typically 70:30 (in favour of the Authority) for all amounts over GBP1 million.

Refinancing has been the subject of intense political and commercial debate in the UK and both incumbent Contractors planning to undertake refinancings and prospective bidders for PFI projects who continue to price bids on an assumption that they will be able to realise a refinancing benefit in the future, would be well advised to obtain specialist advice in relation to the requirements of the PFI Contract in this regard.

6. Insolvency and security position

The insolvency and security position is relatively clear in the UK. In most circumstances it is accepted that following certain events, the senior financiers will be entitled to take over the project, either by exercising security they have over the shares in the Contractor or by appointing an administrative receiver to the Contractor. An administrative receiver owes its duties in relation to enforcement of security principally to the senior financiers and not to the general body of creditors as a whole.

That these rights are accepted by all sides was made clearer through the introduction of the Enterprise Act 2002, which provides a specific exception for PPP projects to what is a compulsory rehabilitation regime (administration) for most types of secured lending and makes clear that an administrative receiver appointment is still a right of senior financiers even when fully secured lenders in other business sectors are unable to appoint such a person. Specialist advice is needed to ensure that a particular PFI Contract does fall within the PPP exception as, if it does not, many of the in-built contractual remedies in a PFI project structure will not work as intended.

7. Sector-specific issues

Many of the common sectors have particular issues that apply to them and in respect of which specialist advice will be needed. More information on these sectors and the standardised documentation that exists in many of them can be found on the websites of the relevant public sector bodies mentioned in this Chapter.

7.1 Road

The roads market has evolved considerably in the last few years. The number of pure Design, Build, Finance and Operate (DBFO) road projects has reduced since the initial waves in the 1990s, but the Highways Agency form of contract is reasonably stable. A key feature of road contracts in the UK has been that no compensation is paid on termination if arising as a result of Contractor default, although even this entrenched view has seemed to be softening in recent years.

The number of roads-related mixed projects is increasing. These involve some or all of road construction and maintenance, upgrading of street lighting and contracts covering specified areas (including urban and local roads), rather than just specific routes (e.g. the GBP2.7 billion Birmingham City Council Highways Maintenance PFI project and GBP2 billion Sheffield City Council Highways PFI project). The form of contract for streetlighting projects has now become relatively standard.
The initial waves of DBFO road projects were shadow toll payment mechanisms. The more recent DBFO road projects such as Westlink in Northern Ireland have involved a congestion-based mechanism and/or an availability mechanism. The Birmingham Northern Relief Road also introduced the concept of real tolls onto a UK road (as opposed to a bridge or tunnel) for the first time.

7.2 Rail

There have been a number of light rail projects in the UK and a lesser number of heavy rail projects, as well as the London Underground PPP projects. The light rail projects that have been closed have generally had availability payment structure (eg the DLR deals). The form of contract has not become standardised. There are currently significant issues with affordability of light rail projects in the UK. Examples of heavy rail projects include the Channel Tunnel Rail Link, potentially certain Crossrail projects and the upcoming High Speed Rail deals (although these are still to be tendered). Increasingly, rolling stock and depots are procured on the basis of principles similar to PPP (Thameslink and IEP, for example).

7.3 Health

The health market in the UK has been undergoing major structural change even outside the PFI world of major acute hospital deals. It has seen, for example the introduction of clinical services being provided to the NHS by persons that are not NHS employees and the use of property financing techniques in NHS LIFT projects. The NHS PFU has its own standardised documents for both acute and LIFT projects from which only project-specific deviations are permitted – this is accepted by the market.

7.4 Education

Under the BSF programme, contracts are let by the relevant local education authority to a project company which is owned by a local education partnership (LEP) comprising the consortium parties, the authority and a publicly owned body called Building Schools for the Future Investments (BSF). Schools may well be bundled so that one contract involves many schools. Partnerships for Schools has developed standardised documentation for BSF projects from which few derogations are expected. The market appears to have broadly accepted this, subject to some derogations, significantly reducing contractual negotiations between the Authority and the Contractor.

8. Employment issues

8.1 TUPE and PFI

The Transfer of Undertakings (Protection of Employment) Regulations, 2006 (frequently referred to as “TUPE”) ensure that on the transfer of a business to a third party or following a so called “service provision change”, the employment of employees engaged in that business/dedicated to providing the relevant services would be protected, together with the terms and conditions of employment enjoyed by those staff. This legislation is of significant relevance in the context of the PFI because if a project involves the provision of services that have historically been provided by the relevant Authority or a third-party contractor (eg catering or cleaning services), staff engaged in the provision of those services will typically transfer to the employment of the Contractor (or a member of its supply chain providing the relevant services) once the Authority ceases to provide (or procure the provision of) the services itself (typically following completion of the construction of the relevant new facility).

The application of TUPE in PFI has been the subject of significant debate over recent years and (some would argue) has been the most difficult PFI-related issue that the Government has had to address to ensure its ongoing political and social viability. The earliest PFI projects that involved TUPE transfers have now been operational for several years, but due to the legal difficulties that needed to be overcome to facilitate PFI in the local government and health sectors, the majority of PFI projects that have closed (and which will involve TUPE) are either still in construction or have only recently become operational.

8.2 Trade Union concerns

During the course of 2002 a number of PFI projects were in operation and a number of issues were brought to the attention of the Government by UNISON (Britain’s largest trade union). There were two principal concerns:

(a) TUPE seeks to protect employees’ terms and conditions for a period of time following transfer of an employee’s employment. TUPE does not, however, protect pension benefits. In the context of those PFI projects that were operational in 2002, most (if not all) staff that had transferred to the private sector no longer had access to a final salary pension scheme operated by their employer (a benefit that they had historically enjoyed, or been entitled to enjoy, when employed by the public sector). Although the relevant PFI Contracts had typically included provisions requiring the Contractor to ensure that transferring staff would be offered similar pension benefits, an ever-decreasing number of private sector employers in the UK (including the contractors providing the services at the operational PFI hospitals) operate final salary pension schemes, meaning that the future performance of the pensions of the transferred staff were wholly dependent on the performance of the markets in which their pension contributions were being invested.

(b) Although the terms and conditions of employment of staff that transferred from the public sector would (through the operation of TUPE) be protected following transfer, the new employer of those staff was at liberty to employ new members of staff on (subject to legislative requirements) whatever terms and conditions it considered appropriate in the market at that time. There were few requirements set out in the PFI Contract. In UNISON’s opinion (supported primarily by complaints from employees in operational PFI hospitals) this incentivised the Contractor to increase its profitability through minimising its staff costs (eg through the use of temporary or agency staff). The concern was that this financial incentive could create a “Two-Tier Workforce” that was contrary to one of the Government’s frequently cited benefits of the PFI, namely that it facilitated an improvement in quality of services through allowing access to private sector innovation.

8.3 Secondment model

This “Two-Tier Workforce” issue forced the Government to reconsider its approach to employment matters under the PFI. The Department of Health made significant revisions to its standard PFI terms in 2003, introducing a new model that seeks to prevent the application of TUPE to employees that would previously have been affected by the PFI and provide for the secondment of those staff to the Contractor (or member of its supply chain providing the relevant services) for the term of the PFI Contract. At a practical level, the secondment model is intended to allow the Contractor (or member of its supply chain providing the relevant services) to have day-to-day operational management of the staff but ensure that all employees engaged in the provision of the services (existing and future) are employed by the Authority. From a political perspective, the principal benefits of the secondment model are:

(a) all employees engaged in the provision of the services at the relevant facility (eg a hospital) can continue to enjoy terms and conditions of employment that will (in a perfect market) be comparable to those enjoyed by contemporaneous employees at other hospitals in the region (including continued access to a final salary pension scheme); and

(b) future employees will be public sector employees, working alongside existing members of staff on comparable terms and conditions of employment.
The proposed introduction of the secondment model immediately raised operational and financial concerns for the private sector, primarily focussed on the constraints within which the Contractor (or member of its supply chain providing the relevant services) would be able to manage the seconded staff (eg in relation to disciplinary matters where there could be a cultural difference between the public and private sectors in relation to how such matters are dealt with) and the extent to which employment costs under the secondment model would be for the account of the public sector. This chapter does not seek to discuss the details of the secondment model now being used in PFI health schemes, but suffice to say that the model is now firmly established and regularly accepted by Contractors. Recent case law has cast some doubt on the legal efficacy of such arrangements but this has not yet impacted on their use in PFI health schemes.
Belgium

Mijn talent is van dien aard
dat geen onderneming hoe
omvangrijk ook mijn moed
overtreft.

My talent is such that no
undertaking, however vast
in size, has ever surpassed
my courage.

Peter Paul Rubens
(1577-1640)

Contact

Antwerp
Filip Tanghe
Allen & Overy LLP
Uitbreidingstraat 80
B-2600 Antwerp
Belgium
Tel: +32 (0)3 287 7222
Fax: +32 (0)3 287 7244
filip.tanghe@allenovery.com

Brussels
Helga Van Peer
Allen & Overy LLP
Avenue de Tervueren 268A
B-1150 Brussels
Belgium
Tel: +32 (0)2 780 2222
Fax: +32 (0)2 780 2244
helga.vanpeer@allenovery.com
1. Introduction

After a late start compared with other EU Member States, Belgian public authorities and other public entities are increasingly structuring their projects as PPPs. The appetite has traditionally been bigger in the Flemish Region, but currently most levels of public authority have ongoing PPPs and even local authorities are turning more and more to PPPs. This has made the Belgian PPP market very active, drawing interest from German, French, UK and Dutch parties.

In the Flemish Region projects for the construction of light rail infrastructure and student housing closed in 2009. It is the Flemish Government’s ambition to use DBFM projects to implement a number of missing links in road infrastructure and a number of public procurements are ongoing. The Belgian federal government has launched public procurements for several prison buildings as DBFM projects. The French-speaking and German-speaking Communities are each conducting public procurements for the building and renovation of schools.

Key obstacles for the development of the market in Belgium include the strict Belgian rules on the use of languages and regulatory barriers which result in high initial investment costs. Procurement procedures also tend to be long and complex with a high risk of litigation.

2. Legal and regulatory framework

2.1 Background

To understand the various forms of PPP in Belgium, it is important to understand how the Belgian legal system operates.

Belgium is a federal state. The federal entities are the Regions (the Flemish Region, Brussels Metropolitan Region and Walloon Region), and the Communities (the Flemish Community, French-speaking Community and German-speaking Community). For reasons of coherence, the Flemish Region was merged with the Flemish Community.

This means that Belgian law applies at EU, federal, regional and local level, and is further supplemented by general principles of good governance. The key principles of good governance are equality of treatment, transparency, and accountability for decisions made by public entities.

Belgian law makes a distinction between private law and public or administrative law, so that specific rules apply to public law entities that do not apply to private companies or individuals. For example, public assets fall under a specific legal regime that restricts the ability to grant property or contractual rights over them. The most basic distinction between public law and private law is that decisions made by public entities, such as the decision to contract with a private entity, are subject to review by the administrative courts, whilst contract performance issues are subject to the jurisdiction of the civil courts.

PPP contracts may be let by public law entities (referred to in this chapter as Authorities) which include public sector bodies at all levels, from state to local, and also less recognisable entities, such as private companies performing public service tasks and autonomous public enterprises. A contract entered into by an Authority becomes an administrative contract when an Authority acts in its capacity as a public authority. All administrative decisions are subject to the principles of good governance.

1. These are limited liability companies under public law owned directly or indirectly by the state and which perform public services and may also develop certain commercial activities (e.g. the public railways operator (SNCB/NMBS), the public telecoms operator (Belgacom), the public post services operator (La Poste/De Post) and the air traffic control operator (Belgocontrol).
2.2 General characteristics of PPP

There is no legal definition of PPP in Belgium. In general, the term refers to any form of co-operation between an Authority and a private partner (referred to in this chapter as a Contractor) which provides for the funding, construction, renovation, operation and maintenance of infrastructure; or the provision of a service (to the Authority or to the public).

2.3 PPP at different levels of government

There is no specific separate legal framework for contractual PPPs within the various levels of Belgian government and PPP projects are generally tendered as public procurement contracts for works and services or as concession contracts. Legislation is different, however, depending on the government in question.

(a) Federal level

There are no specific rules regarding PPP at the Belgian federal level. However, the federal legislature has applied PPP principles since the early nineties.

(b) Regional and Community level

(i) At the regional level, neither the Walloon Region nor the Brussels Metropolitan Region has enacted general PPP legislation, but the Walloon and Brussels legislatures have applied PPP principles in specific legislation, by setting up entities (in the form of public law entities, limited liability companies under public or private law, etc) and granting them the capacity to participate in private law companies or incorporate joint affiliates with the private sector.

For example, the Walloon legislature created a mixed entity (owned by public authorities and banks) in the form of a public law company (SOFICO) which is in charge of the financing, construction or renovation, and operation of major infrastructure projects located in the Walloon Region. To facilitate PPP structures, the legislature authorised SOFICO to grant long-term lease rights or building rights on public assets and infrastructure.

(ii) In the Flemish Region, a general Decree on PPP was passed on 18 July 2003 (the Flemish PPP Decree). This established the Flemish Know-How Centre for PPP (Vlaams kenniscentrum PPS), which is responsible for preparing, advising and evaluating Flemish PPP projects. The Flemish PPP Decree also sets out more general rules that facilitate Flemish PPP projects, for example by easing certain restrictions on public assets and allowing for joint ventures to be established. It also contains some provisions relating to local (ie municipal or provincial) PPP projects.

Further, a number of sector-specific public law entities were set up by the Flemish Region in order to initiate and/or coordinate PPP projects:

- **PMV** (ParticipatieMaatschappij Vlaanderen) – an entity that participates in joint ventures on behalf of the Authority and must initiate, support and develop PPP projects. PMV plays a coordinating role in the public procurement procedures for a number of important road projects in the Flemish Region. It also has an advisory role in many Flemish PPP projects.

- **BAM** (Beheersmaatschappij Antwerpen Mobiel) – a new public entity created by the 13 December 2002 Flemish Decree for the financing, realisation and management of traffic infrastructure works in Antwerp (Masterplan Antwerpen). This Decree gives BAM wide powers and flexibility to co-operate with the private sector, including providing exceptions to the general principle of inalienability of public assets. The Masterplan Antwerpen was one of the first cluster of infrastructure projects that were structured as PPPs in Belgium.

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2 21 March 1991 Act (the Act)
**AGION (Agentschap voor Infrastructuur in het Onderwijs)** – a new entity incorporated pursuant to the Flemish Decree of 7 May 2004 and tasked with coordinating PPPs in relation to school infrastructure in Flanders. AGION is currently in the last stage of the bidding procedure for the financing of the reconstruction and renovation works of approximately 200 schools.

Furthermore, the Flemish Region has enacted some *ad hoc* enabling legislation for a number of specific projects. The purpose of this *ad hoc* legislation in Flanders is generally to make the financing available on the public side and to authorise the granting of rights *in rem* over assets belonging to the public domain. More recently and in response to the liquidity crisis, such *ad hoc* legislation has also introduced additional guarantees from the Flemish Region in order to make certain projects more attractive to financiers.

(iii) The French-speaking Community, which is competent in the field of education for the French-speaking part of Belgium, enacted the Decree of 14 November 2008 on the exceptional financing of programmes for the renovation, reconstruction and extension of school infrastructure through PPPs. This decree provides the enabling legislation for a school infrastructure project which will be the first DBFM project in the French-speaking Community.

(c) **Local level**

At the local level, each region has local laws applying to cities and municipalities (which are public bodies whose powers and duties extend to a local area, eg a section of a city). The ability for cities and municipalities to set up institutional PPPs (which are joint ventures explained in more detail in section 3 below) and the methods under which municipalities and the private sector may contract with each other depends on the region to which the municipalities belong.

3. **Different structures of PPP and the selection of the private partner**

3.1 **PPP forms**

Under Belgian law a PPP project can be structured in various ways. There are two broad types of PPP although it is not always easy to make a clear distinction between the two:

(a) A PPP may be of a purely contractual nature, where the partnership between the Authority and the private sector is based solely on contractual links.

(b) A PPP may be of an institutional nature, involving the incorporation of a joint venture in which the Authority and the Contractor are shareholders. This entity will usually be a special purpose vehicle (SPV), incorporated specifically to carry out the project. This adds additional complexity, as the public sector effectively becomes a shareholder in the SPV. Alternatively, an Authority may award a contract to a wholly private-sector incorporated joint venture.

There are three kinds of contracts that may be entered into, for both contractual PPPs and institutional PPPs. Whatever the nature of the contract, the selection of the private partner must always be in accordance with EU and Belgian procurement rules, as well as with the general principles of EU law and the Belgian principles of good governance:

(i) **Public procurement contracts** are contracts for payment concluded in writing between a Contractor and an Authority for the performance of works, supplies and/or services, awarded in accordance with the public procurement legislation. Public procurement contracts also include promotion contracts for public works, a specific category under Belgian law for public procurement contracts for public
construction works under which the Contractor must also finance the construction works, which are then put at the Authorities’ disposal at the time of their completion via a transfer of ownership or a lease (with or without an option to buy);

(ii) **Public service concession contracts**, whereby an Authority grants the right to a private or public entity to operate a public service according to the terms and conditions set out by the Authority and under its supervision eg the operation of a public transport network. The Authority may also transfer rights to use the infrastructure necessary to manage and operate the public service. In principle the Contractor is allowed to charge a fee to users of the public service, but the Contractor may also be remunerated by means of an annual charge paid by the Authority; and

(iii) **Public works concession contracts**, under which the Contractor must finance, build and operate an infrastructure asset which it owns for the whole duration of the contract (eg tunnels or gas stations along the highway). At the expiry of the concession contract, ownership of the infrastructure is transferred in full and at no charge to the Authority. In principle, the Contractor is allowed to charge a fee to users of the infrastructure. However, the Contractor may also be remunerated by means of an annual charge paid by the Authority.

Also, the Authority may enter into “real estate transactions”, ie private contracts granting long-term lease rights or building rights on its private properties, or administrative contracts granting rights of private use on its public domain (known as “domain concessions”). These rights of use can be unilaterally terminated at all times by the respective Authority if it is in the general public interest to do so.

Most PPPs are availability-based and the contracts are characterised as works contracts, with the exception of a very limited number of concession contracts.

### 3.2 Selection of the private partner

When selecting a Contractor, an Authority must comply with the rules and principles of public law. The applicable rules depend on the form of the PPP.

**(a) Contractual PPP**

For a PPP of a purely contractual nature, the Authority must first characterise the contract to be concluded.

If the contract qualifies as a public procurement contract (ie a public contract for works, services or goods, a promotion contract for public works or a public works concession contract), the Authority must comply with the strict advertising requirements and use one of the awarding procedures described in the regulations on public procurement.

If the contract is not a public procurement contract (eg a real estate transaction, or a public service concession contract), the public procurement rules will not apply, but the Authority must select a Contractor in compliance with the general principles of good governance. This means that the Authority must conduct a transparent and open selection procedure based on objective and non-discriminatory selection and awarding criteria. To a certain extent, these principles are comparable to the EU Treaty principles.³

**(b) Institutional PPP**

The public procurement rules do not generally apply to the establishment of a joint venture, but the Contractor must be selected in compliance with the general principles of good governance. Compliance with the general principles of good governance will usually result in a selection and award process similar to that required under the public procurement rules. However, public procurement rules may still apply if a contract (for works or the supply of services) is subsequently granted to the joint venture.

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³ In its 12 April 2000 Interpretative Communication on concessions under Community law, the European Commission stressed that, even when the public procurement rules do not apply, the State must respect the rules and principles set out in the EC Treaty or laid down by the European Court of Justice. Consequently, contracts must be concluded in accordance with the principles of equality of treatment, transparency, proportionality, mutual recognition, protection of the rights of individuals, etc.
3.3 Consequences of non-compliance with the rules

If an Authority does not comply with the above rules and principles of public law before the contract has been concluded, an aggrieved tenderer may ask the Supreme Administrative Court (Raad van State/Conseil d’Etat) to order interim measures. One possible interim measure is the suspension of the selection/award decision, which prohibits the Authority from executing the contract and obliges them to either restart the tender process or make a new award.

In relation to contracts that fall under the public procurement legislation, the EU remedies apply, so the Authority must notify tenderers of its intention to enter into the contract with a certain tenderer. The rules provide for a stand-still period of 15 days (also known as the Alcatel term) from such notification. During this period, the Authority may not enter into the contract, in order to allow aggrieved tenderers to launch a request for interim measures (ie suspension) with the Supreme Administrative Court.

Once the contract has been entered into, the Supreme Administrative Court will not suspend the awarding decision. However, an aggrieved tenderer may still:

(a) request the Supreme Administrative Court to annul the awarding decision within 60 days from the notification of the awarding decision; and/or

(b) claim damages in the civil courts, either during or after performance of the contract.

In assessing compliance, the courts examine the substance and not the form of the transaction, and may therefore strike down devices that are perceived to circumvent the rules.

In addition, in the event of non-compliance with the European Directives on Public Procurement or general principles of the EU Treaty (equal treatment, transparency, etc), the European Commission is entitled to bring a case before the European Court of Justice.

Finally, most Authorities operate under the supervisory bodies of the Federal or Regional government. Governments usually have the right to appoint an agent who attends the meetings of the board of directors of an Authority and who may refer a board decision to the supervisory body if they deem the decision non-compliant with the above rules and principles, or contrary to the general public interest. The relevant supervisory bodies may within a specified period suspend or annul that decision on the same grounds.

4. Recurring legal issues

4.1 Public law

As PPP involves public law bodies and their assets, public law requirements apply to PPP arrangements, including the following:

(a) Capacity

Authorities must have the capacity to set up (or participate in) private law companies and to execute the contract. Although contested by some legal commentators, it is generally construed from the requirement that every act by an Authority must have a legal basis that the applicable law under which the Authority in question is created and regulated must expressly authorise the Authority to set up affiliates.

(b) Selection of the private partner

Authorities must select private partners according to the general principles of good governance.
(c) Bankruptcy

Authorities cannot usually become bankrupt. Some legal authors take the view that the applicable law under which the Authority in question is created and regulated must expressly preclude the application of bankruptcy rules. Other authors take the view that an Authority cannot go bankrupt based on the general principle of continuity of the public service.

(d) Assets

The assets of an Authority are subject to a specific regime, under which no property or contractual rights may be granted over assets that are necessary to perform a public service, and such assets are therefore immune from lenders’ security. A number of Flemish Decrees, however, contain exceptions to this strict regime.

(e) Language

Contracts concluded between an Authority and a Contractor must be drafted in French or Dutch (depending on where the Authority is located) to be valid. The Commission that monitors the application of the laws on the use of languages has stated that these laws do not apply to public contracts concluded with foreign entities.

(f) Legal form of an SPV

An SPV established for a PPP project may either have a public or private law form. Each specific SPV must be assessed as to whether it is subject to the public procurement legislation or the jurisdiction of the Administrative Court.

(g) Supervision

Authorities fall under the supervision of an administrative authority. At times, Authorities will need approval from the administrative authority for certain decisions. In general, supervision is exercised through commissioners appointed by the government with the relevant competence (federal or regional). The commissioners may suspend Authorities’ decisions that violate the relevant laws (or in certain cases, that are contrary to the general public interest), and the government may then annul the decision challenged by the commissioner (e.g. decisions of autonomous public enterprises such as SNCB, the national railway company, are subject to the supervision of two government appointed commissioners).

4.2 Contract law

In principle, contracts concluded under a PPP framework are subject to civil contract law. However, for public procurement contracts, there is a Royal Decree of 26 September 1996 on standard contract terms (SCT). The SCT apply to all public procurement contracts with an estimated value above EUR22,000 (exclusive of VAT), unless an express derogation has been provided. Below that threshold, only some of the articles of the SCT apply, while the others must be expressly declared applicable. Some of the articles in the SCT cannot be set aside; others can only be set aside for reasons that are expressly justified in the tender documentation.

There are some sector-specific exceptions, such as standard contracts determined by governmental order for social housing PPP projects.

Unless the SCT apply to the project, the parties generally have contractual freedom when drafting PPP contracts. Nevertheless, both the Flemish Know-How Centre for PPPs and PMV have developed contracts which have become the market standard. The standard contract for road infrastructure projects developed for PMV has been used in many major projects (and was drafted by Allen & Overy).
4.3 Corporate law

If the PPP involves the incorporation of a joint venture, the joint venture often takes the form of a limited liability company of private law (naamloze vennootschap/société anonyme (NV/SA)). There are certain requirements in respect of shares, share capital and corporate governance.

4.4 Tax law

There are no specific tax rules governing PPP projects. Broadly speaking, the tax treatment of contractual PPP projects does not give rise to specific tax issues (the tax treatment is similar to the tax treatment of “ordinary” contractual arrangements).

The tax treatment of institutional PPP projects, however, has given rise to uncertainty, as it is unclear how the general tax rules apply. To avoid this uncertainty, the Contractor, who will need to factor the expected tax cost of the project into his bid price, can seek a binding tax ruling prior to execution of the contract covering most aspects of the project. Such tax ruling is valid for the entire period of the project, as long as there is no change in tax legislation (note that a change in tax rules is generally a risk borne by the Authority). Several tax rulings have been issued to date (most of them unpublished), covering different types of PPP projects:

(a) Institutional PPP – Income tax

From a corporate income tax perspective, the key issue is to avoid a “tax before cash” situation, where a profit must be recognised at the end of the construction phase. The Belgian Tax Ruling Commission (the Ruling Commission) is generally willing to issue tax rulings making it possible to avoid this situation.

(b) Institutional PPP – VAT

As a commercial entity, the Contractor qualifies as a separate taxable person and will have a right to deduct input VAT to the extent that it is providing deliverables which are subject to VAT.

According to the tax authorities, a DBFM contract cannot be viewed as a contract for a single service. Instead, the various components of the overall contract for deliverables undergo separate treatment for VAT purposes. This makes DBFM projects expensive, because VAT becomes chargeable on the design and construction components at the time of the provisional acceptance of the construction (even if the DBFM charges are payable on a periodic basis over the entire duration of the contract – Belgium has currently not implemented the possibility granted to Member States by article 66 of Directive 2006/112/EC to have VAT charged at a later time). This means that the Contractor’s financing cost increases. The positive effect of this approach is that no VAT is chargeable by the Contractor on the interest component.

It should also be noted that where construction services are provided to a taxable person, VAT is chargeable on these services according to the reverse charge rule. In that case, the VAT does not give rise to a prefinancing cost.

The VAT treatment (and the VAT rate) of the deliverables received by the Authority is very important, since public law entities are, as a rule, not considered VAT taxable persons for their activities as a public authority, meaning that they may not deduct input VAT in relation to these activities. The activities performed by the public authority may also be exempt (eg school education services), in which case a similar issue arises.

(c) Institutional PPP – Other taxes

If the Contractor is the owner of the infrastructure (or the holder of another right in rem), it is liable for the real estate withholding tax (an annual tax calculated on the deemed rental value of the infrastructure), whereas an exemption would typically have applied had the Authority been the holder of such right in rem).
The transfer of legal ownership in real estate triggers a duty at the rate of 10% in the Flemish Region, or 12.5% elsewhere, of the higher of the contract value or market value. This registration duty may, however, be mitigated through careful planning and structuring of the project.

4.5 Labour law

PPP transactions may trigger complex employment law issues if the transaction requires a transfer of employees from the Authority to the Contractor.

(a) Transfer of employees/undertaking

A first area of concern is whether a PPP transaction gives rise to the application of the transfer of undertaking regime under the Acquired Rights Directive and under the Belgian Collective Bargaining Agreement on transfers of undertaking (the CBA). This issue may arise both in institutional PPP and contractual PPP projects.

If the CBA applies, it will have the following impact:

(i) all employment contracts are automatically transferred to the Contractor at the time of transfer;
(ii) a transfer may not entail any dismissal (unless there are exceptional circumstances);
(iii) the Contractor will be bound, by operation of law, by the terms of all employment contracts and collective bargaining agreements existing at the time of the transfer, as regards terms and conditions of employment (including accrued length of service, remuneration, benefits, position, working time and work place);
(iv) the former and new employer are jointly and severally liable for the payment of all debts existing at the time of transfer; and
(v) the transfer will also trigger some important information and consultation requirements.

Belgian courts have applied the CBA to private sector activities, such as mergers and the incorporation of a new company. Institutional PPP transactions may therefore be subject to the CBA. But the CBA has also been applied to events such as the termination of a concession and appointment of a new concessionaire, the termination of a service contract and the appointment of a new service provider. Consequently, contractual PPP transactions may also be subject to the CBA.

In PPP transactions the application of the CBA is further complicated by the fact that it only applies to private sector companies, but the Acquired Rights Directive requires that the regime also applies to public sector companies. Employees in the public sector may therefore rely on the direct effect of the Acquired Rights Directive to obtain a similar protection as provided under the CBA.

Finally it should be noted that the transfer of undertaking regime (both under European and Belgian law) only applies to contractual employees (whose legal relationship with their employer is based on an employment contract), as opposed to “statutory employees” (see below). The transfer of statutory employees to the Contractor triggers further legal and practical issues. In most cases these require ad hoc solutions.

(b) Merger of groups of employees

A second area of concern is the merger of groups of employees originating from public and private partners. Several complicating factors can be highlighted:

(i) The legal position of employees employed in the public sector is materially different from the legal position of employees employed in the private sector. Most employees in the public sector are statutory employees. Most employees in the private sector are contractual employees. Statutory employees benefit from an advantageous legal status (eg strong protections against dismissal) and their unions and are very reluctant to give up this legal status.
(ii) Collective representation of employees is organised differently in the private sector and the public sector. As a general rule, the influence of trade unions on decision-making is stronger in the public sector. Public sector trade unions often seek to maintain that legal status after the PPP transaction, whereas the private sector may try to avoid this.

(iii) The social security position of public sector and private sector employees is materially different, which may give rise to complex issues on (occupational) pension funding.

5. Current and future active sectors

5.1 Active sectors

PPP is often used in sectors such as transport, public health, education, social housing, national security, waste management, water purification, and water and energy distribution. PPP in these areas is mainly in the form of complex infrastructure projects (including design, building, operation, finance and maintenance), the management of high-tech public services, or the outsourcing of IT services.

The legislation on social housing has been amended to facilitate PPPs in this sector. The amendments set out, amongst other things, the conditions under which PPP projects can benefit from a special fund established for social housing and the requirement to use a standard contract for PPP contracts in the social housing sector.

In the law relating to the social services agencies, a new chapter has been added to enable the co-operation of social service agencies with private partners. It has now become possible to establish a separate private law entity (in the form of a non-profit association) in order to group hospitals belonging to social services agencies under the same management.

The projects below are noteworthy:

(a) BAM, a public entity created by the Flemish Government for the financing, implementation and management of traffic infrastructure in the city of Antwerp, is launching several projects with PPP structures. The Brabo 1 light rail project, which is intended to make the city of Antwerp more easily accessible by public transport, closed in August 2009. The Oosterweelverbinding project (probably the largest PPP/PFI in Belgium so far) is currently on hold.

(b) The “Diabolo Project”, a major railway infrastructure project in the form of a PPP to improve access to the Brussels National Airport, closed in 2007. The project is one of the most complicated PPP projects to date and will encompass several big infrastructure works to make the Belgian national airport directly accessible by train from the north and east of the country. Two different Authorities/public law entities were involved; the Flemish government in relation to the road part of the project and Infrabel (the company that manages the Belgian railway infrastructure) in relation to the railroad part. It is one of Belgium’s most important infrastructure initiatives and it is the first infrastructure project in the country to be funded by a PPP.

(c) Infrabel, the public company that manages the Belgian railway infrastructure, closed the Liefkenshoekspoortunnel PPP in November 2008, the second major PPP to close to date.

(d) The Government of the Flemish Community of Belgium is currently conducting a public procurement procedure for a PPP project relating to the financing of the reconstruction and renovation works of approximately 200 schools.

(e) The Government of the French-speaking community of Belgium is currently conducting a public procurement procedure for a PPP relating to the financing of the reconstruction and renovation of 54 schools.
(f) PMV/Via-Invest, a Flemish government entity, is conducting public procurement procedures for the construction of the southern section of the R4 round Ghent and for the construction of the N2, the North-South link through the Kempen region.

(g) The building agency of the Belgian Government has launched PPP projects in relation to the DBFM of four prisons.

Despite the financial crisis, various projects have been completed or launched. In some cases, governments have taken some legislative initiative in order to make particular projects more bankable. More recently, Authorities are paying increasing attention to limiting bid costs for Contractors and trying to increase competition amongst the lenders.

5.2 Likely future activity sectors

Several proposals and working papers by federal and regional ministers discuss the possibility of using PPP in different sectors and programmes, such as schools, waste collection and treatment, and sports infrastructure. This clearly indicates the positive attitude and momentum towards the further use of PPP in the future in Belgium.
God schiep de wereld, behalve Nederland: dat deden de Hollanders zelf.

God created the world, except for the Netherlands, which was created by the Dutch themselves.

Anonymous
1. Introduction

In the last decade, the Netherlands has seen a number of PPP projects across a range of sectors, principally in the transport and accommodation sectors. The legal and regulatory environment is conducive to successful procurements and PPP looks set to continue as a procurement method. The Government has not yet embraced PPP in quite the same way as in the UK. However, the government’s belief in the merits of PPP projects is steadily growing and resistance within the ranks of various government agencies has reduced considerably over the past few years. In view of both its programme to clear a backlog in transport infrastructure and the recent economic climate, the government has initiated a number of transport infrastructure projects, many of which will be done by way of PPP.

Previous and current PPP projects in the Netherlands are listed below:

(a) Rail
- The High Speed Link Amsterdam-Paris, the first Dutch PPP deal closed in October 2001 (the HSL South Project).

(b) Roads
- The A15 road project which involves a road connection between the newly dredged Rotterdam harbour (Maasvlakte II) and the hinterland which started in early 2009 (the A15 Project);
- The A12 road project which started in early 2009 (the A12 Project);
- The second Coentunnel project, the construction of a tunnel on the west side of Amsterdam, closed in June 2008 (the Coentunnel Project);
- The N31 road project, closed in December 2003 (the N31 Project); and
- The A59 road project, closed in April 2003 (the A59 Project).

(c) Water
- The Harnaschpolder waste water treatment project, closed in December 2003 (the Harnaschpolder Project).

(d) Schools
- The Montaigne school project, closed in December 2004 (the Montaigne School Project).

(e) Accommodation
- The detention centre Zaanstad project, which is expected to start in mid-2009;
- The justice complex Schiphol project, which involves a new court house and a detention centre at Schiphol Airport which started in early 2009 (Schiphol Project);
- The Ministry of Defence headquarters project in Utrecht, closed in July 2008 (the Kromhout Project);
- The IBG/tax office project in Groningen, closed in June 2008 (the Groningen Project);
- The detention centre Rotterdam project, closed in May 2008 (the Rotterdam Detention Centre Project);
- The tax office project Doetinchem, closed mid-2008 (the Doetinchem Project); and
- The renovation of the Ministry of Finance building project, closed in December 2006 (the Ministry of Finance Project).
In the rest of this chapter, the terminology used is Authority for the public sector entity procuring the service and Contractor for the private sector entity providing the service (in the Netherlands this has invariably been a limited company (besloten vennootschap met beperkte aansprakelijkheid) created specifically for the purpose of the project).

2. Legal and regulatory framework

2.1 Background

In the Netherlands PPP projects (ie DBFM/O contracts) are normally referred to as “PPS” projects, which stands for publiek private samenwerking (public-private co-operation). Unfortunately, the same term is also used for genuine joint ventures between the government and a private party. These joint ventures almost always relate to the joint development of real property (and related infrastructure) by lower levels of government and private developers. The result is that the discussions about the merits of DBFM/O contracts are often obscured by arguments that apply to the joint venture model. To avoid that confusion in this chapter, the term DBFM/O will be used.

In the DBFM/O projects to date, the State of the Netherlands has acted through four different agencies. In the accommodation projects (other than the Kromhout Project), the State is acting through the Rijksgebouwendienst, an agency responsible for government housing and part of the Ministry of Housing, Spatial Planning and Environment. In the road projects (other than the A59 Project), the State is acting through the Rijkswaterstaat, an agency responsible for infrastructure and part of the Ministry of Transport, Public Works and Water Management. In the Kromhout Project and HSL Project, the State acted through the Ministry of Defence and the Ministry of Transport, Public Works and Water Management respectively. The Authorities in the other projects were the Province of Noord-Brabant (the A59 Project), the Delfland Waterboard (the Harnaschpolder Project) and the municipality of The Hague (the Montaigne School Project), reflecting the fact that projects can be procured by municipal/provincial governmental authorities as well as by the State.

2.2 The “Dutch model”, a National Standard DBFM/O

The first two DBFM/O projects (the HSL South Project and the Harnaschpolder Project) were very much based on and influenced by the UK PFI model and practices. Later, each of the Rijkswaterstaat in June 2005 and the Rijksgebouwendienst in 2007 developed their own first standard DBFM/O contract and – in the Rijkswaterstaat’s case – also a standard tender document. The Rijkswaterstaat model was heavily based on the structure found in the UK DBFM/O models. The Rijksgebouwendienst model was quite different, resulting in two sets of standard documents being used in the Netherlands.

At the initiative of the Ministry of Finance, the Rijkswaterstaat, the Rijksgebouwendienst and the Ministry of Defence joined forces in 2008 and issued a draft for a new uniform national standard DBFM/O Contract (the National Standard DBFM/O) in early 2009. In addition, they each produced sector-specific standard DBFM/O contracts based on the National Standard DBFM/O. Both the Dutch branch of IPFA (International Project Finance Association) and the Dutch Constructors Association were invited to participate in a market consultation and each provided comments which were discussed in May 2009. The National Standard DBFM/O was issued late summer of 2009 and the sector-specific modules were revised accordingly. On the basis of these standard contracts, we can conclude that the Netherlands broadly follows the same principles as the UK PFI Model. The new standard contracts were used in the A12 and A15 Projects and in the Schiphol project.

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1 Allen & Overy assisted the Rijkswaterstaat in drafting its standard agreement.
2.3 Capacity to contract

Generally speaking, there have been no serious concerns in the Netherlands about the capacity of the state or its agencies to enter into a DBFM/O contract. There were some initial concerns about the capacity to contract in the HSL South Project but these related more to the uncertainty surrounding the upcoming regulatory environment than to the principle of whether a government body has the authority to enter into a DBFM/O contract per se. There is still a question as to what extent the government can delegate its public responsibility to operate a road. This question remains unresolved but is rather a moot point as, to date, the road projects are DBFM contracts only and do not include the ‘operation’ of the road. In most of the earlier projects, the Authority refused to warrant that it actually had the capacity to enter into the DBFM/O contracts. The National Standard DBFM/O does, however, include such warranty. There have been no doubts about the enforceability of DBFM/O contracts vis-à-vis the various Authorities.

2.4 Specific enabling legislation

There has been no need for specific legislation enabling DBFM/O contracts.

2.5 Procurement

It has now become common practice for the Authority to require a fully underwritten bid at BAFO stage which is not subject to lenders’ due diligence. The DBFM/O contract must be in agreed form so that it can be signed immediately upon the preferred bidder being designated. This requires the lenders to perform their due diligence prior to BAFO. Although the private sector initially struggled to accept this approach, later projects have shown that this approach can work. The government has, through this approach, been able to prevent a new round of negotiations on the DBFM/O contract after designating the preferred bidder. This may be the reason why it has now become generally accepted in the Netherlands that the new “competitive dialogue” procedure introduced in the EU procurement directives is well suited for the procurement of DBFM/O projects.

3. Active sectors

3.1 Roads and related infrastructure

The outlook for roads is good. As in various other European countries, investments in roads is high on the political agenda as a means to stimulate the national economy. In addition, in June 2008 a committee chaired by former Minister of Finance Ruding issued a report to the current Minister of Finance and the Minister of Transport on efficient investments in infrastructure (the Ruding Report). The contents were regarded as a strong recommendation for PPP in infrastructure.

The procurement of the A12 and A15 has just started, and in May 2009 a first information presentation was held for the A6/A9/A10 Schiphol-Amsterdam-Almere corridor. Given its size, the Rijkswaterstaat is expected to divide this project into five different parts, four of which will be procured as a DBFM contract. The estimated aggregated deal value of the project as a whole is EUR3 billion. In terms of deal value, roads will be the number one sector for at least the next few years.
3.2 Accommodation

The other sector with growth potential is accommodation. The procurement of the Schiphol Project is under way. From the two other prison projects currently in the market, one has been cancelled by the Ministry of Justice due to an apparent surplus of capacity. The start of the tender for the new Army Museum in Soesterberg is scheduled for the end of 2009. Other projects that are said to be in the market include the new seat of the Supreme Court in the Hague and the renovation of two Ministries.

3.3 Schools

The Montaigne School Project closed in December 2004. Although there was much hope amongst the market participants that more school projects would follow, nothing has materialised yet. One key problem seems to be that the transaction size is not high enough to justify the transaction costs. Also, some on the Authority’s side in the Montaigne School Project have expressed their lack of enthusiasm about undertaking the process again, which may have led to a cautious approach from other municipalities and schools. The Ministry of Education recently established a service centre for the construction of schools (Service Centrum Scholenbouw) with the aim of assisting schools in procuring new school buildings through innovative contracts such as DBFM/O contracts.

4. Future sectors

4.1 Rail or light rail

We are not aware of any rail or light rail projects that are expected to come to the market in the near future. ProRail, the government-held company that is responsible for the rail infrastructure in the Netherlands, has often indicated that it does not believe in DBFM contracts. A few municipalities are considering the construction of light rail or tram systems and it is not to be excluded that these will be procured as PPP projects.

4.2 Waterworks

Roughly half of the Netherlands is below sea level. In the context of recent floods (from rivers) and rising sea levels, waterworks could be an area requiring substantial capital investment with potential for PPP. A second sea lock for IJmuiden (from which the Amsterdam harbour would benefit) is mentioned as one of the waterworks projects which the Rijkswaterstaat is currently investigating. The refurbishment of the Afsluitdijk, the 32.5 km dike connecting the province of Noord-Holland with the province of Friesland, has also been suggested as a candidate for PPP.

4.3 Health sector

The main difference to the UK is that in the Netherlands hospitals are privately owned. The heavily regulated health sector is being liberalised very slowly. There is therefore a lot of uncertainty over how the health sector will develop in the future. It is expected that a number of hospitals may not survive independently. Given this uncertainty, we do not expect DBFM/O projects for hospitals in the foreseeable future.
5. General structure of concessions

5.1 Payment mechanisms

The payment mechanisms in the Dutch DBFM/O contracts focus on availability as being the basis for payment with separate performance-related deductions. No deals have been closed where the private sector has been asked to take usage risk.2

5.2 Financing structure

The turmoil in the financial market has not left the Netherlands unaffected; there is a lack of appetite to provide long term debt and to support BAFO with a commitment period reasonably sufficient to reach financial close.

In recent road projects, the Authority is requiring only partially committed funding at BAFO and is allowing the preferred bidder to hold a funding competition after the contract has been awarded. However, contrary to other jurisdictions, the Authority does not assume the risk of an increase in interest rates between BAFO and the funding competition. In addition, the Authority has in recent projects assumed part of the risk of lenders invoking market flex between BAFO and Financial Close through partial compensation for an increase in margin in line with movements in the iTraxx index.

Prior to the financial crisis, it had almost become commonplace in Dutch DBFM/O projects that, after completion of the construction works, part of the present value of the availability payments was either paid out as a lump sum or took the form of a guaranteed income stream which was always payable even upon termination. Recent projects show considerable lump sum payments both during construction and at completion.

The Dutch government has always taken the clear position that the funding in itself is not the reason why it should be interested in DBFM/O structures. The government is aware that it can still fund more cheaply than any private party.

5.3 Changes

In general, the position in the Dutch DBFM/O contracts is that the Contractor is obliged to carry out any change requested by the Authority, provided that the Contractor is able to prevent that change in certain circumstances (e.g., where the risk profile of the project would change as a result). If the Contractor is required to carry out a change, the approach is that the Contractor should be left in a neutral financial position as a result of the change being effected. The Contractor may seek compensation from the Authority, together with temporary relief from its performance under the contract.

5.4 Supervening events

In the Dutch DBFM/O contracts, the supervening events for which some form of relief should be provided to the Contractor are divided into three categories:

(a) Compensation Events (Gevol van Vergoeding) are events that are the Authority's risk and that give rise to relief for the Contractor in respect of both time and money (i.e., increased costs and loss of revenue), broadly reflecting all losses of the Contractor. However, an incentive is built into any compensation to ensure that the Contractor deals as efficiently as possible with the adverse consequences of the event. This incentive may take the form of a threshold for small claims and a banded system with risk sharing at different rates up to certain levels of claims, with 0% for the Contractor above a certain amount.

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2 Allen & Overy was involved in achieving financial close on all these Dutch DBFM/O projects mentioned except for the Coentunnel Project and the Doetinchem Project. We have not verified this statement on usage risk for these two projects.
(b) **Delay Events** *(Geval van Uitstel or Geval van Opschorting)* are events that give an extension to any time limit for construction. It has become standard in the Netherlands that some form of compensation is paid by the Authority to modify the adverse financial consequences for the Contractor. The compensation takes the form of an extension of the end date (so that in absolute terms the period over which the availability payments are made remains the same) and a compensation for payment of interest, principal and swap breakage costs which are due to the delay plus certain general overhead and building costs for that period. This compensation only applies if the delay exceeds a minimum number of days. If the delay lasts for a very long period (the National Standard DBFM/O Contract suggests a period of two years) either party can terminate the DBFM/O contract. The level of compensation is expected to be less than the termination compensation for an Authority Default but more than such compensation for a Force Majeure Event (as defined below).

(c) **Force Majeure Events** *(Geval van Overmacht)* are a discrete set of events which the Contractor is expected to manage but in relation to which relief from termination is granted to the Contractor. The extended subsistence of a Force Majeure Event can lead to a termination of the DBFM/O contract by either party (see below for a discussion of the level of compensation payable in such circumstances).

To the extent that any other event arises during the term of the project that is not a Compensation Event, Delay Event or Force Majeure Event, such an event will typically be a risk that the Contractor must bear.

### 5.5 Change in law

This is one of the areas where views are very much developing. Presently it is thought that changes in law should **not** in general be for the account of the Authority, either in the first place through the mechanisms of indexation, benchmarking and market testing or, to the extent these leave areas uncovered, through a separate change of law mechanism.

Benchmarking and market testing are common in Dutch accommodation projects. Both features are included in the sector-specific Standard DBFM/O Contracts prepared by *Rijksgebouwendienst* and the Ministry of Defence.

### 5.6 Termination and compensation

The principles underlying the determination of the compensation to be paid to the Contractor upon early termination of the project are quite clear. Upon a Contractor default, the payment should be such that the Authority is left in no better nor worse position than the position it would have been in had the default not occurred. The National Standard DBFM/O Contract follows the standard practice in Netherlands: at the discretion of the Authority, the Project is either retendered or valued. If retendered, the termination compensation will be the amount of the highest bid less certain transaction and retendering costs of the Authority. If valued, the termination compensation is calculated as the net present value (NPV) of payments the Authority would have expected to pay to the Contractor less the NPV of the payments the Authority now expects to pay to a replacement Contractor less a fixed compensation amount payable to the Authority for its early termination costs.

The approach in the event of termination on the basis of an Authority default or Force Majeure Event is very similar to that applied in the UK.

### 5.7 Remedies

It is not generally accepted in the Netherlands that the operation of the payment mechanism should be the Authority's sole remedy in respect of a failure by the Contractor to perform its obligations under the DBFM/O contract. It is, however, accepted that the liability of the Contractor to indemnify the Authority for damages should always be subject to some form of cap.
5.8 Refinancing

The obligation to share any refinancing benefits with the Authority is generally accepted in the Netherlands. This percentage (albeit between brackets) was set at 50% in the National Standard DBFM/O Contract. However, in current projects the Authority is entitled to a higher percentage.

6. Insolvency and security position

Unlike in the UK, in a Dutch insolvency the lenders cannot take control over the project company through the appointment of an administrative receiver. Therefore, under the draft National Standard DBFM/O Contract the lenders’ direct agreements provide that the DBFM/O contract is automatically continued by a special purpose vehicle incorporated by the senior lenders.

After the incorporation of such special purpose vehicle and the remedy of subsisting defaults, the senior lenders have the option either to have that special purpose vehicle sell the DBFM/O contract or sell the shares in that vehicle themselves.

Otherwise, the Dutch model lenders’ direct agreements reflect the same principles as can be found in the UK model.

7. Employment issues

Generally speaking there are no serious concerns in Dutch PPP projects relating to employment. Rather, and on a more project-specific level, the Parties need to establish which employees will transfer to the Contractor and under which terms. In addition, the DBFM/O Agreement must include an indemnification provision in respect of employees who claim to be employed by the Contractor under the transfer of undertaking employment laws, where this was not the intention. In the draft National DBFM/O Contract this has not yet been fully covered.
Sa distraction était, le dimanche, d’inspecter les travaux publics.

Pécuchet’s pastime would be inspecting public works in progress on Sundays.

Gustave Flaubert
(1821-1880)
1. **Introduction**

The private sector has a long-established degree of involvement in the provision of services to the public in France. This has extended across a wide range of sectors and been effected through a variety of arrangements. More recently, recognition of the pressing need for new and redeveloped public infrastructure has highlighted the urgent need for private sector involvement in public infrastructure projects. Parliament has introduced legislation to facilitate this further, particularly through public-private partnership (PPP), and has also taken measures to address potential problems in procuring projects during the economic downturn. In response to the increasing need for private sector finance to supplement limited public funds, some major PPP projects have been launched and the years to come will be crucial for the development of PPPs in France.

2. **Legal and regulatory framework**

2.1 **Background**

Until June 2004, private contractors could provide services to the public under three different types of arrangements which, although they did not qualify as “PPP” in the sense used in the UK, constituted a recognised form of partnership between the state and the private sector:

(a) délégation de service public;
(b) marché public; and
(c) bail emphytéotique.

These forms of partnerships did not provide an ideal method of procuring all public infrastructure projects as they include a certain number of restrictions. The recognised need for private sector finance in future infrastructure projects led to sector-specific laws being passed to deal with this issue and in June 2004 legislation was passed enabling contrats de partenariats (partnership contracts).

Throughout the rest of this chapter, the terminology used is Authority for the entity procuring the service, and Contractor for the private sector entity providing the service.

2.2 **Délégation de service public (Concession)**

A délégation de service public is an arrangement whereby an Authority “delegates” to a Contractor its duty to render a specific service to the public, i.e. the Contractor will manage and operate, under the Authority’s supervision, a service in return for a fee payable by the end-user. The most common form of délégation is a concession granted by an Authority to a Contractor.

Although the Contractor is entitled to receive subsidies from the state, two of the key characteristics of a délégation de service public are that:

(a) most of the risks are transferred to the Contractor; and
(b) the Contractor’s remuneration is based on performance. It is usually paid by end-users and if it is not, it should be proportionate to the actual use of the service.

Under a délégation de service public, the Contractor bears most of the risks, including performance and revenue risk. This transfer of risk is evidenced by the level of subsidy that the Contractor is entitled to: it is usually agreed that no less than 30 per cent. of the project revenues must derive from payments by end-users. If subsidies represent more than 30 per cent. of the project revenues, the contract will not qualify as a délégation de service public but as a marché public (public procurement contract – see paragraph 2.3 below).
To date, all motorways and most urban transport projects have been built and operated under a délégation de service public. Some recent major projects in the rail sector have also been launched following a délégation de service public scheme (for instance the Ligne à grande vitesse Sud Europe Atlantique – LGV SEA – a new high-speed rail line between Tours and Bordeaux allowing commuters to reach Bordeaux from Paris in two hours. The tender process was launched in 2008 and the contract is due to be awarded in 2010).

2.3 Marché public

A marché public effectively means a “transaction with the state” and is similar to the UK public procurement arrangements. It is an arrangement by which an Authority purchases goods or services from a Contractor and is governed by the Code des Marchés Publics. The Authority remains liable for the delivery of the service to the general public. There is no liability or risk transfer by the Authority to the Contractor and the Contractor is acting as a mere “outsourced” service provider. Its remuneration stems solely from the purchase price paid by the Authority.

A specific type of marché public known as a marché d’entreprise de travaux publics (METP) had previously been used to facilitate the construction and management of public infrastructure. Under a METP arrangement, a Contractor was given the responsibility to design, build and operate a project in return for the right to receive a fee, covering construction and operating costs. Authorities favoured the use of this type of arrangement as it enabled them to develop infrastructure using PPP methods, ie using private funds to invest in public infrastructure, outsourcing operation of the infrastructure for a certain period and spreading associated payments over the same period. Unfortunately, METPs did not comply with several aspects of French administrative law, including the prohibition on Authorities spreading payments over time. This led to an amendment to the Code des Marchés Publics in 2002 (based on a decision by the Conseil d’Etat, the French Supreme Administrative Court), which resulted in the prohibition of the use of METPs.

The majority of projects where end-users cannot be expected to pay for the works or the services provided (eg state schools, prisons, police stations and state hospitals) – and therefore where the délégation de service public scheme is not available – have been procured under marchés publics.

2.4 Bail emphytéotique

A bail emphytéotique is a lease granted by an Authority to a Contractor whereby the Contractor becomes entitled to use the land owned by the Authority for a term of between 18 and 99 years to build and maintain a project (but not to provide the services associated with the relevant infrastructure). Only local government bodies (collectivités locales, as opposed to the state) are entitled to enter into these agreements. One key difference in this type of arrangement is that the lease grants property rights to the Contractor as tenant, which allows lenders to take security over the Contractor’s rights in the property.

Examples of projects built and also maintained under a bail emphytéotique include amusement parks, city halls and waste plants.

2.5 Introduction of PPP laws for specific sectors

In 2002 and 2003, specific laws were enacted to allow PPPs to be created in specific areas where there was an urgent need for new infrastructure, namely in the health, justice, internal security and defence sectors. These new initiatives were variations on the established principles of UK PFI, including transfers of risk to the private sector, and constituted a first step in the introduction of legislation enabling PPPs in France.

(a) Single Contractor for the entire project

The first improvement introduced by these laws is that Authorities can now invite tenders and enter into agreements with only one Contractor which will be responsible for both the construction and the operation of the project. Under this new legislation, the agreement with the Authority will cover all steps of the project from design and construction to operation and maintenance. Until 2002, when using a marché public (public procurement arrangement), Authorities had to issue separate tenders
for each part of the project and negotiate and execute contracts for each service or task to be provided for that project. This new legislation authorising Authorities to consider and negotiate a project as a whole allows Authorities to cut costs and time spent on each project.

(b) An additional form of lease made available

Another key improvement of the PPP laws is that an Authority may grant a lease to the Contractor containing an obligation to build and an option to buy (location avec option d’achat à charge de construction). This lease for construction (bail à construction) allows the Authority to remain the owner of the land and the Contractor to be the tenant of the land. The main differences compared with a bail emphytéotique are that:

(i) all Authorities, including the state, may enter into this kind of arrangement; and

(ii) this arrangement covers construction as well as operation of the premises.

2.6 Introduction of general legislation on partnership contracts

An ordinance on partnership contracts came into effect on 17 June 2004 (the Partnership Ordinance). It sets out the general principle that all Authorities (including the state and other contracting authorities such as collectivités locales (local government authorities)) may enter into partnership contracts with the private sector for the provision of almost all public services.

The only services which cannot be outsourced to the private sector are those where the French Constitution provides that they must be provided directly by the state (the custody of inmates in a prison is an example of where the rights of ownership and operation must remain with the state). In a project which involves features for which the state is liable under the French Constitution, the Contractor will be liable for all works and services that can be transferred to the private sector (eg construction and maintenance of the buildings) and the Authority will retain liability for all the services that, under the Constitution, can only be provided by the state (eg custody of inmates). Risks relating to this sharing of liability need to be clearly identified and allocated between the Authority and the Contractor in the project documentation.

As the number of partnership contracts entered into between 2004 and 2008 was not significant (around 30), the Partnership Ordinance was amended on 28 July 2008 (the 2008 Law) to promote this kind of contract. In February 2009, additional modifications (the 2009 Reforms) were passed to address issues raised by the financial crisis which impact on partnership contracts. In particular Parliament: (a) established a new state guarantee for the financing of certain projects due to be awarded and closed by the end of 2010 up to an aggregate amount of EUR 10 billion; and (b) permitted Authorities to accept bids at the BAFO stage without a binding financial offer, thereby allowing bidders to amend the financial costs during the finalisation of the contract (this ability being known as “financement ajustable”). The Conseil constitutionnel (French constitutional court) has ruled that such financement ajustable schemes are acceptable within the constitutional principles applicable to procurement procedures under certain conditions, in particular that (i) the changes agreed after the BAFO stage should only concern financing costs and no other costs (such as construction, maintenance costs, etc.), and (ii) any changes in financing costs after the BAFO stage should not have a material impact on the overall cost to the Authority. As a result, if an unsuccessful bidder challenges an award, there could be some discussion on this issue as to whether or not the amendments agreed during the finalisation of the partnership contract after the BAFO stage go beyond the limits set out by the Conseil constitutionnel.
3. Partnership contracts

3.1 Terminology

The term PPP is used indiscriminately to refer to different arrangements between French public authorities and the private sector, not just to projects governed by the Partnership Ordinance. It can encompass all relationships between the public sector and private sector which involve private finance, including:
(i) a délégation de service public, marché public, or bail emphytéotique; (ii) any project carried out under the special laws applying to the security, justice, military and health sectors; and (iii) a “public private partnership” governed by the Partnership Ordinance.

For the sake of clarity, in the rest of this Chapter the terminology used is partnership contracts for contracts specifically governed by the Partnership Ordinance and PPP contracts for contracts governed by any arrangement between an Authority and a Contractor, including partnership contracts.

3.2 Advantage of partnership contracts

The main advantages of a partnership contract partnership contract are the following:

- similar to the sector-specific PPP contracts described above, the Authority can contract with one Contractor for all the aspects of a project, ie financing, design, construction, operation and maintenance. Therefore the Authority bears no interface risks;
- risks are allocated between the Authority and the Contractor and the risk-sharing is subject to discussion and negotiation and will be set out in the contract between the Authority and the Contractor;
- partnership contracts may contain clauses whereby the Authority and the Contractor agree to meet and discuss on a regular basis (eg every five years) whether any terms of the partnership contract should be reviewed;
- Authorities are allowed to pay the service fee over a long period of time;
- the level of fees is adjusted depending on whether the Contractor meets the performance targets provided in the partnership contract;
- the Contractor is entitled to operate ancillary services and obtain revenues from them (eg a bookshop in a hospital project);
- under a Partnership Contract, disputes can be settled by French administrative courts or arbitration;
- the time limits for construction are usually met by the Contractor;
since the 2009 Reforms, bidders may present, in their final offer, financing structures that can be adjusted at a later stage under certain conditions (and before the signature of the Partnership Contract); and

- the Contractor may finance only part of the project and, in addition, the state can guarantee part of the private financing of the project.

3.3 Requirements for partnership contracts

The Partnership Ordinance sets out that a partnership contract may be used for any public sector activity (subject to the limitations explained in paragraph 3.2 above) but only if the project concerned satisfies one of the following three conditions:

(a) Complexity

The Partnership Ordinance defines a project as being complex if the Authority is objectively unable to determine on its own and in advance the legal and/or financial solutions and the technical means to be implemented in order for the project to come to fruition.

(b) Urgency

The Constitutional Court ruled in 2004 that a project may be regarded as being “urgent” if there is “an objective necessity to make up for a particularly serious loss of time, in a defined area or geographical zone, affecting the creation of collective facilities or the execution of a public service mission”.

On this basis, the 2008 Law provided that “urgency” covers two kinds of situations: (i) to make up for a delay which is harmful to the public interest and which affects the creation of collective facilities or the execution of a public service mission, notwithstanding the reasons for that delay; and (ii) to address an unforeseeable situation. It is worth noting that whenever a tender process (or a contract) is challenged in court, the court may question whether one of the limited circumstances in which a partnership contract is permitted has been met.

For instance, the Administrative Court of Appeal of Nantes ruled that the “urgency” requirement was fulfilled in the case of a school which had been delayed for years, forcing another school to host 300 more pupils than its capacity could handle, resulting in numerous hardships in terms of school management, discipline and safety, and where the use of a partnership contract allowed the building to be completed at least one year earlier than expected under public procurement procedures. (CAA Nantes, Département du Loiret, 23 January 2009, n° 08NT01579).

(c) “Best value for money”

This criterion will be met when, taking into account: (i) the characteristics of the project; (ii) the requirements of the public service for which the contracting Authority is responsible; or (iii) the insufficiencies or difficulties involved in carrying out similar projects, it appears that on balance a partnership contract would prove to be more profitable/attractive to the Authority than other public procurement procedures. The law specifies that the mere ability to postpone payment cannot on its own justify entering into a Partnership Contract. This third criterion allowing the use of partnership contracts was enacted in the 2008 Law to permit the development of partnership contracts in circumstances where there is ambiguity and/or uncertainty about the complexity and urgency conditions.

3.4 Capacity to contract

Partnership contracts can be entered into by all public bodies that are legal entities such as:

(a) the state (acting through its ministerial departments);

(b) public bodies (either administrative or industrial and commercial), établissements publics administratifs (EPA) of the state (eg universities, AMOTMJ (the Ministry of Justice’s Works agency for the first prison project) and EMOC as the public office supervising cultural projects) or établissements publics industriels et commerciaux (EPIC) (eg La Poste (postal services) and SNCF (railways));
(c) local authorities (regions, départements, towns) and their public bodies (e.g., agencies responsible for council housing); and

(d) public agencies dedicated to health services and structures dedicated to co-operation in the health sector (structures de coopération sanitaire) that have legal status.

Moreover, pursuant to the 2008 Law, some of the private entities that are considered as contracting authorities within the meaning of the Ordinance of 6 June 2005 implementing the 2004/18 and 2004/17 EU Directives (e.g., private entities that are financed or controlled by public bodies and publicly-owned companies that are acting as network operators) may also enter into partnership contracts.

In France, the powers of each kind of Authority stem from the law setting up such Authority. For example, in the education sector, towns will be liable for primary schools, départements for secondary schools, and regions for universities. Each Authority will only have capacity to enter into a partnership contract if the related service falls within the scope of powers set out in the law for this kind of Authority. A partnership contract will be legal, valid and binding on an Authority only if it has received the prior approval of the relevant body, for example, in the case of a local authority, the Authority’s governing body, and in the case of the state, the Minister of Economy and Finance.

3.5 Procurement process

An Authority can only enter into partnership contracts if it has carried out an évaluation préalable (prior assessment of the project). If the assessment confirms that the relevant project should be carried out under a Partnership Contract, the Authority will launch the selection process.

(a) Evaluation of the project: is a partnership contract the appropriate arrangement?

During the first stage, depending on whether the Authority is a local government body or the state, the evaluation will be carried out, on the basis of a methodology outlined by the Ministry of Economy and Finance, by the Authority or developed by the mission d’appui aux partenariats privés-publics (the PPP task force of the Ministry of Economy and Finance) or, for a project in the defence sector, the specific expert body set up by the Ministry of Defence.

The evaluation sets out the economic, financial, legal and administrative reasons for the Authority to enter into a partnership contract procedure. It has to prove that one of the three conditions mentioned above (complexity, urgency and best value for money) is met. It also includes a comparative analysis of the various options available and assesses the differences in costs, performance and risk sharing, as well as sustainable development concerns.

(b) Selection of the Contractor: competitive dialogue, invitation to tender or negotiated procedure

Once the evaluation process has been completed, the partnership contract can be awarded pursuant to one of the following procedures:

(i) the competitive dialogue procedure set out in Directive 2004/18/EC of the European Parliament and European Council of 31 March 2004 on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts and implemented under French law in the Code des Marchés Publics and the Partnership Ordinance: the final offers are made after more or less extensive parallel discussions between the public authority and the bidders;

(ii) invitation to tender (appel d’offres): the Authority launches a public tender with a specific scope of work and selects the preferred bidder;

(iii) negotiated procedure: the Authority, upon publication of an invitation to tender, determines freely the procedure to be followed.

The applicable procurement process will depend on the complexity and/or the value of the project.
If, due to the complexity of the project – and notwithstanding the grounds on which the use of a partnership contract is justified – the Authority is objectively unable to determine on its own and in advance the legal or financial solutions to be implemented, the Authority may follow the competitive dialogue procedure. The fundamental principles applicable to arrangements between the state and a private entity, such as freedom of access, equality of treatment and transparency of procedures, apply at all times.

In any other circumstances, the Authority will follow the standard invitation to tender procedure or, for projects below a certain threshold, the negotiated procedure.

The negotiated procedure may only be used if the value of the partnership contract does not exceed:

(A) EUR5,150,000 if the object of the partnership contract is the execution or the conception and execution of works or structures; or

(B) EUR133,000, EUR412,000 or EUR206,000 if the object of the partnership contract is not the execution or the conception and execution of works or structures and depending on the nature of the Authority.

In either instance, the partnership contract will be awarded to the candidate who submits the most economically attractive/profitable tender.

4. Active sectors

Not surprisingly, the first sectors to develop in the PPP arena were those for which legislation was specifically enacted. These sectors are:

(a) justice (the Ministry of Justice launched the first PPP programme in France in respect of the construction of 18 prisons – it is also due to launch court house projects);

(b) police forces – eg the construction of police stations;

(c) defence;

(d) health eg the construction of hospitals;

(e) lighting (mainly projects procured by local governments).

Over the last two years, many projects have also been launched in the following sectors:

(i) universities;

(ii) telecoms; and

(iii) infrastructure, especially railways (eg LGV SEA; LGV Bretagne Pays de la Loire; Contournement de Nîmes et Montpellier; and GSM-R, a new EUR1.2 billion PPP for the installation of a digital communications network for the heavy rail system (closed February 2010)) and roads.

It is worth noting that, in May 2005, the Ministry of Economy and Finance set up a specific taskforce (Mission d’appui aux partenariats privés-publics) which is specifically dedicated to the development and management of PPP programmes in France. This taskforce is similar to the UK’s Treasury Taskforce (1997-1999) and the experts appointed to it will assist Authorities in preparing, negotiating and monitoring PPP contracts. The taskforce has issued a practical guide on the use of PPP projects in France. To date, no standard form of documentation has been issued but this will be one of the main goals for this taskforce in the future.

Updates on the documentation published by the Mission are to be made available on the Mission’s website (http://www.ppp.minefi.gouv.fr).
5. Likely future active sectors

Between 2004 and 2008, 33 partnership contracts were entered into, which is quite a low figure. As explained, the 2008 Law aims to facilitate the development of PPPs, but it is difficult to know whether a large number of partnership contracts will be entered into in the coming years. At the time of writing, many major projects have been launched under the partnership contract scheme (especially in the railway sector) and it will be interesting to see whether these projects will be successful in the context of the financial crisis. It is clear, however, that budgetary constraints are pushing the state and local authorities to look to private investors to assist them in the financing and running of those sectors. Not unsurprisingly, private investors (both French and international, in the lending and the equity markets) are also keen to consider projects where the structure resembles that which has been used successfully elsewhere, including in the United Kingdom, the Netherlands and Portugal.

6. General structure of partnership contracts

6.1 Mandatory provisions

Article 11 of the Partnership Ordinance specifies that partnership contracts must include clauses relating to the following key issues:

(a) duration;
(b) risk allocation;
(c) performance targets;
(d) payment mechanism;
(e) Contractor’s compliance with its public service related obligations;
(f) supervision by the Authority, including with respect to compliance with performance targets;
(g) sub-contracting (including with small- and medium-sized businesses);
(h) penalties, including for failure to meet performance targets;
(i) change orders;
(j) Authority’s approval required for the assignment of the Partnership Contract;
(k) duty owed to the general public as a continuing obligation;
(l) allocation of assets on termination; and
(m) applicable law and jurisdiction clause (French law, dispute settlement and possibility of referring to arbitration).

Any partnership contract which does not contain provisions governing these issues will be void.

6.2 Scope of service

As mentioned above, a partnership contract may govern one or all aspects of a project from financing, design, construction and maintenance to operation. The partnership contract will specifically allocate each risk to a party, ideally the party best equipped to control and monitor it and, as described above, certain essential elements of some services must remain in the hands of the public sector. This will need to be carefully reflected in the risk allocation for each project.
It is also worth noting that the design of the building or equipment may be retained by the Authority and not transferred to the Contractor under the Partnership Contract.

6.3 Payment mechanisms and performance targets

The Partnership Ordinance specifies that the Contractor’s remuneration will be paid by the Authority (not end-users) and will be linked to performance targets imposed on the Contractor.

This payment mechanism is a step forward compared with other forms of French PPP. Under a délégation de service public for instance, the Contractor bears the risks of the project, including project revenues, which would not work for many projects.

The Partnership Ordinance now enables:

(a) Authorities to pay for public sector investment in infrastructure and provision of services by way of periodic fees;

(b) payment to be related to performance targets being satisfied or not. To avoid confusion, it should be made clear that the Contractor’s revenues are based on an availability test (as provided in Eurostat’s guidelines with respect to public accounting rules);

(c) the Contractor to grant an assignment over its receivables under the Partnership Contract; and

(d) as at the date of delivery of the equipment to the Authority, the state to make a direct and irrevocable payment (with no right to set off any amount against this direct payment) to the Contractor’s lenders of a portion of the periodic fees payable to the Contractor under the partnership contract over its term. Since the 2008 Law (as amended in 2009), this direct payment is capped at a maximum of 80% of the aggregate of investment and financing costs.

For transparency purposes, the construction costs and operating costs must be clearly set out in the partnership contract together with the Contractor’s terms for payment.

The Partnership Ordinance also allows the Authority and Contractor to set off amounts owed to each other.

6.4 Change orders

Under French administrative law, Authorities are entitled to alter unilaterally the terms of any contract they are a party to, including partnership contracts and other PPP contracts, or to terminate the contract, on the grounds of public interest.

Authorities may use public interest to force a Contractor to comply with change orders only if the following three conditions are satisfied:

(a) the change relates to the organisation of the public service;

(b) the purpose of the partnership contract remains unaffected; and

(c) compensation is paid to the Contractor.

It is therefore fundamental that appropriate provisions be included in the contract so as to cover the impact of such change orders or termination on public interest grounds. If the change orders are such that they can qualify as fait du prince (see paragraph 6.5(b) below) or imprévisibilité (see paragraph 6.5(c) below), the state will compensate the Contractor. If the change order qualifies as force majeure, either party is entitled to terminate the contract and the loss is to be shared between the parties (see paragraph 6.7(c) below).

If additional work needs to be carried out and such works are absolutely necessary (eg due to a change in law or safety requirements), the Contractor is entitled to recover its costs from the Authority. However, as expected, if the Contractor initiates additional work which is merely useful and not necessary to enable it to complete the project, the Contractor will not be entitled to receive any compensation.
6.5 Supervening events

A partnership contract always includes provisions dealing with supervening events. In any event, as partnership contracts are governed by French administrative law, administrative case law would apply in the case of any deficiency in the contract.

Administrative case law suggests that, if the risk allocation between the parties is changed as a result of a supervening event, damages are payable to the party who is adversely affected by the event. Subject to a force majeure scenario, if the Contractor is adversely affected, the general rule is that the Authority will pay compensation to the Contractor only if the latter has continued to perform its obligations.

The supervening events which entitle the Contractor to claim compensation under most contracts are set out below, but other events are added in some contracts.

(a) A change order issued by the Authority – see paragraph 6.4 above.

(b) Fait du Prince (“Power of the Prince”) – This concept refers to circumstances where a decision by the Authority which entered into the PPP contract effects an act other than under the PPP contract which results in a unilateral change to the terms of the PPP contract.

The Contractor will only receive damages if the damage suffered as a result of the Authority’s action is greater than that which is to be reasonably expected.

Fait du Prince does not cover instances (eg where labour costs are changed centrally) which are general measures whose effects are felt by all economic agents and which do not relate directly to the object of the contract. A general change in labour costs may, if it leads to a permanent financial imbalance in the contract, be classified as an unforeseen event.

(c) Théorie de l’imprévision (Unforeseeable events) – Under French administrative law, an event qualifies as “unforeseeable” if:

(i) it was unforeseeable at the time the contract was signed;

(ii) it falls beyond either party’s control;

(iii) it is a substantial change; and

(iv) it is temporary or has a temporary impact on the performance of the contract.

These criteria are very close to those of force majeure (see paragraph 6.7 below) but to a lesser degree as, under French administrative law, an event will qualify as force majeure only if, further to its occurrence, it becomes impossible on a permanent basis, for a party to perform its obligations under the contract. For instance, an archaeological discovery which delays the construction of the project can qualify as an unforeseeable event or as a force majeure event. Depending on the risk allocation set out in the Partnership Contract, the cost overrun would be borne by the Contractor or compensated for by the Authority. However, if the discovery is such that its impact on the construction costs or the level of compensation that would be required would not be reasonable, ie would have a material impact on the “balance” of the contract, the discovery will be treated as a force majeure event.

(d) Failure to obtain an administrative authorisation for reasons that are external to and beyond the control of the Contractor.

In contrast, risks relating to land are in most cases borne by the Contractor.

Compensation will be calculated so as to reinstate the balance of the contract. If the parties disagree as to the level of compensation, they will refer the matter to an administrative judge. Under a partnership contract, parties can also refer such a matter to experts and arbitration.
6.6 Change in law

Change in law clauses are very often at the core of the competitive dialogue. The first partnership contracts entered into were quite tough on the Contractor as change in law risk during the construction phase was sometimes entirely borne by the Contractor. This situation has evolved and the risk allocation is now often shared during the whole duration of the contract with caps protecting the Contractor. There is still however a distinction between specific change in law and general change in law, and it is still sometimes the case that general changes in law are borne entirely by the Contractor during the term of the contract.

If not covered in the Contract, this risk will be allocated in accordance with general administrative law principles. A change in law is usually covered either by the *fait du prince* theory (see paragraph 6.5 above) or the *théorie de l’imprévision* (see paragraph 6.5 above). As a consequence, if the balance between the parties is adversely affected, the Contractor can claim compensation to reinstate the balance of the contract.

6.7 Termination and compensation

The circumstances in which a partnership contract can be terminated are the same as for any other contract governed by French administrative law.

(a) Termination for general interest purposes

An Authority may terminate a contract without the consent of the Contractor on the grounds of the general public interest. The European Court of Human Rights has held that a public body has the power to terminate a public contract unilaterally.

By way of example, such termination has been permitted on the grounds of “general interest purposes” where:

(i) a Contractor could no longer fulfil the technical and financial requirements of the contract;
(ii) the service provided under the contract needed to be reorganised; and
(iii) the project was abandoned.

Termination on these grounds would entitle the Contractor to damages even if they are not expressly provided for in the contract. However, PPP contracts usually provide for precise compensation, which in most cases covers at least:

(A) the amounts outstanding under the financing, including the breakage costs of the interest rate hedging agreements (or sometimes the non-amortised value of the facilities financed under the contract);
(B) the equity;
(C) the expected profit, ie the Contractor’s margin (*lucrum cessans*) (there may be some discussion however about the method of calculating the *lucrum cessans*);
(D) the breakage costs of the subcontracts.

(b) Termination for breach

Under French administrative law, the contract must clearly set out the breaches that may lead to termination. If there is no such provision, an Authority may terminate the contract if the Contractor fails to perform the contract. If the Contractor disagrees whether the breach entitles the Authority to terminate the contract, the administrative judge will assess whether termination is an appropriate remedy for the breach and set the amount of compensation payable by the Authority to the Contractor.

However, it is now a well established market practice that PPP contracts specify the events of default and the compensation to which the Contractor may be entitled (even where termination is due to a breach by the Contractor). The latter is entitled to claim damages relating to the termination of the contract, equal to the non-amortised value of the facilities in which it has invested.
Regarding the events of default, in most cases they include at least the following: delay of up to a specific number of months; unauthorised assignment of a contract; absence of a mandatory guarantee; and a specific percentage (usually 90%) of the penalties cap being reached. In addition, there is usually a general event of default consisting of every serious default which undermines the continuity of the performance of the contract and/or the public service.

Regarding compensation, the current market practice (as of 2009) broadly allows for the amounts outstanding under the financing (which usually include the breakage costs of the interest rate agreements or, sometimes, the non-amortised value of the facilities financed under the contract) to be reimbursed, but not equity. In most cases, however, these amounts are covered, less the amount of certain indemnities required in order to reimburse the Authority for any costs related to the termination. Finally, sometimes compensation is set at a minimum of a specific percentage (usually 80 to 90%) of the amounts outstanding under the financing. This cap is however distinct from the cap on direct payments permitted under the Partnership Ordinance.

(c) Termination for force majeure

As explained above (see paragraph 6.5), an event of force majeure is an event that is unforeseeable and beyond the control of the parties and makes it impossible for either party to perform its obligations under the contract. An event of force majeure will trigger a right to terminate the contract only if the performance of the contract becomes impossible, not if it merely creates delays or cost overruns. Sometimes clauses relating to termination for force majeure provide for specific compensation for the Contractor, but in most cases contracts may only be terminated in accordance with the terms and the principles set out in the case law of the Conseil d'État (Supreme Administrative Court). This creates uncertainty with respect to the interests of the Contractor as well as those of the lenders, since case law is both rare and imprecise on this issue.

However, the main principles seem to be the following: the Contractor is not entitled to compensation for lost earnings, but will be fully indemnified for losses suffered (note, however, that the issue of indemnification for financial costs has not yet been settled with certainty) and the total indemnity will be reduced by 5 to 10% depending on the Contractor's behaviour during the frustration period – based on the principle that as the state is not liable for the frustration, it should not pay the full indemnity.

6.8 Land rights

The treatment of land and property on termination will depend on the nature of the Partnership Contract:

(a) facilities which are built on state property may be owned by the Contractor during the tenure of the partnership contract but will be transferred to the Authority on termination;

(b) facilities which are built on private land and, where the partnership contract provides that buildings are to be sold to the Authority, will be sold to the Authority; and

(c) if under the Partnership Contract, the buildings and facilities are leased to the Authority, they will remain the property of the Contractor. The 2008 Law has facilitated this.

6.9 Refinancing

In the event of a refinancing which reduces the cost of debt for the Contractor, the Contract may provide for the consent of the Authority and, as the case may be, a reduction in the price payable under the partnership contract. Again, if the parties disagree on the new payment, they will have to submit their dispute to the administrative court which will consider claims using principles similar to those outlined above.
6.10 Cancellation of the contract

In the case of cancellation of the contract, according to the case law of the Conseil d’Etat (Supreme Administrative Court), the Contractor may be entitled to request indemnification on the basis of unjust enrichment (a quasi-contractual action) and on the basis of fault by the state party (a quasi-tortious action), as the case may be. The main point here is that the Contractor is entitled to an indemnity on the basis of unjust enrichment if it can prove that the expenses it incurred were useful to the public body.

The scope of this type of compensation remains a bit uncertain, however, especially as the Conseil d’Etat (Supreme Administrative Court) held in 2008 that financing costs linked to a public procurement contract could not be regarded as “useful expenses”, arguing that the Authority should not suffer the consequences of its co-contractor’s financing decisions. The question has been raised whether such case law should be applicable in the context of a PPP contract. The Conseil d’Etat (Supreme Administrative Court) has not issued any official clarification yet (as of 2009), but there is a strong probability that it will clarify as soon as possible that financing costs must be considered useful expenses if, and when, the partnership contract expressly deals with financing procedures and the general economy of the agreement shows that the public body has supported this approach. This rationale may well have been contemplated by the administrative section of the Conseil d’Etat (Supreme Administrative Court) when it reviewed a PPP contract that contained such a clause.

6.11 Direct agreement

Many public entities in France and especially the French state, have been rather reluctant to enter into direct agreements between the Authority, the Contractor and the lenders, as these public entities refuse to have obligations imposed on them other than those stipulated in the PPP contract itself. In addition, they see no point in entering into an additional contract with the lenders as the “acceptance” of the assignment of receivables is already a kind of contractual link between the Authority and the lenders (see paragraph 6.3 above). This contractual link is, however, limited to the direct payment of the portion of the fees which have been “accepted” and does not address the other terms normally included in a direct agreement.

Historically, lenders took the view that the above position was acceptable, as they were able to enforce their rights and rely on insolvency laws to prevent a termination of a PPP project without a direct agreement (see paragraph 7 below). Some local authorities have, however, agreed to enter into a direct agreement and in recent months, many lenders are applying more pressure to Authorities to enter into direct agreements. On the major projects due to be awarded in the coming years (particularly given the difficulties of financing PPP projects in the context of the global financial crisis), the French state will probably face further pressure on this issue as many players lending internationally expect to see “direct agreements” like those on their projects outside France. Moreover, the French state will have to take into consideration the position of some institutional lenders such as EIB or Caisse des dépots et consignations (a financial public entity linked to the French state, with public service goals such as lending for priority sectors) and therefore the situation on this issue could evolve in the years to come.

6.12 Dispute resolutions

The Partnership Ordinance introduced the possibility of including arbitration clauses in partnership contracts. This is a recent development in public contracts as public bodies were previously prohibited from taking part in arbitration proceedings except if authorised to do so by law. Arbitration is seen as a more attractive dispute resolution procedure to investors and lenders as it may be held in France and is generally quicker than litigation in the French administrative courts. As at the end of 2009, however, only two partnership contracts entered into (out of 47) included an arbitration clause. It shows that French public entities remain quite cautious.
7. Insolvency and security position

Authorities that are public entities are not subject to the rules of bankruptcy and their assets cannot be seized.

When contracting with a local authority, the Contractor has the comfort of knowing that the amounts payable by such local authority must appear in its budget. If the Authority fails to do so, the local state representative (Préfet) is entitled to insert these amounts in the Authority's budget.

There is also some uncertainty about whether a state guarantee applies in the event of an insolvency. In a non-contentious opinion dated 31 August 1995 and acknowledged by the French Government and the French Parliament during the parliamentary debates before the enactment of an Act dated 28 November 1995, the Conseil d'Etat (Supreme Administrative Court) opined that – pursuant to a general principle of French public law and due to the specific situation of public establishments (établissements publics), notably that their assets cannot be seized – the French Republic was to be held liable for the debts of such legal entities. This non-contentious opinion is/was said to have provoked the existence of a garantie implicite (implicit guarantee) of the state vis-à-vis public entities.

Uncertainty about this guarantee has been renewed by the entry into force in 2003 of the Organic Act on Finance Acts (LOLF) dated 1 August 2001, as article 34 of the LOLF provides that no guarantee can be claimed if it has not been previously defined in a Finance Act. Therefore, there may be a debate as to whether the entry into force of the LOLF questions the garantie implicite, the existence of which was acknowledged in 1995 by the Conseil d'Etat. There is no certainty on this issue even if it is arguable that the LOLF only concerns guarantees that cannot exist implicitly.

If the existence of such a garantie implicite is successfully challenged, the French Republic would however not be exempted from liability, especially since the European Court of Human Rights upholds the principle of state liability vis-à-vis creditors, and especially in situations where the debtor is a public entity, and whenever a court decision sanctioning a public entity is not enforced (ECHR, 26 September 2006, Société de gestion du port de Campoloro et société fermière de Campoloro c/ France, n° req. n° 57516/00).

In the event of the Contractor’s bankruptcy, the lenders will be entitled to enforce their rights pursuant to the security documentation, subject always to the application of insolvency laws. All partnership contracts provide for step-in rights for lenders subject to the consent of the Authority. Whilst the Authority is not under an obligation to act reasonably in giving such consent, it is likely that the administrative courts would require the position of the Authority to be justified.

8. Employment issues

The main employment issue in connection with PPP in France concerns the transfer of the Contractor’s employees to the state at the end of the PPP contract.

Under article L. 1224-1 of the Labour Code “further to a modification in the employer’s legal status due to, among other things, succession, acquisition, merger, transfer of the goodwill or incorporation, all the employment contracts implemented on the day of the modification remain in force between the new employer and the employees of the company.”

Further to this provision, employees of the Contractor who are working on the project will therefore be transferred to the state upon termination of the PPP contract. There have been lengthy discussions as to whether the state would keep these employees under private law or administrative law employment contracts, the implication being that the transferred employees retained under an administrative law contract would have increased job security (and the state would concurrently have additional liabilities).
A law dated 26 July 2005 put an end to that discussion and Article L.1224-3 of the Labour Code now provides that if an Authority which is a public entity decides to take over the management of a project on termination of the relevant PPP contract, as part of an administrative public service, it must offer administrative law employment contracts to those employees who are going to be transferred from the Contractor to the Authority.
Germany

Ändere die Welt, sie braucht es.
Change the world, it needs it.

Bertolt Brecht
(1898-1956)

Contact

Frankfurt
Peter Stenz
Allen & Overy LLP
Taunustor 2
60311 Frankfurt am Main
Germany
Tel: +49 (0)69 2648 5000
Fax: +49 (0)69 2648 5800
peter.stenz@allenovery.com

Düsseldorf
Allen & Overy LLP
Breite Straße 27
40213 Düsseldorf
Germany
Tel: +49 (0)211 2806 7000
Fax: +49 (0)211 2806 7800

Hamburg
Allen & Overy LLP
Kehrwieder 12
20457 Hamburg
Germany
Tel: +49 (0)40 82 221 20
Fax: +49 (0)40 82 221 2200

Mannheim
Allen & Overy LLP
New address to be announced
Germany
Tel: +49 (0)621 3285 631
Fax: +49 (0)621 3285 6541

Munich
Allen & Overy LLP
Maximilianstraße 35
80539 Munich
Germany
Tel: +49 (0)89 71043 3000
Fax: +49 (0)89 71043 3800
1. Introduction

Germany is a young market for PPPs compared to other countries such as the UK, which have been delivering PPP deals for a number of years. The German government has, however, been thinking of PPPs for some time, eg in 1994 the German legislature passed the Federal Trunk Road Financing Act (Fernstraßenbauprivatfinanzierungsgesetz) to help promote PPPs in the road infrastructure sector. Despite this, only two projects have so far been constructed and are operational under this Act.

More recently, however, the German PPP market has begun to make progress. Since 2003, approximately 132 projects with a capital expenditure of EUR3.75 billion and 12 projects in the transport sector with a capital expenditure of EUR1.861 billion have been implemented as PPPs. Nevertheless, Germany is widely thought to need more PPPs. The German Institute of Urban Affairs estimated that there will be a need for approximately EUR704 billion to be spent on German communities over the period from 2006 to 2020 for investment in the public sector. It highlighted that the greatest demand for investment exists in the road infrastructure sector (approximately EUR162 billion), schools sector (approximately EUR73 billion) and communal waste water disposal sector (approximately EUR58 billion). In its recommendations, it expressly stated that the participation of private partners through PPPs is an important option to ensure communal infrastructure is operated efficiently, in particular in the schools and sport/leisure/tourism sectors. It added that it should be reviewed as to whether any other areas of investment are suitable for PPPs.

As a result, politicians in the Federal Ministry of Economics and the Ministry of Transport, Building and Housing, in particular, have started to promote support for the implementation of PPP-financed projects. The growing support and interest of the public sector for PPPs can also be seen in the establishment of special PPP task forces. These have been created at both federal and state level in order to support, co-ordinate and advise on pilot projects and also to make PPP concepts available to a wider public. Most of the states have their own task forces. Currently, the most “visible” one at state level is the task force of North Rhine-Westphalia (listing 48 PPPs closed or in tender with a capital value of nearly EUR600 million). Other task forces, such as in Hesse, Bavaria, Schleswig-Holstein and Baden-Württemberg, each list 16 PPPs closed or in tender.

2. Legal and regulatory framework

2.1 ÖPP Deutschland AG

On 9 July 2008 the framework contract for the foundation of a new, independent consulting firm called ÖPP Deutschland AG was signed. ÖPP Deutschland AG was established in November 2008 and started its operations at the beginning of 2009; 60% of ÖPP Deutschland AG is financed by public authorities and the remaining 40% by the private sector. This entity’s main objective is to advise public authorities (in particular the federation, the states and the communes) on topics arising in connection with PPP projects. In addition, ÖPP Deutschland AG aims to develop standards for PPP projects in order to reduce transaction costs and open up new sectors for PPP projects.

The next significant developments are about to be witnessed in road infrastructure. Various PPPs are being planned (especially under the A-Model concept) both at federal and at state level allowing for the construction and private financing of roads, tunnels, bridges and passes.

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1 PPP is also known as ÖPP - Öffentlich-Private Partnerschaften.
2 Please see below in paragraph 2.3 (Specific Enabling Legislation).
3 The press release 01/08 of ÖPP Deutschland AG can be found at http://www.partnerschaften-deutschland.de/projektberatung/projektdatenbank/opp-in-zahlen/?tx_ttnews%5BbackPid%5D=71&tx_ttnews%5Btt_news%5D=42&cHash=c25a1b6313.
4 The study of the Institute dated 21 April 2008 can be found at http://www.difu.de/presse under publications.
5 http://www.ppp-projektdatenbank.de
6 http://www.partnerschaften-deutschland.de/de/.
7 Please see paragraph 2.3(b).
2.2 Capacity to contract

Before engaging in a PPP project in Germany, it is crucial to understand not only the relevant public body (referred to in this chapter as the Authority) which will enter into the PPP contract, but also the public law nature of that body and the respective regulations to which it is subject.

(a) Complexity of German government

In Germany, the procuring Authority may take the form of one of several public law constituted legal personalities, e.g., a regional authority (Gebietskörperschaft) such as a federal (Bund), state (Land), administrative district (Landkreis) and local (municipal) authority (Gemeinde) or a corporate body (Körperschaft) or institution under public law (Anstalt öffentlichen Rechts). The nature of the specific public service being procured will determine which one of these authorities is in charge of the project. Furthermore, depending on the subject matter, the Authority will either act in its own capacity or as an agent for a different local body (e.g., via Auftragsverwaltung). The interface between federal, state and even local (municipal) state levels is therefore not always obvious to those new to the issue and it may sometimes be difficult to understand which body is the relevant procuring entity and which tender procedure should be followed when it comes to a specific PPP project.

In addition, different rules apply with regard to budgets, taxes and subsidiaries in the various states in Germany. The existence of different sets of rules in these areas of law makes it harder for the German PPP market to reach a common understanding on identifying standard issues and how these can be solved.

(b) Local versus central government initiatives

The existence of the various above mentioned organisations within Germany also explains why some information is not yet as easily accessible in Germany as in other countries experienced in PPP. In the UK, for example, early initiatives for the PPP market came mainly from central government. In Germany, however, pilot projects (like the often quoted but rather small project in Monheim) were driven by local requirements and were not prompted by a centralised government approach. Even now, accommodation projects such as schools and prisons are not initiated by a federal body, but by a state authority or even a local body, since their respective administration is part of the state competency, and central government influence in these spheres is traditionally not strong.

2.3 Specific Enabling Legislation

Specific enabling legislation has only been enacted in relation to PPP models for certain road infrastructure projects, in particular the construction and private financing of roads, tunnels, bridges and passes (the F-Model, see below).

(a) The F-Model

As mentioned above, the German Federal Trunk Road Financing Act (Fernstraßenbauprivatfinanzierungsgesetz) came into force in 1994. Its purpose is to enable privately financed construction, maintenance and operation of road projects in Germany (the F-Model). The road projects promoted under this model are limited by statute to bridges, tunnels and passes. Under the F-Model the Authority grants a Contractor (by way of concession) the right to collect tolls from all road users, the level of which has to be approved by the relevant federal state government.

The two projects which have so far been approved under this Act are the Warnow Crossing at Rostock, which was completed and opened for traffic in September 2003, and the Herrentunnel in Lübeck, which was completed and opened for traffic in 2005.

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Shortly after the opening of the Warnow Crossing, traffic numbers were only around 30% to 40% of the original base case. As a consequence the sponsors had to reduce operational costs and to adjust the toll price by a combination of changes to the tariff structure and reclassification of certain vehicles. To avoid an insolvency of the Warnowquerung GmbH & Co. KG, the concession agreement was extended from 30 to 50 years, allowing investors a longer period of revenue generation in which to recover their investment and to refinance. In 2004 between 8,500 and 9,000 cars used the tunnel per day, which was an increase of 60% over the previous years. Traffic numbers seem to have stabilised now at approximately 11,000 cars a day; the forecast for 2030 is currently 16,000 to 17,000 crossings daily. In October 2009 the 21 millionth car was reported to have used the tunnel since it opened for traffic.9

At the moment, further projects are being discussed under the F-Model, including the Alp ascension (Alpaufstieg – A8) in Baden-Württemberg, the Weser crossing (Weserquerung – A281) in Bremen and the port link road (Hafenquerspange – A252) in Hamburg.

(b) The A-Model

The A-Model, promoted by the Federal Ministry of Transport, Building and Housing (Bundesministerium für Verkehr, Bau- und Wohnungswesen), unlike the F-Model projects, required no specific legislation. The A-Model, an operating model (Betreibermodell für den mehrspurigen Autobahnausbau), is designed to allow the privately financed extension of existing motorways by building additional lanes. Whereas under the F-Model the Contractor is granted the right to collect tolls from all road users, under the A-Model the Contractor receives a certain percentage of the tolls collected from trucks as described in paragraph (c) below. Unlike the F-Model, the success of this model does not therefore depend on traffic forecasts for new roads. Instead, it requires a view to be reached as to the likely impact of economic factors and pricing on existing road usage.

At present, the following four projects are being carried out as pilot projects:

(i) the A8 between Augsburg-West and München-Allach;
(ii) the A4 between the state border of Hesse/Thuringia and Gotha;
(iii) the A1 between Buchholz and the motorway junction Bremen; and
(iv) the A5 between Malsch and Offenburg.

These four projects have a total construction cost of approximately EUR1.2 billion to EUR1.7 billion. In addition, two other projects are in tender and six other A-Model projects are currently being planned. The table in Appendix 1 gives an overview of A-Model projects.

(c) The Toll Collect system

The German Toll Collect system has generated significant publicity (not all of it welcome). In mid-December 2004, the Federal Ministry of Transport, Building and Housing approved the preliminary operating licence following positive pilot test results. The purpose of the German Toll Collect system is to levy tolls from road users to finance A-Model projects. Currently, the structure is designed to allow Toll Collect GmbH as agent for the Authority to collect distance-linked tolls from heavy traffic on German motorways. VIFG (Verkehrinfrastruktur-Finanzierungsgesellschaft) (wholly owned by the Federal Republic of Germany) is responsible for reinvesting these revenues in A-Model projects. Each privately financed and operated section of motorway (ie an A-Model project) is then allocated a certain percentage of the collected tolls.

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(d) International agreements

In September 2008, Denmark and Germany signed an international agreement for the construction of a fixed link across the Fehmarnbelt (Fixed Fehmarnbelt Link) covering the 19 km distance between the German island of Fehmarn and the Danish island of Løolland. The Fixed Fehmarnbelt Link – either a bridge or a tunnel construction – will consist of a combined four-lane road and a two-track railway. In the State Treaty both governments agreed that the Fixed Fehmarnbelt Link will be planned, constructed and owned by a Danish project company under private law, entirely owned by the Danish State. The State Treaty came into force in January 2010. The construction phase for the Fehmarnbelt link is scheduled to take place from 2012 to 2018 and the aim is to open it by the end of 2018.

The expected costs of the Fixed Fehmarnbelt Link amount to EUR4.4 (for a bridge-based solution) to 5.5 billion (for a tunnel-based solution) and will be borne by the Danish State. The financing will be provided by loans raised by the Danish project company and secured through Danish government guarantees. Funding is also provided by the European Union’s Trans European Network Programme (TEN). The Danish project company will levy tolls for the use of the Fixed Fehmarnbelt Link. Calculations indicate that the cost of the Fixed Fehmarnbelt Link will be repaid by the collection of tolls for cars, coaches and trucks over a period of approximately 30 years. The Fixed Fehmarnbelt Link will not, therefore, be procured by means of a classic PPP. However, whilst it will initially be owned by a project company owned by the Danish State, the State Treaty between Denmark and Germany generally allows for a future (part) privatisation of the Danish project company.

2.4 Covenant issues for regional authorities

The strength of covenants is much less of an issue than, for example, in the UK. It is, however, expected that investors will still need to understand German budgetary processes in order to be fully comfortable with the covenants of regional authorities. In Germany, PPPs have only been procured by public bodies which, as a matter of German insolvency law, do not face any insolvency risk.

3. Active sectors

The German PPP market comprises various sectors which are already active. A good overview of the market can be found on a website published by the German Ministry for Traffic, Building and Urban Development http://www.ipp-projektdatenbank.de, which lists 161 projects, of which 143 are closed and 18 still in tender, and on a German building industry website for building construction http://www.ipp-plattform.de/index.php?page=266&article=1424, which lists the projects per state. Set out in Appendix 2 is a table of recent transactions which gives an overview of projects with relatively high capital expenditure in the market.

4. Likely future active sectors

4.1 Specific future activities

Tables of interesting upcoming projects which have been published on various state task forces’ and other websites are set out in Appendix 1 (A-Model projects) and in Appendix 3 (Likely future active sectors). Where known, the current status and anticipated capital expenditure of the project is indicated.

10 Figures as at February 2010.
4.2 Potential future sectors

In spite of the current squeeze on the public sector purse, 27 PPP projects with a capital value of nearly EUR1.2 billion were signed in 2009. Since 2002, 144 construction-based (Hoch- und Tiefbau) PPPs have been signed across Germany and further PPP projects are expected to develop in the following sectors:

(a) Road infrastructure

The German Ministry of Transport has launched eight new A-Model highway projects worth a combined EUR1.5 billion, as detailed in Appendix 1. All of these projects are, depending on the outcome of the feasibility study, likely to be procured via the PPP route. In addition, several state roads, country roads and local bypasses are being built or are planned.

(b) Schools

In the state of Hesse, the “100 Schools Project” in Offenbach was regarded as a pilot for further future activities. Other examples of school projects that have closed are: the EUR106 million project in the city of Frankfurt for the building and reconstruction of four schools; the EUR130 million school project in Nuremberg, which includes the refurbishment, expansion and construction of several schools; and the EUR200 million school project in Hamburg for the building and reconstruction of 32 schools.

(c) Other sectors

Further potential projects could well develop in the following sectors: sport/leisure/tourism, healthcare, IT, rail infrastructure, airports, waterways, public transport, energy, water, and waste or waste water disposal.

5. Structure of concessions to date

Since the German market for PPP projects is still relatively new, it is not really possible to generalise as to the structure of concessions. It is possible, however, to recognise certain common elements.

5.1 Project finance

Project finance has been (and is likely to be) a feature of PPPs in Germany. We can expect Germany to use the experience of other countries to help develop its PPP market. Unfortunately there is a lack of public sector experience with regard to project finance structures. As a consequence, the public sector will need to be persuaded of, amongst other things, the role of senior funders and the usefulness of direct agreements or other agreements that allow senior funders to take over a project in distress. Achieving bankable solutions may therefore prolong the negotiation process.

Senior funders may also have difficulties receiving the full security package which is common in project finance structures in other countries. As regards real estate, it appears to be difficult for a Contractor to obtain ownership rights over any real estate. Consequently, lease contracts (or similar) may be the property solution that lenders have to rely on.

Sometimes, similar “step-in rights” and compensation regimes to those in place in the UK are adopted, although these are not yet standard.

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11 http://wwwpartnerschaften-deutschland.de/startseite/detail/6tx_ttnews%5Btt_news%5D=42&tx_ttnews%5BbackPid%5D=36&cHash=7912932d8a
12 The press release 1809 of the German building industry can be found at: http://www.bauindustrie.de/index.php?page=188&article=1275#.
5.2 Factoring type PPP solutions

In accommodation projects, factoring solutions, sometimes also called the “waiver of defence solution” (Einredeverzichtslosung), are common.

In factoring solutions, the idea is to combine private know-how about the construction and the operation of a particular project with the financing terms and conditions that the public sector can offer. In order to achieve this, the Contractor will, during the life of a project and upon having delivered (part of) its contractual duties under the contract, invoice the Authority accordingly. Then, the Authority will formally “accept” the invoice and will waive any defences it might have had against the invoice. Consequently, any credit risk of the underlying payment obligation will be comprised solely of the default risk of the Authority. The invoice can then be sold on to a third party investor or a lender seeking public lending risk in its portfolio.

5.3 Scope of service

It is generally considered that the best way to achieve public-private co-operation is to include only a service description (Leistungsbeschreibung) in the tender documents rather than a full service specification (Leistungsverzeichnis). This, however, depends on the nature of the service to be procured by the Authority. The idea of only including a service description is to enable the Contractor to provide innovative solutions and use staff efficiently. The relevant tender documents therefore focus on outputs, as in the UK. Nevertheless, tender documents will also often include details of services to be delivered and often contain more detailed payment mechanisms.

5.4 Payment mechanisms

Depending on which risks the Contractor accepts, the documentation must carefully balance those risks the Contractor (or its sub-contractors) can manage and other risks which should generally be borne by the Authority. For example, in contracts involving the collection of tolls, the Contractor will bear the risk of anticipated usage of the project, such as the road, tunnel or bridge. However, tolls are only used as payment mechanisms in connection with road projects. Accommodation projects mainly use a payment mechanism based on fixed payments under a lease for services provided by the Contractor with various other elements, including generally performance related deductions.

5.5 Changes

The issues here are the same as in many other jurisdictions. The Authority will generally bear change in law risk, particularly discriminatory change in law risk, although the distinction between general and discriminatory change in law risk is not as pronounced in German PPPs as in other jurisdictions.

5.6 Supervening events

The documentation will generally try to address potential circumstances where the project might face substantial problems with the continued generation of cash flow. The documentation will also try to mitigate the detrimental consequences for lenders in scenarios where the project is abandoned.

For parties not familiar with aspects of continental codified law, it is worth mentioning that the German Civil Code (Bürgerliches Gesetzbuch or BGB) provides for certain provisions to apply that may appear unusual from a common law perspective. For example, the concepts of disturbance of the basis for a contract (paragraph 313 BGB; Störung der Geschäftsgrundlage) and the termination of a contract with continuing obligations for an important reason (paragraph 314 BGB; Kündigung aus wichtigem Grund), were incorporated into written law when the reform of the law of contracts (Schuldrchtsreform) was implemented in the German Civil Code at the beginning of 2002.
5.7 Disturbance of the basis of the contract, paragraph 313 BGB

Paragraph 313 of the BGB provides for a right to adapt (or even terminate) a contract where the circumstances which formed the basis for the contract have materially changed after the parties have entered into the contract and where the parties would not have entered into such a contract (or only on different terms) if they had foreseen such change. Such right, however, will only exist if the continuation of the unamended contract appears to be unreasonable for the party claiming the benefit of this paragraph after due consideration of all the facts of the specific case. The applicability of paragraph 313 BGB is therefore limited and careful advice is needed before agreement can be reached on many provisions that would be typical in other jurisdictions.

5.8 Termination for an important reason, paragraph 314 BGB

German PPP contracts usually contain provisions dealing with termination rights and the consequences of such termination (e.g., damages, potential consequential damages, compensation, obligation to return equipment/plots of land and the release of rights of use).

In addition, paragraph 314 of the BGB allows for a right to terminate continuing obligations for an important reason (wichtiger Grund) even in scenarios where the right is not expressly incorporated in the underlying documentation. An important reason would be a scenario in which, after due consideration of all the facts and interests of both parties, it is unreasonable (unzumutbar) for the party wishing to terminate to actually continue the contract. Parties doing business in Germany regularly accept the risks that arise from this provision.

5.9 Remedies

Generally PPP documentation will provide for termination rights for the Authority in scenarios where the service is not provided as agreed. Unlike in the UK, PPP contracts in Germany are still not standardised (even though e.g., ÖPP Deutschland AG is working on standardising PPP contracts) and it is therefore not possible to produce a meaningful summary of standard compensation terms payable in the event of termination as these are negotiated on a case by case basis. As in other civil law jurisdictions, statutory rights for breach of contract will need to be taken into account.

Since PPPs in Germany have not, so far, resulted in a typical PPP structure, it will be interesting to see whether the step-in mechanisms for lenders which are currently used in other countries can be negotiated with the Authorities. Initial deals suggest that this will probably not be the case. However, this may be influenced in the future by the desire of the Authority to prevent a sale of property used in the Project and the lenders’ desire for proper security rights. Projects which have been financed by way of factoring solutions (and, as a consequence, do not involve the same level of risk for the lenders but rather leave it with the project company), only have to achieve balanced solutions between the Authority and the sponsor. In these scenarios, PPPs try to work with relatively normal mediation procedures, such as the formation of joint committees to monitor and remedy potential damages or, should this not work, resorting to arbitration procedures.

6. Insolvency and security position

PPPs will not normally offer the security packages available in other German projects. If a PPP is financed by way of factoring, security will not usually be required. Should a PPP be a classic project finance type transaction, lenders will have to focus on establishing a model to try to keep the cash flow of the project alive. Insolvency of the public body as the counterparty of the project company is not generally considered
to be an issue under German law. Pursuant to paragraph 12 of the German Insolvency Code, commencing
insolvency proceedings against the assets of the Federal Republic of Germany is not allowed. It is also
not permitted to commence insolvency proceedings against a federal state or against a public legal entity
which is under the supervision of a federal state if this is stipulated by federal law.

7. Sector-specific issues

Many typical sectors have particular issues that apply to them and in respect of which special advice may
be needed.

7.1 Road infrastructure

When tendering for a road infrastructure PPP, the investor should pay particular attention to the level of
planning for the project. (See discussion of A-Models in paragraph 2.3(b) which should make the projects
more attractive to the private sector).

7.2 Building construction

PPPs in accommodation projects will regularly involve some public law issues, such as building law,
environmental law, concession law and sometimes the law relating to neighbouring dwellings. Depending
on the type of project (eg schools, prisons or hospitals), specific legal input will be required.

8. Employment issues

Employment questions may occur in PPPs. If both the function and the operating resources (Betriebsmittel)
are transferred to the Contractor, this may lead to an automatic transfer of employment relationships.
Employment advice should be obtained to deal with the employment aspects of the overall transaction and
to ensure that any risk can be managed or avoided. Key considerations are set out below.

8.1 Transfer of employment relationships with their terms and conditions

It is important to distinguish between a public business in the form of a private entity (Unternehmen mit
privater Rechtsform), the shares of which are owned by the state, and a business in the form of a public
entity (Unternehmen in einer öffentlich-rechtlichen Rechtsform).

(a) Private entities

Businesses run as a private entity are, even if maintained by the state, subject to the German civil law
on business transfers. If operating resources are transferred to a Contractor by way of a transaction
(Rechtsgeschäft), a transfer of business in accordance with paragraph 613a of the BGB may well
take place. This provision also applies to spin-offs in accordance with the German Transformation Act
(Umwandlungsgesetz). Under these rules, employment relationships associated with the business will
transfer to the Contractor with all rights and obligations (including pension rights).

Collective agreements governing employment prior to the transfer will, in most cases, continue
to apply to the transferred employment relationships, either in the collective form or by way of
incorporation into the individual employment contracts. If incorporated into a contract, they cannot be
changed to an employee’s detriment for a period of one year after the transfer.
(b) Public entities

Generally, paragraph 613a of the BGB also applies to a transfer of a business in the form of a public entity to the private sector. There are, however, some modifications which are due to the fact that there is a special system of employee representation and different types of collective agreement applicable to a public entity.

Despite the protection granted by the law on business transfers, in practice, personnel transfer agreements (Personenüberleitungverträge) are often concluded which regulate in detail the future rights and obligations of employment. Such agreements must not, however, deviate from the legal principles of the relevant legislation to the detriment of employees.

A particular issue in this context is the difficulty in transferring public servants to the private sector. As they are not “employees” in the legal sense, they are not subject to the transfer of business regulations. Compared to employees in the private sector, public servants typically enjoy more benefits and rights and are better protected against loss of employment. Due to that protection and the generous pension provisions for public servants, they are usually not willing to give up their status. If public servants do work for the Contractor following the transfer of the business, different types of “transfer” models are possible. One example is the public servant being granted leave of absence and entering into a separate employment relationship with the Contractor, or the State and the Contractor concluding a personnel provision agreement (Personalstellungsvertrag), where the public servant is seconded to the Contractor and is therefore made available to work for the Contractor, but keeps his public servant status.

8.2 Pensions

One of the main issues in the context of the transfer of employees from the public to the private sector (whether formally organised as a private or public entity) arises from membership of public pension fund schemes (Zusatzversorgungskassen). In contrast to private sector pension schemes, public pension fund schemes are carried out on a pay-as-you-go basis (Umlageverfahren), which means that neither funds nor reserves are actually set up for pension obligations, and the amount of contributions is continuously determined based on the actual financial needs of the public fund.

As the Contractor continues to be bound by the pension promise given to the employees, it will either (i) have to conclude an agreement to remain in the public scheme, which requires that even new employees must be granted pension promises via this scheme, or (ii) if it decides to leave the scheme, it is obliged to provide another way to deliver the same pension. This can include the setting up of its own fund or the accrual – after some substantial time – of book reserves. Furthermore, if the Contractor does not remain in the public scheme, typically a substantial compensation amount (Ausgleichszahlung) will have to be paid to the public fund upon leaving the public scheme.

All alternatives create a substantial financial burden for the Contractor and/or can require a commitment from the state to participate in the costs arising out of or in connection with the pension promises, and advice will be needed at an early stage to ensure proper pricing.

8.3 Information and consultation obligations

Employees have to be informed in detail about the transfer of the business and their employment, and may object to the transfer within one month from receiving the prescribed information. If they object, their employment will remain with the public sector.

It is also important that co-determination rights of an employee representative body are observed.

If the business is a public entity, the personnel council (Personalrat) must be informed about all matters which substantially affect employees. Some of the German federal states have further legislation which regulates an explicit co-determination right of the personnel council in the case of a privatisation. The Personalrat cannot prevent, but can delay, the process.
A private entity must consult with the works council (Betriebsrat) if changes to the business are intended. The parties must negotiate an agreement on the reconciliation of interests (Interessenausgleich), and, if the employees might be exposed to disadvantages due to the business change, the employer and works council must agree on a social plan (Sozialplan) to mitigate these disadvantages. Again, whilst the works council cannot entirely prevent change taking place, it can substantially delay the process.

Appendix 1
Project data – A-MODEL projects

<table>
<thead>
<tr>
<th>Section of Motorway</th>
<th>Length (km)</th>
<th>No. of Candidates/Name of Contractor</th>
<th>Start/Beginning of Concession</th>
<th>Value of Concession Approx. (mEUR)</th>
<th>Construction Costs Approx. (mEUR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A8</td>
<td>52</td>
<td>5</td>
<td>Autobahn Plus A8 GmbH</td>
<td>18.03.2005/01.05.2007</td>
<td>750</td>
</tr>
<tr>
<td>A4</td>
<td>44.4</td>
<td>5</td>
<td>Via Solutions Thüringen GmbH</td>
<td>12.08.2005/16.10.2007</td>
<td>550</td>
</tr>
<tr>
<td>A1</td>
<td>72.5</td>
<td>8</td>
<td>A1 Mobil GmbH &amp; Co. KG</td>
<td>20.12.2005/04.08.2008</td>
<td>1,000</td>
</tr>
<tr>
<td>A5</td>
<td>59.8</td>
<td>7</td>
<td>Via Solutions Südwest GmbH</td>
<td>07.12.2005/01.04.2009</td>
<td>1,000</td>
</tr>
</tbody>
</table>
### Projects for expansion, maintenance and operation

<table>
<thead>
<tr>
<th>Section of Motorway</th>
<th>Length (km)</th>
<th>Remuneration Structure</th>
<th>(Possible) Start of Concession Awarding Phase</th>
<th>Construction Cost (mEUR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A8 Ulm/Elchingen – Augsburg-West</td>
<td>56</td>
<td>Shadow toll</td>
<td>July 2009</td>
<td>275</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A9 Lederhose – state line Thuringia/Bavaria</td>
<td>47</td>
<td>Availability</td>
<td>September 2009</td>
<td>128</td>
</tr>
<tr>
<td>A7 Bordesholm – Hamburg-Nordwest</td>
<td>64</td>
<td>Not available</td>
<td>2010</td>
<td>325</td>
</tr>
<tr>
<td>A7 Salzgitter – Drammetal</td>
<td>82</td>
<td>Not available</td>
<td>2011</td>
<td>305</td>
</tr>
</tbody>
</table>

### Project for expansion, maintenance, probably without operation

<table>
<thead>
<tr>
<th>Section of Motorway</th>
<th>Length (km)</th>
<th>No. of Candidates/Name of Contractor</th>
<th>Start/Beginning of Concession</th>
<th>Value of Concession Approx. (mEUR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A6 Wiesloch-Rauenberg – Weinsberg</td>
<td>36</td>
<td>85</td>
<td>2010</td>
<td>t.b.d.</td>
</tr>
</tbody>
</table>

### Projects for maintenance and operation

<table>
<thead>
<tr>
<th>Section of Motorway</th>
<th>Length (km)</th>
<th>No. of Candidates/Name of Contractor</th>
<th>Start/Beginning of Concession</th>
<th>Value of Concession Approx. (mEUR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A45 State line North Rhine Westphalia/ Hesse – Gambacher interjunction</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A9 Mainz Laubenheim – A643, Main-Schierstein</td>
<td></td>
<td></td>
<td></td>
<td>Exact details regarding project and size are still to be confirmed.</td>
</tr>
</tbody>
</table>
## Appendix 2
### Active sectors

This table summarises key PPP projects in Germany since 2004.

<table>
<thead>
<tr>
<th>Project Location</th>
<th>Value of Concession Approx. (mEUR)</th>
<th>Sector</th>
<th>Tender Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>German island of Fehmarn – Danish island of Lolland</td>
<td>4,400-5,500</td>
<td>Fixed Fehmarnbelt Link</td>
<td>Closed</td>
</tr>
<tr>
<td>City of Berlin</td>
<td>2,400</td>
<td>Berlin Brandenburg International Airport</td>
<td>Closed</td>
</tr>
<tr>
<td>City of Kiel</td>
<td>250</td>
<td>Particle therapy centre</td>
<td>Closed</td>
</tr>
<tr>
<td>State of Niedersachsen</td>
<td>245</td>
<td>Helicopter flight simulator</td>
<td>Closed</td>
</tr>
<tr>
<td>City of Hamburg</td>
<td>200</td>
<td>Building and reconstruction of 32 schools</td>
<td>Closed</td>
</tr>
<tr>
<td>City of Hamburg</td>
<td>180</td>
<td>Elb-philharmonics</td>
<td>Closed</td>
</tr>
<tr>
<td>City of Moers</td>
<td>150</td>
<td>City hall and cultural and education centre</td>
<td>Closed</td>
</tr>
<tr>
<td>University Hospital Essen</td>
<td>136</td>
<td>Proton therapy centre</td>
<td>Closed</td>
</tr>
<tr>
<td>District of Offenbach (Los Ost)</td>
<td>131</td>
<td>Reconstruction of schools</td>
<td>Closed</td>
</tr>
<tr>
<td>City of Wiesbaden</td>
<td>128</td>
<td>Centre of justice and administration</td>
<td>Closed</td>
</tr>
<tr>
<td>City of Frankfurt</td>
<td>106</td>
<td>Building and reconstruction of four schools</td>
<td>Closed</td>
</tr>
<tr>
<td>State of Saxony-Anhalt</td>
<td>100</td>
<td>Prison in Burg</td>
<td>Closed</td>
</tr>
<tr>
<td>District of Offenbach (Los West)</td>
<td>92</td>
<td>Reconstruction and operation of schools</td>
<td>Closed</td>
</tr>
<tr>
<td>City of Nuremberg</td>
<td>81</td>
<td>Four schools</td>
<td>Closed</td>
</tr>
<tr>
<td>State of Baden-Württemberg</td>
<td>70</td>
<td>Prison in Offenburg</td>
<td>Closed</td>
</tr>
<tr>
<td>City of Munich</td>
<td>60</td>
<td>Fürst-Wrede-Barracks</td>
<td>Closed</td>
</tr>
<tr>
<td>City of Frankfurt</td>
<td>58</td>
<td>Centre of learning</td>
<td>Closed</td>
</tr>
</tbody>
</table>
## Appendix 3

### Likely future active sectors\(^{14}\)

<table>
<thead>
<tr>
<th>Project location</th>
<th>Value of concession approx. (mEUR)</th>
<th>Sector</th>
<th>Tender status</th>
</tr>
</thead>
<tbody>
<tr>
<td>City of Potsdam</td>
<td>120</td>
<td>Landtag (Parliament of Brandenburg)</td>
<td>In Tender</td>
</tr>
<tr>
<td>City of Bremervoerde</td>
<td>55.5 (building costs)</td>
<td>Building, maintenance and operation of Prison Bremervoerde</td>
<td>In Tender</td>
</tr>
<tr>
<td>City of Ahrensberg</td>
<td>Not available</td>
<td>Community centre</td>
<td>In Tender</td>
</tr>
<tr>
<td>North Rhine-Westphalia</td>
<td>Not available</td>
<td>Two different state roads</td>
<td>In Tender</td>
</tr>
<tr>
<td>State of Baden-Württemberg</td>
<td>Not available</td>
<td>Chemical and veterinary analytic department</td>
<td>In Tender</td>
</tr>
<tr>
<td>City of Ulm</td>
<td>Not available</td>
<td>Multifunctional hall</td>
<td>In Tender</td>
</tr>
<tr>
<td>City of Stuttgart</td>
<td>Not available</td>
<td>Hospital building</td>
<td>In Tender</td>
</tr>
<tr>
<td>City of Schwäbisch Gmünd</td>
<td>Not available</td>
<td>Five schools</td>
<td>In Tender</td>
</tr>
<tr>
<td>City of Potsdam</td>
<td>21</td>
<td>Building of a visitor centre in the park of Sanssouci, reconstruction of supply buildings in the park of Babelsberg and Neue Garten</td>
<td>Pre-Approval</td>
</tr>
<tr>
<td>District of Rhein-Erft</td>
<td>Not available</td>
<td>Reconstruction and expansion of 10 schools</td>
<td>Pre-Approval</td>
</tr>
<tr>
<td>City of Munster</td>
<td>Not available</td>
<td>Refurbishment of a university hospital</td>
<td>Pre-Approval</td>
</tr>
<tr>
<td>District of Soest</td>
<td>Not available</td>
<td>Rescue centre</td>
<td>Pre-Approval</td>
</tr>
<tr>
<td>City of Wilhelmshaven</td>
<td>37</td>
<td>Reconstruction of a school building</td>
<td>Pre-Approval</td>
</tr>
<tr>
<td>District of Harburg</td>
<td>18.6</td>
<td>Road infrastructure; east bypass Buchholz</td>
<td>Pre-Approval</td>
</tr>
</tbody>
</table>

Italy

Study the sciences first, and then pursue the practice stemming from that science.

Leonardo da Vinci (1452-1519)

Contact

Rome
Stefano Sennhauser
Allen & Overy
Studio Legale Associato
Corso Vittorio Emanuele II, 284
00186 Rome
Italy
Tel: +39 06 684 271
Fax: +39 06 684 27333
stefano.sennhauser@allenovery.com

Milan
Stefano Sennhauser
Allen & Overy
Studio Legale Associato
Via Manzoni, 41
20121 Milan
Italy
Tel: +39 02 290 491
Fax: +39 02 290 49333
stefano.sennhauser@allenovery.com
1. Introduction

Infrastructure investments, and particularly PPPs, are seen by governments as a key building block for economic recovery. In response to the recent economic downturn, many governments have, therefore, committed to significant economic stimulus packages, focusing on PPP infrastructure and renewable energy initiatives. In Italy, the government and local authorities are looking at introducing stimulus packages and how to optimise these packages by combining them with the development of more structured rules and a streamlining of bureaucracy to attract investors. Although co-operation between the public and private sector on infrastructure works are common in Italy, there are however still two main obstacles for investors: (i) a lack of lenders willing to lend for sufficiently longer tenors; and (ii) the general lack of consensus about the scope and priorities for PPP projects – an off-putting factor for investors when considering which countries offer the best investment environment.

In accordance with current Italian legislation, both government authorities (ie different Ministries) and local authorities (ie Municipalities or Regions) have responsibilities for infrastructure. Other entities, founded as private companies but with a specific objective relating to public works and services (eg in sectors such as electricity, water and other utilities) could also be involved. Projects may involve more than one contracting authority (the Authority) and specific procedures exist to address this in the approval process.

2. Legal and regulatory framework

2.1 Background

(a) Different forms of PPP

Legislation is required for PPPs to be permitted in Italy.

Italian law, in particular Article 3.15-ter of Legislative Decree 163/2006 – Code of public works contracts, public service contracts and public supply contracts (the Code)\(^1\) recognises several different forms of PPP of the following contractual nature:

(i) public works concessions initiated by private parties (PFI projects);

(ii) public works concessions initiated by public authorities (public works concessions);

(iii) public service concessions (public service concessions);

(iv) sponsorship contracts (contratti di sponsorizzazione) through which the administration (Sponsor) offers a private third party (Sponsor) the possibility of publicising its name, logo, trademark and products in ad hoc spaces, upon payment in the form of assets, services, or other utilities (Article 26 of the Code); and

(v) financial leases (regulated by Article 160 bis of the Code).

Additionally, there are PPPs of an institutional nature, which mainly consist of:

(i) public-private companies for the provision of local public services (ie società miste, regulated by Article 113 of Legislative Decree 267/00 – Consolidated Act on Local Authorities); and

(ii) public-private companies for urban regeneration programmes (ie società di trasformazione urbana – STU, regulated by Article 120 of the Consolidated Act on Local Authorities).

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\(^1\) The Code was enacted in April 2006 to implement EU Directives 2004/17 and 2004/98 in Italy and to restate in a single piece of legislation the various acts relating to public contracts such as the Merloni Law (L.109/94), implementing Directive 93/37/CEE on public works, and the Target Law on major infrastructure projects (L. 443/2001, as implemented by Legislative Decree 190/02).
(b) Policy level

At a policy level, Italian law has provided for the establishment of the Technical Unit for Project Finance (Unità Tecnica Finanza di Progetto – UFP), a task force which promotes the use of private finance in public infrastructure projects as well as other forms of PPP\(^2\).

The UFP is set up by and operates within the Italian Treasury and an interministerial commission (Comitato Interministeriale per la Programmazione Economica – CIPE). However, pursuant to CIPE’s and related bodies’ transfer to the Presidency of the Council of Ministers (PCM) (Law-Decree n. 181/2006 subsequently converted into Law n. 223/2006), the UFP is currently encompassed in the PCM Department for Economic Policy Programming and Co-ordination.

The UFP is entrusted with the task of providing project finance expertise to public sector entities and assisting them in identifying projects capable of attracting the private sector. The UFP has a consultative role, and public administrations are not necessarily required to ask for its assistance in structuring PPP schemes.

(c) Specific level

At a more specific level, the Code also regulates major infrastructure projects of national strategic interest on a case-by-case basis\(^3\). The Code considers the use of private finance through more traditional methods such as PFI projects and public works concessions and also through a new model called the general contractor model (Article 176 of the Code). The general contractor model is a hybrid form of PPP, as the general contractor provides funding for construction of the works and assumes construction risk but does not take on any operational responsibility.

2.2 Authority selection of PFI projects

Italian PFI is regulated by Article 152 onwards of the Code.

Every three years, authorities produce a plan for public infrastructure works for the coming three years (Article 128 of the Code). The programme should set out an order of priority for civil works, among which top priority is ascribed to the following three types of projects: (a) maintenance and renewal of its existing estate, (b) completion of works that have already been started as well as approved and executive projects, or (c) projects that may be mostly privately financed. Although private entities are free to propose projects that do not fall into these categories, as authorities are obliged to assess the merits of any proposal in the context of these priorities, it is often more difficult for new private PPP proposals to gain approval.

As for the award procedures, Article 153 of the Code distinguishes between three main schemes for awarding works concessions:

(i) a “one-step” procedure for the selection of the tenderer and the award of the concession contract (Article 153, paragraphs 14);

(ii) a “two-step” procedure in which the tenderer has the right to be treated as the preferred tenderer (Article 153, paragraph 15);

(iii) a private initiative procedure, governed by Article 153, paragraphs 16-18 of the Code and initiated by a potential tenderer when the relevant Authority does not issue a tender within six months of the approval of the annual programme (as per Article 128) of public works for projects included in the programme to be realised through private financing.

(a) One-step procedure

In the “one-step” procedure for the award of a concession contract, the Authority carries out a public process for the selection of the concessionaire based on the most economically advantageous offer by issuing a tender on the basis of a feasibility study. Entities meeting the necessary requirements which permit

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\(^2\) Art. 7 L. 144/99.

\(^3\) The first strategic infrastructure plan was approved by CIPE resolution 121/01.
them to be considered as “public works concessionaires” (as indicated by Presidential Decree n. 554/1999) can participate in the tender. The tenders to be presented to the Authority must include a preliminary project description, a draft contract, a business plan, and a specification regarding the operational phase of the initiative (project management and service specifications). Following the tender procedure, the authority selects the tenderer in accordance with the tender criteria and approves the preliminary project. As part of this selection phase, the tenderer must make such changes as are necessary for the project to obtain the Authority’s approval, to satisfy the “Service Conference” and to fulfil the requirements relating to the environmental evaluation rules, without receiving any reimbursement or increase in price.

Three scenarios are possible.

(i) The tenderer accepts the changes to the project requested by the Authority and is awarded the concession.

(ii) The tenderer does not accept the changes to the project requested by the Authority. The Authority can then ask its lower-ranked competitors to make the same changes on the same conditions. The concession is awarded to the first of the competitors to accept the proposed changes and the originally selected tenderer is entitled to be reimbursed its tender costs.

(iii) The project does not require any change. The selected promoter is then directly awarded the concession contract.

(b) Two-step procedure

In the “two-step” procedure, the Authority holds a public process for the selection of the concessionaire, specifying that the procedure will result in the selection of a preferred tenderer who has presented the best offer rather than the outright selection of such tenderer. The administration approves the preliminary project (as per Article 153, paragraph 10, letter c) and then requires the preferred tenderer to make the necessary changes in order to achieve project approval. The Authority then starts a new selection procedure on the basis of the tenderer’s preliminary project (as approved by the Authority) and the economic and contractual conditions included in the preferred tenderer’s proposal, using the most economically advantageous tender as the evaluation criterion.

Three scenarios are possible.

(i) The contract is awarded to the preferred tenderer if no other more economically advantageous tenders are presented.

(ii) The contract is awarded to the preferred tenderer if more economically advantageous tenders have been presented but the preferred tenderer agrees to adjust his offer (within 45 days) to match that of the best competitor. In this case, the latter is reimbursed by the preferred tenderer for expenses incurred in preparing the proposal.

(iii) The tenderer does not adjust his proposal to the best offer within 45 days and the best competitor becomes the concessionaire.

(c) Private initiative procedure

Where a project has been included by the authority in its annual programme but a tender for that project has not been issued within six months of the approval of the annual programme, Article 153, paragraph 16 of the Code allows entities satisfying certain conditions to submit proposals for those projects within four months of the last day of such six-month term. Such proposals must contain the same elements as in the procedures regulated by Article 153, paragraphs 1-14 and 15 of the Code. The administration is obliged to issue a preliminary tender notice within 60 days of the end of such

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4 The “Service Conference” (Conferenza di Servizi) is a basic administrative and legislative instrument which is used when several different public administrations are involved in a project in order to simplify the approval process. The procedure is governed by Article 14 and subsequent of Law 241/90 which requires all authorities involved to attend the Service Conference and to issue their opinions on the project within the scope of their competences.
four-month period in order to stimulate further proposals and must include the applicable evaluation criteria. Within 90 days following the issue of the tender notice, new proposals as well as proposals already presented (modified for consistency with the issued evaluation criteria) can be submitted to the administration. The administration must evaluate such proposals within six months and select the one with which it wishes to proceed, which it will declare to be in the public interest.

A public selection procedure will then be held by the Authority using one of the following alternative procedures:

(i) a competitive dialogue in accordance with Article 58 of the Code if changes are required to the preliminary project;

(ii) an open or restricted procedure in accordance with Article 144 of the Code for the award of a works concession; or

(iii) the two-step procedure set out in Article 153, paragraph 15, lett. a) to f) of the Code (see 2.2 (b) above).

(iv) The procedures listed at (ii) and (iii) above can only apply if the preliminary project does not require changes. In both cases, the selected tenderer must participate in this stage of the tender process and its tender is entitled to be deemed preferable to the best tender.

Once a PFI project has been awarded, it has the same characteristics as a public works concession and differs only in this preliminary phase (see paragraph 2.3 below for more detail).

(d) Recent utilisation of PFI in Italy

In 2003, 729 PFI initiatives were launched with a total value of EUR5.3 billion. PFI projects represented 59% in number and 50% in value of the national PPP market5.

In 2003, there were 100 projects with a value of EUR1.2 billion declared to be of public interest and admitted to the subsequent phase of tendering under the restricted procedure and negotiated procedure. These 100 projects represented an increase of 22 projects and EUR329 million in value compared with the projects of 20006.

In 2006, works concessions under the private initiative procedure (see paragraph 2.2(c)) constituted the most widespread procedure both in terms of number and value and accounted for 12.2% in value of the total PPP market. Service concessions accounted for 23.6% in value of the total PPP market. Other PPP forms represented only a residual part of the market. In 2007, there was a further rise of similar proportions to that in 2006.

Market activity was spread fairly widely across the region in 2008. In 2008, Italy saw a total value of USD7 million in global loans. Italy has seen a constant growth in the PPP market compared to the public infrastructure market between 2004 and 2007.

2.3 Public works concessions

One of the main reasons behind the limited interest from foreign investors in Italian project finance has always been the delay in obtaining the permits required for any sort of economic activity. Additionally, in Italy the average time taken for a tender process for infrastructure projects ranges from approximately 600 days in Lombardy to 1,582 days in Sicily. The delays to the process have been particularly significant in this sector where environmental, social and so-called NIMBY (“not in my back yard”) concerns often extend the time required for public tendering by years.

Public works concessions are regulated by Article 142 onwards of the Code and follow a DBOOT model under which the Contractor is granted the right to design, build and operate the project and to hand it back to the Authority once the concession has expired. Pursuant to Article 3, paragraph 11 of the Code,
works concessions are defined as “remunerative written contracts” aimed at final and executive project

design, execution of the public works and structurally or directly connected works and their functional

economic management. They feature the same characteristics as public works contracts, except that

the compensation for works to be carried out consists either of the right to exploit the relevant works only

or both this exploitation right and a right to receive a payment from the Authority. Under this model, the

Contractor does not have full ownership of the major assets and therefore asset security is not generally

available to the lenders.

Unlike Italian PFI projects, under a public works concession, the Authority is responsible for the

preliminary design, draft concession agreement, business plan and operating specifications of public

works concessions. The award of the concession is carried out under the restricted procedure or the open

procedure (Article 144 of the Code). The Contractor is still selected, however, on the basis of the most

economically advantageous criteria.

(a) Payment mechanism

The Contractor (under a public works concession or PFI project) can be paid for its services by charging

fees to end-users (which is usually the case in road projects). Such fees are usually regulated and therefore

the Contractor may be restricted in the fees it can charge to end-users. Alternatively, the Contractor can

receive payment directly from the Authority (which is usually the case in accommodation projects, such as

hospitals, schools and public offices)7.

Accommodation projects are expressly dealt with under Article 143 of the Code, which provides that

the Contractor can be directly paid by the Authority, provided that the works and services provided are

linked to a public service, and that the Contractor bears the economic/financial risk involved in operating

the service. In this regard, it should be noted that, as demand is usually generated by the public sector, the

concession agreement usually provides for a minimum level of services which the public sector must pay

for in order to service the level of the Contractor’s investment, subject always to the Contractor providing

the availability required.

(b) Recent use of public works concessions

In 2003, there were 161 public works concessions projects with a total value of EUR3.3 billion8.

The most active sectors in 2003 were sports facilities (32 projects), parking (24 projects) and

healthcare (20 projects).

In 2006, there were 263 public works concessions projects with a total value of EUR1.953 billion9.

In 2007, however, there were only 160 public works concessions projects with a total value of

EUR655.051 million10.

2.4 Public service concessions

Public service concessions, unlike Italian PFI projects and public works concessions, are not expressly

governed by EU law.

However, this does not mean that public service concessions are not subject to any regulation at all.

Indeed, as pointed out by the EU Commission11, public service concessions, although not regulated by a

specific EU Directive, are subject to the general principles of the EC Treaty and general principles

7  These payment structures substantially comply with the definition set out in Art. 1, lett. d) of Directive 93/37/CEE: “public works

concession is a contract of the same type as that indicated in (a) public works contract except for the fact that the consideration for the works

to be carried out consists either solely in the right to exploit the construction or in this right together with payment”.

8  NWPF Statistics.

9  Source: “Italian PPP at a Glance” by Laura Martiniello, Presidency of the Council of Ministers, Department for Economic Policy

Coordination and Planning, PPP Task Force, Italy (21 February 2008).

10  Source: “Italian PPP at a Glance”, ibidem.

11  See “Commission interpretative communication on concessions under community law” (2000/C 121/02). Please also see Court of

Justice, Judgment of 7 December 2000, Case C-324/98, Teleaustria v. Post & Telekom Austria; as far as the national legal framework is

concerned, please see Circular of the Presidency of the Ministers Council – Community politics Department of 1 March 2002, n. 3944,

relating to “Procedures for the awarding of service and works concessions”. Please also see Judgment of Council of State 253/02.
governing public contracts. In particular, at a national level, Article 30 of the Code expressly states that, in awarding public service concessions, Authorities must comply with the principles of non-discrimination, equality of treatment, transparency, mutual recognition and proportionality.

Service concessions differ from PFI projects and works concessions in that the main object of the contract is the operation of the service, and any works are merely ancillary to that purpose.

As is the case for public works concessions, the Contractor takes responsibility for and bears the risk of operating the service in question, and has the right to earn revenues by charging fees in some form to end-users and/or to the Authority directly.

Service concessions are principally used where a Contractor operates an existing public service infrastructure. Examples of sectors where service concessions are used include network infrastructures (e.g., toll roads), water plants, public lighting, public parks, sports facilities, healthcare and other accommodation facilities. Any construction element is always secondary to the operational element and is generally limited to improvement and reorganisation of existing works. Furthermore, unlike PFI projects or public works concessions, it is the Contractor who usually pays a fee to the Authority, although the Authority may, if appropriate, make a contribution (as would be the case if new works were carried out).

In 2003, there were 233 service concession projects, with a total value of EUR1.4 billion. There was a sharp growth in the number of service concessions between 2003 and 2006 due to the reorganisation of local public services but numbers have now started to stabilise. In 2006, there were 384 service concession projects, with a total value of EUR3.773 billion. Although there were 310 service concession projects in 2007, their total value was only EUR284.532 million.

2.5 PPPs of an institutional nature

PPPs of an institutional nature generally involve the selection, through a public tender procedure, of a private partner to set up a public-private company together with the awarding local authority (e.g., municipalities and provinces) for the provision of local public services (società miste), the carrying out of complex programmes of urban regeneration (e.g., STU) and housing as well as the construction, operation and maintenance of networks, plants, parking, toll roads and other works in the public interest.

3. General structure of PPPs

The contractual structure of a PPP project in Italy is similar to that used in the UK and other European countries and applies to whichever form of PPP is chosen, including PFI projects as described in paragraph 2.1(a)(i).

This Section 3 concentrates on national laws which impact on the contractual relationship of the various parties involved in a PPP/PFI transaction, i.e., those provisions that refer to a special purpose vehicle (SPV), step-in rights of the lenders and termination due to Authority default or Contractor default.

3.1 The SPV

As in other countries, a SPV is typically established for PPPs, as it allows the legal and financial ringfencing of the project from the other activities of the sponsors. Sponsors contribute equity to the SPV and the lenders provide senior debt. In certain circumstances, a public contribution may also be necessary to carry out the project.
Article 156 of the Code regulates SPVs. In particular, it provides that, once the concession has been awarded, the Contractor has the right to set up an SPV which can replace the original entity selected as the Contractor in all the contractual relationships arising from the concession. It is therefore possible to structure a non-recourse project financing as in this case the sponsors’ risk is limited to the equity injected into the SPV.

Sponsors’ risk is not, however, limited in this way during the construction phase. The SPV and its shareholders are jointly and severally liable to the Authority for any required Authority contributions during this phase. However, this liability may be avoided if the SPV provides the Authority with a suitable bank or insurance guarantee for the repayment of the contributions. Such a payment obligation will cease to have effect once the construction works have been completed and accepted by the Authority. This kind of structure is compatible with a limited recourse project financing as there is usually only a limited right to seize assets or enforce guarantees.

The minimum SPV share capital required by the Authority must be indicated in the OJEU notice. If the SPV has several sponsors, each of their shares must be referred to in the bid documents.

The rules for the transfer of the SPV’s shares are set out in the concession contract. Usually, unless otherwise stated in the contract, they are transferable without limitation. However, as a guarantee for the full performance of the construction obligation is required, the shareholders of the construction contractor are usually obliged to retain their participation as shareholders in the SPV and to guarantee the correct performance of the Contractor’s obligations until the issue of the works completion certificate (subject to the rules on Authority contributions during the construction period described above). By contrast, the shareholders who are merely investors (ie not subcontractors) may generally buy and/or sell their shares in the SPV at any time and without limitation.

It is also important to note that, in order to encourage lenders to participate in PPP projects, Article 157 of the Code provides that the SPV may issue bonds beyond the limits set out in the Italian Civil Code for an ordinary commercial company. The bondholders may be protected through a mortgage over the SPV’s assets.

3.2 Supervening events

Supervening events (including, amongst other things, changes in law and Force Majeure (as defined below)) which may affect the economic/financial balance of the project are regulated by Article 143.8 of the Code.

The importance of the economic/financial balance of the project is confirmed by Article 143.8. In particular, this provision states that the economic/financial plan is to be incorporated in the concession contract and that, in the case of supervening events which modify the conditions for the economic/financial plan, such plan shall be reviewed in order to re-establish the original economics of the plan if necessary.

(a) Change in Law

Under the Code, where changes in law are applicable to the industry in general (eg new taxation on company revenue), these changes may not be regarded as supervening events. Where, however, the change in law specifically refers to the activity granted to the Contractor and prejudices the Contractor’s ability to generate the expected cash flow, this may be regarded as a supervening event and accordingly may result in the redefinition of the “equilibrium” conditions.

(b) Force Majeure

The term “Force Majeure” means an event outside the control of a party to a contract, including, inter alia, a strike, natural disaster or war, or in any case an event which is not foreseen or foreseeable, is beyond the Contractor’s control and makes it impossible or unduly difficult to fulfil the obligations under a contract. In a PFI project, the consequence is that, the Contractor is unable to generate its expected cash flow.
Rebalancing may be achieved by the Authority paying additional sums (eg through a contribution or a tariff increase), or by granting extra time (eg through an extension of the concession term). If tariffs are regulated by law, the only rebalancing allowed may be granting extra time by extending the concession term.

If the economic/financial plan is not reviewed, the Contractor may terminate the concession contract.

Supervening events may, of course, work in favour of either party. Accordingly, if the effect is favourable to the Contractor, the economic/financial plan may be rebalanced in favour of the Authority.

Whilst Italian PPP contracts envisage extra time or in some cases extra money via the rebalancing method described above, they do not classify events as relief events or compensation events in the way that PPP contracts in the United Kingdom and some other countries do.

It may be the case that investments made by the Contractor are not completely amortised at the end of the concession period (as is the case if extra works are carried out). In this event, the economic/financial plan must specify the residual value of the investments not yet amortised. It is arguable that there should be a right in favour of the Contractor to be paid this residual value by the incoming contractor on the subsequent concession.

3.3 Termination due to Authority default

Article 158 of the Code provides that in the event of termination of the concession contract due to Authority default or voluntary termination by the Authority, the Contractor is entitled to receive the following compensation:

(a) if the work has already been completed, an amount equal to the value of the work completed plus any related costs (eg interest to be paid on senior debt) net of amortisation;

(b) if the work has not been completed, compensation will reflect the costs actually incurred by the Contractor in carrying out the work;

(c) liquidated damages to be paid to third parties and all other costs incurred or to be incurred as a result of termination of the contract; and

(d) pre-defined damages for loss of profit. If termination occurs in the construction phase, this is an amount equal to 10% of the value of the work still to be carried out. If the operating phase has already started this is an amount equal to 10% of the consideration for the service still to be provided, assessed on the basis of the economic/financial plan.

In order to protect the lenders and encourage their participation in PPP transactions, the legislation gives lenders priority rights and provides that on receipt of compensation from the Authority, the Contractor must apply any compensation received firstly in repayment of senior debt. The Contractor cannot apply the compensation for any other purpose until the lenders have been fully repaid (Article 158.2 of the Code).

Finally, to preserve the rights of the Contractor (and of its lenders), the legislation also provides that, if the contract is revoked by the Authority, the effectiveness of the revocation is subject to payment by the Authority of the compensation owed (Article 158.3 of the Code). Therefore, should the operating phase have started, the Contractor is entitled to continue operating the project until the Authority has fulfilled all its payment obligations outlined above.

3.4 Termination due to Contractor default

In the event of termination due to Contractor default, the Contractor will usually be entitled to receive compensation of an amount equal to the value of the work completed plus any related costs (if the work has been completed) or the costs actually incurred (if the work has not been completed). Such agreements are not based on a specific provision of law but parties usually agree to include such a provision for...
bankability reasons, even if termination is due to a Contractor default. However, the compensation in this case is usually calculated as an amount lower than the one applicable in case of the Authority’s default (eg pre-defined damages for loss of profits are normally excluded).

### 3.5 Step-in rights of the lenders

Article 159 of the Code provides for the step-in mechanics which operate in a Contractor breach scenario.

If the Authority is entitled to terminate the concession contract due to Contractor breach, the lenders may appoint a new company (Newco) on the terms envisaged by the contract or, if no such terms have been included, on such terms indicated by the Authority when giving notice of its intention to terminate the contract for Contractor default. The Newco will replace the Contractor, and take on its role under the concession contract.

The Newco must fulfil the following requirements:

(a) the technical and financial standing of the Newco must be substantially equivalent to that of the Contractor at the time of the concession award; and

(b) any breach by the Contractor entitling the Authority to terminate must be remedied within 90 days after the expiry of the period in which a Newco may be appointed. Therefore, the lenders have a fixed cure period to appoint a Newco and remedy the Contractor’s default. This cure period, however, may be extended by mutual agreement between the lenders and the Authority.

Although lenders’ step-in rights are set out in the Section of the Code regulating PFI, they apply to any kind of concession, not only to PFI projects.

### 3.6 Security

As an incentive to encourage lender participation in PPPs (in all its forms), Article 160 of the Code provides that lenders may benefit from a general lien over the movable assets of the Contractor.

When structuring the project financing of a PPP deal, the security package provided to the lenders includes other standard securities, including eg a mortgage over land, pledge over quotas/shares in the Contractor, pledge over project accounts and assignment of receivables.

### 3.7 Refinancing

Unlike in the UK, there is no prescribed approach to dealing with a proposed refinancing of a PPP in Italy, nor are there any set rules regarding sharing any refinancing gain. The parties are free to negotiate the basis for any refinancing on a project specific basis.

### 4. Sector-specific issues

In order to have a complete picture of the application of PPP structures in Italy, it is worth briefly considering some specific sectors and their relevant issues.

#### 4.1 Toll roads

Toll roads have probably been the most important sector in Italy in terms of revenues generated.
A.N.A.S. is the Authority responsible for roads and toll roads. In 2002, in the course of a privatisation programme of the main state owned businesses, A.N.A.S. was incorporated as a private company and became A.N.A.S. S.p.a. (ANAS)\(^{15}\). The Ministry of Economy and Finance (MEF) is the sole shareholder of ANAS and its shares are not transferable.

Under the terms of a concession agreement between the Minister of Infrastructure and Transport (MIT) and ANAS\(^{16}\), ANAS is entrusted with:

(a) the operation and maintenance of all roads and toll roads of national interest;

(b) the development and construction of new roads; and

(c) the implementation of new laws and regulations concerning roads, toll roads and traffic.

In particular, the activities under (a) and (b) above may be carried out either directly by ANAS or through third party concessionaires to be selected by public tender procedures.

Under Article 822 of the Italian Civil Code, roads and toll roads belonging to the State are known as “beni demaniali”\(^{17}\) and the transfer of these assets from the State to ANAS does not affect this status.

As beni demaniali, the roads and toll roads owned by ANAS are public property which cannot be sold to, or made subject to rights of, third parties other than within the limits set out by law. The only rights that third parties have in relation to roads and toll roads are therefore through concession contracts.

So far, the forms of PPP which have been used in relation to toll roads have been contractual, ie public works concessions under Article 143 of the Code, and, in recent years, there have been several PFI projects under Article 153 of the Code\(^{18}\). In all these cases, the projects required new infrastructure to be built and operated by the Contractor.

Public service concessions have also been used where the Contractor has the right to earn revenues from operating existing infrastructure.

More recently, road schemes have been structured using shadow toll mechanics where tolls could not be charged to end-users for technical or social reasons.

4.2 Water

The water sector in Italy is currently regulated by Legislative Decree 152/2006 (Environmental Code) which repealed Law 36/1994.

The Environmental Code centralises responsibility for the integrated water service (IWS\(^{19}\)) and introduces a tariff system for payments to Contractors.

The Environmental Code sets out the organisation of the IWS as follows:

(a) it reorganises geographical areas of responsibility into Optimal Territorial Areas (ATOs), which are defined by the regions, which in Italy are autonomous entities independent from the State. The ATOs are managed by special authorities (AATOs), which supervise the entire water system;

(b) each AATO must organise the management of the IWS following the general principles of efficiency, effectiveness and low cost;

(c) to ensure consistency and adequate levels of technical and economic efficiency, the AATOs must, in principle, choose a single operator of the IWS for each ATO; and

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\(^{15}\) The incorporation was made by law (Art. 7 of Law Decree. 138/02, restated by L. 178/02).

\(^{16}\) Implementing Art. 7 of L.D. 138/02 – L. 178/02.

\(^{17}\) Stated in Art. 7 of LD 138/02 – L 178/02.

\(^{18}\) The first project under previous Article 37.2 of the Merloni Law, referring to the Milan-Bergamo-Brescia toll-road, was awarded in 2003 to the SPV BRE-BE-MI S.p.A.,

\(^{19}\) IWS is defined in Article 141, para 2, of the Environmental Code as “the public services as a whole used for gathering, delivering, distributing water for civilian use, as well as for sewerage and filtration of waste water.”
(d) AATOs may select any of the following forms of PPP available for local public services (as set out in Article 113 of the DL n. 267/2000):

(i) PFI projects under Article 153 of the Code;

(ii) public works concessions under Article 143 of the Code;

(iii) public-private companies (società miste), within which the private partner is selected through public tender procedures (ie PPPs of an institutional nature); and

(iv) companies fully owned by local authorities (ie municipalities and provinces) located in the relevant AATO, provided that the local authorities exercise control over and work with these companies in a similar way to their own departments (in-house providing).

According to statistics published by the Committee which oversees the use of water resources, in 2003, there were 38 AATOs which granted concessions for the IWS. Of these 38 concessions, 25 were granted to public-private companies, 12 to completely public companies, and only one IWS to a completely private contractor.

The most common form of PPP in the water sector is therefore a PPP of an institutional nature (the public-private company), whilst PPPs of a purely contractual nature do not seem particularly suitable for this sector.

4.3 Healthcare

The healthcare sector was reformed by Legislative Decree 502/92 and Law 229/99. The aim of the reform is to improve the management and organisation of healthcare services by delegating more power to the regions and therefore the use of PPP is likely to increase in this sector.

In general, Authorities responsible for healthcare services are Local Healthcare Authorities (Aziende Unità Sanitarie Locali, ASLs). The ASLs are aziende, ie public companies with a public legal personality and commercial autonomy which are funded by the regions through an endowment fund (fondo di dotazione). Other sources of funding are tariffs or charges paid by users for medical services (which do not, however, fully cover the actual costs incurred). ASLs owe a duty to carry out their activities in an efficient manner, in compliance with budgetary constraints, national and regional legislation and the atti aziendali (ie special resolutions) adopted by the ASL’s general manager (direttore generale).

PPP projects in the healthcare sector mostly relate to hospital buildings, and have been carried out through either PFI projects under Article 153 of the Code or public works concessions under Article 143 of the Code.

The Contractor is remunerated by providing services directly to the Authority and is paid by the Authority. The services provided by the Contractor are non-medical (eg maintenance, parking, catering, laundry), whilst medical services continue to be provided by the Authority.

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20 The concept of in-house provision was formulated by the Court of Justice in the Judgment of 18 November 1999, Teckal Srl v Comune di Viano and Azienda Gas-Acqua Consorziale (AGAC) di Reggio Emilia, Case C-107/98, where it is stated that “Directive 93/36 co-ordinating procedures for the award of public supply contracts is applicable in cases where a contracting authority, such as a local authority, plans to conclude in writing, with an entity which is formally distinct from it and independent of it in regard to decision-making – which is not the position where the local authority exercises over a legally distinct person a form of control similar to that exercised over its own departments and, at the same time, the person carries out the essential part of its activities together with the controlling local authority or authorities – a contract for pecuniary interest for the supply of products, whether or not that entity is itself a contracting authority.”

21 Comitato per la Vigilanza sull’uso delle Risorse Idriche, set up by the Ministry of Infrastructures and Transport together with the Ministry of Environment pursuant to Article 21 of the Galli Law, whose role is essentially to ensure (i) the efficiency and cost of IWS and (ii) the regular calculation and adjustment of the tariffs.
### Table of Italian PPP/PFI projects

This table summarises some of the significant PPP/PFI projects in Italy of recent years across a range of sectors, all of which Allen & Overy’s Italian offices advised on.

<table>
<thead>
<tr>
<th>Project name/location</th>
<th>Capital Expenditure (mEUR)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>WATER</strong></td>
<td></td>
</tr>
<tr>
<td>ATO Siena (Acquedotto del Fiora)</td>
<td>75</td>
</tr>
<tr>
<td>ATO Siracusa</td>
<td>194</td>
</tr>
<tr>
<td>Sorical – construction of the industrial plant of the Company, the management of Acquedotti</td>
<td>237,432</td>
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<tr>
<td>ATO Gorizia (Irisacqua)</td>
<td>110</td>
</tr>
<tr>
<td>ATO Novara</td>
<td>22</td>
</tr>
<tr>
<td>ATO La Spezia (ACAM)</td>
<td>100</td>
</tr>
<tr>
<td><strong>WASTE TO ENERGY</strong></td>
<td></td>
</tr>
<tr>
<td>Trattamento Rifiuti Metropolitani S.p.A. – a waste-to-energy plant</td>
<td>N/A</td>
</tr>
<tr>
<td>CO.GE.AM. – a complex plant engineering system for urban waste</td>
<td>13,345</td>
</tr>
<tr>
<td>Frullo – Refinancing</td>
<td>100</td>
</tr>
<tr>
<td><strong>HOSPITALS</strong></td>
<td></td>
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<tr>
<td>Hospital of Legnano</td>
<td>115</td>
</tr>
<tr>
<td><strong>UNDERGROUND/TRAMLINES</strong></td>
<td></td>
</tr>
<tr>
<td>Milan Underground Line 5</td>
<td>504</td>
</tr>
<tr>
<td><strong>MOTORWAYS AND TRANSPORT</strong></td>
<td></td>
</tr>
<tr>
<td>FS TOMINA – completion of the investments for the System “High Speed/Tall Ability” of the Turin-Milan-Naples railway line</td>
<td>N/A</td>
</tr>
<tr>
<td>Negotiation with ANAS regarding Autovie Venete convention</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Portugal

Tudo é ousado para quem a nada se atreve.
Everything is bold to those who dare for nothing.

Fernando Pessoa
(1888-1935)

Contact
Ian Ingram-Johnson
Allen & Overy LLP
Level 2
Gate Village Building No.8
Dubai International Financial Centre,
PO Box 506678
Dubai
United Arab Emirates
Tel: +971 4 426 7105
Fax: +971 4 426 7199
ian.ingram-johnson@allenovery.com
1. Introduction

Traditionally, countries under a political regime where the administration has broad executive powers have, since the 19th century, used the private sector to provide public services or social infrastructure. Portugal is no exception and the establishment of the public transport systems, telecommunications, water and energy distribution services, at least in the major urban centres, involved the private sector, at a time when state intervention in the economy and in society was minimal.

By the end of the first half of the 20th century, the Portuguese state had nationalised the majority of public services which were formerly subject to concessions either directly or through state-owned companies. This trend continued after the 1974 Revolution and, consequently, for the next 20 years the use of concession contracts by the Portuguese state was almost non-existent.

In the early 1990s, however, Portugal began to explore project financings under BOT, DBFO and more recently PPP. Following financial close of the 600 MW Pego coal fired power plant in 1993 and the 990 MW Tapada do Outeiro combined cycle plant in 1996 on a non-recourse basis, the EUR960 million second crossing over the Tagus river (closed in 1994 and later refinanced in 2000) was the forerunner to the Portuguese DBFO road programme which launched in 1997 to 1999. As the Portuguese government rolled out the road programme on a project finance basis, the model soon spread to other sectors, notably the health sector and most recently, to Portugal's high speed rail sector. The last five years have also seen a range of limited recourse financings in the renewable energy sector with a particular focus on wind, solar and hydroelectric power.

The co-operation between the public and private sectors in the 1990s can be linked to the need to reduce the state budget in order to comply with EU convergence criteria. Commercial bank guarantees and (increasingly) direct lending from the European Investment Bank (EIB), together with EU subsidies and other funding sources, have played a very significant role in the introduction and development of project financings in Portugal. In particular, EIB has provided nearly half of the funds for most of the high-profile projects closed to date at a price which no other entity in the market could better. Additionally, EIB’s presence on the Portuguese PPP scene has undoubtedly added to the confidence of the banking market.

The ongoing difficult market conditions and liquidity constraints have not dampened the Portuguese government’s enthusiasm for PPP projects, particularly in the road, rail and healthcare sectors with a significant number of deals reaching financial close in 2008 and 2009. It is likely however that a renewed focus on project net present values, as well as recent challenges to procurement and tendering processes, may slow deal flow somewhat in 2010.

2. Legal and regulatory framework

2.1 Specific legislation

(a) The Budgetary Framework Law

The Budgetary Framework Law dating from 2001 (Law 91/2001 of 20 August) was the first piece of legislation enacted in Portugal which expressly referred to the use of PPPs. It sets out the principle that PPP projects must be evaluated to provide value for money compared to purely public financed projects.\(^1\)

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1 When referring to budgetary programmes, Article 16 of the Budgetary Framework Law stipulates that “the evaluation of the economy, viability and efficiency of programmes that propose to use partnerships between the public and private sectors shall use as its basis for evaluation an alternative aimed at achieving the same goals excluding the financing and operation by private entities and including, where possible, the estimate of its net impact on the Budget”.\(^1\)
(b) The PPP Health Law

The first attempt to define the general rules applicable to PPPs arose a year later in 2002 with the publication by the Portuguese government of Decree-Law 185/2002, governing the development of PPPs for the construction, financing, operation and maintenance of healthcare units forming part of the National Health Service (the PPP Health Law). An important feature of these PPPs is that they envisage the private partner not only managing the hospital facilities (as has traditionally been the case in hospital PPPs in the UK, for instance) but also providing clinical services.

(c) The PPP Decree-Law (Decree-Law 86/2003)

Both the Portuguese Road Programme and the PPP Health Law opened the door to direct regulation of contractual arrangements between the public and private sectors. This resulted in Decree-Law 86/2003 of 26 April (the PPP Decree-Law) (amended in 2006 by Decree-Law 141/2006).

The scope of the PPP Decree-Law is limited to providing the legal framework for PPPs, by setting out general guidance for the creation of PPPs, taking into account the need to accommodate this type of expenditure with budgetary regulations and allowing for the establishment of further regulations in specific sectors. Unfortunately, the PPP Decree-Law does not contemplate the substantive regulation applicable to PPP contracts but rather focuses almost exclusively on procedural aspects. The law contemplates six legal instruments which may govern PPPs (namely, public works concession agreements, public services concession agreements, continuous supply agreements, service agreements, management agreements and/or co-operation agreements).

The nature of the contracts that will govern the relationship between the public and private partners is not clarified in the legislation. However, most of the agreements are categorised as administrative contracts by the Code of Administrative Procedure and this should not be affected by their use in the provision of PPP for the purposes of the PPP Decree-Law.

(d) Public Contracts Code


Other than setting the rules governing the procurement process, the Public Contracts Code includes substantive provisions dealing with public works and the public services concessions, some of which constitute mandatory provisions of law (including the provisions on sequestration/step-in, redemption and termination of the concession by the grantor) whilst others will only apply in the absence of express provision in the relevant concession contract.

(e) Water PPPs Decree-Law

The most recent relevant legislation includes Decree-Law 90/2009 of 9 April and Decree-Law 194/2009 of 20 August. The first establishes the rules applicable to PPPs between the Portuguese state and the municipalities in connection with municipal water supply and water and wastewater treatment. The second sets out a revised legal regime for the municipal services of water supply and urban water and waste water management and includes specific rules applicable to the provision of those services under a concession regime.
(f) Other legislation

Additionally, certain provisions of the Portuguese Civil Code may be applicable to PPP contracts, including provisions relating to force majeure, change in circumstances and termination of contracts. These provisions may affect the fixed price, turnkey nature of a construction contract. Parties entering into a PPP project in Portugal will need to obtain comfort from their advisers as to whether this body of civil law applies and whether or not it is possible to contract out of it, either partially or in its entirety.

Additionally as indicated in paragraph 2.4 (Specific enabling legislation), specific enabling legislation is also often passed for specific projects.

2.2 Setting up a PPP project

Concessions in Portugal may be granted by central government ministries or local municipalities. The Ministry of Public Works, Transport and Communications in association with the Ministry of Finance is responsible for the proposal, launch and award of concessions relating to roads, heavy railways and airports at a national level. The Ministry of Health in association with the Ministry of Finance is the entity responsible for the proposal, launch and award of management contracts in the hospital sector.

Local municipalities may launch concessions relating to matters of local interest, light railways concessions and roads and airports at a local level. Local authorities are particularly active in water distribution, sewage and waste water concessions. The autonomous regions of the Madeira and Azores archipelagos may also launch and award concessions, which are typically supported by financial institutions and sponsors on the Portuguese mainland. Those concessions must be of specific interest to the autonomous region in question and relate to roads, land, maritime and air transport (between islands).

Traditionally, when the government intends to develop several projects within the same sector, it will first establish the framework regulations for the development of PPPs in that sector and then specific regulations for the individual project. This was the case with the National Road Programme built under the SCUT scheme and also for the procedure being used for the development of PPPs in the health sector.

By contrast, for “one-off” projects, the government approves the regulations detailing the main terms and conditions for the development of that project. This procedure was used for the construction of the Second Tagus Crossing and each of the first two tenders announced for the high speed rail network, and it will also be used in the construction of the new Lisbon International Airport.

Before the entry into service of the Public Contracts Code in 2008, the procurement process set out in the Portuguese Code of Administrative Procedure2 applicable to administrative contracts allowed for five different procedures: (i) public tender, (ii) limited tender by invitation, (iii) limited tender by pre-qualification, (iv) negotiated procedure, and/or (v) direct agreement. The general rule in the Portuguese Code of Administrative Procedure was that a public tender should precede the execution of any administrative contract unless another procedure was permitted by specific legislation. In addition, the Public Works Law expressly required the use of a competitive tender subject to the public procurement rules for any public works contract or public works concessions.

The new Public Contracts Code sets out five different procedures for the procurement process applicable to Portuguese PPP projects: (i) direct agreement, (ii) public tender, (iii) limited tender by pre-qualification, (iv) negotiated procedure and/or (iv) competitive dialogue. The main difference with the regime under the Portuguese Code of Administrative Procedure and the Public Works Law is that the Public Contracts Code does not automatically require a public tender for public works concessions or public services concessions and, even if the contract relates to a “special sector”, the awarding entity may choose between the launch of a public tender, limited tender by pre-qualification or a negotiated procedure.

Notwithstanding the above, to date, all Portuguese PPP projects involving the construction of major infrastructure have been preceded by an international competitive public tender.

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2 Approved by Decree-Law 422/91 of 15 November 1991 and amended from time to time.
Alongside the Public Contracts Code, the PPP Decree-Law implemented a new procedural monitoring system to be conducted by the Ministry of Finance to ensure each PPP project passes the value for money and budgetary requirements of Portuguese law. In particular, Article 8 of the PPP Decree-Law introduced an additional step into the tender process, requiring the ministry that initiates a PPP to give written notice to the Minister of Finance. Within 15 days of that notice a monitoring committee for the PPP project in question is created by joint order of the Minister of Finance and the minister of the relevant sector, consisting of a minimum of two and a maximum of four members representing each ministry.

Typically, in a public tender for the construction of a major infrastructure project, the bidders will be asked to present bids, including variant bids. After an initial assessment of the bids by the awarding entity, each of the bidders is invited to negotiate with the awarding entity, which will ultimately select two consortia to present a binding and final offer (BAFO). These offers are then evaluated and the criterion generally used is that of the most economically advantageous bid to the awarding entity. The BAFO submission must include an agreed financial model and agreed documentation. Following the submission of BAFO, the awarding entity will review the BAFO submissions and announce the selection of the preferred bidder who is then required to reach financial close within the time set out in the tender programme.

The timetable generally set by the Portuguese government or other awarding entities for the closure of the PPP projects is very tight and has often been criticised by lenders and sponsors alike for not allowing the parties sufficient time to perform all the necessary due diligence. This is a particularly significant issue in light of a key requirement of most Portuguese infrastructure financing to submit fully underwritten finance at the BAFO stage. This requires lenders’ due diligence to be fully completed and lenders’ credit committees to have given unconditional approval at BAFO stage. However, in light of recent market conditions, the Portuguese government has indicated its willingness to accept non-underwritten financing proposals and draft documentation at BAFO stage (most notably, in the case of the first tender for the high speed rail network, which went to BAFO in June 2009, and the Pinhal motorway concession currently in tender).

### 2.3 Capacity to contract

For the purposes of the PPP Decree-Law, public partner means the state and any state public entity, any autonomous public fund, or any state-owned company or company held by state-owned companies. In the rest of this chapter, the terminology used is Grantor for the public partner procuring the service and Concessionaire for the private sector entity providing the service, generally under a concession contract. If the state is the public entity launching the PPP, political approval of the project and approval of the procedure for the selection of the Concessionaire is normally taken at the level of the Council of Ministers. The specific terms of the contracts are subject to the joint approval of the minister of the relevant sector and the Minister of Finance.

As a result of the active role given by the PPP Decree-Law to the Ministry of Finance in certain procedural steps of the PPP tender process, the Portuguese legislature has provided that the Ministry of Finance may delegate its responsibilities to a third party. Although not originally founded for this purpose, the state holding company, Parpública – Participações Públicas, S.A. (Parpública), now has responsibility for "the technical support to the Minister of Finance within the context of the procedures relating to the definition, conception, preparation, tender, awarding, amendment and global monitoring of the public-private partnerships"[^3].

### 2.4 Specific enabling legislation

The projects referred to in this chapter were generally developed following the publication of specific legislation which established the terms and conditions of the launch of the relevant concession as well as the procedures for negotiating and entering into the contracts, which in most cases was by way of international public tender. Such legislation concluded the political decision process in relation to the development of the relevant project and the type of contract to be entered into.

[^3]: Order 35/2003 dated 20 August.
3. Active sectors and recent developments

Since the 1990s Portugal has witnessed a high volume of PPP projects, particularly in the transport, power and healthcare sectors, and the Portuguese government continues to tender projects as part of an ambitious investment programme. Following the national elections in October 2009, however, the incumbent socialist government lost its majority and, as fiscal budgets come under increasing pressure, it is possible that delays which have affected recent PPP tenders will continue in the short to medium term. In addition, some larger projects and proposed refinancings (particularly in the roads sector) have also been deferred due to current market conditions and liquidity constraints.

3.1 Roads

Roads and bridges have played a particularly significant role in the development of PPP in Portugal, dating back to the second crossing of the Tagus river in 1994 (which included granting a concession of the old Tagus bridge to Lusoponte, a consortium which built the second bridge in exchange for the right to collect tolls on both). To a certain extent, the Lusoponte project served as a blueprint for the ambitious 1,500 km Portuguese DBFO road programme, which was launched between 1997 to 1999 by the Portuguese State in three stages with a total cost of approximately EUR8.2 billion. The programme initially consisted of 16 public tenders (a first wave of two real toll motorways, a second wave of six shadow toll motorways, and a third wave of a shadow toll and seven real toll motorways) for the design, construction and operation of certain key transport corridors under either a SCUT (shadow toll) or real toll regime, in each case funded by a form of project financing. The programme has since been expanded to encompass more than 20 closed projects with several currently in tender or proposed. The latest wave comprises ten projects of which eight have reached financial close, with a further six concessions scheduled for launch in 2010 (see Appendix).

Allen & Overy acted on the Lusoponte refinancing and is currently advising the lenders to eight further real and shadow toll concessions.

As this is the most developed PPP sector, road concessions have the most established risk allocation mechanisms and a fairly established form of concession agreement. However, there have been some areas in which the Portuguese government has attempted to further develop the risk allocation in recent concessions. Some of the principal developments in the Portuguese road sector include the following:

(a) Estradas de Portugal – the grantor on the third wave of motorway concessions is Estradas de Portugal (EP), a limited liability company established in 2005 and 100% owned by the Portuguese state. Under its 75-year master concession agreement, EP issues subconcessions for new projects and the government has in the past suggested that existing direct concessions might also be transferred to subconcessions of EP. EP is not guaranteed by the Portuguese government and has not been rated by international credit ratings agencies, deriving its funding from toll road revenues, fuel taxes and other potential sources including credit lines from EIB.

However, if EP becomes insolvent, the Portuguese state may be inclined to extend support to EP (eg by means of a restructuring of EP’s debts or the making of further capital injections), if it is considered that the insolvency of EP might seriously disrupt the operation of the national road network and therefore be materially adverse to the public interest.

Additionally, if the Portuguese state privatised EP, it might cease to be in a position to extend financial support to EP (even assuming such financial help were allowed under EU state aid rules). Continued public ownership of EP was specifically identified as a material risk in the setting up of EP’s subconcessions and as a result the state declared (pursuant to a comfort letter dated 29 September 2008) that it would create the conditions required to enable EP to comply with its obligations under the relevant subconcession agreements, and also acknowledged that lenders to EP’s subconcessionaires would have the right to terminate the finance documents if the Portuguese state ceased to be the owner of the majority of EP’s share capital.
(b) **EU and state support** – many road concessions have benefited from support from EIB (typically a combination of guaranteed and unguaranteed tranches). Recent projects have also been supported by grants or subsidies from the EU’s Trans-European Networks (TENs) programme, and innovative products such as the “Loan Guarantee for TENs Transport” financial instrument (LGTT) (jointly backed by the European Commission and EIB which covers the risk of a reduction in traffic revenues during the initial operation phase). In response to current economic conditions, the Portuguese government has also made subsidies available and has indicated its willingness to consider providing state guarantees in lieu of expensive commercial bank guarantees. However, to date no projects have been closed which have the benefit of a state guarantee.

(c) **Refinancing** – in recent road concessions, EP has sought a unilateral right to demand refinancing of the concessionaires, with refinancing gains shared typically on a 50:50 basis. The government is also understood to be negotiating with existing concessionaires to introduce the same terms into the older SCUT concessions.

(d) **Tribunal de Contas** – several of the recently tendered motorway concessions have failed to obtain approval by Portugal’s Court of Auditors (the Tribunal de Contas), a requirement that is typically fulfilled shortly after financial close. Without this approval, the Grantor’s payment obligations will not be enforceable. The Tribunal’s objections relate to potential contravention of EP’s procurement rules by allowing bidders to raise their final offers from their initial bids, and the suggestion that tenders may not meet requirements for best value for money. EP has argued that the financial crisis brought exceptional circumstances which justified changes to the pricing, and highlighted its right unilaterally to demand a refinancing once market conditions improve. EP further argued that as it is run as a separate entity from the government and can raise debt and pay the concession fees from its own budget, its road programme does not fall within the remit of the Tribunal de Contas. The Tribunal de Contas argued otherwise. At the time of writing, the decisions of the Tribunal are subject to appeal. If this is rejected, the concessions are likely to be modified or retendered.

(e) **Payment structures** – the initial Portuguese toll roads were structured as real tolls or shadow tolls (SCUTs) under which the concessionaires took traffic risk based on banded payments. The more recent roads have been structured with utility-type availability payments which have substantially removed traffic risk from the projects. In parallel, the government has sought to convert some of the first wave of SCUT concessions to availability-based payments, while providing EP with the right to collect real tolls on these roads. This will allow EP to supplement its revenue streams and implements the “user pays” principle of a 2004 government resolution.

(f) **Concession length** – most real toll and shadow toll projects are based on concessions for a term of 30 years. However, in 2004 the Litoral Centro project was the first variable-term motorway concession to be project financed in Europe. The concession on this project will terminate when the value of toll revenue collected by the concessionaire reaches a predetermined limit, subject to a minimum of 22 years and a maximum of 30 years.

(g) **Expropriation** – on recent deals, the burden of land expropriation (compulsory acquisition) has been shifted towards the private sector. These risks have been passed through to construction contractors (typically using a separate expropriations JV) and has had an impact on the overall pricing of transactions.

(h) **M&A activity** – there has been increasing M&A activity in the Portuguese road sector, such as purchases by Italian and Spanish motorway operators.

The majority of the road concessions (whether real or shadow toll) have not only involved the construction of greenfield projects but also the taking over and maintenance of existing roads, providing some predictability to traffic volumes and even a potential revenue stream during construction.

A number of feasibility studies have also been undertaken by the government and its advisers as to whether it would be possible for the secondary road networks to be upgraded, operated and maintained by the private sector. So far, no such projects have been launched.
3.2 Rail

State-owned Caminhos de Ferro Portugueses, EP (CP) has been responsible for the operation of the national rail network under a concession regime since 1975. A number of feasibility studies have been undertaken in relation to the upgrading and expansion of the heavy rail network in Portugal, with the majority of funding to date directed to CP. Since 1997, however, the management of railway infrastructure (including new construction projects) has been the responsibility of Rede Ferroviária Nacional – REFER EP (REFER).

While private sector involvement in upgrading Portugal’s existing heavy rail network is still limited, REFER is currently acting as the representative of the Portuguese state in relation to a series of 40-year concessions for the proposed TGV/high speed rail links. The TGV plan comprising five separate projects has been under proposal for some time, and forms one of the EU’s top five priority projects.

The first two phases of the TGV plan were tendered on a PPP basis in 2009 and BAFO for the first phase (Pocerão to Caia on the Spanish border) took place in June, with award in December. The second PPP (from Lisbon to Pocerão) incorporates the long-discussed third crossing of the Tagus river. Allen & Overy is advising one of the bidders in relation to these projects, the phases of which are set out in Section 2 (High Speed Rail) of the Appendix to this chapter.

The risk allocation for the TGV projects originates from the Portuguese road PPP model and employs an availability-based remuneration regime with limited “fare box” risk. A number of issues arose while structuring the deals, including the following:

(a) REFER – although responsible for availability payments to the TGV concessionaires, REFER is not guaranteed by the Portuguese state;

(b) Interface risks – the private sector will expect interface risks arising between different project phases (for example, by splitting the Lisbon-Caia section into two concessions), as well as interoperability risks between the Portuguese and Spanish sides of the Lisbon-Madrid line, to be accepted by the Grantor;

(c) O&M strategy – long-term O&M contracts are unlikely to be available in the Portuguese rail sector for the duration of the TGV concessions, which may introduce an element of lifecycle risk for the concessionaire;

(d) Performance bonds – unlike the road programme, the TGV concessions require a very substantial performance bond (i) expected to be in the amount of 5% of the total construction price for the first year of the concession contract, (ii) from that date up to end of the construction period, 5% of the average annual capital expenditure for each year during the construction period, and (iii) after the construction period up to the end of the concession contract, 2% of the annual availability payments;

(e) Archaeological risks – unlike the historical Portuguese road model, the Grantor has sought to pass archaeological risks on to the private sector;

(f) Environmental risks – the TGV route passes close to sites of special environmental interest; and

(g) Expropriation risks – the Grantor has sought an expropriations model similar to the most recent road concessions.

A large proportion of the financing for the TGV projects is expected to be provided by EIB and EU subsidies including TENs. Further subsidies may be available from REFER and the Portuguese state. As with one of the road projects currently in tender, the Grantor has also expressed a willingness to offer state guarantees to the first phase of the TGV project, although it remains unclear if this will ultimately be available. In addition, objections have been publicly raised in relation the tendering procedures for the first two phases which may delay the commencement of the project.

Historically, Portugal has also procured a number of light rail projects by way of PPP, including light rail, suburban railway and metro projects. The light rail market (subways and trams) is centred on municipalities such as Lisbon, Porto and the Mondego light rail in Coimbra/Miranda do Corvo/Lousã, which have the power to promote light rail schemes. Existing projects (in some cases with significant support from the municipality or central government, and sometimes containing a high degree of patronage/fare risk) are
in Lisbon and Porto. The Porto metro is currently held under a 50-year concession and the Portuguese government has in the past contemplated a phased EUR2 billion extension programme. Extensions to the Lisbon metro have also been mooted.

### 3.3 Airports

The ownership, management, operation and development of all airports in Portugal, including the Portela airport situated a short distance from Lisbon’s city centre, are currently the responsibility of state-owned national airport operator Aeroportas de Portugal (ANA).

Proposals for a new Lisbon airport date back to the 1990s but have been repeatedly delayed and redesigned, principally due to changes in government and ongoing budget constraints. The project has always been linked to the sale of a stake in ANA. After a number of feasibility studies the project (for which a site at Ota, 52km from the centre of Lisbon and north of the Tagus river, was chosen in 1999) was relaunched in November 2005. However, in January 2008 the Portuguese government confirmed that Lisbon’s proposed new airport would be located at Alcochete, 25km from the city centre and south of the Tagus river. The tender process was again relaunched, with new feasibility studies required, although unlike the Ota site (which has been partially acquired by compulsory acquisition), the Alcochete site is already owned by the Portuguese ministry of defence.

In April 2009, Novo Aeroporto SA (a vehicle set up by ANA for the new Lisbon airport) published the masterplan for the EUR3.5 billion project, the construction and operation of which (under a 30 year concession) was to be included in the full privatisation of ANA. However, a number of issues remain which may continue to delay the project, including:

(a) the impact of EU funding requirements on the structuring of the tender;
(b) uncertainty about the extent to which the new airport concession will be tied to the privatisation of ANA;
(c) ongoing uncertainty about the future of the existing Portela airport – previous governments had considered the possibility of running a dual airport system under which both Portela and a second airport would be operational, and delays to the tender launch have meant ongoing investment in Portela (including plans to link it into the existing underground system);
(d) uncertainty over future traffic volumes, with the existing airport not expected to reach full capacity until 2017; and
(e) uncertainty over the proposed use for the Ota site.

Nevertheless, the Portuguese government is again giving the project priority. The proposed new airport will clearly have implications for transport infrastructure, since it is likely to require a dedicated highway and rail connection (currently proposed into Lisbon’s Gare do Orientale).

### 3.4 Ports

Whilst there were three terminal projects around 2000 including the Sines LNG Terminal, port related projects have not been a significant sector for PPPs to date.

### 3.5 Hospitals

The Amadora Sintra hospital, serving approximately 600,000 people in the Lisbon area, was built in the early 1990s. This was not a PPP in the strictest sense as the Portuguese government first commissioned and paid for the construction of the hospital and subsequently let it to the operating company. It is, however, the first example in Portugal of the private management of a public hospital, serving as a model for the development of PPP in the health sector.

Despite the introduction of the PPP Health Law in 2002 setting up the framework for its EUR1.4 billion hospital PPP programme, the development of true PPPs in the health sector has progressed slowly. Out of an initial wave of four projects, only three have reached financial close. A further six projects have been
announced. Most of these ten projects include the refurbishment of existing hospital facilities. A summary of the projects in the first and second waves of the hospital PPP programme is set out in Section 3 of the Appendix to this chapter.

Aside from political vacillation and complexities or disputes in the tendering process, one of the primary reasons for the difficulties seen in Portugal’s hospital programme results from a divergence from the “classic” hospital PPP model. The first wave of projects typically split each PPP into 30-year concession for construction and maintenance of hospital infrastructure and a 10-year concession for provision of clinical services, with separate but cross-related infrastructure companies undertaking the different roles. For the second wave, the Portuguese government has now announced its intention to tender only the infrastructure concession for future hospitals (with the National Health Service providing clinical services) and to simplify the qualification process. However, further delays seem likely. The projects have so far been predominantly domestically rather than internationally financed.

3.6 Prisons, accommodation and stadia

While privatisation of Portugal’s prisons has been contemplated for over a decade, this remains a new sector in the Portuguese PPP market. The Algarve and Coimbra prison projects, each with an approximate value of EUR70 million, are currently in a pre-launch phase and up to ten may be tendered in total. In addition, there are several accommodation projects (including medical campuses, judicial campuses and the consolidation of Lisbon’s various municipal administrative functions) which have been tendered or proposed in recent years.

Portugal has also project financed three football stadia. The EUR156 million Benfica stadium was refinanced in January 2008.

3.7 Water and wastewater

In the 1990s and early 2000s, Portugal witnessed a high volume of water projects including water distribution, sewage and waste projects. Following the introduction of the PPP Water Decree-Law in 2009, more activity is expected in the water sector – not only because the certainty and rules of the new regime (in particular the risk sharing between the Grantor and the Concessionaire) is likely to attract more players to the sector, but also because the new legislation establishes that the concession contracts already in place need to be amended in order to reflect the new rules imposed by it which will undoubtedly result in a great deal of legal work and negotiations. Two small projects (the EUR10 million Aguas de Azambuja water and sewerage financing and the EUR66 million Aguas de Gondomar water and sewerage project) closed in 2009.

4. General structure of concessions

Despite the successful syndication of a number of high-value deals, Portuguese PPP projects contain a number of peculiarities, particularly in comparison with projects in the UK and other European countries.

4.1 Scope of service

As in other countries, the services to be provided and any works to be built by the Concessionaire are generally specified and contracted for on the basis of outputs. The concession contract therefore establishes the obligations of the Concessionaire by reference to the service or public works being delivered rather than the Grantor specifying detailed requirements for any assets being designed and built.
4.2 Financial balance

The key concept which underpins concession agreements in Portugal is the financial balance mechanism which aims to accommodate the conflicting interests of the Grantor which wishes to retain maximum flexibility at all times and the Concessionaire and its investors who wish to avoid scope changes that detrimentally alter the risk profile and return of the project.

Accordingly, if certain events arise, the Grantor agrees to compensate the Concessionaire, by way of direct payment(s), resetting of tariffs/tolls (or in the case of shadow tolls the resetting of the traffic tariffs and bands), extending the length of the concession, or any other measures agreed. The Grantor will only make such compensation available to the extent that there has been a deterioration in the levels of the project ratios (described in more detail below).

Generally, financial rebalance is available in the following circumstances:

(a) unilateral variations imposed by the Grantor, which result in an increase in costs or loss of revenue;

(b) force majeure events (unless the concession contract is terminated as a result);

(c) specific change of law;

(d) delay caused by expropriation (where the cost and delivery risk remains with the Grantor);

(e) construction delays caused by the Grantor; and

(f) in road projects, the creation of competing roads.

The extent of any financial rebalance is decided after negotiations between the two parties, or in the absence of agreement within a certain period, with reference to the project’s base case.

In the case of concession contracts for the Portuguese Road Programme, the financial rebalance is calculated by reference to two of the three pivotal points, chosen by the Concessionaire at the time of the rebalancing, namely:

(i) the minimum value of the Annual Debt Service Cover Ratio (ADSCR) with cash and the minimum value of the ADSCR without cash;

(ii) minimum value of the Loan Life Cover Ratio (LLCR); and

(iii) Shareholders’ Internal Rate of Return (SIRR), in annual and nominal terms, for the whole duration of the concession.

In addition, the Concessionaire is only entitled to a financial rebalance if, as a result of a particular event, or sequence of events, the ADSCR with cash, LLCR or SIRR reduce by more than 0.01 percentage point.

More recent concession and subconcession contracts also envisage compensation being payable by the Concessionaire to the Grantor where a specific change in law has a direct and beneficial impact on revenues.

4.3 Force majeure

A Portuguese concession contract generally defines force majeure events as those “unforeseeable and unavoidable events whose effects occur regardless of the will or personal circumstances of the Concessionaire”. This general provision is followed by a list of examples of force majeure events which may include war or subversion, hostilities, invasion, riots, rebellion, terrorism or epidemics, atomic radiation, fire, lightning, severe flooding, cyclones, earthquakes and other natural cataclysms directly affecting the operation of the concession. Force majeure events are therefore not restricted to a list of events, and the Portuguese Civil Code may add other examples to the list.

Upon the occurrence of a force majeure event, the Concessionaire's obligations are suspended and a financial rebalance is made as described above unless the parties agree to terminate. If no agreement is reached, the matter is referred to arbitration.
Some force majeure events may be covered by insurance available within the EU at commercially reasonable rates and terms. If this is the case, regardless of whether the Concessionaire has taken out such policies, the Concessionaire’s obligations may not be suspended and the financial rebalance will only be applied to the extent the loss suffered exceeds the indemnity applicable under the terms of the insurance policy. Force majeure relief should always be available, however, if the force majeure event arises from an act of war or subversion, hostility or invasion, riots, rebellion or terrorism, or atomic radiation, as well as natural events exceeding their foreseen impact (even if this impact is normally insurable within the EU).

If the concession contract is terminated for reasons of force majeure, the Grantor will assume the rights and obligations of the Concessionaire under the financing arrangements.

4.4 Change in law

The Portuguese concession contracts signed to date typically sub-divide change in law into specific change in law and general change in law. Specific change in law covers changes of law which have a direct impact on the costs or the revenues of the project. General change in law comprises any change to the general law (including without limitation tax and environmental law) which is not a specific change in law.

The Concessionaire may claim a financial rebalance under the concession contract in respect of any specific change in law. The Concessionaire will typically take the risk of general change in law both in the construction phase and operational phase of the project.

4.5 Contract redemption

During a certain period before the end of the concession term, the Grantor is normally entitled to redeem the concession on grounds of public interest by giving notice to the Concessionaire. The time period will vary from project to project; for the majority of road projects, this right will apply during the last five years of the concession. If the Grantor does exercise its redemption rights, all of the Concessionaire’s rights and obligations under the project contracts (including the finance agreements) are transferred to the Grantor.

As compensation for the redemption of the concession, the Concessionaire will receive an amount (either in a lump sum or instalments) corresponding to the shareholder cash flow projected but unpaid, from the date of the redemption until the end of the concession, according to the last projections approved by the Grantor.

4.6 Sequestration/government step-in

Portuguese concession contracts generally provide that, in the event of a gross default by the Concessionaire such as cessation of works, serious management deficiencies or major delays, the Grantor may step into the concession and assume the obligations of the Concessionaire. However, before sequestration takes effect, the Grantor must notify the funders so that they may assess whether they wish to exercise their step-in rights.

During a sequestration period, the Grantor will cease to pay revenues to the Concessionaire and the revenue which would have been paid to the Concessionaire is first applied to cover the costs of ensuring the work or operation of the facilities meets the standards set out in the concession contract. Secondly, the revenue is applied to meet the debt obligations of the Concessionaire under the financing arrangements. Any remaining amounts are returned to the Concessionaire at the end of the sequestration period. The concession is returned to the Concessionaire once the cause of the sequestration has been remedied.

4.7 Termination

The approach taken in Portuguese concession contracts is to distinguish between (i) termination events caused by the Grantor and redemption of the concession, (ii) termination events that are caused by the Concessionaire (principally relating to poor delivery of the service, but also credit related events), and (iii) events that are not attributable to either party (for example, force majeure or change in law rendering illegal or impossible all or substantially all of the Concessionaire’s obligations).
(a) Grantor default

The concession contract is normally silent on the grounds for termination due to Grantor default and the Concessionaire (and the lenders) must rely on the general provisions of Portuguese law. It is generally understood that the Concessionaire is entitled to terminate the concession contract where there has been non-performance of the Grantor’s obligations resulting in the Concessionaire no longer having an interest in continuing the concession (the latter is assessed objectively under Portuguese law). Examples of Grantor default that may lead to termination include excessive delay, obstruction or late payment.

(b) Concessionaire default

The events that may lead to termination due to Concessionaire default comprise breaches of the concession contract which are “serious” and typically include events such as abandonment, persistent default, non-compliance with provisions on change of control and fraud.

Upon the occurrence of any termination event listed above, the Concessionaire will be given a reasonable remedial period if the default is capable of being remedied. Should the Concessionaire fail to satisfactorily remedy the default, the Grantor is able to terminate the concession. However, before the Concessionaire is able to terminate, the funders must be notified, so that they can assess whether they wish to exercise their step-in rights.

4.8 Compensation on termination

The compensation to be paid as a result of termination will depend upon which party was in default.

Portuguese concessions provide that on termination for Grantor default, prolonged force majeure or redemption, the Grantor will pay out the debt over time under the finance documents rather than make a lump sum termination payment. Below is an extract of the termination clause from a closed deal within the Portuguese Road Programme:

“in the case of termination of the Concession Contract by the Concessionaire imputable to the Grantor, the latter shall indemnify the Concessionaire pursuant to the general terms of the law and shall be liable for the assumption of all obligations of the Concessionaire arising under the Financing Contracts, except those relative to breaches occurring before the causes of termination took place.”

As with most civil law contracts, Portuguese concession contract provisions are very short and do not provide any detail on the calculation of termination payments or any clarity on what precisely is meant by “assumption”. Portuguese law experts disagree as to what this “assumption” means. Whilst some take the view that it is an assumption of the debt (scheduled interest and principal), others take the view that (on termination at least) the Grantor will pay a lump sum.

The Concessionaire (and the funders) must rely on the general provisions of Portuguese law and, in particular, on the causation doctrine. Articles 473 to 482 of the Portuguese Civil Code provide for a doctrine of unjust enrichment whereby the courts will assess the “value” of the works completed by the Concessionaire (although it is not clear whether this value is “market value” or “book value”) and compensation will be payable to the Concessionaire if the default that gave rise to termination is in monetary terms less than the value of the works completed to date.

To a greater or lesser extent, funders have got comfortable with the “assumption” provision in concession contracts where the Grantor is the Portuguese State as:

(a) the key provisions of a Portuguese concession contract (including termination payments) form part of a decree-law that was published prior to the date of the signing of the concession contract and therefore, in effect, the concession contract forms part of Portuguese law;
(b) the *Tribunal de Contas* (Portuguese court of accounts) must approve the payment obligations of the Grantor under the concession contract and the *visto* (official stamp of the *Tribunal de Contas*) is typically a condition precedent to financial close in most PPP transactions, although in recent road transactions the *visto* may be delivered as a condition subsequent subject to a cap on drawdown amounts at around the level of equity support guarantees available to the Concessionaire and/or lenders;

(c) all PPP concession contracts are approved by a full meeting of the Council of Ministers and are signed by the minister of the relevant sector and, more importantly, the Minister of Finance; and

(d) the finance documents (including hedging documents) are annexed to the concession contract and form an integral part of the concession for the purposes of Portuguese law.

### 4.9 Remedies

The operation of the payment mechanism is not the Grantor’s sole remedy in relation to a failure by the Concessionaire to provide the services under the concession contract. The Grantor may impose fines on the Concessionaire up to certain amounts for delays in complying with a stated timetable, for periods of unavailability of the works or of services falling below certain thresholds, or in road projects, for high levels of accident rates. These penalties may apply in addition to deductions under the payment mechanism.

### 4.10 Construction contract

In Portuguese road concessions (as in other sectors), although the Concessionaire is the entity responsible for the design, construction, future widening, operation and maintenance of certain motorway stretches under the concession contract, it is expected that the Concessionaire subcontracts its design and construction obligations to a contractor (or group of contractors) under a fixed price, date certain, turnkey design and construction contract. A key feature included in certain design and construction contracts used in the road projects in Portugal is that they are fully back-to-back with the concession contract, transferring from the Concessionaire to the construction contractor all responsibilities, liabilities and risks relating to design and construction. In addition, the construction contractor has historically unlimited liability under the construction contract. However, some subcontractors have recently succeeded in negotiating some exceptions to this rule as well as some caps on liability.

### 4.11 Withholding tax

Whilst withholding tax does not apply to EIB and domestic banks, each borrower is exposed to a withholding tax risk of between 10% to 20% on interest payments depending on the existence of double taxation treaties. The Minister of Finance may grant exemptions from withholding tax for loans sourced outside Portugal which have taken on average between four to six months to obtain. The withholding tax exemption can only be obtained on a bank-by-bank basis and, therefore, each borrower must obtain exemptions for each bank upon syndication. Although fronting arrangements have been considered in the past, we are not aware of any that have yet been implemented.

It is obviously a procedural burden for project companies and lenders to be subject to such a cumbersome procedure and a number of institutions have recommended to the government that an automatic exemption be granted for borrowers and special purpose vehicles relating to infrastructure projects. Whether such automatic exemption will be forthcoming is open to speculation.

### 4.12 Refinancing

A number of refinancings have already taken place in the Portuguese power sector, and both the Grantor and lenders have indicated their willingness to refinance projects in the road PPP scheme (many of which have been operational for some years). However, current market conditions and liquidity constraints have prevented any major refinancing or consolidation of projects in the sector.
There are also certain restrictions in Portuguese law which may constrain refinancings. For example, bonds may only be issued by companies with one year of financial statements (previously two years) and the aggregate amount of live bonds issued by a company may not exceed its paid-up share capital. Although procedures do exist for the waiver of these requirements and it is possible to set up structures which circumvent these restrictions, it is commonly thought that these restrictions should be relaxed if the benefits of bond financing for the Portuguese market as a whole are to be gained.

Additionally, it should be noted that the concession contracts historically used in Portuguese PPP projects did not specify provisions for sharing of the refinancing gains. However, in recent concessions, the Portuguese government has introduced a requirement for a 50:50 public-private split in any refinancing upside.

5. Security position

A number of considerations arise for lenders when contemplating security that is available under Portuguese law and, in particular, funders need to be aware that Portuguese law does not:

(a) permit the creation of security over future assets – promissory agreements are entered into to overcome this hurdle; however, the enforceability of such agreements has not been tested in the Portuguese courts;

(b) recognise the concept of trusts – this results in the cumbersome procedure of requiring each syndicate bank to become a party to the security documents;

(c) recognise the concept of a floating charge – this leads to stamp duty issues;

(d) 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 are pledges where (i) both parties are corporate bodies and one party involved is either a public body, a financial institution under prudential supervision, or a central bank, and (ii) the collateral used is cash or financial instruments (including shares in Portuguese limited liability companies but not quotas in Portuguese limited liability companies). In order to permit more efficient enforcement of security than might otherwise be available through the Portuguese courts, a device known as a “call option arrangement” was introduced whereby, in certain circumstances, the funders are able to call the shares of the sponsors in the concession vehicle for EUR1 making it simply an instrument to effect a takeover of the Concessionaire. Concerns have been raised over the enforceability of such an option which has not been tested in the Portuguese courts.

6. Employment issues

In the roads sector, the concession contract is developed at the risk of the Concessionaire and no particular employment issues arise. The Concessionaire is responsible for all employment issues attached to the concession and its employees, including salaries, other labour payments and social security contributions.

Conversely, in the water and health sectors, where the projects involve the provision of services that have historically been provided by the relevant Grantor, the Concessionaire is required to take the staff engaged in the provision of those services once the Grantor ceases to provide the services itself. The rules applicable to

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4 (Decree-law 105/2004 of May 2004 which implemented the EU Directive on financial collateral arrangements in Portugal)
that transfer of employment vary from project to project and may follow the special assignment/secondment of workers regime, the requisition of personnel or unpaid leave regime, the commission of service and/or voluntary transfer. The rules relating to transfer of employment are generally set out in the relevant tender specification, either in detail or by reference to the applicable legislation.
Appendix
Portuguese PPP deal activity

1. Roads

<table>
<thead>
<tr>
<th>Project Name/Location</th>
<th>Capex (EURMM)</th>
<th>Status</th>
<th>Significance or Points of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CURRENT WAVE OF ROAD PROJECTS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Douro Litoral (129km real toll)</td>
<td>1,601</td>
<td>Closed Jan 2008</td>
<td></td>
</tr>
<tr>
<td>Tunel do Marã€€o (A4) (30km availability and real toll)</td>
<td>488.5</td>
<td>Closed May 2008</td>
<td>First use of LGTT instrument in Portugal. First project to incorporate availability based remuneration.</td>
</tr>
<tr>
<td>Douro Interior (IC5 and IP2) (272km availability and shadow toll road)</td>
<td>943.2</td>
<td>Closed Nov 2008</td>
<td>First subconcession of EP. First project for which objections raised by Tribunal de Contas. A&amp;O acts for the lenders.</td>
</tr>
<tr>
<td>Transmontana Shadow Toll (190km availability/shadow toll)</td>
<td>836.6</td>
<td>Closed Dec 2008</td>
<td></td>
</tr>
<tr>
<td>Baixo Tejo Motorway (IC32) (70km availability/shadow toll)</td>
<td>495.8</td>
<td>Closed Jan 2009</td>
<td></td>
</tr>
<tr>
<td>Baixo Alentejo Motorway (IP8) (353km availability/shadow toll)</td>
<td>551.5</td>
<td>Closed Jan 2009</td>
<td></td>
</tr>
<tr>
<td>Litoral Oeste PPP (109km availability/shadow toll)</td>
<td>694.4</td>
<td>Closed Feb 2009</td>
<td></td>
</tr>
<tr>
<td>Algarve Litoral Coast Motorway (273km availability/shadow toll)</td>
<td>271.8</td>
<td>Closed Apr 2009</td>
<td></td>
</tr>
<tr>
<td>Pinhal Interior (567km availability/shadow toll)</td>
<td>1,200</td>
<td>Awarded to the consortium led by Ascendi in Jan 2010</td>
<td>First road project where BAFO may not be fully underwritten.</td>
</tr>
<tr>
<td>AE Centro (369km availability/shadow toll)</td>
<td>N/A</td>
<td>Initial BAFO March 2009. Retendered Oct 2009</td>
<td>Retendered due to considerable increase in costs and NPV. First project for which state guarantee tabled. A&amp;O acts for the lenders.</td>
</tr>
</tbody>
</table>
### Project Name/Location

<table>
<thead>
<tr>
<th>Project Name/Location</th>
<th>Capex (EURMM)</th>
<th>Status</th>
<th>Significance or Points of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FUTURE PROJECTS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Alto Alentejo (139km availability/shadow toll)</td>
<td>N/A</td>
<td>Scheduled for June 2010</td>
<td></td>
</tr>
<tr>
<td>Rota Oeste (87km availability/shadow toll)</td>
<td>270</td>
<td>Scheduled for June 2010</td>
<td></td>
</tr>
<tr>
<td>Vouga (185km real toll)</td>
<td>150</td>
<td>Scheduled for June 2010</td>
<td></td>
</tr>
<tr>
<td>Tejo Internacional (72km availability/shadow toll)</td>
<td>180</td>
<td>Scheduled for June 2010</td>
<td></td>
</tr>
<tr>
<td>Serra de Estrela (381km availability/shadow toll)</td>
<td>750</td>
<td>Scheduled for June 2010</td>
<td></td>
</tr>
<tr>
<td>Ribatejo (193km real toll)</td>
<td>250</td>
<td>Scheduled for June 2010</td>
<td></td>
</tr>
<tr>
<td>Secondary Road Network Upgrading</td>
<td>N/A</td>
<td>Not currently scheduled</td>
<td></td>
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</table>

### High Speed Rail

#### TGV/HIGH SPEED RAIL PROJECTS

<table>
<thead>
<tr>
<th>Project Name/Location</th>
<th>Capex (EURMM)</th>
<th>Status</th>
<th>Significance or Points of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poceirão-Caia</td>
<td>1,400</td>
<td>Awarded to the consortium led by Brisa and Soares da Costa in Dec 2009</td>
<td>First part of Lisbon-Madrid line. A&amp;O acts for one of two preferred bidders.</td>
</tr>
<tr>
<td>Lisboa-Poceirão</td>
<td>1,600</td>
<td>BAFO expected 2010</td>
<td>Second part of Lisbon-Madrid line. A&amp;O acts for one of two preferred bidders.</td>
</tr>
<tr>
<td>Lisboa-Pombal</td>
<td>2,100</td>
<td>Pre-launch</td>
<td>First part of Lisbon-Porto line.</td>
</tr>
<tr>
<td>Pombal-Porto</td>
<td>1,700</td>
<td>Pre-launch</td>
<td>Second part of Lisbon-Porto line.</td>
</tr>
<tr>
<td>Braga-Valença</td>
<td>845</td>
<td>Pre-launch</td>
<td></td>
</tr>
</tbody>
</table>
### Hospitals

<table>
<thead>
<tr>
<th>Project Name/Location</th>
<th>Value (EURMM)</th>
<th>Status</th>
<th>Significance or Points of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FIRST WAVE OF HOSPITAL PROJECTS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cascais Hospital</td>
<td>68</td>
<td>Closed Feb 2008</td>
<td>First hospital PPP. Includes separate borrowers for infrastructure and clinical services concessions.</td>
</tr>
<tr>
<td>Braga Hospital</td>
<td>167</td>
<td>Closed Feb 2009</td>
<td></td>
</tr>
<tr>
<td>Loures Hospital</td>
<td>135</td>
<td>In tender</td>
<td>Retendered after initial bids varied so much as to be incomparable.</td>
</tr>
<tr>
<td>Vila Franca de Xira Hospital</td>
<td>70</td>
<td>In tender</td>
<td>Last project in first wave. Continues to include clinical services.</td>
</tr>
<tr>
<td><strong>SECOND WAVE OF HOSPITAL PROJECTS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Todos-os-Santos Hospital</td>
<td>150-200</td>
<td>In tender</td>
<td>Likely to be retendered in light of high initial NPVs. First project to exclude clinical services.</td>
</tr>
<tr>
<td>Póvoa/Vila do Conde Hospital</td>
<td>Unknown</td>
<td>Pre-launch</td>
<td></td>
</tr>
<tr>
<td>Gaia Hospital</td>
<td>Unknown</td>
<td>Pre-launch</td>
<td></td>
</tr>
<tr>
<td>Guarda Hospital</td>
<td>Unknown</td>
<td>Pre-launch</td>
<td></td>
</tr>
</tbody>
</table>

With thanks to Teresa Empis Falcão of Vieira de Almeida & Associados for contributing to this chapter.
Spain

La inspiración existe pero tiene que encontrarse trabajando.
The inspiration exists but it has to be found whilst working.

Pablo Ruiz y Picasso
(1881-1973)

Contact

Madrid
Iñigo Gómez-Jordana
Ignacio Ruiz-Cámara
Juan Barona

Allen & Overy
Pedro de Valdivia 10
28006 Madrid
Spain
Tel: +34 91 782 98 00
Fax: +34 91 782 98 99
inigo.gomez-jordana@allenovery.com
Ignacio.ruiz-camara@allenovery.com
juan.barona@allenovery.com
1. Introduction

A number of factors in Spain, especially public sector budget constraints and the need to join the core of the European Union through the Eurozone, have led to the search for alternative ways to develop and finance Spanish infrastructure projects. PPP is one such alternative and revives the old concept of the public concession. Public concessions were used as long ago as the nineteenth century as a way of delivering major public works, and were used in the mid 1960s and 1970s for the construction of toll roads.

An indication of the increasing importance of PPPs in Spain is that central government has decided to invest around EUR15 billion in upcoming PPPs in order to promote the use of PPP models in relation to civil works in Spain. This relates particularly to the construction, operation and maintenance of infrastructure, particularly toll roads, parking facilities and hospitals.

In Spain, PPP is not the preferred way of financing projects because the Public Administrations involved have generally covered all the financial costs of public works in relation to infrastructure through their own budgets.

The first recognition of PPP in Spanish legislation appeared in 2007, when the so-called public and private co-operation formula was included in the laws governing public procurement in Spain.

It is anticipated that the economic situation in Spain, as well as a new law that is now being elaborated will further promote the development of PPP in Spain and will regulate the financial regime applicable to contracts for the concession of public works.

2. Legal and regulatory framework

2.1 Background law

It is helpful to understand the multiple tiers of public entities in Spain which can procure contracts of a PPP nature.

Law 30/2007, of 30 October, relating to contracts within the Public Sector (the Public Sector Contract Law) applies to agreements entered into by the Spanish Public Sector, both territorial and institutional, but with different rules depending on the legal nature of the relevant contracting Public Administration. It is therefore important to understand the territorial organisation of Spain.

Article 137 of the Spanish Constitution specifies that the territorial Public Administration in Spain consists of: (a) local administration (consisting in essence of municipalities (for example, the City of Barcelona), and provinces (for example, the province of Vizcaya)); (b) the Regional Administration or the Autonomous Communities (Comunidades Autónomas) (for example, the Autonomous Community of Cataluña); and (c) the State Administration itself.

In addition, there is the so-called institutional Public Administration, which comprises: (i) public entities with a separate legal personality relating to or subordinated to a territorial Public Administration that are themselves also categorised as a Public Administration, eg autonomous bodies (organismos autónomos) (for example the Confederaciones Hidrográficas), public entities (entidades públicas empresariales) (for example the rail operator RENFE or airports operator AENA) and state agencies (agencias estatales) (for example the official state gazette BOE); and (ii) entities belonging to the public sector that cannot be considered to be a Public Administration, eg public corporations (empresas públicas) (for example courier company CHRONOEXPRESS, S.A.) and public foundations (for example the Thyssen-Bornemisza Museum).

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1 There are more than 8,000 municipalities in Spain. There may be other local territorial administrations, such as regions (“comarcas”), metropolitan areas, an association of municipalities (“mancomunidad de municipios”), parishes (“parroquias”) and councils (“concejos”).

2 The Spanish state is heavily decentralised. Municipalities, provinces and Autonomous Communities are known as “territorial administrations.”
The Public Sector Contract Law is basic legislation that has been passed centrally by the state. Autonomous Communities can develop this law in relation to procedural matters but are not permitted to develop substantive matters themselves.

2.2 Specific enabling legislation

The Public Sector Contract Law introduced from scratch a complete regulatory regime applicable to PPPs. It provides the enabling legislation required for the use of PPPs and its key features are as follows:

- it sets out the basic laws applicable to all Spanish Authorities (the State, Autonomous Communities and local authorities);
- it provides the legal framework to be applied to all sectors of public works (including ports, railways, airports, roads and sewage plant infrastructure), notwithstanding specific legislation that applies in an individual sector; and
- it has a wide scope of application and opens the market to foreign companies that wish to tender for public works concession contracts.

The construction and financing of public works in Spain may be implemented through one of two methods.

(a) The most common method is an administrative works contract\(^3\), where the works are financed directly by one or more Authorities and also, where applicable, by aid from European Union funds. In this case, payment to the Contractor is made on a milestone basis for sections of works certified as complete\(^4\). The Contractor finances work in progress which has not yet been completed and the milestone certificates can be assigned to a credit entity.

(b) Administrative works which are not financed directly by the Authority may be financed by one of the following methods:

(i) a bullet payment for the total contract price paid by the Authority once the construction works are completed. The Contractor has to finance the works itself during construction (and therefore may want to have recourse to bank financing)\(^5\);

(ii) granting the Contractor a concession over the assets that are the subject of the public works. This differs from a concession regime (see (iii) below) in that this type of contract cannot be the subject of an independent economic operation (an example would be maintenance of roads, where the Contractor is granted a concession to maintain the road and is paid by the Authority, rather than by the end-user); or

(iii) construction and operation of public works under a concession regime. This is the type of contract regulated in the Public Sector Contract Law, which is described in further detail in Section 4 below.

2.3 Procurement process

Any bidders that meet the technical and financial requirements of the Authority may participate in the bid process. The process must be conducted through competitive dialogue (diálogo competitivo) during which procedure the Authority selects a number of bidders with whom possible solutions for its needs are shaped. The ultimate offers of the selected bidders will be based on these solutions.

The award may be granted to the bidder who offers the lowest price, or the bidder who offers the most advantageous proposal (which is assessed on all issues and not just price).

Once the award has been granted, the administrative contract is complete and must be formalised within ten days of the definitive award being notified to the Contractor. Once the Public Administration concerned has reviewed all the offers, it will issue a provisional award, and within a period of up to one month and ten days, such provisional award will normally be confirmed as a definitive award.

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3 Title I of Book II of the Public Contracts Law.
4 Article 145 of the Public Contracts Law.
5 Article 147 of Law 13/1996, of 30 December, on tax, administrative and social measures.
The specific terms of a PPP contract are included in: (i) the applicable administrative bidding conditions \( (\text{pliego de cláusulas administrativas particulares}) \), (ii) the deed of the technical specifications of each public bid \( (\text{pliego de prescripciones técnicas}) \), and (iii) the draft contract in the tender documentation.

If the Authority considers it appropriate, a bid bond equivalent to 3% of the budgeted contract price may be required from the bidders in order to ensure commitment to their offer prior to the provisional award of the contract\(^6\). Such a bond has to be posted by tenderers when they submit their bid. Bid bonds are returned to unsuccessful bidders, whilst the bid bond of the entity that is awarded the administrative contract (ie the Contractor) is retained by the Authority until the administrative contract is formalised.

As a general rule, the Contractor or an acceptable affiliate of the Contractor must post a performance bond equivalent to 5%\(^7\) of the contract price approved in the contract award, within 15 days from the publication of the award in the relevant Spanish Official Gazette or on the official website of the Authority. The performance bond will guarantee the obligations of the Contractor under the administrative contract, including any penalties that may be imposed on it for breach of, or default in, the performance of its obligations. The bond can take the form of a letter of credit, an insurance policy from an acceptable provider or cash collateral.

3. **Active sectors**

The main infrastructure investment activities in Spain have mostly occurred in the sectors listed below. Although not all of these sectors have utilised PPP, this model is increasingly being used, particularly for road infrastructure.

### 3.1 Rail

State rail legislation is contained in Law 31/2003, of 17 November, in force since 1 January 2005. It separates ownership and operation of the rail network to encourage competition in freight rail transport projects. Autonomous Communities and local authorities may promote rail infrastructure. Autonomous Communities, in conjunction with the state’s rail network, are permitted to develop suburban trains that link the suburbs with the metropolitan areas, whilst local authorities have powers to develop subway trains.

The previous government implemented several rail infrastructure programmes which were financed on a conventional basis rather than using PPP, including the following high-speed rail projects: (i) Madrid to Zaragoza to Barcelona (including the section connecting Lleida); (ii) Barcelona to France (to be completed); (iii) Córdoba to Málaga; (iv) Madrid to the North of Spain (Valladolid, Vitoria, Bilbao and San Sebastián) and onwards to France; and (v) Spain to Lisbon, Portugal.

Whilst these high speed rail projects have been procured using conventional methods, there are some examples in the city of Madrid of train infrastructure being procured through a PPP, eg the urban railway in Sanchinarro (North of Madrid) and in Parla (South of Madrid). It remains to be seen whether PPP will generally be utilised for the procurement and financing of rail projects but there is certainly potential.

### 3.2 Roads

The relevant state legislation is contained in Law 25/1988, of 29 July, on roads, and Law 8/1972, of 10 May 1972, on toll highways. Prior to the law on toll highways, certain Spanish highways were built and operated using the concession technique. Law 8/1972 was passed at a time when the state was subject to budgetary constraints and its intended aim was to provide legal certainty for potential foreign investors by

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\(^6\) The bid bond may be deposited in cash, be provided through an insurance bail \( (\text{seguro de caución}) \) or by means of an irrevocable first demand guarantee by a credit entity established in Spain.

\(^7\) In special circumstances, the Authority may require a performance bond of up to 10% of the contract price (and even 20% in certain circumstances).
granting a very beneficial tax regime and the right to create a mortgage over the concession. Autonomous Communities and local authorities may also promote road infrastructure projects within the scope of their public powers.

In the last decade, there has been a sharp increase in interest in PPPs in the road sector. The use of PPPs was favoured by the previous government to implement certain road projects, including:

(a) the ring roads in Madrid:
   (i) Calle 30 (September 2004-April 2007);
   (ii) M-40 (1996);
   (iii) M-45 South-Eastern (March 2002). End of the contract term (August 2029);

(b) improved access to Madrid and Barcelona:
   (i) R-2 Madrid-Guadalajara (October 2003);
   (ii) R-3 Madrid-Arganda del Rey (February 2004). End of contract term (2049); and

(c) the toll highways along the Mediterranean coast south of Alicante to Cartagena and towards Almería and one of the regional highways in Galicia:
   (i) Motorway Alicante-Cartagena (6 July 2001);
   (ii) Motorway Cartajena-Vera (24 January 2007);
   (iii) Motorway A Coruña-Carballo AG-55 (30 December 1997);
   (iv) Motorway of the Atlantic AP-9 (December 2003).

The most recent PPP projects to be carried out in Spain further illustrate how PPP is positively evolving in this sector, in particular:

(a) the R-4 Toll Road Concession:
   (i) Opening date (April 2004);
   (ii) End of the contract term (December 2065)

(b) the A-1 Motorway tranche between Santo Tomé del Puerto and Burgos (North of Spain);

(c) the development of 77.5 kilometres of shadow toll motorway; and

(d) the development of 63.72 kilometres of shadow toll motorway from Madrid to Cádiz.

Besides PPPs, there have been other important investments in the road sector, some of them financed on the basis of shadow tolls. These include:

(a) the Autovía de la Plata from Galicia and Asturias towards Seville (with AP 66 due to open in 2011);

(b) the corridor between Valencia and Zaragoza towards the north of Spain (with the A-23 Autovía Mudéjar having opened on 21 February 2008); and

(c) the corridor north and south of Madrid to improve transport from the Mediterranean Sea towards Portugal, avoiding central Spain.

As well as the Spanish state, other public entities such as Autonomous Communities and local authorities are also planning to invest in large infrastructure projects that fall within their public responsibilities. For example, the Autonomous Community of Madrid is promoting a new toll road to the north of Spain, a suburban network to service housing areas north of the city of Madrid and its public hospital programme. Subways in Málaga and Seville are also planned.
At the time of going to print, a number of Spanish road PPP Contractors are reportedly facing serious financial problems as a result of failing to meet their initial base cases due largely to traffic levels being significantly lower than those forecast (in one case 80% lower). As central government is eager to ensure the banking sector’s continued confidence in the PPP model and its support of the EUR15 billion infrastructure plan, it is currently studying a number of ways of assisting failing projects, including (i) providing guarantees relating to the difference between actual and forecast tolls collected; (ii) taking participating loans; and (iii) lifting toll charges so as to make the motorway free (which would effectively mean a full bail-out of the project due to the fundamental change in the underlying basis of the concession).

3.3 Airports

Major investments have been made in expanding the airports of Madrid and Barcelona. The Madrid airport of Barajas has been completed, and at the airport of Barcelona, which recently opened a new runway, construction will start soon on a new terminal. Additionally, the development of a greenfield international airport in Castellón is being carried out under a PPP scheme.

3.4 Water

The former government considered an ambitious EUR3 billion programme to transport water from the river Ebro, in the North of Spain, to the southern Mediterranean region of Spain. Following a change in government and a shift in the political landscape at a regional level, the current government called a halt to the programme and has instead proposed to install various desalination plants nearer the water supply areas.

The following minor water infrastructure projects are being executed as PPP schemes:

(a) water treatment facilities in Catalonia; and

(b) the development of a waste thermal drying plant in Reocin (Cantabria, North of Spain).

3.5 Health

The Spanish state has delegated its responsibilities in relation to public health to the Autonomous Communities. To date, the Autonomous Community of Madrid has tendered and awarded the construction of eight public hospitals that have now been completed. Other Autonomous Communities have taken the same approach to the building of new public hospitals, eg the Manises Hospital (Valencia), the Baix Llobregat Hospital (Catalonia) and the Burgos City Hospital (Castilla-León). Asturias and Cantabria are also promoting similar plans.

3.6 Other

PPP is also being utilised in other areas, eg Catalonia is developing two PPP prison facilities (Quatrecamins Prison and Lledoners Prison). Currently, some of the Autonomous Communities are also developing government buildings with PPP schemes, eg the Sant Andreu police station, judicial courts and a judicial complex in Barcelona (all located in Catalonia).

Public parking spaces, a responsibility of the local municipalities, may also be procured under a PPP. The experience has not been positive in some cases, particularly in relation to residential parking projects which tend to have very long maturity periods. The experience has, however, been relatively positive in the context of commercial parking projects aimed at non-residents in the centre of cities.
3.7 Potential sectors for future PPPs

In July 2005, the Spanish Ministry of Development published its strategic plan for infrastructure and transport for the period 2006 to 2020, with the intention of reviewing it every four years. A total of EUR248,892 million of capital expenditure was planned, 40.5% of which to be financed by private finance. Despite there having been a change of government since the plan was first published, the current government appears to be committed to it and the first review took place in 2009. According to the most recent publicly available figures (2005/6), it contemplates a total investment of EUR248,892 million, as set out below.

<table>
<thead>
<tr>
<th>Type of Project</th>
<th>Capital Expenditure (mEUR)</th>
<th>% Financed Out of Budgetary Expense</th>
<th>% Financed by Private Finance</th>
<th>% of Total Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Road (non urban)</td>
<td>62,785</td>
<td>75</td>
<td>25</td>
<td>25.23</td>
</tr>
<tr>
<td>Rail (non urban)</td>
<td>108,760</td>
<td>81.4</td>
<td>18.6</td>
<td>43.70</td>
</tr>
<tr>
<td>Airports</td>
<td>15,700</td>
<td>2.2</td>
<td>97.8</td>
<td>6.31</td>
</tr>
<tr>
<td>Ports</td>
<td>23,460</td>
<td>9.7</td>
<td>90.3</td>
<td>9.43</td>
</tr>
<tr>
<td>Other public works</td>
<td>38,187</td>
<td>27.7</td>
<td>72.3</td>
<td>15.34</td>
</tr>
<tr>
<td>Total</td>
<td>248,892</td>
<td>59.5</td>
<td>40.5</td>
<td>100</td>
</tr>
</tbody>
</table>

Unfortunately, the strategic plan does not split the amounts between specific projects or years of investment, but it is apparent that the government will prioritise investment in the transport sector, including transport links to the rest of Europe specified in the Communication of the EU Commission to the EU Council and the European Parliament (COM/2004/0101).

Improving ports on the Mediterranean Sea has been a recent priority due to the significant role that ports play in Spain’s transport infrastructure – 70% of freight imported or exported is now transported via ports. Investment has been aimed at improving rail and road connections to and from ports, as well as increasing the capacity of Spanish ports. The biggest investments to date have been made in Sagunto, Barcelona and Cartagena, with other major investments in Tarragona and Algeciras. The Atlantic Ocean ports have also seen major investments in La Coruña and Santander. This investment in ports has been co-ordinated with the improvement of the rail freight transport network and road networks. Whilst these projects were not procured as PPPs, there may be scope to use PPPs in this sector in the future, particularly as the law on ports of 1992 (as amended) already contemplates the possibility of awarding concessions for the use of land within ports for commercial purposes.

4. General structure of concessions

The structure and risk allocation of PPP contracts are examined in more detail below.

4.1 Method of financing

The Public Sector Contract Law does not currently include any provision relating to the methods of financing projects; however, it is expected that a new regulation on financing will be passed in the near future.
For this reason the former regulation, Law 13/2003, of 23 May, on works concessions (Law 13/2003) is still being applied. According to this regulation the Authority usually determines the method of financing the project taking into account budgetary stability objectives, cost-efficient use of financial resources, the nature of the works and their importance to the public interest. Public works concessions may be financed, in total or in part, by the Contractor who, in all cases, assumes all risks of the works and operations, including commercial risk when the project is fully funded from payments collected from end-users.

4.2 Payment mechanisms

The Contractor is entitled to receive consideration from the Authority as agreed in the contract and in the particular administrative bidding conditions. The payment mechanism will vary depending on the specifics of the concession and there may be staged payments during the course of works or the payments by the Administration will be made in the form specifically envisaged in the Contract. The Contractor is entitled to suspend the works or terminate the contract in the event of a prolonged payment default.

4.3 Changes

There is a distinction between changes the Authority may make to the terms of the concession contract, changes to the public works and changes in law. However, in either case, the financial model will be adjusted to take into account any increase or decrease in costs as a result of the changes. This is called economic balancing and is further described in paragraph 4.5.

(a) Changes to the terms of the concession contract

Once the contract is executed, the Authority may only introduce amendments to the contract (e.g. duration or price payable by end-user) for reasons of public interest, as long as these are justified due to new needs or unforeseen causes.

In the event of a merger of companies, demerger, or transfer of the business in which the Contractor is involved, the relevant agreement shall continue in force and bind the resulting or beneficiary company which shall be subrogated to the position of the Contractor, provided that the resulting or beneficiary company meets any solvency tests required by law.

(b) Changes to the public works

When the public interest so requires, the Authority may modify, extend or require additional works to the project which are directly related to the objective of the concession.

(c) Change in law

A change in law, per se, will not trigger any additional time or cost relief unless it has affected the economic balance of the contract.

4.4 Supervening events

Under the Public Sector Contract Law, the Contractor bears the risks associated with the construction of the public works except for any part of the works which may be executed by the Authority. Such joint works are not common because, if the Administration interferes in the works, it will have to recognise the impact of this on the Contractor (for example, by an extension of the period for carrying out the works).

When the Contractor is in default because of a delay caused by a force majeure event or by circumstances attributable to the Authority, the Contractor shall be entitled to an extension of time and of the overall period of the concession which should be at least equal to the period of the delay.

In addition, if the occurrence of a force majeure or Authority action substantially increases the costs to the Contractor despite an extension of time being granted, the financial model will be adjusted accordingly as set out in paragraph 4.5.
If the force majeure or delay caused by the Authority completely hinders the performance of the works, the contract may be terminated, and the Authority will pay the Contractor for works that are already completed and any amounts the Contractor owes to third parties. The right to terminate is not linked to a specific duration of the force majeure event but rather to the severity of the force majeure event and its consequences. Force majeure is an event that is either not foreseeable or, even where it is foreseeable, it would not be possible to prevent it affecting the concession, such as war or earthquake.

4.5 Economic balance

A concession contract should maintain the same economic balance as that established at the time of its award, taking into account the public interest and, as far as practicable, the interests of the Contractor. The Authority must re-establish the economic balance of the contract for the benefit of the relevant party in the circumstances described in paragraphs 4.3 and 4.4 above and in any other circumstances expressly set out in the concession contract. Amendments may consist of modifying the payment stream, extending or reducing the term of the concession and, in general, modifying the applicable provisions in the contract.

In the case of force majeure or Authority action, provided that more than 50% of the consideration to be received by the Contractor is generated by the tariff to be paid by the end-users, the concession period can be extended by a maximum period of up to 15% of the initial term of the concession.

In the case of force majeure only, the Authority will ensure that the minimum yields agreed in the contract are maintained, so long as this does not completely prevent performance or operation of the works. This means that the economics of the concession modelled by the Contractor at the time of entering into the contract, have to be maintained. This can also be achieved by an extension of the time period of the concession.

As a general rule, the price of the concession contract cannot be varied in any other circumstances. The Contractor will bear the risk of future investment required to maintain the public works as established in the concession contract. In long-term agreements, this may present problems for the Contractor as it may be difficult to predict unforeseen costs that may arise in the future9.

It is important to note that when considering the economic balance, it is not necessary to take the provisions of any finance documents into account and, accordingly, the concession agreement will not necessarily ensure that payments are made to the Contractor by the users of the concession and/or that the Contractor continues to comply with financial covenants throughout the life of the concession on the same basis as set out in the concession agreement.

4.6 Termination and compensation

(a) Expiry

An agreement shall be deemed to be completed once finalised in accordance with its terms and conditions and once the Authority has confirmed the service obligations have been fully satisfied.

Additionally, the agreement shall set out a guarantee period (starting on the works acceptance date) after which the Contractor’s liability shall have expired (unless otherwise established by law or other regulations).

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9 This is the so called cláusula de progreso, which is a requirement on the Contractor to keep the works in state-of-the-art condition; in certain long-term contracts, this represents a major challenge, eg, hospitals. As a general rule, the Contractor will bear these costs and will not be entitled to a review of the price.
(b) Termination

The consequences of termination depend on the relevant termination event. Spanish law provides for a variety of termination events whose nature and main effects vary depending on the breaching party. These are summarised below.

(i) Termination caused by the Contractor

If the agreement is terminated as a consequence of the Contractor breaching any of its obligations, the Contractor is obliged to compensate the Authority for the damages and losses incurred. Sums due under this rule shall first be recovered from the performance bond provided, or may be set off against any payments due to the Contractor from the Authority. Any of the Contractor's liability over and above the value of the performance bond shall be recovered as a debt under a directly enforceable procedure.

If the Contractor is in default, instead of terminating, the Authority may opt to impose economic penalties in proportion to the breach and to the economic importance of the operation, or taking into account the period of delay involved. These are recoverable as described above.

When calculating the level of compensation which the Authority will pay the Contractor, the Authority assesses the value of the works completed and any fixtures and fittings acquired to deliver the service and then adjusts these sums to reflect any amortisation.

(ii) Termination caused by the Authority

As a general rule, when termination is caused by the Authority, the Authority will compensate the Contractor for the damages and losses suffered including the Contractor's loss of profit and, in most cases, the Contractor's financing costs.

(iii) Mutual agreement between the Authority and the Contractor

Termination by mutual agreement may only take place if there is no other termination event attributable to the Contractor, and provided that the public interest makes continuation of the contract unnecessary or inappropriate. The relevant contract will include details of the applicable compensation regime. This will be agreed on a case-by-case basis.

5. Security position and insolvency

5.1 Permitted financing in PPP projects

As mentioned in Section 4 above, until a new regulation is passed, the provisions on financing set out in Law 13/2003 are still being applied. This regulates two methods of financing public works: the issue of debt instruments (Corporate Bonds) and the issue by the Contractor of securities incorporating the Contractor's credit rights (Concession Notes). It also contemplates the possibility that the state Administration will grant participating loans to the Contractor. The forms of finance specifically regulated in the Public Sector Contract Law (including participating loans) are in addition to other forms of financing that are generally available to a Contractor, such as bank loans, shareholder equity contributions and other participating loans.
(a) Corporate Bonds

Corporate Bonds may, subject to any applicable EU state aid rules, benefit from a guarantee from the state, Autonomous Communities or local entities, or other public entities.

(b) Concession Notes

The issue of Concession Notes requires the prior authorisation of the Authority. Concession Notes represent a share in certain credit rights of the Contractor. These credit rights consist of:

(i) the right to collect tariffs from the end-users of the public infrastructure (eg tolls); and/or

(ii) income the Contractor may receive from operating commercial areas of the public works (either by itself or under an operating agreement with a third party); and/or

(iii) payments owed by the Authority.\(^{12}\)

The Public Sector Contract Law offers sufficient flexibility by allowing different tranches of Concession Notes to be issued, representing shares in different credit rights, or credit rights accrued in different years. Concession Notes may be acquired by asset securitisation funds.

If the concession agreement is terminated, the Public Sector Contract Law contemplates the arrangements set out below.

(i) If the concession is terminated due to Contractor default and if the Concession Note holders have not been fully repaid, the Authority may choose to:

(A) (save where the default is due to the liquidation of the Contractor – see paragraph 5.3) seize (secuestro) the concession in which case the Authority will cease to pay the Contractor any further revenue but will pay amounts owing to the Contractor's creditors; or

(B) terminate the concession, having agreed with the Concession Note holders' representative\(^{13}\) the amount of the outstanding debt and the terms for its repayment. In the absence of such agreement, the Authority will be released from any payment obligation by allowing the creditors to choose between the following amounts:

I the amount of any indemnity which the Contractor is entitled to receive under Article 266 of the Public Contracts Law (as enacted by the Public Sector Contract Law)\(^{14}\); or

II the balance between the nominal amount of the Concession Notes and the amounts paid (whether for interest or principal) until the termination of the concession.

(ii) If the concession is terminated for any cause, and the Concession Note holders have not been fully repaid, the Authority may elect to proceed as set out in (i)(A) above or may terminate the concession, having agreed with the Concession Note holders' representative the amount of outstanding debt and the terms for its repayment. In the absence of such an agreement, the Authority will be released from its obligation by paying the amount in (i)(B) (II) above.

In addition, provided that a person (natural or legal) is appointed to act as sole representative of all the Concession Note holders, the Concession Note holders may exercise the same rights as a mortgagee of the concession. (See paragraph 5.2 below.)

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\(^{12}\) Although the Public Sector Contract Law specifies that in the event of insolvency of the Contractor, such credit rights will not form part of the insolvency estate and that the holders of Concession Notes will rank equally with creditors secured with a mortgage over the concession, this would be in conflict with the Insolvency Law (the Insolvency Law was approved and came into effect after the Public Sector Contract Law, but does not include any grandfathering provision in respect of such rights). See paragraph 5.3 below as to the effects of the Insolvency Law on this provision.

\(^{13}\) The Public Sector Contract Law refers to “creditors”. Perhaps this reference to “creditors” is incorrect since the holders of the Concession Notes would be owners in their own right of the rights attached to the Concession Notes, and not creditors as against the Contractor. Arguably, they will be creditors against the Contractor since if the concession contract is terminated (and thus, the rights attached to the Concession Notes cease to exist) they will be entitled to claim an indemnity against the Contractor. See paragraph 4.6(b) above.
(c) Participating loans (Préstamos Participativos)\textsuperscript{15}

The Public Sector Contract Law provides that interest is payable by the Contractor on participating loans but only out of the income of the Contractor. In addition, it allows for prepayment of participating loans\textsuperscript{16}. Public authorities may make participating loans to the Contractor, but in this case no prepayment is allowed unless the Contractor pays the net present value of the expected future yield on the participating loan.

Any participating loan needs to be approved by the Authority. From a lender’s perspective, the ability to prepay participating loans may be controlled contractually to avoid them being subordinated at the time of payment.

There had been some indication that the government would pass new legislation in the autumn of 2009 to require at least 20\% of projects to be financed by equity but to date this has not happened.

5.2 Security in PPP projects

A concession may be mortgaged in favour of funders to provide security over the concession rights and the project specific assets, but only with the approval of the Authority.

The Public Sector Contract Law establishes a mortgagee’s rights as set out below, but the Authority has a wide discretion as to whether to allow the mortgagee any of these rights (ultimately, the mortgagee’s protection is the right to enforce its security over project assets and rights under the concession contract), as set out below.

(a) If the mortgagee is entitled to enforce its security, the concession agreement may allow the mortgagee to request the following as an alternative to enforcement:

(i) that the Authority allocate amounts it owes to the Contractor towards repayment of the secured obligations. The law does not specify a limit nor who should determine the amount; and/or

(ii) administration of all or part of any commercial premises that form part of the concession (ie the business situated on the site of the concession (such as restaurants or petrol stations) but not of the whole concession itself). If the operation of these premises is subcontracted to a third party, the third party will need to be notified and amounts owed to the Contractor will instead be paid to the mortgagee.

(b) If the Authority is entitled to terminate the concession due to a Contractor default, it may offer the mortgagee the option to step-in to the concession if, in the Authority’s opinion, the mortgagee would be able to operate the concession successfully. Such step-in rights are not normally set out in a direct agreement at the start of the project, unlike in other countries.

If the value of the concession has materially deteriorated due to acts or omissions of the Contractor, the mortgagee may require the Authority to verify the amount by which the value of the concession has decreased. If the deterioration is confirmed, the mortgagee may either request that the Authority require the Contractor to remedy the damage, or request the administration of the concession through court proceedings. If a decision is taken to enforce security, enforcement is made through a public bid conducted by a competent court. As a result of the court sale, the person awarded the concession takes over the contractual position of the Contractor, subject to the prior authorisation of the Authority. Any person that intends to bid in a public sale (including, if applicable, the mortgagee) must notify the Authority 15 days prior to the public auction, or otherwise they will not be allowed to bid.

\textsuperscript{15} Participating loans are regulated under Article 20 of Royal Decree-law 6/1996, of 7 June. From a technical point of view, Spanish law treats participating loans not as equity (ie capital plus reserves) but as part of the company’s “estate” (patrimonio de la sociedad). While participating loans are not “equity”, they will be treated as part of a company’s “net equity” (patrimonio de la sociedad) for the purposes of establishing thresholds for mandatory capital reduction and liquidation or the “mandatory capitalisation” rule (Spanish limited companies should have a net equity of not less than 50\% of share capital as otherwise they need to be wound up or recapitalised). The participating loans must be subordinated to all other debts and interest (or at least a portion of the interest) paid on the participating loan may be tied to the economic performance of the company. If a pre-payment is to be made, it can only be pre-paid by converting the principal into ordinary share capital.

\textsuperscript{16} There is doubt as to whether the Contractor’s equity will need to be increased by the same amount as this requirement has not been expressly repealed.
If, for any reason, the concession is not awarded to any person (e.g., if there are no bidders, or if, following the applicable procedural rules, the court cannot award the bid to any bidder, and the mortgagee does not elect to award itself the concession), then pursuant to Article 257 of the Law of Finance, the Authority has the following options:

(a) to seize (secuestro) the concession and stop paying the Contractor any income. Arguably, these amounts should be used to repay the mortgagee, although the Public Sector Contract Law is not clear in this respect. At this stage of the proceedings, the mortgagee may propose to novate the concession to a new entity (including the mortgagee) who must comply with certain eligibility criteria. The new entity will become the Contractor under the concession and assume the Contractor’s debt obligations. Failing this, the Authority may sell the concession under public procurement rules to a third party; or

(b) to terminate the concession, agreeing with the mortgagee the amount of outstanding debt and the terms for its repayment. In the absence of an agreement, the Authority is released from any payment obligation and the creditors are entitled to receive the compensation to which the Contractor would have been entitled in the event of a concession being terminated.

The Public Sector Contract Law provides certain protections for beneficiaries who have registered rights or charges over the concession. In the administrative proceedings following termination of the concession, the Authority must notify the beneficiary of each registered right or charge that the concession will be terminated. The concession will not be terminated until all amounts owed by the Authority to the Contractor (if any) have been deposited to the order of such beneficiaries. The termination of the concession may be requested by the Authority, or by the Contractor, or be effected ex officio by the registrar or upon the request of any interested party.

5.3 The effects of the Insolvency Law on concession contracts and security in PPP projects

Article 206 of the Public Sector Contract Law provides that insolvency of the Contractor is an event of default. The termination operates by law upon the liquidation of the insolvent party. A mere declaration of insolvency would not automatically terminate the concession contract, but the Authority can choose whether to terminate or to continue the contract if it receives sufficient guarantees from or on behalf of the Contractor for the performance of its obligations.

In relation to Concession Notes, the Public Sector Contract Law specifies that upon the insolvency of the Contractor the following will apply:

(a) credit rights attached to the Concession Notes will not form part of the insolvency estate; and

(b) Concession Note holders will rank equally with creditors secured with a mortgage over the concession.

However, Law 22/2003 of 9 July on insolvency (the Insolvency Law) was approved after the Public Sector Contract Law, and does not include any grandfathering provision to protect these rights. Most notably, the Insolvency Law will not enforce the termination of an agreement (e.g., acceleration of a loan) based solely on the declaration of insolvency by the Contractor. Moreover, the Insolvency Law expressly provides that no creditor will be recognised as holding any privilege that is not expressly contemplated in the Insolvency Law.

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17 The Public Sector Contract Law cross-references the terms of Article 251, which contemplates the repayment of the creditors of the Contractor. However, Article 257 deals with the enforcement of the mortgage over the concession, so that, from a mortgage law perspective, any income should be applied first towards the repayment of the mortgagee.

18 See paragraph 4.6(b) above.

19 These beneficiaries can be persons other than the mortgagee. These may include tax authorities, employees, etc and any person that has registered a right or a charge over the concession. These persons have similar rights as to those of the mortgagee in the concession as explained above. They are the holders of rights “in rem” that have been registered after the creation of the mortgage, and that therefore, will disappear after the enforcement.

20 The Public Sector Contract Law was published on 24 May 2003, and came into effect on 24 August 2003, whereas the Insolvency Law was published on 10 July 2003 and came into effect on 1 September 2004. The Insolvency Law is of universal application to the insolvency of a Spanish company, and has repealed all legislation that was contrary to the Insolvency Law.
Notwithstanding the Public Sector Contract Law, Concession Note holders will rank *pari passu* with ordinary creditors with no special privilege. Consequently, the rights granted to Concession Note holders or to a mortgagee would not be exercisable immediately upon the insolvency of the Contractor.

To date there has been little guidance on how the Public Sector Contract Law and the Insolvency Law will work in practice.

### 6. Employment issues

The Contractor is responsible for all employment issues relating to the concession.

The Contractor may subcontract works to third parties. However, the Contractor remains responsible for salaries and other labour payments owed by the subcontractor to its employees in respect of salaries and social security contributions during the term of the subcontract. This may, however, be altered by other specific agreements between the Contractor and subcontractor. Any claim by an employee against the Contractor must be made within one year of the termination of the relevant subcontract.

A Contractor will also need to consider how any transfer of employees from the public sector to the private sector for the purpose of the project should be structured. Where an employee is a civil servant or government employee, a “services commission” (*comision de servicios*) is used, whereby the employee provides the services to the private entity but remains employed by the public sector. If the individual is not employed by the public sector, a detailed analysis is needed to determine how to structure any transfer.
Wer hohe Türme bauen will, muss lange beim Fundament verweilen.

Those who want to build high towers must spend a great deal of time at the foundations.

Anton Bruckner
(1824-1896)
1. Introduction

The market for PPPs in Austria has grown considerably in the past few years. Recently, the Austrian government has emphasised the need for greater co-operation between the public and private sector for two reasons: first, to reduce their budget deficit, and secondly, because it has taken the view that the private sector is able to implement projects more efficiently than the public sector.

Early attempts at PPP schemes started about ten years ago and have gained importance in the Austrian business sector. However, it is only in the last few years that major PPP projects have been successfully developed.

The transport sector (primarily roads, tunnels and rail) is the most significant market for major PPP projects, not only due to Austria’s topography, but also as a result of the accession of Eastern European countries to the EU. This has increased Austria’s geographical importance due to increased transit traffic to and from Eastern Europe. The environment and health sectors are potential areas of growth for small to medium sized PPP schemes. Education and defence PPPs are still in their infancy although it will only be a matter of time and political will before these appear on the market.

The Austrian government’s “Programme 2007 – 2010” stated that there would be a focus, inter alia, on “Expanding and modernising the infrastructure and facilitating the application of PPP models”.

However, given the number of PPP schemes put into effect so far, the Republic of Austria is still lacking a general strategy for the implementation of PPPs. The establishment of a competence centre, as recommended by the private sector, would not only provide legal guidance for both public and private sectors but would also serve as a know-how centre for the preparation and implementation of PPP schemes. It was hoped that, although not a priority of the current government, the establishment of an Austrian competence centre for PPP, would further boost activity in the market for PPP schemes in Austria. However, the government announced at the end of 2008 that, due to the financial crisis and the priorities of the current government, a more cautious approach towards PPP schemes is to be followed. Initiatives in connection with the establishment of an Austrian competence centre for PPP are currently not being continued by the government.

2. Legal and regulatory framework

There is no legislation for PPPs in general and there is currently no intention to introduce any statutory act relating to PPPs in Austria. The procurement of PPP schemes falls within the ambit of existing Austrian and EU procurement rules, neither of which specifically refers to PPPs, whilst the contractual framework and risk allocation, such as the payment mechanism, are governed by the principles of general civil law and are dealt with on a case by case basis.

The Federal Procurement Act (2006) introduced changes to the award procedure. In particular, the competitive dialogue (wettbewerblicher Dialog) procedure was introduced. This procedure may only be used for particularly technically, legally or financially complex transactions which are usually the case with PPP projects.

In a competitive dialogue (at least three) tenderers are invited to the dialogue stage after having passed a pre-qualification. The aim of the dialogue stage, during which all aspects of the contract may be discussed, is to identify and define the means best suited to satisfying the contracting authority’s needs. The contracting authority may provide for this procedure to take place in successive stages, in order to reduce the number of solutions to be discussed during the dialogue stage by applying the award criteria. After the conclusion of the dialogue stage the (remaining) tenderers are invited to submit their final

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1 http://m3.bmf.gv.at/Budget/Allgemeines/PublicPrivatePartnerships_7614.htm
tenders on the basis of their solutions presented and specified during the dialogue. The project will then be awarded to the best bidder.

In Austria, the federal government and authorities at both regional and municipal level can be a “contracting authority” as well as certain bodies governed by public law which are established for the specific purpose of meeting needs in the public interest but which do not have an industrial or commercial character, such as the road and rail operators described below.

It is also worth noting that, for road projects and rail projects, Parliament has conferred certain powers on special state-owned companies, in particular on the highways operator Autobahnen- und Schnellstraßen Finanzierungs-AG (ASFINAG) (which is responsible for roads, tunnels and bridges) under the ASFINAG Act 1982, and on the Railway Infrastructure Financing Company (SCHIG) under the Railway Infrastructure Financing Act. On the basis of these laws, both agencies are, *inter alia*, enabled to enter into contracts in relation to PPP schemes. Thus, in most road and rail projects, ASFINAG or SCHIG (as agencies of the Austrian government) will usually be the party taking the role of the Authority.

### 3. Early PPP attempts

There have been several attempts to use a PPP scheme in different projects in the past which have failed (at least on their first attempt, such as the TETRA emergency services radio network project in 2002 – please see section 3.1 below).

However, there have also been some successfully implemented PPP schemes, such as the Vienna Climatic Wind Tunnel rail vehicle testing facility in 2002 and the Cargo Center Graz also in 2002 (described below). In addition, Austria celebrated its first major internationally financed PPP project with the launch of the electronic tolling system for heavy goods vehicles on 1 January 2004, following a number of unsuccessful attempts by the government to involve a private partner in a major PPP scheme. Furthermore, in 2007 the Ostregion Package 1 (Ypsilon) toll road PPP project (described below) reached financial close.

#### 3.1 The TETRA radio network project

In 2002 the Austrian Ministry of the Interior awarded a contract worth EUR190 million to Mastertalk, a consortium of Siemens AG and the Viennese municipal utility to set up a nationwide TETRA radio network in Austria for security and emergency services. Disputes as to the remuneration and the system specification between the Authority and the Contractor led to an early termination of the concession contract, followed by a new invitation to tender. A new concession contract was awarded to TETRON, a consortium of Alcatel Austria AG and Motorola GmbH in 2004 to replace the various legacy networks of emergency services with a single network implementing standard technologies. The system has been successfully deployed in Vienna and Tyrol since 2006 and has been successfully rolled out in other provinces (Carinthia and Salzburg in 2008 and Lower Austria in 2009).

The earlier failure cast doubts on the effectiveness of co-operation between the public and private sectors and contributed to increased political discussions on whether privatisations, in particular by way of PPP schemes, are a viable method of financing public infrastructure. However, both sectors, in particular the public sector, have learnt lessons from the past.

#### 3.2 Cargo Center Graz

Shortly after the successful launch in 2002 of the first rail sector PPP, namely the Vienna Climatic Wind Tunnel (the world’s largest testing facility for rail vehicles), the Cargo Center Graz became the second PPP model to be procured by SCHIG with total investment costs of EUR110 million. The sponsors were a consortium of private transport companies and forwarding companies, three of the largest Styrian banks, the Styrian provincial government, and the federal government of Austria.
In June 2003, the Cargo Center Graz started operation as one of the most efficient European freight traffic centres. In 2008 this centre handled freight with an overall weight of 800,000 tonnes.

3.3 The Austrian Truck Tolling System

The electronic tolling system for heavy goods vehicles (LKW-Mautsystem) was the first major internationally financed PPP scheme in Austria. In June 2002 ASFINAG awarded the contract for the construction and operation of the tolling system to Europass LKW-Mautsystem GmbH, the Austrian subsidiary of Autostrade S.p.A., the leading Italian road operator. The project, which is based on a microwave system rather than the GPS/GSM used for the German toll system, involved the construction of some 400 toll equipment gantries.

Although the project can be considered as a success (given that it was fully operational on the specified deadline, unlike the German toll system), the arrangement of the project financing took almost two years. The project was considered by several banks, in particular foreign banks, to be unbankable in light of its complex contractual framework and perceived off-market requirements imposed on the Contractor by ASFINAG. In August 2005, ASFINAG exercised its call option to buy the shares in the project company from Autostrade S.p.A. The project is now indirectly owned by the Republic of Austria.

4. Current and future active sectors

4.1 Health

In the Austrian health sector, the state typically plays a strong role in procuring and operating hospitals. However, the market has seen numerous small and medium-scale PPP schemes let by municipal authorities. Various hospitals run by municipalities have decided to co-operate with the private sector in order to meet their increasing expenses.

One leading private Austrian company in this sector is VAMED AG. Via a special purpose company, VAMED AG is engaged in the general planning, turn-key implementation and operation of various hospitals and health centres. Examples include the Mother and Child Centre in Linz, Upper Austria, which was completed in 2005 and which was financed by an Austrian bank together with co-financing from the EIB. Other examples include the construction of a hospital in Vöcklabruck and the reconstruction of a hospital in Steyr. Another successful example is the design, build, financing and operation of the emergency hospital UKH in Linz. The project was constructed and completed in 2005 by a joint venture company owned by Alpine Mayreder (responsible for the construction), Raiffeisenlandesbank Oberösterreich (responsible for financing, operation of the car park and facility management) and VAMED AG (responsible for the overall co-ordination of the project and for general and medical technology advice). The structure provided cost and tax savings and, in particular, for the merging of sector specific know-how of the different partners. In addition, a new psychosomatic hospital in the city of Eggenburg, Lower Austria, with VAMED AG being one of the project sponsors and a psychosomatic hospital in Bad Aussee have also started operations recently.

In 2010 construction of a new major hospital in Vienna containing up to 850 beds is scheduled to commence. The hospital will be located in north Vienna granting access to medical care in this area to some 140,000 people. The DBFO project has been awarded in the form of a PPP to a consortium of Porr AG, Siemens AG and VAMED AG.
4.2 Education

There are currently fewer PPP projects in the education sector than in the health sector. The main reason for this is that most public schools and universities are state owned and the property management of such schools is run by a state-owned company, Bundesimmobiliengesellschaft mbH (BIG). This agency is responsible for building, refurbishing and maintaining state-owned schools and universities. The necessary financing is raised by BIG in the national and international capital markets. Due to the fact that its shareholder is the Republic of Austria, BIG enjoys an Aaa rating from Moody's.

An example of a successful education PPP scheme is the elementary school project “Bednar Park” in Vienna, which reached financial close in June 2009. The City of Vienna awarded a contract for the construction, operation and maintenance of a primary school and kindergarten building for a period of 25 years following construction completion to Porr Solutions Immobilien- und Infrastrukturprojekte GmbH. The overall project costs are approximately EUR38 million.

4.3 Roads and related infrastructure

(a) ASFINAG

The state-owned highway operator ASFINAG is in charge of planning, financing, building and maintaining the entire Austrian motorway and high-speed road network which as a total length of 2,000km. By means of specific enabling legislation, ASFINAG was granted the right to levy user tolls for motorways, which currently represent the most significant income base for ASFINAG.

(b) PPP Ostregion

In September 2004, ASFINAG launched the tender procedure for the first road scheme in Austria in the form of a concession (PPP Ostregion project). The tendered project consisted of 51 km of highways to be constructed in the greater Vienna region and was completed on time and on budget in January 2010.

The project which has overall project costs of EUR988 million reached financial close in 2007 and was financed by a combination of equity, junior, mezzanine and senior debt instruments, including a EUR350 million loan from the European Investment Bank and a multiple drawdown EUR425 million senior project bond purchased by Deutsche Bank. Both the EIB loan and the senior bond were guaranteed by Ambac as monoline insurer resulting in a AAA rating of the bond. For the first time in Austria, a PPP project was financed by a project bond and guaranteed by a monoline insurer.

The project was not materially affected by the downgrading of Ambac but the downgrading is one of the reasons why, according to a recent press statement in November 2009, the management of ASFINAG has decided not to tender as a PPP a 34-km section of the PPP Ostregion project (from Poysbrunn to the State border) with a construction cost of approximately EUR380 million. It is expected that this will be tendered in a conventional manner or in the form of a functional construction and maintenance contract (Funktionsbauvertrag).

4.4 Defence

Although there has been no significant defence PPP in Austria to date, it is likely that a number of services will be outsourced by the Austrian Armed Forces in the coming years, following a recommendation in 2004 by the Armed Forces Reform Commission that PPPs be considered as an alternative financing method. Services to be put out to tender could, according to press reports, include fleet management, facility management, aircraft maintenance and canteen facilities.
4.5 Rail

(a) SCHIG

SCHIG is owned by the Republic of Austria. Its task is the financial management of the expansion of the Austrian railway infrastructure, *inter alia*, by way of alternative financing methods, such as public private partnerships.

(b) Summerau-Spielfeld railway link

The Summerau-Spielfeld railway link is expected to be the first Austrian railway project to be achieved in the form of a PPP model. The link, stretching from the Czech border to the Slovenian border, will form an important part of the railway axis between the Baltic Sea and the Adriatic Sea, connecting Prague, Linz, Graz and Maribor. The project was expected to be completed in 2009. However, to date, it has not been finalised how Upper Austria and Styria will participate in the financing of the project. Recent figures also show that the initial estimated costs of approximately EUR900 million have increased by nearly 100%.

(c) Brenner Base Tunnel

The second major rail project to come to the Austrian market will be the construction of the Brenner base tunnel (BBT), a 64 km-long tunnel rail link forming part of the Munich to Verona rail axis. It is not clear whether a PPP scheme will be the preferred procurement model for the project which is expected to take approximately ten years to complete. The project value is estimated at EUR5-10 billion. In 2004 the Republic of Italy and Republic of Austria signed a treaty on the implementation of what is likely to be one of the world’s longest rail tunnels.

The construction, financing and procurement will be co-ordinated by the project company Galleria di base del Brennero Brenner Basistunnel BBT SE, a European Company incorporated in Austria acting on instructions of the province of Tyrol, the Republic of Italy and the Republic of Austria.

A memorandum of understanding for the joint implementation of the tunnel was signed by the Austrian and Italian Ministers of Transport in July 2007. Construction of the pilot tunnel started in early 2008. In February 2008 the European Parliament decided to participate in the financing of the project with an amount of approximately EUR900 million.

(d) Nordkettenbahn funicular

In 2007 operation of the newly constructed Innsbruck Nordkettenbahn funicular commenced. The concession for the construction, financing, operation and maintenance of the funicular for a period of 30 years was awarded to a consortium of Strabag and the ropeways manufacturer LEITNER. The overall construction costs amount to approximately EUR50 million.

4.6 Water and wastewater sector

Although the Republic of Austria is probably the country with the largest water resources in Europe (it is estimated that Austria’s water supply could serve more than 440 million people), privatisation and marketing of Austria’s water is a controversial issue. According to recent surveys, more than 80% of Austria’s population disapprove of the privatisation of the drinking water supply. In 2001, in order to protect Viennese water resources and to render a privatisation more difficult, the city of Vienna placed drinking water under the protection of the Austrian constitution.

In the waste and wastewater sector however, there have been several pilot projects on a community scale, most of which were waste water treatment plants. Experience shows that private sector engagement in the waste water sector has been a success and it is very likely that more communities will use PPP models in this sector.
4.7 Potential for PPPs in the future

PPP schemes are still relatively rare in Austria compared to other countries with a developed PPP market. The most active sector with small- to medium-sized PPPs is the health sector, followed by an increasing number of waste water projects, mainly waste water treatment plants. There is, however, still a need for more government focus on PPP and this has been less of a priority for the incumbent government in the current economic climate.

5. General structure of concessions

5.1 Risk allocation

Given that there have only been a few Austrian PPP schemes, there is no established risk allocation model in Austria.

The following chart shows the implemented risk allocation model for the PPP Ostregion project, the first road PPP. It remains to be seen whether this approach will also serve for future similar infrastructure concession-based projects to be tendered by ASFINAG.

<table>
<thead>
<tr>
<th>Risks</th>
<th>Authority</th>
<th>Contractor</th>
<th>Shared</th>
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</thead>
<tbody>
<tr>
<td>Approval risk for road layout (section 4 of the Federal Roads Act Order)</td>
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<tr>
<td>Approval risk for statutory procedures</td>
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<tr>
<td>(Nature Protection Act, Forestry Act, Water Protection Act)</td>
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<tr>
<td>Geological risk</td>
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<tr>
<td>Archaeological risk</td>
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<tr>
<td>Increase in construction costs</td>
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<tr>
<td>Completion risk</td>
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<td>Force majeure</td>
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<tr>
<td>Tolling risk</td>
<td></td>
<td>X</td>
<td></td>
</tr>
</tbody>
</table>
5.2 Payment mechanisms

It is not possible to define a common approach by the Authority (or its agencies) for payment mechanisms due to the fact that only a small number of PPPs have been successfully implemented, of which less than half a dozen are of mid-to major size.

However, it is worth noting that for the PPP Ostregion Project, the payment mechanism was based on a combined payment model. Approximately 30% of the payment is made up of a shadow toll, whilst the remaining 70% is based on availability.

5.3 Termination and Compensation

As in other countries, Austrian PPP contracts usually contain specific provisions dealing with termination, distinguishing between termination events allowing the Contractor to terminate and events allowing the Authority to terminate. It is worth mentioning that Austrian courts have developed a general rule that contracts entered into by any party for the performance of a continuing obligation (Dauerschuldverhältnis) may be terminated at any time for good cause without having to comply with specific notice periods. There is no definition of good cause in the Austrian General Civil Code; however, according to Austrian case law, it depends on the nature and purpose of the transaction. This extraordinary termination right can cause concern to senior lenders.

In principle, a continuing obligation may be terminated for good cause by any party to a contract if the continued fulfilment of its contractual relationship cannot reasonably be expected. Such termination may be justified in the event of material default or breach of contract by the other party. However, termination for good cause is not limited to the other party's violation of the underlying contract. It may also apply if conditions have unpredictably changed since the conclusion of the contract, provided that such change was not caused by the party claiming termination for good cause (eg possibly, including force majeure events or changes in law). The burden of proof lies with the party terminating the contract for good cause.

There is no standardised compensation regime in Austrian PPP contracts. Liquidated damages for delays or failing to meet certain quality criteria are common. However, it should be noted that this does not always mean that payment of liquidated damages precludes the other party from suing for further damages in the case of wilful intent or gross negligence.

6. Insolvency and security position

Contrary to the position in the UK and in other developed PPP markets, in Austria it is far from established that senior lenders will be entitled to independently take over a project if things go wrong. Experience has shown that the public sector prefers to have the final say in a project, eg by exercising a call option to buy back the project. Such rights of intervention may conflict with senior lenders’ interest in creating effective security over the project assets and shares in the project company.

Direct agreements which are entered into between the Contractor and the Authority or a major supplier may not be effective upon an insolvency of the project company. Whilst it was initially not standard market practice for senior funders to obtain direct agreements in the context of Austrian project companies and Austrian-based projects, a typical direct agreement with step-in rights was provided in the PPP Ostregion Project.
Whilst Austrian laws on insolvency and security are relatively clear in non-PPP projects, there are several issues in project financings that need to be addressed very carefully. For instance, direct agreements may not be enforceable upon an insolvency of the project company. With respect to taking security, the concept of a floating charge is not known in Austrian law which means that, in principle, it is necessary to hand over possession of a moveable asset from the pledgor to the pledgee (i.e., to the security trustee) in order to create a security interest. Should this not be practicable, it will be necessary to attach plaques onto each item to certify that the item is pledged in favour of the pledgee. Creating and maintaining effective security on assets and receivables can therefore be a burdensome and time-consuming task and may, in addition, give rise to major tax issues.

7. Employment issues

Although employment issues in privatisations are not uncommon in Austria, until now there have been no major PPP schemes which involved the transfer of employees from the public sector to the Contractor. Therefore, it is not clear how the Authority will deal with the issue of transfer of public sector employees and their benefits in future PPP deals which may involve transfer of public sector staff. The impact of secondment models or transfer of staff models will need to be carefully examined in each individual case.

This chapter has been prepared by Wolf Theiss (one of Austria’s largest law firms) in co-operation with Austrian law qualified lawyers in Allen & Overy’s PPP practice.
Czech Republic

Proč nezůstat stále přikloněn k tomu, co nás může sjednotit a ne obracet se k tomu, co nás odtrhává od hromadného společenství.

Why not continue to tend to what can unite us instead of turning to what forces us away from the collective community.

Franz Kafka (1883-1924)

Contact
Prague
Václav Valvoda
Allen & Overy (Czech Republic) LLP, organizační složka
V Celnici 4
5th Floor
110 00 Prague 1
Czech Republic
Tel: +420 222 107 111
Fax: +420 222 107 107
vaclav.valvoda@allenovery.com
1. Introduction

In recent years the Czech public authorities have shown an ever-increasing interest in co-operating with the private sector through public-private partnership (PPP) projects. The signal to investors seems clear: public authorities at all levels are prepared to make use of the private sector’s expertise and/or capital in the construction of new infrastructure and the provision of public services. The Czech government is equally keen to share project risks with investors but seeks, as far as practicable, to exercise effective control over investors’ obligations.

In 2004 a number of projects were selected by the Czech government to be part of a group of “pilot” PPP projects. The projects identified were in the justice, education, health, accommodation and transport sectors. Some of these are still in procurement, while others have been discontinued. Although several PPP projects have been completed at a regional level (including those in Bruntál, Bohumín and Tachov), it is surprising that, despite repeated political proclamations and, in general, full support from the public sector (led by the Czech government, the Ministry for Regional Development (the MoRD) and the Ministry of Finance) for co-operation between the private and public sectors and the perceived advantages of such co-operation, not a single PPP project had been completed by the Czech government by the end of 2009.

In 2006, the enactment of Act on Concession Contracts and Concession Procedure (No. 139/2006 Coll., as amended) (the Concessions Act) and the new Public Procurement Act (No. 137/2006 Coll., as amended) (the Public Procurement Act) clarified the awarding procedures for PPP projects and introduced a special regime for concession projects. The new framework is being (and/or is expected to be) tested on a number of stalled or upcoming PPP projects.

2. Current and future active sectors

2.1 Progress of pilot projects

Some of the PPP projects originally selected by the Czech government were dropped because they were considered unsuitable for PPP and some of them were unsuccessful (such as the Regional Hospital in Pardubice where the project was suspended). Each of the following may have been contributory factors:

(a) the financial crisis (although banks continue to be interested in PPP projects, the availability of long-term financing has been substantially limited);
(b) the continued availability of EU funding as a means of financing projects;
(c) the collapse of the Czech government and, in general, a lack of political will;
(d) the lack of know-how in some spheres of the public sector (given that PPPs may at first appear complicated) – although the public sector can draw on the superior know-how of its PPP knowledge centre, PPP Centrum;
(e) arguably a lack of co-ordination and project management on the public sector side; and
(f) certain legislative deficiencies.

2.2 Projects in development

(a) Central Military Hospital PPP project

At the moment it seems that the PPP accommodation project for the “construction, maintenance and operation of a hotel-type lodging house and a parking lot in the Central Military Hospital (CMH) in Střešovice, Prague, with the lodging house being intended for CMH staff (construction)” has the best
chance of being completed. Under the new framework, three bidders were selected during concession dialogue proceedings and received procurement documentation. Two submitted bids at the end of 2009 and a decision is awaited. The key features of this project are:

(i) its design, build, operation and transfer structure (with transfer of ownership to the State at the end of the construction phase);

(ii) a contract duration expected to be 25 years from the start of the operating phase;

(iii) the strategic (private sector) partner bearing key risks, particularly construction and service availability risks, and partly also demand risk (in respect of commercial activities as the project is divided into public and commercial parts, each with a specific operation and maintenance regime). CMH and the Ministry of Defence will bear the risks associated with the failure to utilise the contracted capacity to its full extent; and

(iv) the Authority paying a fixed charge for capacity and activities agreed in advance which will not be subject to any deductions (except in the event of a serious breach by the concessionaire). The operator will also directly collect fees from the users as regards selected activities and will have an income from permitted commercial activities.

(b) Advanced PPP projects

Other PPP projects which are at an advanced stage include:

(i) the design, construction, financing and operation of a new guarded prison, meeting European standards, in the Rapotice area (with capacity for 500 inmates and staffed by public sector wardens). The concession project document (a preparatory document prepared by the authority, as defined in more detail in 3.1(d) below) has been approved by the government, various preparatory works are pending and the time schedule for the awarding procedure is being prepared;

(ii) the construction, maintenance and operation of a courthouse in Ústí nad Labem. The concession project document has been approved by the government, various preparatory works are pending and the time schedule for awarding procedure is being prepared; and

(iii) the construction, maintenance and operation of selected sections of the D3 motorway and the R3 speedway. The concession project document has been approved by the government, but as a result of the financial crisis the Ministry of Transport has been working on a reduced-scope version of this project which is awaiting government approval. The reduced size of the project will be confirmed once the new concession project document has been issued but it is expected to be as described in paragraph 2.2(d) below.

(c) Other PPP projects

Other PPP projects in various stages include:

(i) the construction of a railway connection to the Ruzyně Airport (AirCon) under the new framework. The concession project document has been prepared but not submitted to the government for approval as the project has recently been suspended for financial reasons; and

(ii) the operation and maintenance and rationalisation of real estate owned by the Czech Republic/Ministry of Industry and Trade (to result in one central administrative building instead of the current twelve). The concession project document has been prepared but not yet submitted to the government for approval.

Various other potential PPP projects have been mentioned in the Czech press. Additionally, new regional PPP projects are planned, eg in Kopřivnice and Třebíč.
(d) D3/R3 PPP project

Given its particular size, the PPP project for the construction, maintenance and operation of selected sections of the D3 motorway and the R3 speedway is worth considering in detail. As mentioned above, it is expected to involve the financing, construction, operation and maintenance of approximately 27km of motorway, as well as the operation and maintenance of approximately 42km (with an expected capital expenditure of EUR 436 million. Its main features are expected to be as follows.

(i) the project is a design, build, operation and transfer model (with transfer of ownership to the State at the beginning of the project);

(ii) the operating phase will be 30 years from the start of operations or from the assignment of each functional section;

(iii) the private partner will bear the construction, availability and service risks, but not traffic risk, which will be fully borne by the Czech state; and

(iv) the project will be structured on an availability payment basis.

Future LPPs

The competitive dialogue process will be used by the State to determine whether to award one contract for both the new-build and the existing roads, or two separate contracts.

(e) Future PPPs

It is possible that when the Czech Republic’s access to EU funding becomes more limited after 2013, this may increase the appetite for PPPs. Due to the financial crisis it is also expected that there will be a shortage of available public finance (in particular, after certain big privatisations are completed and the proceeds spent). The impact will be particularly felt in the transport sector – at the moment, significant finances go into transport (tolls from toll road users, EU funds and proceeds from privatisations) and a shortage of finance is already being experienced.

3. Legal, regulatory and institutional framework

3.1 The Concessions Act

(a) Scope/subject matter of the Concessions Act

The Concessions Act which became effective on 1 July 2006 regulates the conditions and procedures applicable to contracting authorities (the Authorities) when entering into concession contracts within the framework of co-operation between contracting Authorities and other persons (unless a specific law, such as the Public Roads Act, contains special conditions and procedures).

The Concessions Act, however, does not only apply to concession contracts. Several provisions of the Concessions Act (eg those related to a concession project document and approval of a concession contract) also apply to generic publicly procured contracts where their value exceeds the relevant statutory limit, provided that the contracts are entered into for a specified period of at least five years and the supplier bears certain economic risks linked to the performance of the contract (which are otherwise customarily borne by the Authority (public contracts for public procurement).

To determine the extent to which the provisions of the Concessions Act apply, it is important to classify a contract as either a concession contract or a public contract for public procurement. As Czech law does not have a legal definition of PPP, it is unfortunately not always clear if a particular contract is a concession contract for a PPP or a public contract for public procurement.
The Concessions Act covers both the contractual and institutionalised form of co-operation between public and private partners but only deals briefly with PPP project special purpose vehicles (SPVs). In particular, Section 13 specifies the circumstances in which a contracting Authority may enter into a concession contract with a party which has not taken part in the concession award process.

The expected value of a PPP project must be determined before initiating concession proceedings. It is determined on the basis of a specific formula which is set out in a separate implementing regulation (No. 217/2006 Coll.). If the expected total revenue of the concessionaire over the term of the contract is less than CZK20,000,000 (approximately EUR749,000) (excluding VAT), the contracting Authority is not required to follow part of the Concessions Act related to the concession proceedings.

(b) Parties to a concession contract

Both the Public Procurement Act and the Concessions Act specify which types of public entities are able to enter into concession contracts. The types of entities envisaged are broadly the same. In particular, Section 2 of the Concessions Act specifies that the following parties may constitute a contracting Authority:

(i) the State of the Czech Republic;

(ii) institutions receiving contributions from the State Budget (státní příspěvková organizace) (eg certain large hospitals);

(iii) regional self-governed administrative units (územní samosprávný celek) or institutions receiving contributions from the budget of their founding regional self-governed administrative unit (příspěvková organizace) (eg regional hospitals and state schools (excluding universities);

(iv) other generically defined entities established to provide public services, if they are financed (at a minimum of 50%), or “controlled”, by an Authority (eg certain utility companies owned by municipalities); and

(v) a group of the above parties or a group of persons created for the purpose of running a joint procedure to select a concessionaire where at least one member of such a group is one of the above parties.

(c) Award procedures

The award procedures for PPP projects are based on the same principles as the corresponding types of award procedures set out in the Public Procurement Act. In fact, most of the procedural rules are incorporated into the Concessions Act by way of reference to the Public Procurement Act. The Public Procurement Act covers all the standard award procedures provided for in the currently applicable EU directives.

Although the selection of a private partner is governed by a standard public procurement regime, introduced in line with the European directives, the cross-references between the Concessions Act and the Public Procurement Act may make the tendering rules rather difficult to comprehend for bidders. The option of a competitive (or concession) dialogue is also explicitly endorsed. This allows for a high degree of flexibility and effectiveness in selecting the private sector partner for more specialised projects or where a unique solution to public needs is sought. However, this process seems to offer only limited protection for bidders intellectual property and specific know-how, as well as being costly for competing bidders.

(d) Major Concession Contracts

Major Concession Contracts (such as the D3 and R3) are defined in Section 20 and subsequent sections of the Concessions Act as concessions contracts which reach certain financial thresholds based on the expected total revenue of the concessionaire. The thresholds vary depending on the
type of Authority involved and range from an overall revenue over the term of the contract of CZK50,000,000 (approximately EUR1,872,660) for a municipality with up to 25,000 inhabitants, to CZK500,000,000 (approximately EUR18,726,600) for the State of the Czech Republic.

Before private partners are invited to submit their bids, the Authority is required to prepare a concession project document based on a detailed analysis of the concession project (koncesní projekt). The analysis must include a basic description of the activity which will be the subject matter of the concession agreement, a basic description of the economic terms and legal relationships arising from the performance of the concession contract and an economic assessment of procuring the activity by concession contract. The detailed requirements are set out in a separate implementing regulation (No. 217/2006 Coll.). Detailed analysis must also be prepared for each public (non-concession) contract to which the Concessions Act applies (ie not only Major Concession Contracts).

Based on the results of the concession project document, the relevant approving entity/body will decide whether or not a concession project document is to be implemented by the Authority in the form of a PPP and, if applicable, potential private partners will then be invited to submit their bids.

After a private partner is selected, a Major Concession Contract needs to be approved by a qualified entity/body (as defined in Section 23 of the Concessions Act) (eg where the State of the Czech Republic is the contracting Authority, the concession contract is required to be approved by the Czech government). If the concession contract is not approved, the Authority is required to cancel the concession proceedings.

(e) Concession contract

A concession contract forms the basis of co-operation between the public and private partners and for all related contracts (such as loan agreements, purchase agreements and insurance contracts). The Concessions Act sets out some requirements and limitations for these contracts in Section 16 and subsequent sections.

Under a concession contract, the concessionaire provides services or also carries out works for the Authority and in exchange obtains a benefit from providing such services or such works, which may include consideration in monetary form. The concession contract must be in writing and is governed by the relevant provisions of the Czech Commercial Code.

A concession contract is required to:

(i) stipulate that a significant portion of the contractual risks are borne by the concessionaire in exchange for obtaining the contractual benefits;

(ii) set out the allocation of other risks between the Authority and the concessionaire;

(iii) be entered into for a specified period;

(iv) set out early termination events; and

(v) specify the legal ownership of assets which are to be used in the project and any transfer rules applicable following early termination.

It was initially assumed that prior to the Authority and private sector party entering into a concession contract, all concession contracts would have to be formally approved by the relevant public authorities. However, this requirement has only been retained for Major Concession Contracts as set out in Section 23 of the Concessions Act.

(f) Capacity of Authorities to enter into concession contracts

Under Section 17(1) of the Concessions Act the Authority has capacity to enter into concession contracts “unless such capacity is excluded by a specific or sector law”. Such exclusions could be express or (indirectly) implied and need to be analysed on a case-by-case basis. Particular caution is recommended in relation to the education and healthcare sectors.
Section 19(1) of the Concessions Act confirms that, when concluding concession contracts, Authorities may agree to make future payments or deliveries which are not covered in the current budget.

(g) **Collection of charges from users by the concessionaire**

If any fees/tolls are to be collected directly from public end users in connection with a concession contract, it will be necessary for Parliament to adopt appropriate statutory regulations and to define the fee regulation method, because standard fees and taxes can only be imposed by law in the Czech Republic. Tolls/fees under concessions must, therefore, be permitted by law and their legal regime (including the determination of the amount of fees/tolls) must be clearly set out.

Under the Concessions Act, the Authority can enable the concessionaire under the concession contract to levy and collect charges from users only if the Authority is expressly entitled to do so by law. This is the case in respect of tolls set out in the Public Roads Act.

(h) **Liability for damage caused to users**

Under Section 19(3) of the Concessions Act the Authority is liable to users for any damage they suffer due to the concessionaire in direct connection with the latter’s provision of service to the users.

(i) **Risk sharing**

In the Concessions Act neither risk sharing nor limits on liability are actually covered. It merely states that the private partner shall bear a substantial portion of the risks in exchange for enjoying the benefits of the provision of the relevant services or utilising the relevant works (eg the collection of fees – Section 16(2) of the Concessions Act). The detailed risks associated with a particular concession project will be allocated between the contracting Authority and concessionaire in the concession contract.

(j) **Fiscal discipline**

Concession contracts may affect the financial management of central as well as local state bodies and the use of central/local government budgets. For this reason, concession contracts must comply with rules relating to the management of financial funds of such central/local government bodies set out in Act No. 218/2000 Coll., on Budget Rules (as amended) and Act No. 250/2000 Coll., on Budget Rules Applying to Regional Budgets (as amended) (together the **Budget Acts**).

The relevant Budget Acts have been amended to ensure that mid-term obligations of the public sector resulting from concessions contracts are recorded, monitored and subject to transparent evaluation during the term of the contract at both a local and central government level.

Separately, the Ministry of Finance should also issue an opinion in respect of entry into a concession contract (or an amendment to such a contract) by a regional self governed administrative unit such as a municipality (and other Authorities linked to a regional self-governed administrative unit). If this opinion is not provided, the concession contract or the relevant amendment will be invalid. The opinion of the Ministry of Finance need not however be favourable.

Authorities are also required to ensure that their balance sheets contain a breakdown of items related to the activities connected with the subject matter of the concession contract, as well as items related to other activities.

(k) **Concessions Act – miscellaneous**

The Concessions Act further regulates a number of specific issues such as the concession contracts register (which is a publicly accessible register containing all relevant information regarding the concessionaires, including the estimated value of the contract, the date of concluding the contract and its duration, as well as basic corporate information about the concessionaire), publication requirements and supervision by the Office for the Protection of Economic Competition.
3.2 Public Road Act

The Czech legal system contains only one sector-specific area where co-operation between the public sector and the private sector is based on broadly perceived principles of PPP and where the concept of a concession is recognised outside the Concessions Act. This is in the area of construction, operation and maintenance of highways under the Public Road Act No. 13/1997 Coll. (as amended) (the Public Road Act). Initially, it was expected that the relevant provisions of the Public Road Act would be abolished after the Concessions Act was adopted. However, according to the Concessions Act, these rules remain in force as specific rules for the area of highway construction.

Section 18a (and subsequent provisions) of the Public Road Act contain fairly detailed rules as to what the concession contract should contain when it relates to the financing and procurement of the construction, operation and maintenance of highways and first class roads. The concessionaire in such a project must be selected via public procurement proceedings.

3.3 Other applicable legislation

Other issues concerning PPP projects are indirectly regulated by a number of laws, mostly in a way that is not conducive to the successful development of co-operation between the public and private sectors on a PPP basis.

(a) Public procurement

As in the rest of the EU, PPP projects represent public procurement in the broad sense under Czech law and the Authority must comply with the provisions of the Public Procurement Act. The Public Procurement Act became effective on 1 July 2006 and was adopted in order to fully harmonise Czech public procurement law with the concepts and principles of EU public procurement legislation.

(b) State owned property

Property acquisitions, ownership transfers and other transactions concerning the State’s property usually play a key role in the establishment and implementation of a PPP project. As such, Act No. 219/2000 Coll., on Property of the Czech Republic and its Position in Legal Relationships (as amended) (the Act on Property) will apply. This regulates the methods of, and conditions applying to, the management of the State’s property and the State’s status in legal relationships and seems unduly restrictive in some respects (eg Section 27 of the Act on Property sets out various limitations on organisational units of the State when entering into lease agreements).

(c) Bankruptcy regime

Contrary to its initial intention, the Concessions Act does not contain any special provisions in the event of insolvency proceedings concerning the private party to the concession. Concessions concluded under the Concessions Act are therefore not exempt from the provisions of the Insolvency Act (No. 182/2006 Coll. (as amended)), which provides that an insolvency administrator may withdraw from a bilateral contract that has not been fully performed by either party. Similarly, all other provisions of the Insolvency Act apply to concessions without any exemptions, granting the Authority no special treatment within its creditor class.

3.4 Future legislative changes

The new framework should be sufficiently workable to facilitate most PPP projects currently planned. Looking ahead, further developments seem necessary to implement new PPP projects, such as the enactment of sector-specific rules on the exploitation of concessions and the implementation of a framework for the operation of institutionalised PPP projects (ie projects where the public service is provided by a jointly owned public-private entity).
Czech Republic

The draft of a new act on public concession procurement has been prepared by the MoRD. It is intended to replace the Concessions Act. The draft is currently being commented on by various ministries and other public and professional bodies. At this stage it is difficult to foresee when the draft act will become law, particularly as Parliamentary elections are scheduled to take place in the Czech Republic in May 2010. Tax and accounting rules also need to be amended so as not to limit the development of PPP projects.

4. General structure of concessions

The Model Concession Agreement (version 1.1 – April 2006), which is governed by Czech law, was created by the Ministry of Finance of the Czech Republic and PPP Centrum based on standard forms and transaction precedents used abroad, in particular in the United Kingdom, for accommodation projects (such as schools, hospitals, administrative buildings and prisons). This sophisticated document which is fairly extensive compared to typical Czech law documents is to serve as a starting point for drafting concession contracts. In practice, given the value of the projects for regional PPP projects, the Model Concession Agreement has either been used in part or not at all. However, the Model Concession Agreement could be used as a negotiation tool.

The Model Concession Agreement is being used in the CMH PPP project.

4.1 Changes

Any Authority will want to retain maximum flexibility at all times, including when entering into a long-term service contract with a concessionaire.

The position in the Model Concession Agreement is that the concessionaire is obliged to carry out any change requested by the Authority, save that it is entitled to refuse change requests in certain circumstances (eg where the risk profile of the project would change as a result). If the concessionaire is required to carry out a change to the project, it should be left in a financially neutral position as a result of the change being effected. The concessionaire may seek compensation from the Authority, together with temporary relief from its performance under the concession contract, as well as contractual changes in order to maintain its position.

4.2 Supervening events

Supervening events are used to contractually establish the level of relief or compensation that the concessionaire should be granted during and following certain events. The commercial parties are free, therefore, to set out and agree in the concession contract how and when any relief mechanisms should apply.

The Model Concession Agreement contains a range of terminology for describing and dealing with supervening events that delay either progress of the project or the delivery of the services to be provided under the concession contract. Broadly speaking, supervening events for which some form of relief should be provided to the concessionaire under the contract are divided into three categories:

(a) Compensation events – events at the Authority’s risk that give rise to relief for the concessionaire through both time and money (ie increased costs and loss of revenue), broadly reflecting all of the concessionaire’s losses. Unsurprisingly, the scope of compensation events is extremely narrow and is restricted to breaches of the Authority’s obligations and certain actions by the state authorities;

(b) Relief/delay events – events whose consequences the concessionaire is expected to manage financially, but in relation to which relief from termination is granted, as well as an extension to any time limit for completion of construction works (but not a right to any additional compensation); and
(c) **Force majeure events** – events which the concessionaire is expected to manage but in relation to which, amongst other things, relief from termination is granted. Unlike with relief/delay events, the extended subsistence of a force majeure event can lead to termination of the concession contract by either party. The subsistence of a force majeure event should not result in a proportionate suspension of the payment mechanism during the force majeure event.

To the extent that any other event arises during the term of the project that is not a compensation event, relief/delay event or force majeure event, such event will typically be a risk borne by the concessionaire under the terms of the Model Concession Agreement for which it will not benefit from any form of relief.

### 4.3 Change in law

The extent to which the concessionaire is protected against changes in law will typically be dictated by the nature of the project. A summary of the approach contained in the Model Concession Agreement is set out below.

**Change in Law** risk is divided into two main categories:

(a) **Qualifying Change in Law** which consists of:

(i) Discriminatory Change in Law – changes in law which are (broadly) targeted at the project, the concessionaire or companies providing similar services to those being provided under the concession contract; and

(ii) General Change in Law (ie any change in law which is not a Discriminatory Change in Law) provided that as a result of such General Change in Law capital investments must be carried out during the concession period; and

(b) any other General Change in Law.

The concessionaire may claim compensation under the concession contract in respect of any Qualifying Change in Law. However, the concessionaire will take the risk of General Change in Law (which is not a Qualifying Change in Law).

### 4.4 Early termination and compensation

The Model Concession Agreement distinguishes between early termination events that are caused by the Authority (such as non-payment or expropriation of a material part of the property of the concessionaire or sub-contractor), those that are caused by the concessionaire (principally relating to poor delivery of the service but also credit-related events) and those that are not attributable to either party (such as force majeure).

Early termination compensation would, based on the Model Concession Agreement, be paid on the basis described below.

(a) **Concessionaire default** – the market value of the remaining cash-flows under the project, less costs to be incurred (being costs to deliver the service and to complete construction and/or restore the service to the contracted level) are assessed. The assessment is done in one of two ways. First, if there is a liquid market for projects of a similar nature, then the Authority may conduct a competition to find a replacement project company and pass on any payment made by the winner of that competition (the value of the net cashflows, discounted by that bidder) to the concessionaire. Secondly, if there is no liquid market, a desktop analysis by an expert who assesses what payment would result if such a competition were run.

(b) **Authority default** – the concessionaire will have the senior debt outstanding reimbursed and any redundancy costs paid. In addition the concessionaire will receive an amount that compensates it for the loss of its future equity return. For this amount, the Model Concession Agreement contains three alternative approaches which should be chosen by the Authority.
(c) Force majeure – the concessionaire is paid an amount equal to the senior debt outstanding and any redundancy costs. In addition, the concessionaire is paid the nominal amount of equity and subordinated debt initially invested in the project, less any equity return paid up to the date of termination.

(d) Corrupt gifts and fraud – the concessionaire is paid an amount equal to the senior debt outstanding.

(e) Breach of refinancing provisions – the concessionaire is paid an amount equal to the senior debt outstanding.

4.5 Remedies

Under the Model Concession Agreement, the operation of the payment mechanism should be the Authority’s sole remedy in relation to a failure by the concessionaire to provide the services under the concession contract. Ensuring that the sole remedy principle is not compromised requires a complex legal analysis of the Authority’s rights under the concession contract and rights available as a matter of law (eg right to claim damages). Not protecting this principle could expose the concessionaire to risks that have neither been priced nor passed down to the sub-contractors.

4.6 Refinancing

Under the Model Concession Agreement, 50% of refinancing benefit (defined broadly as an increase in the concessionaire’s equity-related returns) must be paid to the contracting Authority. Certain types of refinancing are prohibited.
...those who wish to turn the fate of mankind for the better must undertake some risks.

István Örkény (1912-1979)
1. Introduction

Since their appearance in Hungary well over a decade ago, PPP projects have become one of the main legal structures for infrastructure development in the public sector. The most active sectors are the road, health and cultural sectors as well as education and sport.

The PPP sector remains active. Notable infrastructure projects such as the M3 motorway between Nyíregyháza and Vásárosnamény, the M44 between Tiszakürt and Kondoros and the M60 between Pécs and Szentlőrinc are planned or already being implemented.

2. Legal and regulatory framework

2.1 Contracting Authority

PPP projects have so far been mostly procured by central government, but can also be procured at local/regional government level. At central government level, the decision to launch a particular project is typically within the remit of the Government or the Parliament, depending on the project value, and there are certain procedures which need to be followed (see below). Ownership of a project usually lies with the relevant Ministry, but several organisations (eg offices, committees, etc.) have been established to manage particular projects. If the project is developed at a local or regional level, the decision to carry it out is made by the relevant municipal body, although such structure is less likely to be categorised as a “classic” PPP solution. The contracting authority (Authority) is typically the State, a Ministry or a local or regional governmental body. It could also be an agency, such as the National Development Agency (Nemzeti Fejlesztési Ügynökség) if supported by appropriate authorisations and guarantees. However, agencies are more usually in charge of preparation, consultancy and other ancillary tasks, as opposed to entering into PPP contracts in their own name.

2.2 Background law

There is no specific PPP act in Hungary, nor are there plans to adopt such an act. PPP projects in Hungary are regulated under the framework of long-term liabilities undertaken by the State of Hungary. The relevant legislative background is set out in the following acts and subordinate legislation:

(a) Act IV of 1959 on the Civil Code of Hungary (Civil Code);
(b) Act XXXVIII of 1992 on Public Finances (Public Finance Act);
(c) Act CXXIX of 2003 on Public Procurements (Public Procurement Act) and its various subordinate execution decrees;
(d) Act XVI of 1991 on Concessions (Concession Act);
(e) the annual State budget acts; and
(f) numerous Government resolutions in connection with specific projects or areas to be developed in the PPP framework.

Whilst there is no legal definition of PPP under Hungarian law, “classic” PPP projects are considered to be projects that meet the following four criteria: (i) they provide a public service previously provided by a state monopoly; (ii) the private sector delivers and operates (and sometimes finances) the infrastructure asset; (iii) the remuneration of the private sector party is often linked to performance; and (iv) the public sector monitors cost and performance closely. Regional/local government projects may not meet the first criterion.
2.3 Project approval process

(a) Financial requirements

State budget deficit and public borrowings have been key issues in Hungary over the past couple of years. Under the Public Finance Act, the annual budgetary commitments of State institutions may be exceeded upon an individual decision of the Government, or, if the commitment exceeds HUF50 billion, the Parliament. The financial implications of a PPP project are carefully examined before the approval of any PPP project by the Government or the Parliament as applicable. The maximum payment fund for all PPP projects may not exceed 3% of the State’s budgetary income per year. The current limit laid down in the annual State budget act for 2010 is HUF238.4 billion (approximately EUR860 million).

In order to observe and monitor the budgetary commitments with regard to the projects in question, the relevant Ministry responsible for the particular project should brief the Inter-Ministerial Committee (see below) during the life of the project on a yearly basis, which in turn should prepare yearly reports based on these briefings.

(b) Presentation of the agreement to the Government

Commitments for payments in excess of those budgeted for in the relevant year may only be assumed if they can be financed without jeopardising fulfilment of the obligations of the relevant State budget entity at the time of the commitment.

The agreements with the private sector may only enter into force upon obtaining the approval of the Government, unless the Public Finance Act prescribes Parliament’s approval (see below). If the approval of Parliament is needed for the agreement to enter into force, the project should be developed and presented to the Government according to a timetable which would enable the Government to deliver a preliminary decision to Parliament in support of the project (bearing in mind the main components of the development, financial needs and their timing).

(c) Presentation of the agreement to Parliament

As mentioned above, the Public Finance Act states that if the aggregate amount of the project is HUF50 billion (approximately EUR180 million) or more, the Government should ask for Parliament’s approval in order to enter into such an agreement. The request should include the relevant provisions of the agreement, the need for State financing, its timing and the amount.

2.4 PPP bodies

(a) PPP Inter-Ministerial Committee

Over the past few years the PPP Inter-Ministerial Committee established by Government Decree 2098/2003 (29 May), superseded by Government Decree 2028/2007 (28 February), (the Committee) has administered, managed and supervised PPP projects in Hungary. The Committee consists of six members: a representative of each of the Ministry of Finance, the Ministry of Justice and Law Enforcement, the Ministry of the Economy and Transport, the Prime Minister’s Office, the National Development Agency and the Hungarian Central Statistical Office. The chairman of the Committee is the administrative secretary of the Ministry of the Economy and Transport.

The Committee’s task is to establish the background and prerequisites for the introduction of PPP structures in Hungary and to circulate information in relation to PPP structures within the public administration framework. The Committee also reviews and comments on the plans for PPP projects which have already been conceptually developed before they are submitted to the Government or Parliament depending on the value of the public sector’s commitment. Furthermore, the Committee is responsible for monitoring and evaluating project implementation.
In connection with commenting on PPP project proposals, the Committee worked out a scheme of requirements and also a set of procedural rules relating to PPP projects.

(b) Secretariat of Public Private Partnership (PPP Secretariat) of the Ministry of the Economy and Transport

To promote the adoption of PPP structures in Hungary, the Ministry of the Economy and Transport established the PPP Secretariat as a unit of the General Directorate of Development Projects. One of the main tasks of the PPP Secretariat is to support and provide assistance to the PPP Inter Ministerial Committee. This task covers commenting on documents submitted to the Committee, maintaining contact with ministries and other governmental bodies as well as preparing for professional debates held in connection with the legal and procedural issues to be addressed by the Committee. The PPP Secretariat also reviews the legal and financial aspects of PPP structures, carries out co-ordination duties and provides assistance to the Ministry of the Economy and Transport during the initial phase of PPP projects.

2.5 Public Procurement Act

Most projects implemented using a PPP structure are subject to the Public Procurement Act. Public procurement rules shall apply if the contracting authority (the State, regional or local authorities, etc.) enters into a contract with the private sector for consideration exceeding a specific value and entered into for (i) the supply of goods, (ii) construction, (iii) a construction concession, (iv) the provision of services or (v) a services concession.

One of the most important questions to be clarified in the case of PPP projects is to determine the body of rules applicable to the procedure in question, depending on whether the procedure relates to a supply contract, a construction contract or a services contract.

The answer to this question is often not straightforward because most PPP projects involve complex matters and normally involve a contract for supply, building and services. A BOOT contract relating to real estate, construction and management, for instance, contains elements of all three. According to the Hungarian rules, if the contract necessarily involves more than one matter, the contract has to be qualified in accordance with the matter of greatest value, and the rules applicable to this type of contract will govern the procedure.

The procedure may be (i) an open procedure, (ii) by invitation, (iii) a negotiated procedure or (iv) a competitive dialogue. Competitive dialogue, a new type of public procurement procedure, has been available since January 2006.

The competitive dialogue procedure may be applied if:

(a) the Authority is either unable to elaborate on the technical specifications or unable to elaborate them at a level of detail required for the open or restricted procedures; and

(b) the Authority is unable to identify the type of legal and financial criteria relevant to the contract or is unable to identify them at a level of detail required for the open or restricted procedures.

Under the Public Procurement Act, as of 1 April 2009 the winning bidder may establish a project company. However, the winning bidder remains jointly and severally liable for the obligations of the project company. This significantly differs from deals which are not publicly procured, where the parent company is not liable for the obligations of its subsidiary/project company, although lenders may ask for parent guarantees or similar instruments. As far as concessions under the Concession Act are concerned, a concession company must be established by the winning bidder after winning the tender, but it does not share joint liability with it.

Under the Public Procurement Act, the equity interests in the project company may not be transferred, nor may the project company be merged, demerged, transformed or wound-up. If either the winning bidder or the project company becomes insolvent the other will remain liable for the project due to their joint and several liability.
If the winning bidder is a consortium, the consortium will remain jointly and severally liable for the obligations of the project company. It is up to the consortium members how they apportion this liability amongst themselves. In the absence of any agreement, their liability to each other will match their respective participation in the project company.

2.6 Concessions

Concessions have historically been regulated in Hungary by the Concession Act. The Concession Act lists all of those activities which fall under its scope:

(a) national roads and appurtenances;
(b) sewage systems;
(c) mining and related activities;
(d) transmission pipelines and storage;
(e) radioactive material production and trade;
(f) gambling; and
(g) public transportation by trolley-bus.

The Concession Act’s principal aim is to provide private parties with an exclusive right to manage certain assets exclusively owned by the state or local governments, where those assets can be managed more effectively and economically by private parties. As such, it can be regarded as a certain type of PPP project. The carrying out of these activities by private parties is always subject to the rules and regulations set out in the Concession Act and is subject to a concession tender. The maximum term of a concession is limited to 35 years and can only be extended once, by half of the original concession period.

If the particular construction concession or services concession is subject to both the Public Procurement Act and the Concession Act, the Concession Act must be applied with certain differences laid down by the Public Procurement Act.

2.7 Long-term commitments by the State

Enforceability of the State’s long-term civil law commitments is ensured under the Civil Code. The State must fulfil its compensation, reimbursement and restitution obligations as well as its contractual obligations towards persons acting in good faith, even if the budget allocated to such commitments is insufficient. This is commonly accepted by lenders in PPP projects.

3. Active sectors

3.1 Roads

In PPP structures, the M5 motorway and the first phase of the M6 motorway became operational on 11 March 2006 and 13 December 2006 respectively. The second and third phases of the M6 motorway are being implemented.

3.2 Health

In the last couple of years Hungary has seen smaller-scale projects for the reconstruction and long-term operation of heat provision for hospitals whereby a private party chosen in a public procurement tender procedure reconstructs and operates the boilers and related pipelines of a particular hospital.
Hungary was amongst the first in the Central and Eastern European region to allow private capital and experience into the provision of medical services. During the early 1990s the first privately owned CT and MRI diagnostics centres were established, and long-term service contracts have been entered into by the National Health Fund (OEP) under which the OEP pays private service providers for services rendered according to a points system determined by the relevant laws.

3.3 Education

One of the most active sectors in Hungary so far has been higher education, with more than 30 dormitory or university campus construction projects and other research and educational infrastructure developments. These projects were implemented within the framework of the so-called “Universitas Program” run by the Ministry of Education and Culture with a view to attracting private capital for reconstructing university dormitories. The dormitories are developed and operated by private companies for an agreed term in return for an operation and maintenance fee.

3.4 Sport

Several swimming pools and other sports facilities were implemented within the framework of the National Sport Office’s (NSH) plan. The NSH provided assistance for the local governments tendering these projects. More than 100 swimming pools and other sport facilities were built using a DBFO structure in 2005 and 2006.

3.5 Culture

In 2005, a cultural centre in Budapest, the so-called “Palace of Arts”, was built under a PPP scheme with a major investment by Hungary’s Trigánit Rt. The Hungarian State pays an availability fee to the private operator for the operation and maintenance (in accordance with agreed performance requirements) of this state of the-art building in which the Ludwig Museum, the National Concert Hall and the Festival Theatre have established their new homes.

3.6 Prisons

Two prison projects under the supervision of the Ministry of Justice have recently been implemented and these prisons are now operated under a PPP structure. The private party of the project is responsible for the building, operation and maintenance of the prisons, including provision of prison guards and catering services.

4. Future sectors

We expect that infrastructure and education will continue to be active sectors and will lead the way in attracting private capital within this framework. According to the most recent annual report of the PPP Inter-Ministerial Committee (published in 2009), further areas of activity could be:

(a) development of the national railway network with special emphasis on certain high speed rail links, such as the proposed rail link between Budapest and its Ferihegy International Airport (FEREX);

(b) development of a national electronic road toll payment system;

(c) development of the Governmental Quarter (headquarters of various ministries) (currently on hold);

(d) development of public utility networks (water, sewage) by local governments;

(e) construction of gymnasiums and other types of secondary schools, university buildings and dormitories;

(f) reconstruction and operation of the Supreme Court and other court buildings;
(g) private healthcare services; and
(h) construction of larger-scale sport facilities such as a new national stadium in Budapest and a world-class watersports centre.

5. General structure of concessions

5.1 Scope of service
The scope of service largely depends on the type of the project. Current and future projects are mostly being realised on the basis of a classic DBFO structure. In case of concessions, a single concession contract is entered into between the public sector and the private sector for transferring the right to carry out certain activities within the scope of the Concession Act or the Public Procurement Act. Accordingly, the project documentation of a concession type structure typically consists of: (i) the concession agreement (if applicable), (ii) an engineering, procurement and construction contract, (iii) an operation and maintenance contract, and (iv) related finance documents including the loan agreement, intercreditor agreement, and security documents.

5.2 Payment mechanisms
Again, different mechanisms apply to different projects. In motorway projects, typically, availability fees are paid over a certain period of time thereby shifting the traffic risk to the public sector. In the case of building developments, however, the building is typically leased by the public sector from the developer with transfer of ownership at the end of the lease.

5.3 Changes
The risk of change of law is usually shifted to the public sector. This may include both general changes and discriminatory changes in law, although a cap is often applied. Changes in the specification of the services may be initiated, to a limited extent, by any of the parties (subject to the parties' agreement) and require the counterparties' and lenders' approval.

5.4 Supervening events
In the case of supervening events, when no party is liable for the specific event which frustrates the performance of the obligation under the project agreements, the risk is divided between the parties. The parties have an obligation to mitigate the risk and the private sector is typically reimbursed for costs and is entitled to an extension of deadlines, if necessary. Concession agreements typically differentiate between compensation events, delay events and force majeure events, each of which gives rise to different types of relief, for example: additional time and money for compensation events; additional time for delay events; and relief from termination with a right to terminate in the event of a prolonged force majeure event. Careful drafting is needed to define these events and reflect the risk allocation commercially agreed by the parties.

5.5 Termination and compensation
Termination and compensation provisions largely depend on the type of project. In general, neither party is entitled to terminate the project agreement except for very limited, narrowly defined termination events due to the other parties' breach of contract and for force majeure events exceeding a specified amount of time. Causes for termination typically include the counterparty's bankruptcy, insolvency or winding up of the project company, failure to pay the fees under the agreement or stopping the construction or operation of the facilities. As mentioned above, under the Public Procurement Act, as of 1 April 2009, if the winning bidder has established a separate project company, it will remain jointly and severally liable for its project company's obligations.
Also, in motorway projects, for instance, the project documentation between the private sector project company and its sub-contractors typically includes pass-through clauses to transfer the construction and operation risk to the sub-contractors. Hence, upon any breach of the finance documents by the project company due to the sub-contractor’s breach of the project documents, the sub-contractor typically has to hold harmless and indemnify the project company; and, at the same time, the project company is entitled to terminate the project agreement.

Upon termination, the compensation scheme is usually threefold: compensation for private sector’s default, compensation for public sector’s default, and compensation for non-default (such as due to a force majeure event). The extent of compensation typically varies from paying costs to cover debt service only, to full compensation including damages, costs and loss of profit.

5.6 Remedies

Available remedies will depend on the type and particular facts of a project. Termination and sometimes indemnity are typically the available remedies. Specific performance, such as the obligation to find a replacement operator to operate a project in the event of termination is also possible, subject to the parties’ agreement. Lenders’ step-in rights to secure cashflow are generally required by lenders.

5.7 Refinancings

Refinancing is allowed in most projects, but to a limited extent only and always subject to the public sector’s approval, unless refinancing is intended to avoid bankruptcy or for similar purposes such as maintaining the project and its cashflow, in which case the provisions may be looser. The public sector party is usually entitled to a certain percentage (mostly 50%) of any refinancing gain.

6. Insolvency and security position

6.1 Common issues

There is no specific regime in relation to insolvency or the taking of security that applies to project finance or PPP structures. However, this brief overview of Hungarian security legislation is intended to address issues commonly encountered in these kinds of projects. Collateral arrangements can be flexible and can facilitate projects in general.

6.2 Scope of security

Most assets can be the subject of security interests, subject to certain restrictions. It is also possible for a company registered in Hungary to charge all of its present and future assets by way of a universal corporate security interest (floating charge).

6.3 Future assets

Future assets of the security provider can be covered automatically by the initial security agreement. The assets must be specified so that they must be existing or determinable as they arise. Some assets (eg rights, receivables and moveable assets) can be identified by way of a general description. Assets which cannot be covered automatically (eg real estate) must be charged separately under a covenant to do so, when the security provider acquires them. This may, however, involve risks of avoidance on liquidation, compliance risks and costs.
6.4 Chattels and bulk assets

Security may be created over moveable assets, including equipment, raw materials and inventory etc. Security over bulk fluctuating assets is also possible in a generic manner (eg in relation to receivables, raw materials and inventory). There are no possessory requirements. Instead, registration of the security is required in the Notarial Registry.

6.5 Particular assets

In relation to PPP, project security is not available over rights to manage non-transferable state or local government owned assets. The ability to grant security may also be restricted by the nature of the asset itself (eg restrictions in contracts or licences) or the consent of a third party may be required (eg real property leases or utilisation rights relating to the provision of services subject to concession).

6.6 Security over non-transferable state or local government owned assets

PPP projects almost always affect assets which are either in exclusive or partial state ownership and as such could entail certain restraints when it comes to providing security over these assets. Banks financing PPP projects would certainly like to have the strongest security available, which often involves mortgages. However, the Public Finance Act, Act LXV of 1990 on Local Municipalities and its various subordinate legislative decrees set out that assets in exclusive state or local government ownership cannot be mortgaged or otherwise be subject to security. These issues can be overcome (if indeed so required by the lenders) by either removing these restraints at the outset of the transaction or ensuring that other types of security provide the banks with adequate comfort.

6.7 PPP project-specific issues

As mentioned above, assets in exclusive or partial State ownership may not be charged. This is of particular concern in the case of road and rail projects where the roads and rails are owned by the State and in the case of public institutions such as courts, schools or prisons owned by the State or local municipalities. In such PPP structures the project company typically secures its loan with a parent company guarantee and charge over receivables arising from the construction and operation of the specific project, among other things.

7. Employment issues

PPP projects have a positive impact on the labour market by increasing the volume of infrastructure projects implemented at the initiative of the public sector. The development of adequate infrastructure also supports the emergence and development of businesses, including the foreign investment.

There are no particular PPP project related employment issues. Parties to a PPP project, however, should be aware that if the project is transferred to a third party, the employees whose work relates exclusively or mainly to the project must be taken over by the successor company. This requirement may be triggered, for instance, by the lenders exercising their step-in rights or a third party taking over the project. In such cases, the employment relationship of an employee established with the legal predecessor employer continues with the legal successor employer on the same terms and conditions, and the successor employer may not terminate the employment relationship for reasons connected with the takeover.
Poland

Człowiek jest wielki nie przez to, co posiada, lecz przez to, kim jest; nie przez to, co ma, lecz przez to, czym dzieli się z innymi.

A man is great not because of what he owns but because of who he is; not because of what he has but because of what he shares with others.

Pope John Paul II (Karol Jozef Wojtyla) (1920-2005)

Contact

Warsaw
Tomasz Kawczyński
Kamil Jankielewicz

Allen & Overy, A. Pędzich sp. k.
Rondo ONZ 1
34 floor
00-124 Warsaw
Poland
Tel: +48 (0)22 820 6100
Fax: +48 (0)22 820 6199
tomasz.kawczynski@allenovery.com
kamil.jankielewicz@allenovery.com
1. Introduction

The opportunities for PPP projects in Poland are considerable and Poland started to develop projects involving the co-operation of the public and private sectors relatively early in comparison with some European countries. The demand for PPP projects (especially in the road sector) increased on Poland’s accession to the European Union in 2004. However, the legal framework was not conducive to procuring projects successfully and implementation of PPP projects has consequently been slow to get off the ground, with a number of false starts, particularly in the roads sector. This is now changing, however, and with Poland being one of the largest of the EU member states, the size of the potential PPP market is significant.

Government enthusiasm to make a success of PPP has been demonstrated by its enactment of new legislation, support of the recently established PPP Centre and a statutory obligation on the Minister for Economic Affairs to gather, develop and promote best PPP practice. Potential access to EU structural funds through PPP projects is another indication that the prospects are good for an increase in PPP activities in the near future. PPP initiatives are seen as an attractive way of stimulating infrastructure investments and a way of supplementing public sector spending (including EU funds co-financing). PPP projects are also likely to be of great importance in allowing Poland to develop the infrastructure relating to the European Football Championships in Poland in 2012.

2. Legal and regulatory framework

2.1 Background

Poland is a civil law jurisdiction and in an effort to promote PPP, the Public Private Partnership Act of 28 July 2005 (the old PPP law) was introduced. It did not meet the expectations of either the public or private sector, however, and was heavily criticised for being too complex and formalistic. As a consequence, no PPP projects were procured under the old PPP law and even though it was amended in 2008, the legal difficulties and widespread aversion to developing PPP projects under it remained. Such problems highlighted the importance of a PPP-friendly legal infrastructure. To introduce changes and to meet the challenges of organising the 2012 European Football Championships, a new Public Procurement Law was adopted at the end of 2008 and the Public Private Partnership Act came into force in 27 February 2009 (the new PPP Law).

2.2 The new PPP Law

According to the commentary on the new PPP Law, its main objective is to stimulate public sector investment, particularly in infrastructure, by providing a legal framework for public bodies to participate with private entities and to remove obstacles in the current legal framework to such partnerships. In a broader context, the new law aims to remove psychological barriers to private sector involvement in public sector tasks and to safeguard PPP projects from political volatility. The new PPP Law is also consistent with the “Guidelines for successful public-private partnerships” published by DG Regional Policy in 2003.

The new PPP Law removes many obligations and obstacles envisaged under the old PPP law, eg there is no longer a need for the public partner to provide a detailed and expensive analysis of the entire undertaking in order to specify its effectiveness and identify any risks, significantly reducing potential project costs. It also specifies a shortlist of essential issues that a PPP agreement should cover to ensure that key risks are properly allocated between the partners. If the statutory requirements regarding remuneration of the private partner and the risk allocation are fulfilled, the partnership will be allowed by law.

The new PPP Law specifies which entities can take part in a PPP project. The private partner may be a Polish or foreign business entity. The procuring Authority under the contract may, broadly, be: (i) a public finance sector unit such as a central government body (eg the Minister of Finance or the Minister
of Treasury) or a municipal local government (e.g. the city of Warsaw); (ii) a specially created entity which is financed, owned or controlled by one or more public finance sector units (e.g. a special purpose vehicle owned by the City of Warsaw; or (iii) an association between units or a unit and a specially created entity (e.g. an association between two or more local government bodies). The public partner's main obligation under the PPP agreement is to co-operate with the private partner to implement the project, which in particular includes making its own contribution. The private partner is obliged to implement the project in exchange for appropriate remuneration, bear the project's costs from its own resources in whole or in part or via third party debt and then recover such costs from the remuneration it receives.

PPP projects may also be conducted using a special purpose vehicle established jointly by the relevant public and private partners (including for the purpose of financing the project) in one of these legal forms: (i) a limited partnership (spółka komandytowa); (ii) a limited joint-stock partnership (spółka komandytowo-akcyjna); (iii) a limited liability company (spółka z ograniczoną odpowiedzialnością); or (iv) a joint-stock company (spółka akcyjna). The purpose and business of such a company cannot exceed the scope specified in the PPP agreement.

As PPP projects may take different forms, e.g. BOT, DBFO, BOO, BTL or BOR, and may relate to different sectors, the definition of a public-private partnership in the PPP Law is intended to be a framework for all types of PPP projects. The PPP Law therefore focuses on two elements: the contract between the public body and private entity, and the applicable procedure for concluding such a contract.

### 2.3 Concession Law or Public Procurement Law

Two methods of awarding a project to the private partner under the new PPP Law are envisaged in two different legal acts. Both acts contain regulations about selecting the private partner. The first method is under the Act on Concessions for Construction Work and Services of 9 January 2009 (the **Concession Act**). Under the new PPP Law, the Concession Act applies if the private partner is to be remunerated from revenue generated by its exploitation of the subject of the private-public partnership, i.e. from payments made directly by the end-user (e.g. tolls for road use) or from such payments levied from end-users with an additional payment made from the contracting Authority (e.g. based on availability) provided that the payment by the Authority does not constitute the greater part of the total amount. In all other instances, the PPP agreement will be awarded under the Polish Public Procurement Act of 29 January 2004 (**Public Procurement Law**).

Current experience suggests that public entities are more willing to choose a private partner and co-operate with it under the Concession Act. As indicated above, under this form of procurement, the private investor finances the entire investment on the basis of a right to profit from the subject of the particular PPP project (e.g. a toll-funded ring road) and not from the payment coming from the public entity. Although in certain projects the revenue may also include certain payments from the public entity, the private investor assumes the commercial risk of the success of the project. In other words, public entities can procure the construction and development of infrastructure at the private investor's expense, which is of great importance in a time of economic crisis. Additionally, the Concession Act sets out a separate procedure for appointing the private investor, which is clearer than that under Public Procurement Law.

In addition to the two methods described above, it is also possible to structure a project on the basis of the Concession Act, without the new PPP Law applying.

The key characteristics specified in the Concession Act are that:

(a) the concession applies to both construction work and services;

(b) the term of the concession agreement must not exceed a maximum period, generally 30 years for concessions involving construction work only or construction work and services, or 15 years for services-only concessions;
(c) the concession agreement must cover certain issues, including a description of the subject of the concession, the construction period, the term of the concession, the method of the concessionaire’s remuneration, the allocation of risks between the parties and the conditions and procedure for terminating the concession agreement; the other terms and conditions can be shaped as the parties agree; and
(d) remuneration for the completion of the construction work and operation of those works is based on revenue from the right to exploit the constructed facility, or such exploitation right together with an additional payment by the contracting Authority.

3. PPP Centre

The PPP Centre is a new unit (established 10 July 2008), whose main purpose is to promote public-private partnerships in Poland on a non-profit basis. The PPP Centre was founded by 41 entities including banks, law firms, consulting companies, firms, regional development agencies, foundations, associations, chambers and business agencies. The PPP Centre enjoys strong support from the Polish government – presently an agreement between it and the Polish government is being drafted obliging the PPP Centre to perform the role of government agency in preparing best practice standards and promoting PPP in Poland.

The main structural aims of the PPP Centre include:
(a) preparing standard agreements and procedures and maintaining a project database;
(b) promoting ideas and knowledge-based solutions in the PPP domain;
(c) gathering and disseminating foreign experiences; and
(d) monitoring PPP investment, preparing and lobbying for legislative changes and improvements.

The 2009 work plan that the PPP Centre adopted includes:
(a) organising 16 regional conferences under the patronage of the Ministry of the Economy, with the aim of introducing PPP procedures under the new PPP law;
(b) organising a database for PPP undertakings in Poland;
(c) monitoring PPPs;
(d) co-operating with the organisation of “The PPP Good Practice Competition”;
(e) publishing activities; and
(f) training activities.

Standardised contractual terms have not yet been developed by the PPP Centre, so contract terms in projects currently in procurement are likely to be based on models used in other jurisdictions, factoring in relevant Polish law including any requirements under the new PPP Law, Public Procurement Law and the Concession Act, as applicable.

4. Current and future active sectors

The likely scope of new PPP projects in Poland can be gauged from the new PPP Law. PPP project is defined very broadly as “PPP contract-based co-operation between a public entity and a private partner, aimed at performing an undertaking based on the division of tasks and risks between a public entity and a
private partner.1 From this it is clear that the new PPP Law envisages that PPP projects will cover a broad range of sectors.

The first PPP projects under the new PPP Law are already in procurement. The local government unit in the region of Warmia (north-eastern Poland) has decided to co-operate with a private investor for the construction of a thermal swimming pool-hotel complex. The investment value is EUR35 million, half of which will be financed by the private investor.

The number of PPP projects in 2010 should increase considerably. According to public research conducted among representatives of local government units, more than half are willing to co-operate with private investors, in particular in the tourism and sports infrastructure sectors. In order to familiarise representatives with the new PPP Law, the PPP Centre (described below in more detail) has appointed several working teams to prepare forms of procedures for various types of projects, eg parking lots and railway stations. These forms aim to provide representatives and administrative officers responsible for the PPP projects with a step-by-step-guide to the procedures under the new PPP Law.

The rationale statement accompanying the new PPP Law also specifically states that the new PPP Law aims to facilitate projects to meet investment needs, eg roads, railways and environmental protection (which are necessary pursuant to EU legislation) and to improve existing services in healthcare, social welfare and public order despite pressures on public budgets. Current legislation does not allow local government units to assume financial obligations in excess of 60% of their budget. Therefore, as units are not able to take loans or credit facilities to finance investments, in many cases PPP projects are not just an option, they are a necessity.

In view of the need for development of municipal infrastructure, eg water, heating, waste water and sewerage, it is likely that PPP will be mainly used in these areas. However, projects connected with the development of the infrastructure needed in light of the approaching European Football Championships in Poland in 2012 will also represent a substantial number of future PPP projects.

The city of Warsaw alone has identified some PLN3 billion worth of infrastructure projects required, including a ring road and a new metro line. This sum relates to 15 projects which Warsaw cannot finance on its own. It therefore plans to seek private investor co-operation to develop particular investments, including: (i) underground parking lots in the city centre; (ii) a football stadium; (iii) a hospital; (iv) a tram line; (v) a system for registering and prosecuting minor offences; and (vi) a waste disposal plant. Furthermore, a company which manages Warsaw Fryderyk Chopin Airport plans to expand with the construction of an adjacent shopping mall, hotel and office building. A major part of this investment, with a total estimated value of PLN10 billion, will be procured and financed by a PPP project.

The city of Warsaw is not alone in its active interest in PPP projects. Wrocław also plans to invest in infrastructure under the new PPP Law. Private investors will be sought to construct part of a ring road, swimming pools, a cemetery and parking lots. The total estimated value of these investments is PLN500 million. Kraków intends to use a PPP to construct a ring road with an estimated construction cost of PLN3.4-4 billion.

Modernisation of the Polish road and railway infrastructure is also urgently needed as lack of investment in these sectors has been a key factor in holding back the country’s development. The use of PPP in these sectors would also increase competitiveness and encourage better co-ordination of the Polish rail and road system with the rest of the EU.

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1 This definition is defined further in the new PPP Law. In particular, the terms highlighted in bold have all been defined in the PPP Law.
The only battles lost are those that you have never started.

Mircea Eliade
(1907-1986)
1. Introduction

From as long ago as 1900, certain public services in Romania were regulated by private operators with the legal relationships involved being based on concepts borrowed from French administrative law. During the communist era private ownership of such commercial enterprises was abolished. In the early 1990s new regulations on the use of public assets were passed in the context of reorganising state enterprises into companies and the privatisation process. Specific legislation emerged regarding concessions in various sectors, in particular mining, oil and gas, transport and energy, however much of this specific legislation was repealed in 2006.

The first general law regarding concessions, Law No. 219/1998 on the regime of concession agreements was passed in 1998. Based on this law various water concessions have been entered into, eg the City of Bucharest and City of Ploiesti water services. Since 1998 the legislation on concession and public-private partnerships has flourished. However, this regulatory proliferation has often led to confusions: concessions and public-private partnerships were simultaneously regulated by the above Law No. 219/1998, the legislation on public procurement of concessions, the special Public-Private Partnerships Law (ie Government Ordinance No. 16/2002), and various sector specific concession laws.

The PPP sector in Romania is still at an embryonic stage. Although the government considers PPP as a solution for infrastructure development, as well as a stimulus for further investment and economic recovery, there have not been many significant PPP projects in Romania to date. Given the poor state of Romanian infrastructure there is great potential for growth.

Furthermore, the Romanian government has indicated that the use of infrastructure PPPs as a means of stimulating the economy is one of the main features of its strategy to deal with the economic crisis. As in many countries, the recession and limited liquidity have had an impact on both existing and potential PPPs in Romania. However, there are now some signs of changes in banks’ lending policies. It is anticipated that these changes, together with the amendments to public procurement legislation, will have a positive impact on the development of PPP. Moreover, the financial support package of EUR19.95 billion agreed by Romania with the International Monetary Fund and the European Commission in 2009 is also expected to help revitalise the PPP market.

2. Legal and regulatory framework

2.1 General legislation on public concessions

(a) The Procurement Law

As indicated, the proliferation of PPP legislation in the 1990s led to a degree of confusion. Therefore, in 2006 all specific regulations relating to PPP were repealed by the Government Emergency Ordinance No. 34/2006 on the awarding of public procurement agreements, public works concession agreements and public services concession agreements¹ and subsequent implementation norm² (the Procurement Law). The Procurement Law also implements the provisions of the European Directives 2004/18/CE, 2004/17/CE, 1989/665/CEE and 1992/13/CEE which regulate the regime of public procurement in EU Member States. Secondary regulations on procurement procedures (including the competitive dialogue process) and concession contracts (including content and risk sharing matrix) followed.

¹ Published with the Official Gazette No. 418 of 15 May 2006 and approved by the Law No. 337/2006 of 20 July 2006.
² The Decision No. 925/2006 approving the application norms of the Government Emergency Ordinance No. 34/2006 regarding the award of public procurement contracts works concession contracts and services concession contracts and the Decision No. 71/2007 approving the application norms of the provisions referring to the award of the public works concession contracts and of services concession contracts from the Government Emergency Ordinance No. 34/2006.
The core principles of the Procurement Law relate to transparency, non-discrimination and equal
treatment, mutual recognition, proportionality and efficient utilisation of public funds, as well as the
assumption of responsibility by the contracting authorities for the entire public procurement process.

(b) Contracting authorities under the Procurement Law

The following entities constitute contracting authorities under the Procurement Law:

(i) State entities such as public authorities and public institutions at central, regional or
local level;

(ii) any legal entities established to serve public interests and which are financed,
subordinated or under the administration of a State entity;

(iii) any association between entities listed under paragraphs (a) and (b) above;

(iv) any public enterprise which is active in the field of water supply, energy, transport and
postal services, whenever it lets a procurement contract concerning such services; and

(v) any other entity (other than those listed under paragraphs (a) to (d) above which carries
out activities related to water supply, energy, transport and postal services based on
special or exclusive rights granted by a competent authority.

(c) Procurement process under the Procurement Law

The new legislation no longer expressly deals with the concept of public-private partnership, nor does
it refer to such partnerships. Instead, the Procurement Law follows the EU approach and provides
rules for:

(i) public procurement contracts for works, services or goods;

(ii) sectoral agreements regarding the provision of certain public services such as water,
energy, transport and postal services;

(iii) procurement of public media and advertising services;

(iv) concessions of public works; and

(v) concessions of public services.

Under the public works concession contracts and the services concession contracts (as regulated
under the Procurement Law) one or more contracting authorities (the Authority) and one or more
operators (the Concessionaire) agree on the execution of works or provision of services in return for
which the concessionaire receives:

(A) the right to exploit the resulting works; or

(B) the right to provide the services for a pre-determined period, plus in some cases a specified
amount of money.

(d) Subsequent amendments to the Procurement Law

The Procurement Law was subject to a number of amendments in 2009, the most important changes
relate to the terms for awarding concession contracts, appealing contract awards and the judicial fees
relating to such appeals. The main purpose of these changes was to develop PPP practice in Romania,
facilitate the access of private entities to partnerships with public authorities and ensure that the
concession contracts are awarded within a reasonable time.

2.2 Specific enabling legislation

The Procurement Law must be considered in conjunction with other legislation which regulates matters
relevant to concessions, eg the regime of public assets, the administrative litigation procedure and the
local government legislation.
Special legislation has been enacted to regulate the exploitation of existing public assets by private entities which do not involve construction or the provision of a public service (such as the concession of a plot of land or of an existing building for commercial purposes only). If, however, the exploitation does involve construction or the provision of the public service then the Procurement Law applies.

2.3 Local Public Utilities

Local utilities legislation is regulated by a framework Law No. 51/2006 on local public utilities (the Local Utilities Law).

The Local Utilities Law sets out special rules for arrangements with private entities for the provision and management of public utility services, including: water supply, sewage, district heating, sanitation, public lighting, administration of public and private domain assets of the local public entities known as “administrative-territorial units”, and local public transport. Each of these local utilities is regulated by secondary legislation, which applies in conjunction with the framework Local Utilities Law. Local public utilities are directly managed by local governments under the supervision of government regulatory agencies. The local governments are directly responsible for entrusting the provision of the local public utilities to public entities.

(a) Management Delegation Contracts

Under the Local Utilities Law the local authorities may manage public services through arrangements with private entities set out in contracts for the delegation of management of public services (the Management Delegation Contract). Under this type of contract one or more authorised operators are awarded the management of the public service or a specific public activity and the concession of the related infrastructure. These operators undertake to manage and exploit the public service in exchange for the payment of a royalty to the Authority. The Management Delegation Contract also usually sets out any requirements relating to the construction of the infrastructure needed to deliver the delegated service.

A PPP mechanism applies when the operator awarded the Management Delegation Contract is organised as a company with shared public/private ownership or 100% private ownership.

Management Delegation Contracts are awarded by way of an open tender or a direct negotiation, except for certain public services, eg public sanitation, public lighting and the administration of public and private domain assets used by local public authorities, which must be delegated in accordance with the rules set out in the Procurement Law.

Subject to certain limitations under the special sector specific legislation (eg public transportation, oil and mining legislation) Management Delegation Contracts may be concluded for a period up to 49 years. The initial term may be extended once only but for a term not exceeding half of the initially agreed term, provided always that the total duration of the agreement does not exceed 49 years.

(b) Joint ventures between local public authorities and private entities

A widely used practice for partnerships between local public authorities and the private entities is the joint venture. These joint ventures are regulated by art. 251-256 of the Romanian Commercial Code (the Commercial Code), but there are no specific rules for contracting with public authorities nor for publicising existing or potential partnerships. Local government legislation however specifies that local public authorities may enter into arrangements (eg joint venture agreements) with private entities for the financing and execution of works, services or projects in the public interest.

Although it is not expressly provided under Romanian law, it is assumed that the tendering regime in relation to public domain assets that are also owned by public authorities must be followed in relation to joint venture agreements. The Romanian courts have considered such agreements on several occasions and decided that they have a mixed nature comprising both a lease and a concession. They therefore ruled that a tendering procedure should have been followed. Nonetheless,
the awarding practice for such agreements is not uniform and local authorities continue to enter into such joint ventures without any prior tendering procedure.

2.4 Active sectors and future sectors

(a) Roads

Until recently the Romanian government has chosen to finance the construction and operation of the public roads from public budgets. This policy is now no longer tenable because of the limited efficiency of this public financing approach and the relative shortage of public monies required to implement Government priorities. Additionally, it is widely thought that the failure to develop an efficient road infrastructure is hindering the country’s economic development. Therefore, the tender for the first road PPP – the A3 Comarnic-Brasov Motorway – was launched in 2007 and the concession agreement was signed with Vinci-Aktor consortium on 18 January 2010. Other road PPP projects have been announced by the government, eg the Sibiu-Pitesti Motorway, Ploiesti-Buzau-Focsani Motorway, Iasi-Roman-Tg. Mures Motorway, and Bucharest Ring road.

The estimated values of the future road PPP projects announced by Ministry of Transport are:

(i) up to EUR3.08 billion for Sibiu-Pitesti Motorway;
(ii) up to EUR2.3 billion for Ploiesti-Buzau-Focsani Motorway;
(iii) up to EUR4.4 billion for Iasi-Roman-Tg. Mures Motorway; and
(iv) up to EUR1 billion for Bucharest Ring road.

(b) Airports

The airports sector is expected to be very dynamic in future years as projects for the extension and modernisation of existing airports are envisaged.

Major current and potential projects in the airport sector include:

(i) a concession for the construction of a new departure terminal at Baneasa Airport;
(ii) the construction of a new airport in the South of Bucharest;
(iii) the Bacau International Airport Contract for the modernisation of the airport and upgrade of the landing strip awarded to Blue Air;
(iv) the extension of the Oradea Airport;
(v) the modernisation of the Airport of Sibiu; and
(vi) a concession of the International Airport of Iasi; and
(vii) the modernisation of the International Airport of Brasov-Ghimbav.

(c) Health

The main projects executed in partnership with the private sector include:

(i) the concession for part A of the Hospital for Midwifery and Gynaecology Polizu in 2004 for the construction of a private clinic within the state hospital;
(ii) the concession for the construction and operation of a private dialysis centre on a 1,500 m² plot of land at the County Hospital “Sfântul Ioan cel Nou” Suceava a for a period of 49 years;
(iii) the construction of a hospital in Timisoara;
(iv) the procurement of works and services by the Ministry of Health for the rehabilitation and modernisation of “Matei Bals” National Institute and “Victor Babes” Clinical Hospital; and
(v) the recently launched procurement of works for the improvement of the Cantacuzino Institute.

Looking to the future, the Ministry of Health has announced plans to procure the building of a public hospital based on a PPP and recently indicated that the management of this hospital would be carried out by a private entity (but not clinical services).

(d) Accommodation

The Romanian authorities have considered the possibility of developing accommodation projects using PPPs since early 2000.

Major projects to date with private partners include:

(i) the Esplanada Project for residential accommodation, offices and parking facilities in Bucharest developed by TriGranit;

(ii) several ongoing projects in the Municipality of Cluj involving the concession of land for the construction of blocks of flats, eg the concession contract awarded to Tomsa Import Export SRL and Goldprest SRL in 2006;

(iii) a number of partnerships with private entities established under the LAA project (the Local Accommodation Agency) (Agentia Locala a Locuintei) in Brasov for several projects for the construction of blocks of flats; and

(iv) the award of concession agreements for the construction of six blocks of flats in Arad to the companies Tehnodomus and Amarad Do.

(e) Defence

In Bucharest a special PPP project has been developed between the Ministry of Defence and the private company South Pacific for the construction of a residential project for soldiers.

(f) Prisons

Recently, a new law on prisons has been proposed by the government which appears to provide for the construction of prisons in partnerships with private developers. Any prisons will, however, be established based on a government decision and will be subject to the National Administration of Prisons which is established under the Ministry of Justice. Private investment should benefit this sector as the state has borne all the costs related to prisons to date.

3. General structure of concessions

As there have only been a limited number of projects in Romania, the description of the general structure of a concession draws heavily on the provisions of Procurement Law and on general Romanian contract law.

3.1 Scope of Service

The general purpose of the public works and services concession contracts is to ensure the assets resulting from the works or services are exploited in accordance with the standards and objectives imposed by the Authority. The concessionaire has the right to use and collect the proceeds from the exploitation of the assets in accordance with the concession agreement.

The specific quality requirements and standards to which the works are to be executed or services are to be provided are set out in the tendering documentation and are also included in the concession contract.
3.2 Payment mechanisms

The concession contract regulates the cost of the project so that the service provided is at a level affordable for end-users and also so that the concessionaire can afford to satisfy requirements relating to the maintenance and development of the assets entrusted to it. The payment mechanism must be structured in a way which ensures the concessionaire makes all necessary efforts to manage costs in a reasonable manner.

The concessionaire bears the largest risks in relation to the performance of the works or the provision of the services under the concession contract. The structuring of the payment mechanism varies from project to project.

If the concessionaire bears the whole operational risk, the Authority does not pay anything. The concession contract could even require the concessionaire to pay royalties to the Authority, which are set at a fixed level or as a percentage of the value of the proceeds collected by the concessionaire from the end-users of the works or services.

If the operational risk is shared by the Authority and the concessionaire, the Authority’s financial contribution during the performance of the contract, as well as any other undertakings of the Authority, must be set out specifically in the public works or services concession contract. The concession contract must also contain specific provisions regulating the allocation of the risks throughout the concession contract.

3.3 Changes

The Authority does not have the right to accept or request amendments to the contract which might result in restricting the concessionaire’s responsibilities to such an extent that the majority of the risk would be reallocated to the Authority. Additionally, the contract may only be changed if the core terms of the initial contract are not significantly amended.

Furthermore, the financial terms of the contract can only be changed in accordance with adjustment formulae specified in the contract or if certain specific events occur which require an adjustment as contemplated by the contract.

3.4 Supervening events

The parties bear the consequences of supervening events according to the risk allocation set out in the contract. The contract will specify supervening events based on the different types of risks involved and will include remedies to manage those risks.

The Procurement Law identifies the following types of risks:

(a) location risk, eg an increase in costs and increase in time necessary to complete the project;
(b) risks related to design, construction and acceptance of the works, eg a delay in carrying out the works by the required deadline, including due to an increase in costs;
(c) risks related to the concessionaire and financing sources, eg a negative impact of tax changes on the revenue of the concessionaire;
(d) operational risks, eg increases in operating costs and any negative impact on operations due to technologies chosen during the construction phase;
(e) legal and policy risks of the Authority, eg a change in legislation or political changes that affect costs and revenues; and
(f) the risks related to project assets, force majeure or project profitability, eg: loss or damage of project assets and the loss/decrease of the opportunity to achieve expected revenues.

Whilst the Procurement Law identifies a number for risks it does not address these in a binding way. The parties, therefore, negotiate the rights and obligations related to the consequences of these supervening events on a project specific basis.
3.5 Termination and compensation

According to the Procurement Law the works concession contract and the services concession contract must specify the events which can cause the contract to be terminated. Generally the concession contract will terminate as set out below:

(a) Termination upon expiry of the contract term

If the contractual term is not extended, the contract shall terminate upon the expiry of its initial term.

(b) Termination for breach of contractual obligations

(i) In the event of serious breaches by the concessionaire in the fulfilment of its contractual obligations, the Authority may unilaterally terminate the concession contract. In this scenario the concessionaire may be obliged to pay damages;

There are no specific provisions in the Procurement Law that allow for step-in rights under concession contracts. However, in view of the mandatory provisions of the Procurement Law, it could be construed that a new awarding procedure is required if the initial concessionaire fails to complete the contract, as concession contracts are awarded to concessionaires in consideration of their specific relevant qualities (the intuituu personae character of the concession contracts).

(ii) In the event of serious breaches by the Authority in the fulfilment of its contractual obligations, the concessionaire may unilaterally terminate the contract. In this scenario, the Authority will be obliged to pay damages.

(c) National or local public interest

If national or local public interest requires termination, the Authority has the right to terminate the contract unilaterally. In such circumstances the Authority will be obliged to pay the concessionaire compensation at a fair and previously determined level.

The value of damages and compensation for premature termination of a contract is a matter for contractual agreement between the parties. Whilst the parties may contractually agree on a project specific basis on approach for the Authority to calculate and pay compensation and equity to ensure the principal debt owed by the concessionaire to its lenders can be repaid, in view of the small number of PPPs executed in Romania, it is not sure whether such arrangements will be enforced by Romanian courts. Moreover, if the parties do not agree on the level of compensation the court will carry out and impose its own assessment of the level of compensation.

3.6 Force majeure

In the event of a prolonged force majeure (or an event which justifiably makes it impossible for the concessionaire to continue the performance of the concession contract) the contract can be terminated by either party, without the payment of any compensation.

3.7 Remedies and jurisdiction

The concession contract must contain adequate procedures for settling breaches of performance and quality requirements/ratios, including penalty mechanisms applicable to breaches. When specifying performance and quality requirements/ratios in the concession contract the parties must also specify from the outset the level of liability owed by the concessionaire if unexpected emergencies occur which prevent the concessionaire achieving the performance and quality requirements.

Under Romanian law disputes under the concession contracts are resolved under a special administrative jurisdiction procedure involving administrative courts. Arbitration provisions are not allowed in concession contracts.
3.8 Refinancing and additional financing

Refinancing is also subject to the risk allocation provisions set out in the concession contract. If the concessionaire is able to access financing on more favourable terms and a refinancing occurs, the Authority must share any refinancing gain as the concession contract sets out that the concessionaire cannot exclusively benefit from such a change. The basis on which any refinancing gain is shared is a matter for commercial negotiation.

If supplementary financing is necessary for reconstruction, changes or additional equipment due to changes in legislation, politics or other changes, the concessionaire may be required to procure part of that additional financing. The Authority will fund the shortfall in additional financing which cannot be covered by the concessionaire. The method by which the Authority contributes to any shortfall in funding is a matter for contractual negotiations between the parties.

3.9 Insolvency and security position

The general legislation regarding security in Romania applies to concession contracts. Romanian law allows floating charges and the ring-fencing of the project company's proceeds and assets (except public domain assets which cannot be pledged). Direct agreements providing for termination delays and step-in rights have, however, not been tested. Also, Romanian law does not currently recognise the concept of a security trustee, although it is envisaged under the new Civil Code due to enter into force in the coming years.

Concession contracts include provisions regarding the insolvency of the concessionaire. However, to minimise the risks related to the insolvency of the concessionaire the Authority carries out a thorough analysis of the financial resources proposed in the offer submitted by the prospective concessionaire. Additionally, to address the insolvency risk a performance bond, usually for 10% of the contract price, is also required from the concessionaire if the concession contract involves construction works.

The insolvency of public authorities is a novel concept in Romanian legislation. Until 2006 when the new law on local public finances (Law 273/2006 on local public finance) (the Local Public Finances Law) was enacted there was no concept of insolvency of the public authorities. The Local Public Finances Law, however, addresses:

(a) the inability of the public authority to pay its debts as they fall due, that are outstanding for more than 120 days and that exceed 50% of the annual budget of such authority (except for those that are subject to a court proceeding); and

(b) the failure to pay staff salaries as provided under the income and expenditures budget for a period exceeding 120 days from the due date.

Although the Local Public Finances Law has been enacted, the concept of the insolvency of local public authorities has not yet been tested. A new law setting out a specific insolvency regime for local public authorities is also expected to be passed by the Romanian parliament.

4. Employment issues

The Authority must set out in the awarding documentation the compulsory rules related to the specific employment protection and working conditions that are in force at national level and must be complied with during the performance of the contract. Alternatively, it must indicate the competent bodies which shall provide the “economic operators” (in practice the concessionaire) with the appropriate information regarding the respective regulations.

The Authority will require the concessionaire to demonstrate that it has taken account of the specific employment protection and working conditions requirements when drawing up its tender. Employment protection requirements provided under the Romanian labour law are in line with the EU regulations on the protection of employees in the case of a “business transfer”.
When progress and amelioration have pushed their frontiers further out, in time (to quote the calculation of philosophic brains, about five hundred years) for sure our byways will blossom into splendid highways: paved roads will traverse Russia’s length bringing her unity and strength; and iron bridges will go arching over the waters in a sweep; mountains will part; below the deep, audacious tunnels will be marching.¹

Alexander Pushkin (1799-1837)

¹ Translation by Charles H. Johnston.
1. Introduction

For the past 20 years Russia has had to rely on the deteriorating infrastructure it inherited from the Soviet Union. As the country had one of the most distressed budgets in Europe in the 1990s, Russian Government officials at the federal, regional and municipal levels deferred investment in public infrastructure (in line with the position adopted by most Western governments). New infrastructure was not provided and essential maintenance, repair and expansion of existing infrastructure did not take place. As a result, the average level of degradation of fixed assets in transport, power and other infrastructure sectors reached 60%, with the electricity grid and transport network in Russia's regions needing significant redevelopment.

It is estimated by the Russian Government that approximately USD1 trillion is needed by 2020 to upgrade Russian infrastructure to modern international standards. The investments required in Russian infrastructure are vast:

(a) USD195 billion is needed for roads;
(b) USD204 billion for railways;
(c) USD380 billion for the health system; and
(d) USD462 billion for power generation.

Although Russia's economic growth over the past few years has been stable and reached 7.8% in 2007, Russian authorities have come to recognise that they cannot finance the necessary investments in public infrastructure from current budgets and that a major part of future financing must flow from the private sector. The Russian Government has estimated that approximately 80% of the required investment should be leveraged from private investors. The need for the inflow of capital is becoming even more pressing in the current downturn in the global financial markets. As a result, the authorities in Russia are trying to offer some fiscal incentives and optimise the legal framework to encourage private investment in public assets, including by way of PPPs.

2. Legal and regulatory framework

2.1 Background

The Russian legal system is based on civil, not common, law. The current legal framework governing PPPs consists of the Constitution of the Russian Federation (the Russian Constitution), the Russian Civil Code (the Civil Code), various federal laws, decrees of the President of the Russian Federation (the Russian President), decisions and ordinances of the Government of the Russian Federation (the Russian Government) and implementing regulations, instructions and procedures adopted by federal and regional regulatory agencies, as well as municipalities.

Since Russia is a federation with a complex, multi-level system of government, all the powers in the sphere of PPP activities have been allocated to federal authorities, regions and municipalities. The federation is composed of 83 political subdivisions, each of which is an autonomous district (avtonomnyi okrug), autonomous region (avtonomnaya oblast), federal-level city (Moscow and St Petersburg), region (oblast), territory (krai) or republic (regions). Each region has a regional legislative body that has the power to pass laws providing that they do not conflict with federal legislation. Within each region there are municipalities which have their own local bodies empowered to pass ordinances which do not conflict with applicable regional and federal laws. It is generally accepted that, together with the federal government, regions and municipalities can use PPP-type structures to develop projects in the areas over which they have responsibility: they are free to decide which PPP initiatives they wish to undertake, although the choice of
regulatory framework for such initiatives, in principle, very much depends on the nature of the project and may not contradict any mandatory requirements of the federal legislation. Under the Russian Constitution, federal authorities are responsible for a number of areas, including federal transport (federal roads, railway and other federal infrastructure), the federal electricity system, nuclear energy and defence. The regions' and municipalities’ responsibilities include water policy, social housing and transport infrastructure (other than federal transport).

2.2 Legislative challenges

Particular problems regularly encountered in Russia are internal inconsistencies in the legislation and the patchy enforcement and implementation of laws, including inconsistent court practices on a number of matters sensitive for the development of PPPs in Russia, eg enforceability of certain types of security (pledges over a bank account, direct debit (or withdrawal) agreements, conditional assignments, loss payee appointments), parallel debt structures, step-in rights and direct agreements between a grantor and lenders. This characteristic of the Russian legal system partially explains why Russian PPP legislation could be regarded as a set of specific, separate regulations, rather than a detailed, coherent and comprehensive system of rules and solutions. This is something that PPP participants may have to address in all PPP sectors until an accepted solution is reached.

2.3 PPP legislative developments

Although Russia developed some experience of PPP-based projects during the 1990s, it became obvious that the successful implementation of such projects would not be effective without a more comprehensive statutory legislative package on concessions and PPP procurement. In the period from 2005 to 2008, Russian legislators introduced far-reaching changes to the legal framework applicable to PPPs, but Russia still does not have a specific law or set of rules governing all types of PPP project. However, a number of initiatives in this period have facilitated the development of PPPs, including the adoption of modern concession and investment legislation, including Federal Law No. 115-FZ “On Concession Agreements” of 21 July 2005, as amended (the Concessions Law), the implementation of the Investment Fund of the Russian Federation (the Investment Fund) (see below) and the liberalisation of sector-specific regulation, especially in the areas of energy, construction, transport and infrastructure. At federal level, the main PPP instruments are the Investment Fund and a number of state corporations, being in essence separate “special investment funds” through which the Russian Government may provide state financing to particular national projects and programmes. Examples include the preparation for the 2014 Winter Olympic Games in Sochi and the reform of housing and utilities infrastructure. Such state financing may be used for the implementation of both federal and regional PPP projects.

2.4 Advisory initiatives

There is no single central PPP policy unit to guide the implementation and promotion of PPPs in Russia. Some sector-specific ministries at the federal level and a number of regional governments have championed the formation of advisory councils, PPP forums and other entities with the aim of addressing the lack of co-ordination and consistency of approach in the PPP market, increasing competition between private sector participants and reducing transaction costs. As a result quite a few legislative initiatives have been developed recently, and a number of public forums and consultations have been held. For instance, the PPP Expert Council of the Committee for Economic Policy and Business of the State Duma of the Russian Federation has come up with a list of PPP initiatives which are intended for discussion at governmental level. The Vnesheconombank (VEB) PPP unit has arranged numerous round-tables and conferences for Russian market participants to discuss key PPP issues and share experience in overcoming associated difficulties. Although it is probably too early to speculate about the overall success of such bodies, they do raise public awareness in relation to PPP problems in Russia and provide valuable assistance to state authorities and private investors in improving the existing framework for PPP.
Various government representatives have announced on many occasions that concessions, and PPPs in general, are acknowledged and welcome in Russia. However, there is still a long way to go to create a transparent and investor-friendly legislative environment for PPP deals. Despite the existing shortcomings of the Russian legal and regulatory regimes in the area of PPPs, there have been a number of PPP projects implemented in Russia to date, as further discussed below.

3. PPP market overview

3.1 Early PPPs

PPPs emerged in Russia in the mid-1990s as an alternative to privatisation and the traditional methods of state and municipal development, financing, construction, operation and maintenance of public infrastructure. Russia has a relatively young but growing PPP market. Taking a historical perspective, about 40% of all the projects in the water supply, sewage water treatment and power sectors developed in the 1990s were completed in the form of various project financings. The first PPP projects were medium-sized regional or local projects and were structured as Build, Own, Operate, Transfer (BOOT) projects where a special purpose vehicle (SPV), wholly-owned by a private sponsor, built and acquired ownership of the completed facilities and transferred them to a state enterprise at the end of the operational phase. Those first Russian project finance deals included, for example, the project for the reconstruction of wastewater treatment plants in the South Butovo district in Moscow, the project for the reconstruction and refurbishment of the Southwest Wastewater Treatment Plant in St Petersburg and the project for the construction of a waste incineration plant in Moscow.

3.2 Recent activity

This successful initial testing of project finance techniques in relation to medium-sized regional projects and individual private projects (without any state involvement) has contributed to widespread confidence in promoting large-scale national projects using project finance, and PPPs in particular. Although there was limited PPP activity moving into the new millennium, recently, a further tier of PPPs and independent private investment projects have been coming to the market with continued investment in water and sewage treatment and an increased move into the transport, oil and gas (including both greenfield and complex brownfield projects), electricity, housing and other social infrastructure sectors. There is a strong pipeline of projects in Russia, although none of the major rating agencies has yet assigned a public rating to any Russian project finance deal.

3.3 Investment Fund

In 2006 the Russian Government established the Investment Fund to facilitate and promote PPP projects. Its size amounted to RUB69.7 billion (USD2.56 billion) for 2006, RUB95.8 billion (USD3.74 billion) for 2007 and RUB91.4 billion (USD3.7 billion) for 2008.1

Most of the current large-scale PPPs co-financed by the Investment Fund are structured as concessions or provide for direct financing of the assets under the project on the basis of an investment agreement between the relevant governmental body granting the contract (the Authority) and a private investor. Under an investment agreement, the project is partially financed by the relevant budget and/or the Investment Fund and partially by a private investor or consortium of investors. The major PPP deals being co-financed by the Investment Fund are as follows:

(a) Nizhnekamsk refinery and petrochemical complex in the Republic of Tatarstan (direct co-financing);
(b) M-1 “Belarus”, a section of the Moscow-Minsk Motorway (concession);

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(c) Moscow to St Petersburg Motorway (15-58 km) (concession);
(d) Boguchansk Hydropower and Metallurgical Complex (Lower Angara Project) (direct co-financing); and
(e) the Chita Region transport infrastructure (direct co-financing).

3.4 Developments at local level

The Russian Government’s intention is for regional and municipal medium-sized and small-scale infrastructure projects to be procured at a local level. Some regions and municipalities such as the City of Moscow, the City of St Petersburg, the Altay Republic, the Republic of Dagestan and the Tomsk Region have been quicker than others to embrace the PPP initiative. At the same time, across all regions and municipalities, the attitude towards PPPs is changing as more infrastructure needs are identified and regional and municipal authorities warm to private sector investment as an alternative to more traditional state procurement methods. Quite a few regional and municipal authorities have already used PPP as a tool for delivering public transport, airports, sea or river ports and motorway construction projects.

3.5 City of St Petersburg

The extensive experience of the City of St Petersburg in the PPP field merits a separate mention. Due to its unique location as a port city on the Baltic Sea and its relatively high level of economic development, the City of St Petersburg has recently become a leader in PPPs, pushing forward with a number of large projects:

(a) Western High-Speed Diameter Road (WHSD);
(b) Orlovsky Toll Tunnel;
(c) Pulkovo Airport Expansion;
(d) “NADEX” high-speed light rail;
(e) “Nevskaya Tower” Business Centre;
(f) “Morskoy Fasad” St Petersburg Seaport Redevelopment; and
(g) Waste processing plant in Yanino.

Three of these projects (WHSD, Orlovsky Toll Tunnel and the Pulkovo Airport Expansion projects) were initially launched as PPPs under the Concessions Law. The rest were structured as BOOT and other non-concession type PPP projects on the basis of Law No. 627-100 of the City of St Petersburg “On the participation of the City of St Petersburg in Public Private Partnerships” of 25 December 2006, as amended (the St Petersburg PPP Law). However, as a result of the financial crisis, most of the projects mentioned above have either been postponed (eg Orlovsky Toll Tunnel and “NADEX” high-speed light rail project), or have undergone restructuring (eg WHSD). Some of the above projects have been more successful eg a PPP agreement has recently been signed with regard to the Pulkovo Airport Expansion project.

3.6 Typical size of projects

The size of projects being implemented in Russia varies. At federal and regional levels, the typical size is approximately USD2 billion (though most of the large-scale projects, particularly in the oil and gas sector, substantially exceed this figure), while at the municipal level it is approximately USD50-70 million per project. It is estimated that the total value of the projects currently in procurement in Russia amounts to USD142 billion, which may be as much as a quarter of all such projects in the pipeline in Europe. However, many of these projects been put on hold. The Investment Fund has also been forced to freeze new investment projects and reconsider the financing schedule for existing projects. None of the infrastructure projects so far launched has yet been completed.
4. Concessions

4.1 Concession Agreement

In Russia, the Authority may grant a concession to a project company only by awarding a concession agreement. Granting the concession by way of a licence or special enabling legislation is not permitted under Russian law. A concession involves mutual obligations of the parties to the concession agreement, rather than an exclusive right or authorisation issued by the Authority to the project company to develop a project (as may be the case in some countries). Russian law classifies the concession agreement as a private law contract which combines several types of civil law agreements envisaged by the Civil Code.

The concession agreement entered into between an Authority and a private sector partner, often a consortium, (concessionaire) will require the concessionaire to design and construct (or reconstruct) the relevant asset(s) or piece(s) of infrastructure (concession facilities) by a certain date, operate them for a certain period of time (concession period) and transfer them to the Authority at the end of that period. The concessionaire will be responsible for the financing of the construction and operation of the concession facilities; however, the Authority may compensate the concessionaire for part of the construction and operation costs. The concessionaire may assign its rights or transfer its obligations under the concession agreement only with the Authority’s consent and only after putting the concession facilities into operation.

4.2 Concessions Law

The Concessions Law contemplates government concessions only, which means that a project will qualify as a concession only if it relates to immoveable property owned (or, if to be constructed, to be owned) by a public entity. All concessions in Russia are one-off concessions, while routine concessions from federal, regional or municipal authorities are not permitted.

Upon completion of the construction phase, ownership of the relevant concession facilities must be transferred to the Authority. Under the Concessions Law the concessionaire cannot own the concession facilities. Nor does the Concessions Law provide for structures where there is no transfer of the concession facilities to the Authority at the end of the concession period, such a structure being, in effect, a full privatisation. Hence Russian concessions may only be structured as either Build, Transfer, Operate (BTO) or Design, Build, Transfer, Operate (DBTO) projects. The Concessions Law appears not to apply to BOOT or Build, Own, Operate (BOO) or similar structures where the project asset is owned by the project company for the period of the project.

The Concessions Law fails to provide for some key concepts broadly recognised in other jurisdictions and necessary for an effective PPP such as lenders’ cure rights, step-in rights, direct agreements and transparent availability fee and termination payment mechanisms, which are currently subject to complex budgetary rules.

The Russian concession model does not contemplate any specific land, tax or environmental regime applicable to a concession project.

5. Other forms of PPP

Due to the absence of a federal law dealing with all types of PPP structures or of any other national level guidance on PPPs, regional authorities keen on using PPP structures as an alternative to the traditional methods of procuring public services and infrastructure may introduce regional PPP laws. Often such laws differ from the Concessions Law and provide for various non-concession forms of PPPs.
Some legal commentators take a liberal view that the Concessions Law is not intended to restrict PPP structures to concessions alone and that other forms of PPPs (such as BOOT) are permitted if they are authorised by the relevant regional PPP laws. However, there is still an ongoing discussion in respect of potential inconsistencies between the relatively prescriptive Concessions Law and Federal Law No. 94-FZ “On the Procurement of Goods, Works and Services for State and Municipal Needs” of 21 July 2005, as amended, on the one hand, and often more flexible regional PPP laws, including the St Petersburg PPP Law, on the other hand. So far the private sector has been left to rely on its own judgement in deciding how any such inconsistencies may be resolved. Although in the event of an obvious contradiction the federal laws prevail, there are many grey areas where inconsistencies may exist or where the regional PPP laws have a broader scope, which leaves room for debate.

By way of example, there is a risk that the inflexible tender rules for state procurement stipulated by Federal Law No. 94-FZ may apply to a non-concession PPP. At the regional level, the most developed St Petersburg PPP Law sets out the powers of the City of St Petersburg to provide budgetary funds under non-concession PPP projects which go beyond the scope of the Russian Budgetary Code (Art. 80).

6. Additional issues

A number of other important legal issues need to be taken into account when contemplating a Russian PPP, whether it is structured as a concession agreement or otherwise. We have highlighted some of them below.

6.1 Tariff regulation

The existing procedure for setting tariffs is based on the broad discretion of the tariff regulators in determining the components of a particular tariff. The calculation models used by the tariff regulators often do not take into account the economic interests of a project company and the debt service pattern of a particular project. As a result, when the applicable tariffs are decreased by the tariff regulators, the project company may face the risk of not being able to comply with its debt service obligations because of the lack of revenues generated by the project.

The Concessions Law provides that the concessionaire is entitled to request amendments to the concession agreement in the event of a negative change in its financial position due to the reduction of applicable tariffs during the concession period. However, the Concessions Law does not clarify how the concessionaire may in practice claim amendments to the concession agreement.

In addition, as the tariffs levied in Russia are denominated in Roubles, this will result in a currency mismatch for the project company whose debt obligations are in whole or in part denominated in another currency. Hedging arrangements, if available, can be prohibitively expensive in the current market conditions and, as a result, may not be available in all cases for the tenor needed.

6.2 Security

Existing security enforcement procedures under Russian law, even after recent improvements, still impede effective and quick realisation of secured assets for the purpose of satisfying creditors’ claims. The restrictions on the creation of security over certain types of assets, such as bank accounts, limit the security package available to creditors under PPP projects in Russia. In addition, the concessionaire may not grant a security interest over either its rights under the concession agreement, or the concession facilities2. It is possible to create a security governed by foreign law (except in respect of Russian real estate) but the enforcement of such security and related finance documents may still be problematic due to mandatory provisions of Russian law, especially if the project company goes into insolvency.

2 Although this position is not fundamentally different from that in some other jurisdictions.
The uncertainty over the application of the security agent concept in Russia results in the need to apply complicated legal structures in order to provide security for a debtor's obligations in favour of multiple lenders in project finance transactions. The enforceability of such structures in Russian courts is yet to be tested.

6.3 Infrastructure bonds

Infrastructure bonds (ie bonds issued specifically to finance infrastructure) have been under discussion for some time in the Russian market. Only recently, the Federal Service for Financial Markets amended its regulation on the organisation of trading in the securities market. Although the concept of infrastructure bonds has not been developed, the regulations allow for certain categories of Russian corporate bond to be entered into quotation lists of Russian stock exchanges, including “list A” (the highest standard), without complying with some of the requirements which would otherwise be applicable. This simplified listing procedure covers only bonds: (i) secured by state guarantee issued by the Russian Federation (but not one of its regions); (ii) secured by guarantee issued by the State Corporation Bank for Development and Foreign Economic Affairs (aka Vnesheconombank); or (iii) issued by a Russian legal entity which has entered into a concession agreement under the Concessions Law with either the Russian Federation or one of its regions.

In the last case, the issuer of bonds may benefit from the simplified listing exception if the terms and conditions of the bonds have been approved after the execution of the concession agreement and provide for the bond proceeds to be used for the purposes of the concession agreement. For the exception to apply, the bondholders must have a right of early redemption if the bonds are delisted, or if a party to the concession agreement has filed an early termination claim with the relevant court, or if the concession agreement has been terminated upon consent of all the parties.

According to the Russian Transport Ministry, the first offerings of infrastructure bonds to finance PPP projects are going to be launched in early 2010 in relation to the M1-“Belarus” (Moscow-Minsk) concession, the Moscow to St Petersburg Motorway (15-58 km) concession and the “Ust-Luga” sea port investment project. Russian Railways are also expected to enter the infrastructure bonds market in 2010. According to media reports, the Russian Government is ready to earmark in the relevant budget RUB75 billion and USD2.5 billion for state guarantees under the bond-financed projects. The Russian Government’s anti-crisis plan approved in November 2008 expressly mentions infrastructure bonds among other measures aimed at tackling the consequences of the financial crisis in Russia.

6.4 Anti-crisis measures

The Russian Government has not adopted a specific set of anti-crisis measures to encourage PPP in response to the recent downturn. However, certain measures have been taken in various infrastructure sectors, eg interest rate subsidies under investment credits and control over increase of tariff rates in the transport sector. The general Russian anti-crisis package provides for the support of the financial and banking system, inter alia, to make long-term money available to private investors and project companies. In order to inject liquidity into the Russian banking system VEB has obtained access to a certain part of the National Wealth Fund to be used for unsecured subordinated loans to Russian banks. VEB may also participate in PPP projects, including those co-financed by the Investment Fund. This makes VEB one of the key instruments for arranging the financing for major projects in Russia.
Prekážky treba rozbit, a nie sa im poddávat.

Obstacles are to be overcome – never surrender to them.

Milan Rastislav Štefánik
(1880-1919)
1. Introduction

Despite notable progress and the recent increasing interest of public authorities in cooperating with the private sector, PPP in the Slovak Republic is still very much in its infancy. After some initial hesitancy, the Slovak Republic successfully launched its pilot PPP projects – the first one in autumn of 2007 – but to date only one project has reached financial close\(^1\). Despite slow progress with existing PPP tenders, the public sector seems to be continuously exploring options where private sector experience and capital can be effectively utilised.

Historically, large infrastructure projects such as construction, maintenance and operation (eg of roads and bridges) have been funded primarily by the Slovak state from the state budget, loans from commercial banks, EIB and other supranationals (such as JBIC), and partially from EU funding. Similarly, schools, hospitals, transport and other sectors which typically fall within the ambit of PPP structures have been primarily state-funded, although some privately funded health centres and schools have been established on a smaller scale.

In addition, the Slovak Republic is a comparatively young country, formed in 1993 after its separation from the Czech Republic (from what was Czechoslovakia). Furthermore, the former reformist centre-right coalition had limited time to develop and implement PPP structures, preferring to focus on more urgent and fundamental reforms necessary in order to prepare the Slovak Republic for EU accession in May 2004 and for large macro-economic reforms such as tax and pension reforms.

Therefore, it was only in 2005 that the Slovak government devoted significant attention to the topic of PPP, mainly focusing its viability as a means of financing large infrastructure projects, the traditional financing of which was neither first sustainable when preparing for EU accession nor afterwards when meeting the Maastricht criteria for adoption of the Euro. It was and still is to some extent a learning process. Since 2005 the Slovak government has approved several materials and documents establishing the aims, framework and principles of co-operation between the public and the private sector in relation to PPP projects.

There is still a question as to whether the PPP model is the best model for the Slovak Republic and, if so, to what extent and in which sectors and projects PPP should be facilitated. It is, however, beyond debate that the political and to some extent economic pressure to progress rapidly with the construction of important and economically strategic roads means significant investment is required. Further, possible pressure to keep public spending under control with a view to maintaining compliance with the Maastricht criteria may also have an influence on determining the source of funding for larger infrastructure projects, particularly in times when the public budget is likely to spend more on supporting the economy through the current market situation.

2. Legal and regulatory framework

2.1 Concept of PPP

As in many other countries, PPP is a term that is applied to a whole range of ways of providing public services and public infrastructure and is used in the widest sense to describe the use of private finance in connection with the provision of public services or infrastructure under a long-term contract.

Some commentators believed (especially in pre-credit crunch times) that Slovak public finances were not under so much pressure as to necessitate the use of private finance in this manner. Others believed that

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\(^1\) The R1 motorway PPP project, described in paragraph 3.1 below.
the need for significant and perhaps long overdue investment in public services such as transport, schools and hospitals meant that the level of investment required would be too great to be sustainable without examining some alternatives that did not constitute a drain on public finances.

Therefore, some of the initial phases of discussion about PPP have focused on defining PPP, explaining the basic concept and its perceived benefits. Step by step the early discussions have evolved into the preparation of initial studies supporting the implementation of PPP in certain sectors and the preparation of laws required to create the necessary legal framework.

2.2 Public Procurement Act

(a) Main features of new Act

As far as the legal regulatory framework is concerned, since 1 February 2006, a new act (the Public Procurement Act) has applied, adopted with the aim of implementing (among other things) EU directives 2004/17/EC and 2004/18/EC. Like the former procurement legislation, the Public Procurement Act recognises the concept of a “public contract” as well as a “concession” – the latter being a contract of the same type as a public contract (except that the consideration for the works to be carried out or the services to be provided consists either solely of the right to exploit the construction or services, or of this right together with a payment from the Authority). The new Public Procurement Act has not, however, created a specific PPP legal regulatory framework. Moreover, the rules relating to concessions are rather focused on defining a project as a concession rather than identifying a specific procedure to be followed in the case of PPP projects.

(b) Introduction of Competitive Dialogue

It is worth mentioning that the new Public Procurement Act introduced a competitive dialogue procedure as one of the methods of public procurement, the aim of which is to identify and define the most appropriate way of satisfying the relevant needs of the procuring authority. Competitive dialogue, which was used in the case of the road projects mentioned below, can apply for a particularly complicated project when the open procedure (verejná súťaž) or the restricted procedure (užšia súťaž) cannot be used.

(c) Effect of new Act

In many respects, the regulation by the Public Procurement Act could still be described as rather formalistic and, as far as concessions are concerned, rather brief. This could represent material challenges for the proper structuring and negotiating of PPP deals, which tend to be complex and may not fit well with the formal procedural requirements of the Public Procurement Act. Similarly, as highlighted by ongoing projects, the regulatory framework may need to be adjusted in particular areas in order to maximise the potential use of PPP projects. For example, in relation to the road construction projects, it was necessary to amend the Road Act and the National Motorway Company Act in order to provide the concessionaire with the statutory rights necessary for effective control and administration over the roads constructed.

2.3 Legislative amendments to facilitate PPP

The learning process with respect to ongoing projects has, in addition, demonstrated that the government needs to be prepared to react flexibly to new matters and issues that may arise in the course of the process. For example, in light of the current market and financial situation, the banks involved in negotiations on the financing of the road projects requested that the state should provide greater guarantees. This request
resulted in changes to the public procurement legislation being adopted. In particular, an amendment to the Public Procurement Act was quickly approved by the Slovak Parliament. The adopted changes shortened the period during which the validity of a concession agreement (or its amendment) may be challenged in the relevant court. According to Slovak law, the following persons may challenge the validity of a concession agreement (or an amendment thereto): the Slovak Public Procurement Office, a tenderer (uchádzač), a candidate (zľaženec) or other person (entity), which might have had an interest in being awarded the concession or whose rights or legally protected interests were or might have been affected by the actions of the public authority or the procuring authority. A petition now has to be filed within 30 days of the announcement of the results of a tender being published in the Official Journal of the European Union instead of the original one-year period, or in respect of an amendment to the concession agreement, within 30 days from the announcement that an amendment to the concession agreement has been concluded.

2.4 Ministry of Finance role

During the early stages of exploring the viability of PPP structures and the attempts to close the pilot projects, it was possible to avoid any major confrontations regarding the suitability of the regulatory framework and the readiness of the central and regional governmental authorities for the complexities of PPP structures. The readiness and ability of the public authorities to manage PPP projects was a particular concern of the central government and, in this context, the role of the Ministry of Finance of the Slovak Republic should be noted. The Ministry was tasked with providing regulatory (including assessing the impact of PPP projects on public budgets), methodological, controlling and supporting functions to public authorities throughout the process of preparing and implementing PPP projects. In addition, the Ministry was to act as the PPP knowledge and know-how centre. In this context, the Ministry prepared a set of methodological instruments and guidelines to help public authorities to assess a particular project, explore the viability of a PPP structure and help implement the project.

2.5 Procuring Party

The Slovak Republic can enter into contracts as the sovereign state and is defined as a “procuring party” in the Public Procurement Act. As such, it enters into contracts through the relevant state authority (usually a Ministry or a similar central governmental organisation).

If the intended PPP project falls under the auspices of one of the relevant Ministries, then the correct counterparty is the Slovak Republic represented by its relevant Ministry (such as the Ministry of Transport, Post and Telecommunications, the Ministry of Health, or the Ministry of Defence), which is in turn represented by the relevant minister.

2.6 Capacity to contract

(a) Central Government

No enabling legislation is required in the Slovak Republic to ensure that central government departments procuring a PPP project have the requisite power to enter into a PPP contract. Since this power, with a few exceptions, has not been specifically defined, the parties involved must base this interpretation solely on certain generally binding principles governing the authority of administrative bodies.

(b) Regional and municipal governments

In addition to the Slovak Republic as the sovereign state, both regions and municipalities are defined as “procuring parties” in the Public Procurement Act. The division of authority to enter into a PPP-type contract between the central government, regional government and municipal government needs to be examined in each case, given the constitutional and statutory responsibilities of the state, the region and the municipality in the context of the procured work, supply or service.
(c) Other entities

All other public entities are also subject to the Public Procurement Act in their capacity as the “procuring party”. Each of these public entities is defined as a legal entity which has been established or instituted for the purpose of fulfilling a public interest need, is not of an industrial or commercial nature, and is financed, managed or controlled (directly or indirectly) by another public entity, state, region or municipality (e.g. government agencies such as SARIO, the Slovak Investment and Trade Development Agency, and the Slovak Academy of Sciences).

Finally, any legal entity (including a corporate entity) would fall within the scope of the “procuring party” definition if it were controlled by a public entity or, as the case may be, entitled to exploit a specific or exclusive right in relation to its activities in water, energy, transport or telecommunications (e.g. the Slovakian railway companies, the National Motorway Company (NMC), Bratislava Airport, Slovenský plynárenský priemysel (the Slovak Gas Industry) and Slovenské Elektrárne (the Slovak Electricity Company)).

Any reference to “procuring parties” in this chapter includes the parties referred to above. In each case the procuring party needs: (a) to comply with the provisions of the Public Procurement Act; and (b) to approve the relevant transaction in accordance with the applicable statutory rules.

2.7 Contract Validity

Provided that a PPP contract is (a) properly executed by the procuring party; (b) entered into following the procedures outlined in the Public Procurement Act; and (c) approved by the requisite internal bodies of the procuring authority, it should be possible to establish that a PPP contract is valid and enforceable against the procuring party. In some cases, where the law or implementing legislation does not specify any required internal approvals, a third party may assume that the authorised signatory has the power and authority to sign. However, it is always prudent to check what internal approvals are needed and that they have been duly obtained to avoid any negative consequences, although this is not strictly a legal requirement.

It is usually very easy to establish whether or not the procuring party is represented by the authorised signatory. Also, the existence of the requisite internal approvals may be relatively easy to ascertain, depending on the type of entity and kind of project. However, in some circumstances compliance with the Public Procurement Act may cause some concerns for a private contractor as it is not always that easy to verify. This is primarily because the procuring party’s choice of procurement method is dependent on a number of criteria, some of which can be interpreted subjectively or are based solely on the internal circumstances of the procuring party. If, in any given case, it is not possible to establish the procuring party’s compliance with the Public Procurement Act, the strict representation of that compliance should be required as a bare minimum.

The consequences of non-compliance with the Public Procurement Act could vary from penalties being imposed on the procuring party to a claim being filed by the Public Procurement Authority with the local court, demanding that the contract be declared void.

It should be noted that the general position under Slovak law is that a breach of Slovak law may also result in the contract being declared void.

Finally, since the Slovak Republic acceded to the EU as of 1 May 2004, standard EU state aid considerations need to be taken into account in PPP projects.

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5 NMC is a joint stock company wholly-owned by the State and responsible for the operation of motorways and first class roads.
2.8 Specific enabling legislation

Other than the Public Procurement Act and the legislation that creates, enables the creation of, or defines the scope of authority of public law entities (such as municipalities or regions) or entities otherwise qualifying as procuring parties, there is no specific enabling legislation in place.

Slovak law contains some limitations on the acquisition, disposal, encumbering and lease of property by certain parties. Some PPP projects may contain elements that would breach these limitations. Where this happens, either the structure of the PPP project or the applicable legislation would need to be amended (as was the case with the specific road legislation mentioned above). This also applies, for example, to motorways or airports where certain assets constitute “priority infrastructure assets” that are immune from bankruptcy and cannot be charged or disposed of beyond the acceptable terms of their lease.

Also, if a fee is to be collected from the end-users of any public infrastructure in connection with a project, the relevant legislation will need to be adapted to set out a system for regulating the fee that can be charged or the circumstances in which the fee can be charged to make the PPP project viable and sustainable.

In terms of the contractual relationship between the public and private parties, the parties are free to negotiate their own contractual terms subject only to the regulatory framework applicable in the individual sector (eg applicable pricing regulation), the provisions of general contract law (including, without limitation, the applicable state aid rules) and, of course, the requirements of the procuring party.

The exercise of any rights by the private partners constitutes the exercise of contractual rights rather than the exercise of any rights of a public body.

2.9 Covenant issues for procuring parties outside central government

Some PPP projects contemplate that works, supplies or services may be procured by public entities or corporates that sit outside central government. As a general rule, contractors entering into PPP projects with such procuring parties would not have any recourse against the Slovak Republic.

Where a procuring party of this type wishes to enter into a PPP transaction, its underlying covenant needs to be assessed and, to the extent that potential investors do not believe that such party sits comfortably within the government framework or there is no long-established history of this type of party being supported by central government, it may be necessary to obtain some form of support for the project from central government.

In each case the support, as well as its form, needs to be examined to assess whether it is legal for central government to provide such support from both a capacity and state aid perspective (especially if the connection between the procuring party and the government is more remote).

3. Active sectors

3.1 Main sectors

The main focus in PPP is on road projects, including opportunities for involving the private sector in financing and operating national motorways. Private players, especially commercial banks, are also showing some interest in exploring the viability of structures similar to PPP for smaller-scale projects such as regional hospital projects or administrative buildings.
3.2 Roads

After elections in 2006, lengthy political discussion about the feasibility and political convenience of using PPP financing to speed-up the construction of the Slovak motorway network resulted in three major packages of motorway construction being publicly tendered, with an approximate value of EUR5 billion in total (although the price has since escalated):

(a) the first package D1, comprised of Dubná Skala-Turany, Turany-Hubová, Hubová-Ivachnová, Jánovca-Jablonov and Fričovce-Svinia (with an estimated value in excess of EUR3 billion), was announced in the middle of November 2007. Eventually, two major participants, the Vinci Concessions S.A.-Skanska Infrastructure Development AB consortium and Bouygues Travaux Publics (involving two Slovak firms Doprastav, a.s. and Váhostav-Sk, a.s.) were shortlisted, with the latter being declared the winner in February 2009. Contrary to the projected schedule, the project has not yet achieved financial close, mainly due to the situation in the financial markets and the failure to reach a settlement with the owners of the land proposed for the highway. The parties agreed to postpone the deadline for financial close to February 2010 and it is anticipated that close will occur soon.

(b) the second package R1, comprised of Nitra-Selenec, Selenec-Beladice, Beladice-Tekovské Nemce and Banská Bystrica-northern bypass (with an estimated value in excess of EUR1.5 billion), was announced in the middle of December 2007. Strabag/Porr, Vinci Concessions/ABN Amro Highway B.V., Obrascón Huarte Lain, and Bouygues Travaux Publics participated in the public procurement with Vinci/ABN Amro being selected in December 2008. After delays caused mainly by the global financial crisis and credit crunch, the project successfully achieved financial close in August 2009. Previously the Slovak government had agreed to provide additional guarantees to financing banks, but it rejected requests to underwrite the project fully.

(c) the third package D1, Phase 3, comprised of Hričovské Podhradie-Lietavská Lúčka, Lietavská Lúčka-Višňové and Višňové-Dubná Skala (with an estimated value in excess of EUR2 billion with construction costs estimated at EUR1.4 billion), was announced in April 2008. The Ministry received only one tender offer for the project from Hochtief PPP Solutions, Alpine Bau, FCC Construcción and Western Carpathians Motorway Investors Company and appeared to be considering other alternatives and the postponement of this third package until both the first two projects had reached successful financial close. However, recent indications are that the project will proceed to financial close.

In 2005, PPPs were also used by the Košice and Prešov regional governments to repair local roads (contracts with values exceeding EUR30 million). The works were performed by Inžinierske stavby, a.s. and Cestné stavby, a.s.

3.3 Electronic toll collection

On 13 January 2009, NMC signed a contract worth more than EUR860 million for the implementation of an electronic toll collection system with the winning tenderer, SkyToll, a.s., (selected in 2007) , making it the first major deal with PPP elements to reach contract close.

4. Likely future active sectors

4.1 Administrative buildings

Despite the economic crisis and worse than expected economic results of the Slovak economy for the first half of 2009, in June 2009 the Slovak government announced its intention to continue with the PPP project for the construction and operation of the new media complex where both Slovak Statutory Television and Slovak Statutory Radio will be located.
The estimated value of the project (including technical equipment and facilities) is around EUR139 million (excluding VAT). The concession is intended to be granted for 28 years, with the first three years designated as construction phase and the next 25 years as operating phase.

According to the Ministry of Finance of the Slovak Republic there are still a number of issues to be discussed and resolved before the project procurement enters its last phase and, with an election due in 2010, it is likely this project will stall until the new government is in place.

### 4.2 Regional infrastructure

In the course of 2008 and 2009 some of the Slovak municipalities announced a plan for the reconstruction of local road infrastructure, although they were still considering the possibility of financing the project through a PPP scheme. Their final decision on using a PPP scheme will probably be influenced by the success or failure of the highway and motorway PPP projects, as well as the availability of financial sources in the market.

Although such regional infrastructure projects are much smaller compared to the road projects organised by the Slovak government, if successful they could constitute a significant opportunity for investors in terms of future continuous business.

### 4.3 Water

Currently the water industry is predominantly under the ownership of a few regional companies which are in turn owned by a large number of municipalities located in each case in the region covered by the relevant company.

The ownership of such companies involves so many parties that structuring and approving a transaction, the scope of which would extend beyond the regular management authority of the board, is difficult. However, it is understood that these businesses are presently undercapitalised or will become undercapitalised and unable to meet future demands for the improvement of infrastructure and it is possible that the need for investment may encourage participants to consider PPP structures in this sector.

### 4.4 Other

There has been some discussion concerning possible projects in the health sector, but these are very much in their infancy. The question at present seems to be whether some of these projects will ultimately be simply outsourcing projects for certain aspects of healthcare, or whether there is any appetite to examine PPP projects for substantial schemes, such as the construction of new hospitals.

It is possible that the government may also consider PPP projects in areas such as schools and defence, but at this stage this is rather speculative. The outcome of the pilot R1 and D1 road projects will be a key factor in determining future use of PPP.

Although PPP has been commonly used across the world for financing various sports facilities, probably due to the reportedly rather weak performance of similar projects in the Central and Eastern European (CEE) region, there has only been limited interest from investors to participate in the reconstruction of sports facilities in the Slovak Republic (such as the reconstruction of the Ice Hockey Arena or the National Football Stadium (both in Bratislava)). The approach of investors might change if similar projects prove to be successful in similar economical and political environments in the CEE region.
5. General structure of concessions

Lately the Slovak government has implemented a concession scheme in several high profile and financially demanding projects, including an electronic collection toll system project and construction of highway and motorway networks. In these projects it has been demonstrated that the current regulations on concessions do not present any major obstacles, although, based on practical experience, several areas would benefit from better or more specific regulations.

The current legislation focuses on identifying a project as a concession rather than establishing a detailed framework specifying the content and particulars of a concession contract.

If a particular project is identified as a concession, under the requirements stipulated by the Public Procurement Act, all the following must be met:

(a) the rules for awarding concessions must apply if the proposed value of the concession for works is at least EUR5,150,000;

(b) the concession period (determined by the nature of the project and the level of payment for the construction works and an appropriate revenue return for the concessionaire) cannot be longer than 30 years and shall not commence before the concessionaire has had or might have had the right to exploit revenues from operating the structure;

(c) the concessionaire becomes the manager and operator (správca) of the property used in/created in the concession, but the rights of the concessionaire are limited and it cannot dispose of, encumber or put the property into auction or otherwise transfer the management of the property to a third party; and

(d) if a major project is being tendered, the concessionaire may be under an obligation to apply the procurement rules for awarding works relating to the concession to its sub-contractors (unless these are recognised as an affiliated company of the concessionaire).

In addition to the public sector’s perceived lack of readiness to administer complex PPP projects, there may be three factors which influence the choice of any structure for a PPP project: (a) the experience (both positive and negative) from other CEE projects; (b) the model and structure for PPPs driven by UK models (which are largely seen as seminal); and (c) the results of independent analyses of the optimal model carried out by advisers selected by the Slovak government. It is however not yet possible to speak of “general” or “typical” structures of projects or concessions.

6. Insolvency and security position

6.1 Security Legislation Reform

There is no specific regime in relation to insolvency or the taking of security which applies to project finance or PPP structures. However, the wholesale review of Slovak security legislation which took place in 2002 was intended to address issues commonly encountered in these kinds of projects, and to inject some flexibility in the overall framework so as to facilitate projects in general.

With a view to introducing a long-expected and comprehensive reform of the security law, the Slovak Parliament passed two new laws which became effective as of 1 January 20036.

The following key rules and procedures are embodied in the reform of security law:

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6 Act No. 526/2002 Coll. on the Amendment to the Civil Code and Act No. 527/2002 Coll. on Voluntary Public Auctions.
(a) Collateral

Any assets which are transferable may be pledged to secured creditors, including future assets that are not yet owned by the pledgors or do not even exist. It is possible to secure by way of a pledge both debts existing at the time of the creation of the pledge as well as future debts. Also, both monetary and non-monetary debts may be secured. In addition, it is also possible to create a pledge over a generic class of assets or assets described in any other general terms. A pledge over the business as a whole or a part of the business is also possible although utmost care should be used with this arrangement due to some uncertain implications in the context of insolvency. Specialist advice should be obtained if this area is to be explored in detail.

(b) Pledge registration

A new system for the public registration of pledges was created, enabling swift registration of pledges over many types of assets.

(c) Priority

Streamlined priority rules which implement the “first in time, first in right” principle were introduced. These also permit contractual subordination between creditors, subject to registration of the security in the appropriate register.

(d) Tax authority's pledge

The preferential treatment of the tax authority's pledges was repealed.

(e) Secured creditors versus unsecured creditors

A new system for the protection of secured creditors against enforcing unsecured creditors was implemented.

(f) Third-party pledge

Streamlined and more practical rules in relation to the transfer/passage of pledged assets to a third party were introduced.

(g) Enforcement

Comprehensive, more practical and more creditor-friendly rules on enforcement proceedings were introduced. The legislation does not explicitly provide for any specific enforcement mechanism. It is therefore up to the parties themselves to stipulate in the pledge agreement how to enforce the pledge in the event of the debtor's default (e.g., through a private sale). In practice much depends on the circumstances surrounding each individual transaction.

6.2 Direct Agreements

Based on experience to date with the road projects, direct agreements, or more precisely, the lenders’ step-in rights under the direct agreements, appear to be permitted pursuant to two legal concepts – freedom of contract and the share pledge.

The former manifests itself in the direct agreement through a freeze on the public authority's ability to terminate the concession agreement and file an insolvency petition, and in the public authority's duty to notify the lenders of the occurrence of a concessionaire's default. The freezing of these rights is time limited. During this freeze the parties can agree on a rectification plan. If the plan is not agreed, then the effects of the freeze are lifted and the party is free to terminate the concession agreement and freely exercise any other rights available to it at the time.
Another manifestation of the step-in right in the direct agreement is the fact that the freeze on public authorities’ rights is not affected by the lenders enforcing the pledge over the shares in the concessionaire if certain pre-agreed processes are complied with and the shares are sold to an entity which meets the criteria set out in the direct agreement. In other words, the benefits of the freeze remain preserved even after lenders have commenced enforcement of the share pledge. This in turn gives the lenders the ability to sell the shares in the concessionaire to an “acceptable” entity by way of private sale or other agreed enforcement route.

There is no explicit concept of receivership under Slovak law (unlike under English law) and the share pledge in itself does not provide for the ability to appoint a receiver. Yet there may be certain creative mechanisms whereby, in the context of PPPs, the concept of administrative receiver could be “imported” into Slovak legislation or whereby it might at least be possible to approximate an English law style enforcement of a Slovak pledge through an administrative receiver. However, as such mechanisms are untested they are not discussed in this chapter.

6.3 Financial collateral-related changes

In addition to the 2002 security reform, the implementation of EU legislation governing financial collateral entered into force and effect in August 2005. However, its applicability is restricted to financial institutions. Therefore, financial collateral does not give financiers of PPP projects any enhanced security. However, the position of creditors in Slovakia, insofar as the creation and enforcement (outside bankruptcy) of security is concerned, is strong.

6.4 Insolvency Legislation Reform

A comprehensive reform of insolvency legislation entered into force and effect in 2006. One of the aims of the reform is that the enforcement of security in bankruptcy becomes much more certain and the value of security much less vulnerable to being diminished in a bankruptcy scenario. Among other goals, the reform also aims to incentivise a rescue culture inspired by US Chapter 11 and rescue statutes in some other jurisdictions. The practical impact of this insolvency reform is yet to be assessed. However, a few high profile restructuring cases have recently been carried out within the framework of the new restructuring legislation, which, together with the flexibility of the rescue legislation, signals that the legislation may be successfully applied even in the context of a PPP restructuring.

7. Sector-specific issues

In the course of the PPP projects for the construction of highway networks, many sector-specific regulatory issues have been addressed and solved. Currently there seem to be no major regulatory obstacles to completing projects in the motorways and roads sector.

The same cannot be said of other sectors where PPP schemes could potentially be used, such as airports or the national postal service. Until the first projects come under consideration in these sectors, any sector-specific issues will not be readily identifiable.
8. Employment issues

If a PPP project involves the provision of services that have historically been provided by the procuring party, staff engaged in the provision of those services will often transfer to the employment of the private contractor once the procuring party ceases to provide (or procure the provision of) the services itself (typically following completion of the construction of the relevant new facility).

The Labour Code provides that if there is a transfer that concerns an employer, a part of an employer, or a task or activity of an employer to another employer, the rights and obligations arising under the employment relationships between the former employer and the employees concerned will be transferred to the new employer. The original employer is under various notification obligations in relation to such transfer and there may be other technical issues which need to be addressed as part of the process.

The magnitude of this issue is as yet uncertain and in some cases may concern only a very limited number of staff. The viability of any models intending to address this issue (for example, by way of secondment or similar) would need to be examined on a case by case basis and matters such as pension protection would also need to be taken into account.
The Americas
Se, na verdade, não estou no mundo para simplesmente a ele me adaptar, mas para transformá-lo; se não é possível mudá-lo sem um certo sonho ou projeto de mundo, devo usar toda possibilidade que tenha para não apenas falar de minha utopia, mas participar de práticas com ela coherentes.

If, in fact, I am not in the world simply to adapt to it, but to transform it; if it is not possible to change it without a certain dream or project of the world, I shall then use all possibilities that I have to not only speak of my utopia, but to participate in practices coherent therewith.

Paulo Freire  
(1921-1997)
1. Introduction

Despite the economic stability and growth that Brazil has experienced over recent years, there is still a great need for infrastructure and more efficient provision of public services. After the wave of privatisations that occurred in the 1990s, a combination of overstretched public spending, stricter fiscal responsibility laws and complex public procurement and concession rules left investments in key areas of the public sector lagging behind expectations. Due to this “deadlock” in public investment, in 2003 the PPP model began to be considered more seriously by the government as an alternative for delivering and implementing key public services and public works in Brazil and a year later specific legislation was enacted in order to facilitate the implementation of PPPs in the country.

Despite high hopes engendered by the new PPP legislation, five years after the key enactments only a few projects have reached financial close. Many factors have contributed to this, including the global financial crisis, a decline in commodity prices and currency depreciation. Despite that, the steady increase in export-import activities since the 2008 economic crisis and the fact that Brazil will host the 2014 World Cup and the 2016 Olympic Games has forced the government to refocus its attention on the urgent need for infrastructure in the country and, consequently, restored its interest in PPPs.

This chapter focuses on the current legal framework for Federal PPP projects in Brazil and highlights some of the progress already achieved in some of the Brazilian States.

2. Legal and regulatory framework

2.1 Background

Following intense congressional debates over the proposal of a PPP bill in 2003\(^1\), on 30 December 2004 the Brazilian government enacted the Federal Public-Private Partnership law (the Federal PPP Law)\(^2\) which introduced the PPP model into the Brazilian legal framework. This new law created two new models of concession agreements to be used in the procurement of public services and public works in Brazil, which in many respects mirror the PPP structures existing in the UK and other countries.

Most of the existing PPP legislation was enacted after the Federal PPP Law came into effect, although five of the 26 Brazilian states enacted their PPP statutes before the Federal PPP Law\(^3\) based on general provisions of the 1988 Constitution regarding public and private sector collaboration. Some of these earlier statutes gave a broader definition to PPPs than the Federal PPP Law, but once the federal statute was enacted such earlier statutes had no choice but to comply with, and be interpreted in light of, the narrower definition within the Federal PPP Law. Today eleven of the 26 Brazilian states have enacted their own PPP statutes and further federal and state legislation has been enacted in order to implement PPP projects in various regions of the country.

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\(^{1}\) Projeto de Lei nº 2.546/03.
\(^{3}\) Minas Gerais (Law 14.869/93), Goiás (Law 14.910/04), São Paulo (Law 11.688/04), Bahia (9290/04) and Santa Catarina (Law 12.930/04).
2.2 Capacity to contract

The Federative Republic of Brazil (Brazil) is formed by the union of 26 states, the Federal District4 and more than 5,000 municipalities, each an autonomous political entity within Brazil working in a non-hierarchical structure. The Federal Constitution of 5 October 1988 (the 1988 Constitution) sets out the political organisation of the country and establishes a tripartite government comprising an executive, a legislative and a judiciary branch. It provides that each branch of government has the full power to regulate itself and has limited powers to oversee the acts of the other branches in an integrated system of checks and balances.

The power, capacity and competency of each political entity within the Brazilian public administration (including all instrumentalities, special funds, departments (autarquias), public foundations, public companies (empresas públicas), mixed capital companies (sociedades de economia mista), and other companies controlled by the federal, state, or municipal governments, whether directly or indirectly, together the Public Administration) to act and represent the relevant political entity in any legal transaction derives from the 1988 Constitution. Such public entities, although autonomous, can only do what they are expressly permitted to do under the law and must always act in the public interest. Each public entity acts through, and is represented by, several divisions created within its legal structure. All acts taken in accordance with, and within the limits of, the law will be valid and binding obligations of the public entity they represent.

2.3 Specific Enabling Legislation

Two Federal Acts (Decree N. 5.384 of 4 March 2005 and Decree No. 5.411, of 6 April 2005) were instrumental in the implementation of the Federal PPP Law as they created a governmental committee responsible for PPPs and enabled the government to provide guarantees to PPP projects, two essential features for success of the PPP programme in Brazil, as further explained below.

(a) The PPP Management Council (Comitê Gestor de Parceria Público-Privada)

The PPP Management Council (the CGP) was created pursuant to Decree N. 5.384 of 4 March 2005 to be the governmental body responsible for defining the public services that may be executed through PPPs as well as the criteria for analysing whether a PPP contract complies with the administrative law principles of “convenience” and “opportunity” imposed on the Public Administration. Its responsibilities comprise, inter alia, (i) defining the priority of services to be executed and the criteria for financing contracts under the PPP regime; (ii) approving and initiating the PPP competitive procurement process as well as the invitations to bid; (iii) approving the bid documents as well as the PPP contracts and their amendments; (iv) approving the PPP plan and supervising its execution; and (v) establishing the proceedings and requirements for, and proposing the rules relating to, the delivery of PPP projects.

The CGP members are appointed by the Ministry of Planning, Budget and Management, the Ministry of Finance and the Brazilian Civil Cabinet and must be instructed by such Ministries as to: (i) the compliance of projects with the Federal PPP Law; (ii) the importance of the PPP project in question; (iii) the risks to the Treasury relating to the project; and (iv) the feasibility of the guarantee purported to be given by the relevant public entity entering into the PPP. The CGP must deliver annual reports on the performance of all PPP contracts. In addition, at the federal level a PPP unit has been created within the structure of the Ministry of Planning, Budget and Management to support and help implement the PPP projects.

(b) Public-Private Partnership Guarantee Fund (Fundo Garantidor de Parceria Público-Privada)

The federal guarantee fund (the FGP) was created pursuant to the Federal PPP Law to provide guarantees for the financial obligations of contracting authorities that are involved in PPP contracts. The FGP is a legal person capable of assuming rights and obligations and its capital shall comprise assets and rights transferred to it by its quota holders (and the proceeds derived therefrom), which

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4 The area reserved as the site of the national capital of the Federative Republic of Brazil, ie Brasilia.
assets are separate from the assets of its quota holders. The quota holders can be any of the entities of the Public Administration and subscriptions for quotas may be made in cash, government bonds, real estate, equipment and other assets, including shares of government-owned enterprises that exceed the amount necessary for the maintenance of public control over such enterprise. Quota holders are not required to meet any of the Fund’s obligations, but will be liable for their share in the FGP’s capital to the extent it has not been paid up in full.

The Federal PPP Law provides that the FGP guarantees to each quota holder may be made pro rata to the value of each quota holder’s quota. Additionally, the FGP may not provide guarantees with an aggregate net present value that exceeds the total value of its assets. Article 18 of the Federal PPP Law provides that the guarantee may be granted as approved by the board of quota holders, in any of the following forms:

(i) contractual guarantee;

(ii) pledge of the FGP’s assets or assignment of its rights without transfer of possession of the assets and rights before the enforcement of the guarantee;

(iii) mortgage of the FGP’s real estate;

(iv) fiduciary transfer of ownership of assets until the execution of the guarantees, where possession of such assets remains with the FGP or with a fiduciary agent appointed by it;

(v) other contracts with the same effect as a guarantee, provided they do not transfer the ownership or direct possession of the FGP’s assets to the private partner before the enforcement of the guarantee; and

(vi) an in rem or personal guarantee covering segregated assets and rights owned by the FGP.

It is important to note that not all of the obligations of the contracting authority in a given project are necessarily guaranteed by the guarantees provided above, and even when such obligations are guaranteed, not all types of guarantees available might be given for the same project. Individual PPP contracts shall set out the extent to which the obligations of the contracting authority are guaranteed in favour of the private partner and what guarantees are available for the specific project.

In addition, the FGP may provide counter-guarantees to insurance companies, financial institutions and international organisations guaranteeing PPP contracts.

The Federal PPP Law required that the FGP be created, administered, managed and legally represented by a financial institution controlled by the Federal Government and therefore the FGP is now managed by the Bank of Brazil (Banco do Brasil), which is responsible not only for the management of the fund but also for any disposal of assets, assignments of rights and for ensuring the FGP’s profitability and liquidity. The FGP must also comply with the rules and regulations of the Brazilian Securities and Exchange Commission.

The Federal PPP Law provides that the FGP’s capital shall comprise quotas in an aggregate amount of up to six billion Reais (approximately GBP2 billion). Pursuant to Decree No. 5411/2005 the Federal Union paid up its quotas by transferring to the FGP certain shares of mixed capital companies owned by it.

2.4 Covenant Issues for Regional Authorities

The Federal PPP Law also sets out guidelines to be followed in any PPP project:

(a) efficiency in complying with the state’s mission and the use of public resources;

(b) respect towards the rights and interests of the private partner and the end-users of the public service provided under the PPP project;

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5 See Article 4 of the Federal PPP Law.
(c) non-delegation of regulatory and juridical functions as well as other activities which are within the exclusive power of the state;
(d) fiscal responsibility under the contract and the execution of the PPP project;
(e) transparency in its proceedings and decision-making processes;
(f) objective criteria governing risk sharing between the partners; and
(g) financial sustainability and socio-economic advantages of the PPP project.

Regarding the fiscal responsibility covenant, it is worth noting that all public entities are subject to the Law of Fiscal Responsibility (the LFR), which imposes limits on public bodies’ expenditure and financial commitments and regulates the use of public funds. Although applicable to all branches of government (executive, legislative and judiciary), the LFR focuses on executive power at federal, state and municipal level. It sets out rules regarding budgetary control and fiscal goals and targets primary surplus and the relationship between consolidated debt and gross national product of the country. It aims to make it possible to monitor how efficiently the government manages expenses and ensures that it does not incur budgetary imbalances or excessive indebtedness.

### 3. Existing and future sectors

In view of Brazil’s government plans for further economic growth, expansion of the country’s infrastructure has become a key priority. The increase in import-export activities, combined with the discovery of large oil fields on the coast off Rio de Janeiro and the proximity of the 2014 World Cup and the 2016 Olympic Games, have revamped the government’s interest in several infrastructure projects relating to ports, airports, roads, railroads, power plants and sports stadia, and other investments in telecommunications, energy (including renewable energy), public safety, health, water, sewage and hospitality are also under discussion. It is expected that some of these projects and investments will be done through PPPs and other long-term concessions.

Since the enactment of the Federal PPP Law, several projects have been proposed and are either in the pre-approval or the bidding phase or are in tender. Not many PPP projects, however, have reached financial close either at federal or state level. Among the PPP projects already proposed are projects relating to the construction or renovation of airports, ports, rail roads, sports stadia, hospitals and telecommunication facilities, but those that have reached financial close relate to construction of buildings, roads, light rail, prisons, water and sewage systems and hydro power plants.

### 4. General structure of PPP concessions

#### 4.1 Conventional concessions, sponsored concessions and administrative concessions

The Federal PPP Law provides the legal framework for the implementation of PPPs in Brazil and sets out the general rules for the procurement of PPP contracts. These rules are self-applicable and obligatory to all public bodies (including states and municipalities). Where state legislation has also been enacted, such legislation must comply with the limits imposed by the Federal PPP Law and will only be valid to the extent it does not contradict with or violate it. In addition to the Federal PPP Law, the general concessions law, Law No. 8,987 of 13 February 1995 (the Concessions Law) and the general public procurement

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7 See the Appendix 1 for a list of PPP projects that have reached financial close in the past five years.
law, Law 8.666/93 of 21 June 1993 (the Public Procurement Law) (as well as general principles of administrative law) apply subsidiarily to PPP concessions with respect to any issues that have not been expressly regulated by the Federal PPP Law.

In addition to the conventional concessions, which existed in Brazil long before the enactment of the Federal PPP Law and are still regulated by the Concessions Law, the Federal PPP Law created two additional types of concessions for the provision of public services or public works where the concessionaire can rely both on the payments received from end-users and payments from the contracting authority (which may be responsible for all or at least part of the remuneration owed to the private partner) in order to recover its investment in the project. These innovative types of concession are:

(a) **sponsored concessions**, which are concessions for the provision of public services or public works, where the remuneration of the private partner is paid partially by the end-users by way of service charges or similar payments and partially by the contracting authority. The contracting authority's consideration may consist of financial remuneration to the private party or the right to exploit the services for the term of the concession; or

(b) **administrative concessions**, which are concessions for the provision of services to the contracting authority (whether or not such services would require the prior execution of construction works), directly or indirectly, where the remuneration of the private partner is paid exclusively by the contracting authority.

Typically, sponsored concessions are to be used for the procurement of services which are capable of yielding some financial return to the private partner throughout the life of the concession (such as toll roads, railroads, etc.), and administrative concessions are to be used for the procurement of services that cannot be economically exploited either because of their social nature or due to a prohibition in the law (such as education, healthcare and cultural projects), or because the sole end-user is the contracting authority. In any event, the Federal PPP Law expressly prohibits the use of PPP concessions solely for the provision of public construction works, or for the supply and installation of equipment or for the supply of manpower. These latter services shall continue to be contracted through the common concession regime.

Each PPP project will have specific characteristics, objectives and risk profiles and the corresponding PPP contract shall be tailored by the contracting authority and private partner (subject to the pre-set criteria and parameters provided in the procurement documentation) in order to meet the project's characteristics, objectives and risk profile. There are, however, certain necessary provisions that must be set out in the PPP contract by law, such as, *inter alia*:

(a) a term compatible with the amortisation of the relevant investment by the private partner, which term shall be at least five years and no more than 35 years (including any extension of time);  
(b) a projected contract value of no less than 20 million Reais (approximately);  
(c) penalties applicable to the contracting authority and the private partner for breach of contract, which shall always be proportionate to the seriousness of the breach;  
(d) a clear and detailed mechanism for price and risk allocation between the parties, including the risk of changes in circumstances (*ie* force majeure, change in law, adverse economic conditions, etc.);  
(e) compensation payable and revision of the contract values;  
(f) mechanisms for monitoring compliance performance standards;  
(g) payment adjustment provisions; and  
(h) default and remedy provisions for a contracting authority's breach of its payment obligations under the PPP contract.

The law also allows for a period (after the selection of the private partner) during which the PPP contract can be further adjusted by the parties.
As set out in paragraph 2.2, the contracting authority may be any of the entities comprising the Public Administration. The federal government may only enter into PPP contracts when the sum of its total current expenditure relating to existing PPP contracts has not exceeded 1% of the net current revenue of the previous fiscal year and nor will the projected annual expenditures of existing PPP contracts exceed 1% of its projected annual net current revenue for the next ten fiscal years. The states, federal district and municipalities are also subject to an expenditure limit, but such limit was recently increased from 1% to 3%, which is expected to result in more investments in PPPs at the state level. If the states, the federal district and/or municipalities exceed the 3% limit at any time, the Federal government will not be allowed to make voluntary transfers of money or provide guarantees to such public entities.

The private partner must execute the PPP project through a special purpose vehicle (SPV), which shall be the concessionaire. While the use of an SPV is allowed under the other types of concession, under PPP concessions this is a mandatory requirement. These SPVs may take the form of limited liability companies, corporations (publicly traded or not) or any other form permitted by law, although a change of control in the SPV without prior consent of the contracting authority will cause the termination of the concession (except where step-in rights permitted under the PPP contract are duly exercised by the lenders). The contracting authority can participate in the capital of the SPV, but it cannot hold the majority of its voting capital, although there is no express provision in the law prohibiting the contracting authority from assuming control of the SPV or a State-owned lender (such as the Development Bank of Brazil – BNDES) from exercising “step-in rights” upon default of the private partner under the financing agreement.

Private partners shall be selected through a competitive bid process which shall be preceded by studies aimed at evaluating the impact of the project on the contracting authority’s budget, as well as the projected forecast of the cash flow that will be available to the contracting authority for the payment of its financial obligations under the contract. The Federal PPP Law also permits the inversion of the procurement phases to allow the technical qualification to be analysed before the assessment of the price proposals. The intention is to shortlist the qualified private partners that will be allowed to participate in the following phases of the procurement process and to avoid procrastination by reducing the likelihood of lawsuits being filed by dissatisfied bidders. Proposals may be selected according to the following criteria, at the option of the contracting authority (as set out in the tender notice (edital)): (a) best price (ie the lowest tariff to the end-user); (b) best price and best technical qualification; (c) lowest contribution by the contracting authority; or (d) lowest contribution by the contracting authority and best technical qualification.

4.2 Scope of Service

A PPP project may include any of the following:

(a) the total or partial assignment of the provision or management of a public service, which may or may not be preceded by public works;

(b) the performance of an activity within the jurisdiction of the relevant contracting authority, which may or may not be preceded by public works;

(c) the carrying out public works on behalf of the contracting authority; and

(d) the carrying out public works which are subsequently sold, rented or leased to the contracting authority.

4.3 Payment mechanisms

Payments from the contracting authority to the private partner can be made:

(a) in cash, through bank deposits;

(b) by assignment of credits (other than tax credits);

(c) by granting rights vis-à-vis the contracting authority;

(d) by granting rights over government assets; and
The form of payment must be set out in the tender notice (edital) and the PPP contract, which shall also stipulate how payments are made to the private partner: whether on a services availability basis or according to pre-determined performance targets (milestones) and quality standards.

In sponsored concessions, the contracting authority may make direct payments to the private partner in addition to the service charges (or similar payments) paid to the end-users. As a general rule, the contracting authority may only assume up to 70% of the total payment owed to the private partner, unless specific legislation has been enacted authorising otherwise. If the contracting authority group includes pension funds, such limit is increased to 80%, due to the fact that part of the money given by the pension fund is private money coming from its members and therefore not public money.

In administrative concessions, however, the services involved generally cannot be charged to end-users or the end-user is the contracting authority itself; thus payments are made entirely by the contracting authority on a services availability basis.

Payments to the private partner may be increased or reduced periodically, based on set parameters pre-defined in the tender notice and the PPP contract regarding availability, goals, performance and quality of the services provided.

In either case, when the PPP project requires the execution of public works, and unless otherwise stipulated in the PPP contract, the contracting authority shall retain ownership of the real estate or other asset(s) upon completion of the project, regardless of the payment mechanism chosen for such PPP project.

4.4 Security

The payment obligations of the contracting authority under a PPP contract can be secured by:

(a) earmarking of public revenues;

(b) the creation or use of special funds established by law;

(c) surety bonds from insurance companies not controlled by the Public Administration;

(d) guarantees by international organisations or financial institutions not controlled by the Public Administration;

(e) guarantees by a guarantee fund or a state-owned company set up for this purpose; and

(f) other mechanisms permitted by law.

Guarantees out public funds such as the earmarking of public revenues and the creation of special funds can mitigate political risk and give extra comfort to the private partner investing in the PPP project, but they do not create impervious protection. Although it is true that the provision of financial and budgetary funds for a PPP contract (including the payments owed to the private partner) should take precedence over the general obligations of the contracting authority, in reality, the contracting authority is subject to constitutional limitations on the use and application of public funds and must follow the government budgetary process which includes rigidity of the expenditure budget (eg how much of it has been previously committed to other mandated PPP projects).

In the case of an earmarking of public revenues or the use of special funds, in particular, the private partner may not be able to enforce its rights and immediately receive outstanding payments owed by the contracting authority. The enforcement of the earmarking of public revenues by the private partner would simply allow it to obtain a judgment against the contracting authority which would rank pari passu with the other obligations of the contracting authority with respect to the relevant PPP project. Likewise, the enforcement of rights against the special fund referred to above would be subject to the same restrictions.

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8 Federal PPP Law, Article 6.
9 Federal PPP Law, Article 8 (Guarantees).
imposed on the earmarking of revenues, since such special funds are not separate legal entities and belong to the contracting authority that created it.

Except for the guarantees provided by earmarking public revenues and those provided by special funds, the other guarantees provided in Article 8 of the Federal PPP Law shall be enforceable against its provider. This is because such guarantees are provided by non-governmental entities and are subject to the same rules governing personal guarantees and guarantees in rem as are applicable to private entities under Brazilian civil law. It is important to note, however, that the establishment of guarantee funds (such as the FGP) as well as state-owned companies aimed at guaranteeing obligations under PPP contracts must be authorised by specific legislation.

4.5 Supervening Events

As mentioned above, under the Federal PPP Law, the parties are allowed to allocate project risks among themselves so that such risks are allocated efficiently and to take into consideration which party is in the best position to assume such risks. This also includes the allocation of risks relating to acts of God, force majeure, acts of state and unforeseeable economic events. This is contrary to the traditional approach applicable to conventional concessions, where it was always believed that certain risks, by their very nature, should be borne by the contracting authority (e.g., risks of unilateral change in the contract, changes in law, etc.).

The PPP contract shall also deal with the economic and financial imbalances that may affect the PPP contract over time, and the Federal PPP Law provides that PPP contracts can be revised at regular intervals in order to ensure that such economic balance is maintained. Whenever unexpected events that are not within the private party’s control occur which affect the original economical and financial conditions of the agreement, the Federal PPP Law allows for the parties to revise the PPP contract in order to re-establish such economic and financial balance. Common ways of achieving this goal are the revision of public tariffs charged by the concessionaire or the receipt by the private partner of some indemnification from the contracting authority.

4.6 Termination and compensation

The termination of a PPP concession follows the general rules set out in the Concessions Law and therefore the PPP contract will provide for the same list of termination events as do conventional concessions, namely:

(a) end of the term;
(b) early termination by the contracting authority for public interest with no fault of the private partner (encampação);
(c) early termination for default of the private partner (caducidade);
(d) voluntary termination by both parties (rescisão);
(e) termination due to illegality in the procurement process or in the execution of the concession as declared by a judicial or administrative decision (anulação); and
(f) concessionaire bankruptcy or winding-up (falência).

All assets transferred to the concessionaire during the PPP concession term are considered reversionary assets and must revert to the contracting authority upon termination or expiry of the PPP concession. As a consequence, upon termination the contracting authority may occupy the project facilities, use the project assets and assume the execution of the public services previously carried out by the concessionaire.
In the case of early termination, including where the early termination is caused by the contracting authority with no fault being attributable to the concessionaire (encampação), the concessionaire will be entitled to indemnification for any portion of the project assets that have not yet been amortised or depreciated. The concessionaire may also seek appropriate compensation in the case of termination for default by the contracting authority, but such compensation shall be determined by the courts and the private partner shall continue to provide the services rendered under the PPP contract until the respective lawsuit is settled.

No compensation will be paid to the concessionaire if the PPP contract is declared null or void, or if the termination is caused by the concessionaire’s default. In the latter case, the contracting authority may keep payments owed to the concessionaire in order to compensate itself for damages caused to the project assets before their reversion to the contracting authority.

4.7 Remedies

Remedies in favour of lenders financing the project include:

(a) step-in rights, to be approved by the contracting authority based on specific criteria to be set out in the PPP contract;

(b) a guarantee in favour of the lenders for the obligations of the contracting authority, as provided in Article 8 of the Federal PPP Law; and

(c) indemnification to the lenders for early termination of the contract, including payments under the applicable guarantees.

Unlike conventional concessions regulated by the Concessions Law, the Federal PPP Law expressly provides for the lenders’ right to control the SPV carrying out the PPP contract in order to guarantee the financial recovery of the PPP project and so that the continuity of the services may be assured. In such event, the lenders shall meet the requirements of legal and fiscal regularity that are necessary for the assumption of public services and the contracting authority may change or waive the other requirements established under the PPP contract or applicable law for the transfer of the concession (namely, technical capacity and financial standing). Such assumption of control by the financiers shall not modify the obligations of the SPV carrying out the PPP contract and its controlling shareholders vis-à-vis the contracting authority.

The PPP contract, as well as all other administrative contracts, establish not only the rights and responsibilities of the parties, but also the applicable penalties and any fines applicable to the parties. The innovation introduced by the Federal PPP Law in this regard is that it expressly requires that penalties shall be proportional to the obligations of the parties and to the severity of the breach. In any event, penalties shall always aim at maximising the economic efficiency of the PPP contract.

4.8 Refinancings

The Federal PPP Law provides for the possibility of the contracting authority and the private partner sharing any economic gains arising from a change in the credit risk of the project which ultimately leads to a renegotiation of the financial terms of the PPP contract\(^{11}\). Unlike UK projects, where any material change to the financial and economic structure of a PPP project which has “\textit{the effect of increasing or accelerating Distributions to investors or of reducing their commitments to the Project}”\(^{12}\) could constitute a refinancing gain, the Federal PPP Law only allows for the sharing of gains when such gains derive from a refinancing based on a change in the credit risk of the project.

The Federal PPP Law does not set out any criteria as to how refinancing gains should be shared between the parties, but it does require that the sharing provisions must be provided for in the PPP contract.

\(^{11}\) Federal PPP Law, Article 5(IX) (Public-Private Partnership Contracts).

\(^{12}\) Sections 34.1 and 34.2 of the Standardisation of PFI Contracts, version 4, March 2007 (SoPC 4).
5. Insolvency position

In the case of default or bankruptcy of the SPV, the lenders financing the PPP project are able to exercise their step-in rights and take control of the SPV. If such lenders do not comply with the requirements of legal and fiscal regularity required for the assumption of public services or the requirements of technical capacity and financial standing (unless they are otherwise waived), the PPP contract may be terminated and, as would happen upon any other termination event, the reversionary assets transferred to the SPV must revert to the contracting authority. From then on, the contracting authority may occupy all project facilities, use all project assets and assume the execution of the public services previously carried out by the SPV.

6. Dispute resolution

The Federal PPP Law expressly allows for the use of alternative dispute resolution (including arbitration13) for the settlement of conflicts arising under the PPP contract. Any arbitration proceedings must be held in Brazil and conducted in Portuguese.

7. Employment issues

In order to execute the public services or public works for which it was selected, the concessionaire must employ the necessary personnel qualified to carry out the concession, or agree with the contracting authority that certain activities intrinsic, ancillary or complementary to the public services and public works objectives of the concession can be sub-contracted. Any employment issues arising from those relationships will follow the general labour laws applicable to the private sector but no relationship will be created between the contracting authority and the project personnel, although when executing the public services those employees must comply with the laws, rules and regulations imposed with regard to those relevant public services. In other words, there is no need to observe the procurement procedures for the admission and termination of civil servants working in the Public Administration (to whom broader job security rules are applied). It is important to note, however, that labour laws in Brazil are usually perceived as imposing heavy costs on employers.

13 Federal PPP law, Article 11(III).

Whilst there are numerous sources of information on PPP in Brazil, particular acknowledgement is made of the information provided by Isaac Pinto Averbuch, Director of the Brazil PPP Unit within the Ministry of Planning, Budget and Management (http://www.planejamento.gov.br/hotsites/ppp/index.html) and of the publication “Comentários à Lei de PPP – Parceria Público-Privada: Fundamentos Econômicos e Jurídicos” (RIBEIRO, Mauricio Portugal, PRADO, Lucas Navarro. Comentários à Lei de PPP – Parceria Público-Privada: Fundamentos Econômicos e Jurídicos. São Paulo, Malheiros Editores, 2007).
Appendix

PPP Projects in Brazil (Closed Transactions)\(^{14}\)

<table>
<thead>
<tr>
<th>Project Name</th>
<th>Project Sector</th>
<th>Transaction Value (USDm)</th>
<th>Project Status</th>
<th>Signing Date</th>
<th>Project Type</th>
<th>Project Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FEDERAL LEVEL</strong></td>
<td></td>
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</tr>
<tr>
<td>Dengue Research Center</td>
<td>Health</td>
<td>546</td>
<td>Financial close</td>
<td>25-Sept-09</td>
<td>N/A</td>
<td>Construction of a research centre in Brazil for the development of a vaccine against Dengue fever</td>
</tr>
<tr>
<td><strong>SÃO PAULO</strong></td>
<td></td>
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</tr>
<tr>
<td>São Paulo Metro Line N. 4 (Amarela)</td>
<td>Light rail</td>
<td>1,114</td>
<td>In construction</td>
<td>7-Oct-08</td>
<td>Sponsored concession (DBFO)</td>
<td>Increase of water production capacity by 5m(^3)/s</td>
</tr>
<tr>
<td>Taiaçupeba (Alto Tieté) Water Treatment Facility</td>
<td>Water and sewerage</td>
<td>175</td>
<td>Financial close</td>
<td>18-June-08</td>
<td>Administrative concession</td>
<td>Increase of water production capacity by 5m(^3)/s</td>
</tr>
<tr>
<td><strong>MINAS GERAIS</strong></td>
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<tr>
<td>MG-050 Highway PPP Project</td>
<td>Road</td>
<td>378</td>
<td>In operation</td>
<td>April-07</td>
<td>Sponsored concession</td>
<td>Construction and operation of the 372km highway</td>
</tr>
<tr>
<td>Ribeirão das Neves Penitentiary System</td>
<td>Prison</td>
<td>102.3</td>
<td>In construction</td>
<td>16-June-09</td>
<td>Administrative concession (DBOT)</td>
<td>Construction and operation (under Government supervision) of a resocialisation centre with 5 penal units and a capacity for 3,040 inmates</td>
</tr>
<tr>
<td><strong>BAHIA</strong></td>
<td></td>
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<tr>
<td>Jaguaribe Underwater Emissions Pipeline</td>
<td>Water and sewerage</td>
<td>110</td>
<td>Financial close</td>
<td>28-Oct-08</td>
<td>Administrative concession</td>
<td>Construction and operation of an underwater water and sewage pipeline and water treatment facilities</td>
</tr>
</tbody>
</table>

\(^{14}\) Transactions closed between December 2004 and January 2010.
<table>
<thead>
<tr>
<th>Project Name</th>
<th>Project Sector</th>
<th>Transaction Value</th>
<th>Project Status</th>
<th>Signing Date</th>
<th>Project Type</th>
<th>Project Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fonte Nova Stadium</td>
<td>Sport stadia frastructure</td>
<td>318</td>
<td>Financial close</td>
<td>21-Jan-10</td>
<td>Administrative concession</td>
<td>Demolition, reconstruction and operation of a football stadium with capacity for 50,000 seats, 50 boxes and 2,000 parking spaces to be used in the 2014 World Cup.</td>
</tr>
<tr>
<td>PERNAMBUCO</td>
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<tr>
<td>Ponte do Paiva Bridge &amp; Toll Road</td>
<td>Road</td>
<td>862</td>
<td>In construction</td>
<td>28-Dec-06</td>
<td>Sponsored Concession (BOT)</td>
<td>320m bridge; 6.2km real toll road</td>
</tr>
<tr>
<td>Itaquitinga Resocialisation Centre (Centro Integrado de Ressocialização de Itaquitinga – CIR)</td>
<td>Prison</td>
<td>5.1</td>
<td>Financial close</td>
<td>09-Oct-09</td>
<td>Administrative Concession (DBFO)</td>
<td>Integrated resocialisation centre with 5 penal units and a capacity for 3,126 inmates</td>
</tr>
</tbody>
</table>
Canada is a place of infinite promise.

John Maynard Keynes (1883-1946)
1. Introduction

Having seen its first PPP project close in the early 1990s, Canada ranks globally among the more mature and active markets for PPP (which is generally referred to in Canada as P3 or sometimes as alternative financing and procurement (AFP)). Recent projects in the Canadian market have seen a broad public-private consensus on risk allocation, the use of some well developed precedents and the involvement of major international players from the global PPP market.

PPP projects in Canada have largely been procured at three levels: federal, provincial/territorial and municipal.

Federally-procured PPP projects have represented a small portion of the Canadian PPP market, but this is beginning to change following the launch of the federal procurement agency PPP Canada and its CAD1.2 billion fund for projects. Under the Building Canada Plan the federal government requires that PPP procurement be formally considered for all projects seeking CAD50 million or more in federal contributions.

Canada consists of ten provinces and three territories and provincially-procured PPP projects have long been the mainstay of the Canadian PPP market. The first PPP project in Canada is widely considered to be the Confederation Bridge linking Prince Edward Island and New Brunswick, the financing of which closed in 1992. Since then PPP has become well-developed in British Columbia and Ontario and more recently Québec. It is now also becoming established in Alberta, New Brunswick and the Northwest Territories.

Projects can also be procured at the municipal level. The cities of Calgary (in Alberta) and Ottawa (in Ontario) have particularly well-developed PPP frameworks and have procured some smaller-scale projects.

In its 2009 budget, the Canadian government announced that it would provide almost CAD12 billion in new infrastructure stimulus funding over two years for federal investments in infrastructure projects, some of which will be procured as PPP projects.

2. Legal and regulatory framework

2.1 The project participants

The procuring authority for PPP projects in Canada is commonly one of the following: Her Majesty the Queen in Right of Canada, a Crown (federal) agency, a province/territory or a provincial agency (or office), or a municipality. In each case, the term used in this chapter for the procuring authority is the Authority and the term used for the private sector entity providing the services is the Contractor.

The Contractor may be a Canadian domestic corporation or a limited partnership structure – as often preferred by foreign sponsors, especially where there is a joint venture and where this structure will be advantageous for tax reasons.

2.2 Background law

Consistent with Canada’s common law tradition (at federal level and in all provinces although Québec also has civil law), PPP has developed in Canada by evolution and there is no overarching legislation that covers PPP projects. However, the concept and existence of PPP is mentioned in the Canada Strategic Infrastructure Fund Act (2002, c. 9, s. 47), which provides for “the payment of contributions to eligible recipients for the carrying out of large-scale strategic infrastructure projects that contribute to economic growth or quality of life in Canada and that advance Canada’s objectives with respect to infrastructure” (section 3(1)), and states (in section 3(2)) that “The Fund shall, where appropriate, promote the use of partnerships between public and private sector bodies.”
The governing law and jurisdiction in respect of a PPP project will as a rule be determined by the province or territory in which it is located and certain aspects of federal law should also be taken into account where applicable (as described below).

2.3 Specific enabling legislation

Specific enabling legislation has not so far been required for PPP projects in Canada in the same way as has been the case in some US states. The 2009 Federal Budget provided that the Government would work with PPP Canada to ensure that the policy and legislative framework are conducive to the promotion of PPPs.

2.4 Covenant issues for regional authorities

Municipal governments are in many cases prevented from entering into contracts with an expenditure commitment longer than five years without obtaining an electoral mandate through a referendum. However, this does leave scope for municipal PPPs that do not require the Authority to make availability payments. For example, the cities of Victoria, Guelph and Cranbrook have completed stadia PPPs in which the Contractor is paid directly from user revenues.

2.5 Other PPP bodies

Support to further development of PPPs is also provided through the Canadian Council for Public-Private Partnerships (CCPPP). CCPPP aims to foster innovative forms of cooperation between the public sector at the municipal, regional, provincial and federal levels and the private sector. Its membership of nearly 300 organisations spans both the public and private sectors. CCPPP undertakes research, publishes findings and facilitates forums for discussion and knowledge exchange.

3. Active sectors

The use of PPP is well developed in the transport sector and for healthcare and accommodation projects, as more particularly described in the review of geographically active markets in Section 4 below.

4. Active geographical markets

4.1 Federal

PPP in Canada received a significant federal boost in February 2008 when the federal government established PPP Canada Inc. (PPP Canada), a Crown corporation modelled on Partnerships British Columbia (Partnership BC), which was in turn modelled on the UK’s Partnerships UK. PPP Canada’s mandate is to develop the Canadian market for public-private partnerships (P3) for the supply of public infrastructure in the public interest. It manages the Government’s CAD 1.2 billion Public-Private Partnerships Fund (P3CF), the objective of which is to develop the market for quality infrastructure projects best procured via PPP or AFP. The P3CF is focused on provincial, territorial, municipal and First Nations P3 or AFP infrastructure projects. PPP Canada intends to work directly with both provincial/territorial and municipal governments and is working with the Department of Indian and Northern Affairs Canada (INAC) to identify potential First Nations P3 projects.

1 http://www.pppcouncil.ca
Federally-procured projects have included the Confederation Bridge between New Brunswick and Prince Edward Island (closed in 1992), and the Royal Canadian Mounted Police Headquarters being procured in Surrey, British Columbia (BC) (preferred bidder appointed in January 2010).

### 4.2 Alberta

Alberta has an Advisory Committee on Alternative Capital Financing (ACF) which reports to the province’s Treasury Board. Within the Treasury Board there is also an ACF Office which aids in negotiating PPPs. The early projects have been mainly in the areas of education and transport (eg various ring roads around major urban centres). Alberta has entered into a memorandum of understanding with BC to collaborate on the development of PPP procurement in the two provinces. As mentioned above, at municipal level, Calgary in particular seems to have embraced PPP.
4.3 British Columbia

BC has undoubtedly been an early adopter of PPP in the Canadian market. Partnerships BC\(^2\), a wholly-owned company of the provincial government was created in 2002 and is widely seen to continue to lead the charge in the field of Canadian PPP procurement. Partnerships BC has also provided advisory services to other provinces (e.g., Nova Scotia). The provincial government has been an enthusiastic proponent of PPP, requiring any public project valued at more than CAD20 million to be considered for procurement as a PPP project.

The early PPP projects in BC were mainly transportation projects, including the Sea-to-Sky Highway, the Kicking Horse Canyon Highway and the William R. Bennett and Golden Ears Bridges projects. More recently, there has been a substantial deal-flow in social infrastructure projects, especially in the healthcare sector (primarily hospital projects). PPP projects in BC now span a diverse range of sectors.

4.4 New Brunswick

New Brunswick has procured a number of PPP accommodation projects in the education, justice and water sectors and one further transport project – a stretch of the Trans-Canada Highway from St Leonard to Longs Creek. At least one other road project is being procured in New Brunswick (the Route 1 Atlantic Gateway Project) and a small number of projects in the health, education and justice sectors are also being proposed.

4.5 Northwest Territories

The Northwest Territories have entered the PPP market by procuring the Deh Cho Bridge project, the construction of which is due to be completed in 2011.

4.6 Ontario

Ontario is currently seeing greater PPP deal-flow than any other Canadian province, dominated by projects in the healthcare sector. More than 20 healthcare PPP projects have already closed in Ontario and several more are in procurement. Ontario has also procured a handful of other PPP accommodation projects and has more accommodation projects, as well as some transport projects, in procurement. As mentioned above, Ottawa has been a keen proponent of PPP at municipal level.

PPP in Ontario was given a significant boost in 2006 when the provincial procurement agency and Crown corporation Infrastructure Ontario\(^3\) was established. Like its counterpart in BC, Infrastructure Ontario has helped to standardise procurement processes and documentation in line with the global market, making Ontario an attractive market for international PPP financiers and investors.

4.7 Québec

The province of Québec set up L’Agence des Partenariats Public-Privé du Québec in 2004\(^4\) (PPP Québec), which was broadly modelled on Partnerships BC. Since then Québec has seen a small number of high-value projects close, notably the A25 toll highway and bridge linking Montréal and Laval (closed in 2007). Feasibility assessments of the appropriateness of PPP for proposed capital projects under provincial jurisdiction and for receiving provincial funding are required.

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\(^2\) [http://www.partnershipsbc.ca](http://www.partnershipsbc.ca)

\(^3\) [http://www.infrastructureontario.ca](http://www.infrastructureontario.ca)

4.8 Other provinces and territories

In general, PPP is yet to be developed or is at an early stage of development in all other provinces and territories, but there are some notable signs of future development of PPP procurement in certain of those regions. For example, the Provincial Government of Saskatchewan set up a P3 Secretariat in January 2009 to explore the potential use of public-private partnerships as a means of delivering public sector infrastructure and now requires that any infrastructure project costing CAD25 million or more be screened by the P3 Secretariat for consideration as a PPP project.

4.9 Municipal

The first PPP project at the municipal level in Canada was the Charleswood Bridge PPP project in Manitoba (closed in 1995). Other examples of PPP projects procured at the municipal level are provided above. PPP Canada also has a firm focus on municipal infrastructure projects.

5. Future sectors

There appears to be a steady flow of PPP projects in the pipeline for Canada, with the health and transport sectors continuing to dominate the deal-flow both in volume and value. In the transport sector, there are proposed PPP projects in the prairie provinces of Alberta and Manitoba and a significant bridge project in New Brunswick. Future projects in New Brunswick are likely to include courthouses, a psychiatric hospital and possibly detention centres.

In the health sector, it appears that Québec will be making significant investments in PPP projects, namely the CAD1.3 billion McGill University Multicultural Health Network and the CAD1.7 billion Centre Hospitalier de l’Université de Montréal projects. There also appears to be an increasing number of PPPs in the pipeline in BC and Ontario relating to justice and government buildings. Québec is planning to use the PPP in the culture sector to deliver a new concert hall for the Montréal Symphony Orchestra. Some new environmental projects covering waste and water treatment also in the pipeline in Canada.

6. General structure of concessions

Given the decentralised nature of PPP procurement in Canada and the relatively recent moves towards standard documentation, no national standard for the structure of concessions and risk allocation has yet emerged. Road and bridge projects, in particular, use a wide variety of structures and risk allocations. However, in the area of accommodation projects, some provinces, notably BC and Ontario, have developed standard form concession agreements and related documentation which follow a risk allocation broadly consistent with the UK Standardisation of PFI Contracts.
7. Specific legal issues

7.1 Insolvency and security position

Subject to the exception in relation to Crown debts, discussed below, Canadian law allows financiers to take broadly the same types of security as in any other common law jurisdiction – this applies even to Québec, which, although it is a mixed civil and common law jurisdiction, has adopted laws on security interests which are functionally very similar to the rest of common law Canada. In the Canadian PPP market, senior financiers would usually take, via a collateral agent, a first-ranking specific mortgage, charge, assignment and security interest over all of the project company’s significant assets, including interests in real property (if any) and personal property, such as intellectual property rights, rights under licences and permits, contractual rights and accounts.

7.2 Security over Crown debts

Where the Authority is the Crown and the financiers wish to take security over payments to the Contractor under the project agreement, financiers will need to ensure that any assignment of Crown debts complies with the Financial Administration Act (Canada) R.S., c. F-11. Under section 68(1) of that Act, the assignment will only be valid if:

(a) it is absolute, in writing and made under the hand of the assignor;

(b) it does not purport to be by way of charge only; and

(c) notice of the assignment has been given to the Crown as provided in section 69.

If the assignment fails to comply with the Act, it is invalid not only against the Crown, but also against the assignor (Marzetti v Marzetti [1994] 2 S.C.R. 765 (Supreme Court of Canada)). The Canadian courts have found that a security interest which does not involve an assignment is also rendered ineffective by the Act (Profitt v Wasserman (2002) 32 C.B.R. (4th) 94, (2002) 157 O.A.C. 356 (Ontario Court of Appeal)).

Financiers will therefore frequently ask for an absolute assignment of Crown debts as part of their repayment plan and some concession agreements will allow for this structure.

7.3 Employment issues

There is no specific legislation governing the transfer of employees from the public sector to the private sector. Any employment arrangements of this type would be addressed in the concession agreement.

7.4 Canada-specific legal issues

(a) Appropriations risk

Like a number of jurisdictions in the Americas, Canada has a statutory provision that contractual obligations of the state (Her Majesty the Queen in Right of Canada) to make payment are subject to an annual appropriation of funds by the legislature to make those payments.

Section 40(1) of the Financial Administration Act (Canada) provides:

"It is a term of every contract providing for the payment of any money by Her Majesty that payment under that contract is subject to there being an appropriation for the particular service for the fiscal year in which any commitment under that contract would come in course of payment."
In a federally procured availability-based PPP project, if the Canadian parliament does not appropriate funds for the service payments in any given fiscal year, the concessionaire could lose its revenue stream.

Sponsors and funders typically get comfortable on one or more of the bases set out below:

(i) a federal entity (e.g., a health authority) that is not an agent of the Crown (and therefore not caught by the appropriations provisions of the Financial Administration Act (Canada)) can enter into the concession agreement as the Authority. The sponsors and lenders would need to be satisfied with the creditworthiness of that entity;

(ii) the state can provide a guarantee, which does not require an annual appropriation, but merely a one-off appropriation\(^5\). This route has been used in conjunction with that in paragraph (i) above where the contracting federal entity is judged not be sufficiently creditworthy; and/or

(iii) Canada is viewed as a politically stable jurisdiction and – based on historical record – the risk of parliament actually refusing to appropriate funds to meet a contractual commitment is judged to be remote.

There are similar appropriation provisions in provincial legislation and thus appropriations risk also needs to be considered when contracting with provincial entities.

(b) Limitation periods

Statutory limitation periods in Canada can be much longer than in other jurisdictions (for example, subject to certain exceptions, the limitation period in BC is 30 years from the accrual of the cause of action). The parties to a contract – especially at the sub-contract level – will sometimes agree to shorten the limitation period for the purposes of a given contract.

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\(^5\) Section 29 of the Financial Administration Act (Canada): (1) Where a guarantee has been given under the authority of Parliament by or on behalf of Her Majesty for the payment of any debt or obligation, any amount required to be paid by the terms of the guarantee may, subject to the Act authorizing the guarantee, be paid out of the Consolidated Revenue Fund.
The American, by nature, is optimistic. He is experimental, an inventor and a builder who builds best when called upon to build greatly.

John F Kennedy (1917-1963)
1. Introduction to the US PPP market

Since 2005, more public-private partnerships (PPPs) for public infrastructure in the United States have reached commercial and financial close than during any comparable period in United States history. Jurisdictions around the US are increasingly relying on PPPs due to severe and worsening shortfalls in state and municipal budgets for public works and the declining performance of transportation networks after decades of undercapitalization and mismanagement. Some eight states have enacted transportation PPP enabling legislation since 2005 alone, bringing the total to 25 states with such legal authority in place. Further, in those states that have not enacted PPP enabling legislation, many have broad municipal Home Rule authority to procure PPPs on their own. Over 20 major PPP projects with an aggregate project cost of more than USD30 billion are currently in procurement in the US. Parties already breaking ground in the US PPP market include concessionaires with track records from other jurisdictions; major US and Canadian public pension investors; certain European institutional lenders; and a number of US, European and Australian private equity and infrastructure investment funds. Appetite for the US market from overseas parties has been further demonstrated by the Allen & Overy LLP Infrastructure Survey 2009 of international infrastructure investors in which over half of the respondents identified the US as a target destination for infrastructure investment capital looking forward.

This chapter summarizes certain legal and project developments in the five most active states in the US PPP market and describes the emerging role of municipal governments in the market; key Federal initiatives organized to support US PPPs; and some of the key risk allocation issues inherent in US PPP projects.

2. US States leading the US market

2.1 California

Among the first states in the United States to authorize PPPs, the State of California enacted PPP enabling legislation in the late 1980s but allowed its legislation to lapse in 2003. In 2006, legislation was enacted establishing a pilot program which permitted, among other things, solicited and unsolicited proposals for PPP projects that improved the movement of goods in California. On February 20, 2009, the State of California enacted legislation known as SBX2 that favorably amended the state’s existing legislative framework in three principal ways. First, SBX2 amended the state’s transportation PPP legislative framework by:

(a) eliminating the limit on the number of transportation projects that regional transportation entities and the California Department of Transportation (Caltrans) may undertake;

(b) removing the requirement of California legislative approval for lease agreements and only requiring submission of these lease agreements to the legislature for its review;

(c) allowing unsolicited proposals and the award of a project on an unsolicited basis if at least one other responsible bid has been submitted; and

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3 Cal. Streets & Highways Code § 143(c)(2) – (c)(4). Former § 143(c)(2) limited transportation projects, the definition of which remained unchanged, to only two in northern California and two in southern California. See also Cal. Streets & Highways Code § 149.7, which still limits the number of high-occupancy toll (HOT) lanes to two in northern California and two in southern California.
4 Cal. Streets & Highways Code § 143(c)(2) – (c)(4). Former § 143(c)(2) limited transportation projects, the definition of which remained unchanged, to only two in northern California and two in southern California. See also Cal. Streets & Highways Code § 149.7, which still limits the number of high-occupancy toll (HOT) lanes to two in northern California and two in southern California.
5 Cal. Streets & Highways Code § 143(c)(5). Former § 143(c)(3) required that “all negotiated lease agreements shall be submitted to the Legislature for approval or rejection.”
6 Cal. Streets & Highways Code § 143(g)(1)(E). The second sentence in § 143(g)(1)(E) was added by SBX2.
Secondly, SBX2 4 amended the Public Contract Code and created the Design-Build Demonstration Program (DB Demonstration Program),\(^8\) In addition to the general authority of Caltrans and regional transportation entities to enter into PPPs elsewhere provided by SBX2 4, the amendment authorizes D&B projects by a local transportation entity and ten by Caltrans as part of the DB Demonstration Program.\(^9\) The DB Demonstration Program, set to expire on January 1, 2014,\(^10\) creates its own procurement and prequalification processes\(^11\) and additionally gives the State significant leeway in imposing performance and payment bonding (ie surety) requirements upon private entities.\(^12\)

Finally, SBX2 4 added a distinct Design-Build Pilot Program (DB Pilot Program) to the Public Contracts Code.\(^13\) This program, which focuses on social infrastructure PPPs, enables PPPs as provided in California’s Community Redevelopment Law.\(^14\) Since it is in the trial phase, the DB Pilot Program is limited to ten new social infrastructure projects,\(^15\) defined to include utilities, parks, playgrounds and other improvements that are part of the State procuring agency’s redevelopment plan.\(^16\)

A number of projects have been procured under the primary statutory authority of the California Streets & Highways Code. The SR-125 Toll Road, an 11-mile toll road between SR-905 and SR-54, was sponsored by Macquarie Infrastructure Group Ltd. and funded in August 2003 under the original regime. Under the legislation, as amended in 2006, a Design-Build/Operate & Maintain (DBOM) project was tendered to construct a transit link between the Oakland International Airport and the Bay Area Rapid Transit (BART) system. After bids were delayed in 2006, two prospective sponsors withdrew from the bidding in early 2008 and the remaining consortium was unable to submit a bid by the deadline in October 2008. BART withdrew the tender and is pursuing public-sector financing alternatives for the project with bids expected by September 2009.\(^17\) Outside of the transportation sector, the construction of the Long Beach Courthouse is being procured as a social infrastructure Design-Build/Finance Operate & Maintain (DBFOM) PPP pursuant to the Trial Court Facilities Act.\(^18\) A shortlist of three prospective bidder groups was published in May 2009 and bids were submitted in December 2009.\(^19\) In addition, as discussed in Section 3 below, there are several proposals pending to create PPPs related to the City of Los Angeles’ parking system. Finally, as many as ten toll road projects have been identified as being possible PPP projects since the passage of SBX2 4. These projects, all of which could be in the multi-billion dollar range, include High-Occupancy Toll (HOT) lane networks in San Diego, San Francisco and Los Angeles, various tolled trucking lanes and tolled tunnel projects, the Doyle Drive Route 101 reconstruction project in San Francisco, the Interstate 710 freight corridor project between Long Beach and Los Angeles, the Gerald Desmond Bridge replacement project in Los Angeles County and the Riverside County Route 91 Corridor improvements.\(^20\)

### 2.2 Colorado

The State of Colorado enacted PPP legislation in 1995 which allows the public sector to engage in a variety of public-private initiatives both to improve existing infrastructure and to create new facilities. Colorado legislation allows private entities to participate at all levels of a project’s growth, commencing

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\(^7\) Cal. Streets & Highways Code § 143(t).
\(^9\) Cal. Pub. Contr. Code §§ 6802 (authorizing 5 local and 10 Caltrans projects), 6803 (limiting the total number of projects under the Demonstration Program to 15).
\(^17\) Source: Infrastructure Journal.
\(^18\) Cal. Govt. Code, Title 8, Chapter 5.7.
\(^19\) Ila Halai, Shortlist Revealed for Long Beach Courthouse P3, P3 Americas, May 12, 2009.
\(^20\) Ila Halai, Ten Californian Toll Roads Could be Procured as P3s, Says Reason Foundation, P3 Americas, March 30, 2009.
with the pre-developmental stage and concluding with DBFOM agreements covering the entirety of a project’s existence. In keeping with this wide array of opportunities for participation, Colorado law also offers a variety of financing options for private investors. However, the Colorado Tax Payers’ Bill of Rights (TABOR), an amendment to Colorado’s constitution passed in 1992, presents some risk to investment in Colorado, as it limits the ability of Colorado to enter into multiple-year contracts without first securing voter approval.

Colorado has been co-operating with private enterprises in transportation-related projects for nearly fifteen years. The E470 Toll Motorway project, signed in 1995, is Colorado’s longest running PPP project and continues to generate profits for Colorado through user tolls. A small number of other PPP transportation projects have been successfully completed since then, providing much needed infrastructure development, and revenue to the State from lease and concession agreements. For example, the privatization of the Northwest Parkway, a 70-mile toll road that connects several toll and non-toll highways, providing convenient access to residential and employment centers in the Denver metropolitan area, provided Colorado with an upfront payment of USD603 million in exchange for the right to collect tolls for a period of 99 years. The latest of these projects, being tendered by the Denver Regional Transportation District, is the “Eagle P3” portion of the transit agency’s FasTracks capital program, a USD4.7 billion light rail system that will provide mass transit along 122 miles of rail line.21 The Eagle P3 project is comprised of several lines, including a commuter rail portion, which will be executed on a DBFOM basis.22 It should be noted that Colorado has developed a number of project finance transactions in the power (the Alamosa Country Solar Power Plant), wind (the Colorado Green Wind Project) and stadium (the Denver Broncos football stadium) sectors as well.

### 2.3 Florida

The State of Florida amended its PPP enabling legislation23 in 2007 to provide broad authority for PPP projects and significant powers and protections for the private entity and to reserve only essential police powers for Florida.24 Specifically, allowing for both greenfield and brownfield projects, and with no restrictions as to geography or mode of transportation, Florida’s statute allows for PPPs by way of pre-development agreements (PDAs), any combination of DBFOM agreements and long-term concessions of existing assets. Private entities may submit both unsolicited and solicited proposals that the public authority can evaluate on a “best price” or “best value” basis with the assistance of private consultants. The authority has the ability to grant private entities the right to charge tolls directly and to permit broad flexibility in financing structures and access to state and federal funds.25 However, legislative approval is required for both proposal solicitation and annual availability payments. While the authority may consent to arbitration in the procurement documents, neither arbitration nor waiver of sovereign immunity is explicitly provided for in the legislation.

A substantial number of PPP projects have been undertaken in Florida in recent years. Both the Florida I-595 Project and the Port of Miami Tunnel Project (POMT) have reached financial close; six PPP projects are either in tender or finance; and six other transportation PPP projects are awaiting legislative approval.26

POMT was halted last year due to the credit crisis27 and the selected bidder consortium, backed by Bouygues, was forced to identify a new equity partner, Meridiam Infrastructure, after its original partner experienced significant financial difficulties in late 2008. After initially cancelling the project in December 2008,28 the Florida Department of Transportation (FDOT) approved Meridiam as the new equity investor and achieved financial close of the project in October 2009.29

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24 Florida Code, § 334.30.
25 Companies are protected by state FOIA, but not by the PPP legislation itself.
26 Source: Dealogic.
27 Id.
The I-595 project was Florida’s first PPP to close and the first availability payment deal to close in the US. The ACS Dragados-Macquarie partnership for the I-595 Project emerged as the selected consortium in late October 2008, with a bid to receive an annual availability payment in the amount of USD64 million for the 35-year concession. The consortium will design, build, finance, operate and maintain auxiliary lanes to the I-595 corridor roadway, financed on an availability basis by toll rates subject to control by FDOT.

In December 2007, FDOT issued a request for qualifications to potential bidders on a long-term concession to develop, design, construct, finance, operate, maintain and toll the First Coast Outer Beltway, a 46.5-mile toll road to connect I-95 in St. Johns County to I-10 in Duval County. FDOT received four responses but delayed the project because of uncertainty as to whether it would charge property taxes on the land slated for use. Legislation passed in May 2009 exempts the company developing this land from property taxes and will enable the project to advance.

In June 2008, FDOT also reissued a request for qualifications for the Alligator Alley project, a 50- to 75-year concession for an upfront payment and periodic toll revenue sharing in exchange for the right to toll, operate and maintain the 84-mile cross-Florida parkway. However, possibly due to credit market conditions, FDOT did not receive any bids for the project by the deadline for offers in May 2009 and to date there have been no further developments.

2.4 Texas

The State of Texas was initially at the forefront of developing PPPs and authorized transportation PPPs in 2003. Subject to a moratorium on highway PPPs that was enacted in 2007 (described in more detail below) the State’s legislative framework authorizes the Texas Department of Transportation (TxDOT) to engage a private entity to design, develop, finance, construct, maintain, repair, operate, extend or expand a variety of transportation projects including toll roads, highways and related facilities. Texas’ statutory regime for PPPs permits a wide array of projects, on both a solicited and unsolicited basis, but limits the projects by geographic location. For instance, only projects identified in the unified transportation program of the TxDOT or the state-wide transportation program are eligible subjects of a PPP. Like California, the Texas legislation prohibits non-compete clauses for roadway projects but allows for compensation for lost revenue due to any limited access highway that is within four miles of the centerline of the project. TxDOT additionally has access to federal and state funds and the private entity has flexibility in structuring the financing. Texas also protects the confidentiality of information submitted in a proposal until the final contract is entered into and allows the TxDOT to pay unsuccessful bidders for work product contained in the proposals.

There are a number of Texas PPP projects of note. The Camino Columbia Toll Road, a 21.8-mile, USD75 million project launched in 1999, was the first privately financed toll road in Texas. The Trans-Texas Corridor project, a network of super-highways to be developed as individual PPPs involving long-term concessions, includes the 600-mile TTC-35 project for which a Comprehensive Development Agreement (CDA) was signed between the TxDOT and a consortium of Cintra and Zachry in 2005 with an expected investment of USD6 billion. It also includes the 650-mile I 69 project stretching from Texarkana to the...
Mexican border for which a CDA was signed between the TxDOT and a consortium of Zachry and ACS in 2008 with an expected investment of USD1.5 billion. Another major Texas PPP project is the LBJ-635 Managed Lanes project, located in the Dallas-Fort Worth area and awarded to a consortium of Cintra, Dallas Police and Fire Pension System and Meridiam in February of 2009. The Managed Lanes will feature eight rebuilt main lanes with no toll and six barrier-separated lanes with dynamic tolling. Additionally, a CDA was executed in June of 2009 for the North Tarrant Express with a consortium including Cintra and Meridiam. Like the LBJ-635 project, the North Tarrant Express is being developed as a toll-based PPP.

However, the future of highway PPPs in Texas should be considered in the context of the political risks introduced by the State Highway 121 (SH-121) project and the subsequent Moratorium on Certain Terms in CDAs (the Moratorium) or Sale of Toll Projects enacted in 2007. The Moratorium suspends CDAs relating to toll projects entered into after May 1, 2007, with allowances to maintain only CDAs related to specified projects. Although the Moratorium expired on September 1, 2009, the Texas legislature has not reauthorized the state’s highway PPP program. No new highway PPPs are expected to proceed in Texas for some time.

In the SH-121 project, a 25.9-mile, all-electronic toll road in northern Texas, TxDOT had completed a competitive bid process and had awarded the project to a consortium led by Cintra. Nonetheless, TxDOT suspended the project and granted the North Texas Tollway Authority (NTTA) a “first option” to control the project and match the greatest commitment received from private entities prior to March 26, 2007. The NTTA was awarded the contract but the Federal Highway Administration (FHWA) advised TxDOT that the procurement violated two Federal laws. First, allowing NTTA to submit a proposal after the selection had been completed was a violation of the Federal requirement to conduct a fair and open procurement process. Secondly, Federal regulations specifically prohibit a public entity from bidding against a private entity. While TxDOT and FHWA later agreed to a negotiated solution whereby the TxDOT-NTTA contract was cancelled, the experience points to the possibility of modifications being made to the procurement process by the legislature at unexpected points in the procurement process.

2.5 Virginia

Virginia is at the forefront of states that have adopted PPP legislation. With four PPP projects up and running, and an additional five projects in various stages of tender and pre-approval (including four transportation projects which have been signed and are in various stages of construction and operation, and five transportation projects which are in various stages of tender or pre-approval), Virginia is making good use of the opportunities offered by the involvement of private enterprise in public works. Other projects developed, constructed and maintained by partnerships between Virginia and the private sector include roads, correction facilities and schools.

Virginia’s flexible legislation accommodates various models of project finance, enabling a mix of public and private funding via a variety of bond and equity instruments. Virginia’s PPP statute enables Virginia to accept both solicited and unsolicited proposals for a wide range of projects and accounts for the differences between regular procurements and PPP enterprises that, at times, require different methods for contracting with private providers. This system provides Virginia with the ability to approach different
projects using flexible timelines, while protecting sensitive information during the bidding process. Virginia legislation reduces variable contractual risks by allowing for flexible bonding requirements; enabling the use of eminent domain (or compulsory sale to the public) for acquisition of real-property and rights of way; and requiring the close co-operation of utility companies in respect of transportation projects.

Under the authorization of the Virginia Public-Private Transportation Act (1995), Virginia has been able to engage in sophisticated transportation infrastructure projects with private investors. In 2006 Virginia turned over the management, operation, and toll collection responsibility for the Pocahontas Parkway to Transurban (895) LLC in exchange for a USD500 million payment that was used to retire the debt that the Virginia Department of Transportation had accrued while operating the highway. The sharing of future revenues with Virginia and the financing and building of a much needed road linking the city of Richmond and its growing international airport are further commitments undertaken by Transurban (895). The Capital Beltway HOT Lanes project, which will implement variable congestion tolling of single-occupant vehicles on a 14-mile length of new highway, is expected to contribute a total of USD3.46 billion dollars to Virginia’s economy.55 In addition, Virginia is negotiating a PPP for a new tunnel between Norfolk and Portsmouth beneath the Elizabeth River.

3. Home rule and key US municipalities of interest

3.1 Home Rule

Municipal Home Rule is a legal doctrine, embodied in certain state constitutions, statutes, and judicial decisions, which grants cities broad legal authority to conduct their affairs without significant interference from state legislatures. Inherent in such a doctrine is the authority for a municipality to negotiate PPPs relatively freely, without substantial involvement, and the associated delays and complexities, of state-level approval. PPP projects undertaken in Home Rule jurisdictions can benefit from a more manageable political environment and more flexible procurement due to locally fashioned rules; and offer a more competitive cost of capital as compared to municipal debt. PPP projects have already taken advantage of the benefits of Home Rule in certain notable cases, in particular the city of Chicago as described below. Some 27 states offer meaningful levels of Home Rule authority and thus represent potentially attractive venues for PPP projects.

12 states have “broad” home rule.
15 states have “partial” home rule.

3.2 Chicago

Despite the lack of explicit PPP enabling authority under Illinois law, Chicago’s Home Rule authority under state statutes provides the city with the flexibility required to co-operate with investors and entrepreneurs from the private sector for the benefit of the city. To date, Chicago has undertaken three major public-private initiatives, realizing a value of nearly USD3.6 billion.\(^{56}\) This revenue has provided Chicago with much-needed funds for paying off millions of dollars of debt, funding current city-wide projects and investing in reserve funds for Chicago’s future.

The three PPP projects which have been undertaken by Chicago to date are the leasing of the Chicago Skyway (which generated USD1.83 billion for Chicago), the leasing of a downtown parking garage (USD563 million), and the leasing of Chicago’s metered parking system (USD1.15 billion).\(^{57}\) Since the City Council of Chicago can amend municipal codes with each ordinance, Chicago found it useful to craft an individual ordinance for each of the three initiatives. Through this method, Chicago has been able to fashion each code to fit the financial and regulatory standards for each project, providing the private partner with a large degree of flexibility in the execution of the projects.

3.3 Los Angeles

In Los Angeles, the Los Angeles County Metropolitan Transit Authority (LACMTA) is charged with the power and responsibility to plan, develop, operate, maintain, or otherwise take steps necessary to “achieve optimal transport service for the movement of goods and people on a countywide basis.”\(^ {58}\) LACMTA has exercised this power, sometimes under specially created statutory guidelines,\(^ {59}\) in order to implement PPPs. The legislative regime thus provides LACMTA with significant leeway to engage in PPP projects.
developments, privatizations and leases within its county. LACMTA has continued to screen projects for development as PPPs.60 LACMTA also selected a consulting team to advise on its PPP program for the county’s priority transit and highway transportation projects.61 Recently, LACMTA has engaged a team of financial advisors to assess the monetization of its parking assets.62 Separately, Mayor Antonio Villaraigosa has proposed the monetization of the City’s on-street and off-street parking.

4. US federal aspects and funding

On the Federal level, assistance for funding PPP Projects is made available through a number of programs, including credit assistance under the Transportation Infrastructure Finance and Innovation Act (TIFIA), Private Activity Bonds (PABs), grants, and stimulus funds.

4.1 Financing – Transportation Infrastructure Finance and Innovation Act of 1998

TIFIA established a Federal credit program under which the US Department of Transportation (the USDOT) may provide three forms of credit assistance for use in funding infrastructure projects: secured (direct) loans, loan guarantees and standby letters of credit. Since 1998, 15 projects have been approved for a total of USD4.8 billion in assistance. As of February 2010, the TIFIA program funds are significantly oversubscribed and the US DOT has adopted a competitive process to ration such funds.63

TIFIA funding is limited to certain types of eligible costs, including costs incurred before and during construction, acquisition of equipment, capitalized interest necessary to meet market requirements, reasonable reserves and other carrying costs during construction. The total amount of TIFIA support may not exceed 33% of eligible project costs.64 In addition, project costs must be at least the lesser of USD50 million or 33% of the state’s Federal-aid highway apportionment.65 Projects eligible for funding include highway, transit, passenger, and certain freight facilities and port projects. Eligible projects must have a dedicated revenue source, such as tolls, user fees, availability payments or other dedicated revenue sources that also secure the project obligations.

An important feature of TIFIA credit instruments is the “springing lien” whereby in the event of bankruptcy, insolvency or liquidation, the TIFIA instrument springs to a senior position in terms of repayment such that it is in parity with senior commercial instruments. The risk of a springing lien provision is often mitigated by the flexible repayment terms of TIFIA loans. For example, USDOT may allow the borrower to postpone commencement of repayment for up to five years following substantial completion of the project and to capitalize interest during this time period, or permit payment deferrals (in which latter case certain restrictions apply eg preventing certain amortizations and voluntary prepayment of senior debt and equity distributions). Furthermore, borrowers may contractually agree that certain events will not constitute bankruptcy-related events.

4.2 Financing – Private Activity Bonds

Qualified Private Activity Bonds (PABs) are bonds which exempt the holder from Federal income tax if the bond was issued by a state or local government conduit and if the bond’s proceeds are used for a defined qualified purpose by an entity other than the issuing government. PABs may be subject to state income tax depending on the state, and are subject to the alternative minimum tax (AMT). Typically, the authority

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60 See, eg, Robert Lovell, LA Metro P3 Screening Due in September, Infrastructure Journal, June 6, 2009 (“The Los Angeles County Metropolitan Transportation Authority (Metro) is expected to complete initial screening of 60 potential P3 projects by September.”).
61 Ila Halai, Advisory Team Selected for LA Metro P3 Program, P3 Americas, Apr. 29, 2009.
63 See TIFIA website, at http://tifia.fhwa.dot.gov/. See also, TIFIA to Clarify Programme at the End of the Year, P3 Americas, Dec. 12, 2008.
64 23 USC. §§ 603(b)(2), 604(b)(2).
65 23 USC. § 602(a)(3).
procuring a PPP project will apply for the PABs under the condition that the private entity concessionaire repays the debt with toll revenue generated from the project. Although PABs have existed for some time, they were not a popular source of PPP funding until 2005 when qualifying facilities were expanded to include qualified highway or surface freight transfer facilities.

Tax-exempt facilities eligible for PAB funding include: airports, docks and wharves, mass commuting facilities, facilities for the furnishing of water, local electric energy or gas, sewage facilities, solid waste disposal facilities, qualified residential rental projects, local district heating or cooling facilities, qualified hazardous waste facilities, high-speed intercity rail facilities, environmental enhancements of hydro-electric generating facilities, qualified public educational facilities, and since 2005, qualified highway or surface freight transfer facilities under a USD15 billion program administered by USDOT. To qualify, highway or surface freight transfer facilities must receive certain Federal assistance, be an international bridge or tunnel or be a facility for the transfer of freight from truck to rail or rail to truck.

PAB issuances related to highway projects contain several material restrictions. At least 95% of the net proceeds must be used on the highway facility within a five-year period commencing on the date of issuance, and the availability of PABs is conditioned upon an investment grade rating by a nationally recognized bond rating agency. Additionally, PABs:

(a) may not have an average maturity that exceeds 120% of the average reasonably expected economic life of the facility being financed;
(b) may not be held by any “substantial user” or related person of the facility being financed;
(c) may not incur insurance costs above 2% of the PAB proceeds; and
(d) must receive appropriate government approval.

Future changes to PABs will increase their attractiveness as modes of funding for PPP projects. In addition, there are plans to exempt PABs from the AMT and to remove the USD15 billion cap on the USDOT program.

4.3 Financing – public-private partnership pilot program – Penta-P

Penta-P, a federal PPP pilot program established in January 2007, further indicates the US Government’s interest in promoting the PPP approach. The Federal Transit Administration (FTA) accepted into the Penta-P three projects – the BART Oakland Airport Connector, the Denver RTD FasTracks project, and the North Corridor and Southeast Corridor Bus Rapid Transit project in Houston – to demonstrate the advantages of PPPs versus conventional procurements in terms of allocating new construction risks, accelerating project delivery, improving reliability of project cost/benefit projections, and enhancing project performance. Through Penta-P, the FTA affords the pilot projects certain rating benefits and accelerates due diligence processes in connection with Federal project funding decisions. In the event that Denver RTD receives certain FTA funding for the FasTracks project, the market will have the opportunity to see whether the Penta-P proves to be a useful tool in promoting transit PPPs in the United States.

4.4 Stimulus package

The American Recovery and Reinvestment Act of 2009 (ARRA) further promotes the evolution of US PPPs, by authorizing stimulus spending for high speed rail (HSR), renewable energy and surface transportation (excluding HSR).

ARRA provides USD8 billion for the development of a comprehensive high speed intercity passenger rail network, and authorizes the US Secretary of Transportation to prioritize HSR over other rail projects. These funds are available through September 30, 2012, which is likely to be extended until these funds are fully used. In addition, President Obama’s FY2010 proposed budget provides for a USD5 billion grant (to be spent over five years) to create HSR corridors of 100 to 600 miles linking regional population centers.
HSR construction requires the involvement and approval of various stakeholders, such as Federal and state environmental authorities, the Bureau of Land Management and local cities and towns. In addition, HSR developers may need to obtain rights of way over the land on which they will construct HSR. Some states, however, have already acquired rights of way for their HSR projects, which will shorten timelines for project delivery.

ARRA provides USD6 billion in loan guarantees for renewable energy projects and USD1.5 billion of discretionary grant funds for surface transportation infrastructure – USD200 million of which may be used for subsidy and administrative costs of TIFIA, which can support an estimated USD2 billion in TIFIA credit assistance. Projects eligible for discretionary grants include, but are not limited to, highway or bridge projects, public transportation projects, passenger and freight rail transportation projects and port infrastructure investments. Grants must be between USD20 million and USD300 million, with no more than 20% of such funds awarded to a single state.

5. Summary of key risk allocation issues

Through an analysis of concession agreements from a number of recent US PPP transactions, several key risks arise which merit consideration, as does the apparent market norm for how such risks are accounted for in project documentation.

5.1 Termination and compensation

A threshold risk to assess when bidding for a US PPP project is the extent to which the authority is contractually obligated to pay the concessionaire compensation in the event of termination of the concession.

(a) Authority default and convenience

Generally, in the United States, the termination compensation owed to a concessionaire in the event the concession is terminated for the authority's default or convenience is measured by the fair market value of the concession as determined by an independent appraiser. Alternatively, the termination compensation package may be calculated in accordance with the traditional formula of outstanding senior debt, plus contributed equity plus a return on such equity (at the rate set forth in the best case financial model), plus breakage costs and demobilization costs.

(b) Concessionaire default

In the US market, there has been a wide range of resulting termination compensation owed to the defaulting concessionaire in the event of termination of the concession for the concessionaire's default. In many of the brownfield projects, the authority is not required to provide any compensation at all, and lenders have relied on relatively robust cure and step-in rights to protect against recovery loss on their investment. In the greenfield context, if termination occurs during construction, the authority is typically required to compensate the concessionaire for the value of the work completed. If termination occurs after construction is completed, the authority will typically compensate the concessionaire in an amount equal to the fair market value of the concession or the outstanding senior indebtedness. In some instances of greenfield projects, authorities have been successful in being obliged to compensate the defaulting concessionaire only a percentage of senior indebtedness (eg 80%) and in one reviewed project the authority was not required to compensate the concessionaire at all. Authorities have also begun to introduce a retendering process in the event of concessionaire default, although they have resisted (to date) the obligation for the authority to pay the fair market value of the concession in the event there is a failed retendering or there is not a sufficiently liquid market, which presents obvious concerns.
In most US projects, each party will typically have the right to terminate the concession agreement upon the occurrence of an extended force majeure event (e.g., 180 days). In such event, the authority is typically required to pay the concessionaire an amount equal to the outstanding senior debt, plus contributed equity plus breakage and demobilization costs, but will typically not compensate the concessionaire for any return on such equity. In some instances, the parties are not given the right to terminate the concession, but rather rely on the right to extend the term of the concession so as to restore the concessionaire to the same economic position it would have been in had such event not occurred.

5.2 Bonding and performance risk

One of the outgrowths of the traditional public construction works regime is the perceived need for authorities to protect themselves against non-completion of the construction. From a policy perspective, it is questionable whether any security is necessary, since private equity and debt investment in the project provides a high level of certainty of completion and performance, and no revenue is generated until after completion of construction works. Nevertheless, several states statutorily require the concessionaire to provide surety bonds to the procuring authority equal to the full value of the construction costs, which introduces a significant cost to the private sector. In some jurisdictions with proper PPP-enabling legislation, there have been legislative exemptions to the traditional construction bonding requirements that grant the authorities flexibility in determining the scope of adequate safeguards against non-performance. In others, bidders have forced the authority to seek legislative amendments in order to continue the project.

Nevertheless, some authorities continue to impose a performance security requirement in the form of letters of credit or surety bonds. The amount of performance security required can range from USD10 million to 100% of the contracted construction cost. The authority will also typically require a payment bond in order to guarantee payment to subcontractors and protect the property against liens.

5.3 Relief, compensation and force majeure events

The allocation of risks caused by intervening events is often highly negotiated, based upon the sensitivities of each project and authority. However, the market has slowly begun to develop a standard list of relief, compensation and force majeure events, as summarized below.

(a) Relief events

Relief events encompass a broad range of occurrences that grant the concessionaire relief from performing its obligations and grant extension of time deadlines to the extent caused by such events. In the US, relief events typically include the following: the discovery of pre-existing contamination or hazardous materials, threatened or endangered species or archeological artifacts; a failure of governmental bodies to grant the necessary approvals or permits; a breach by the authority; and a change in law that materially affects the project. Some relief events are also compensation events and may therefore give rise to financial compensation as well.

(b) Compensation events

Compensation events encompass a broad range of occurrences beyond the concessionaire’s control that grant the concessionaire compensation for any increased costs and lost revenue to the extent caused by such events. In the US, compensation events typically include the following: failure by the authority to provide access to the site; discovery of pre-existing contamination; interference with works by the authority; delay caused by the authority; legal proceedings, including injunctions; a discriminatory change in law; and a change in operating standards.
(c) Force majeure events

Force majeure events are generally events outside each party’s control that prevent the performance of the obligations under the concession agreement. In US practice, this concept is often defined broadly but in other instances is specifically defined to include the following: war, invasion and armed conflict; nuclear explosion or radiation; riot or civil commotion; government expropriation; natural disasters; radioactive or chemical contamination; widespread strikes; epidemics or quarantines; and embargoes. Provisions typically address relief from obligations, rights to terminate for prolonged events and payment (or otherwise) during the subsistence of events.

5.4 Appropriation Risk

Traditionally, most US state agencies are funded, in part, by general appropriations granted by the state legislature on an annual basis. Therefore, a significant risk to equity and debt investments is that of non-appropriations by the legislature such that the state agency is unable to fulfill its contractual obligations to its PPP partner. Although this risk is magnified in availability payment deals where the source of revenue is inherently tied to the state authority, it also exists in tolling projects in respect of compensation payments and termination payments, each of which could be large sums of money. Further, in some jurisdictions, depending upon the nature of the contract, a failure to appropriate funds would relieve the authority from having an enforceable payment obligation under the concession, thereby preventing the concessionaire from seeking appropriate legal recourse.

Investors generally get comfortable with appropriations risk on the basis that the state has a “moral obligation” to provide funds to its agencies in order to enable them to meet their contractual obligations. This is evidenced by the historical rarity of state legislatures failing to appropriate necessary funds for an agency to meet its contractual or municipal financing obligations. Similarly, investors sometimes rely on the “essentiality” of the asset as a means of assessing this risk. If an asset is so essential to the public’s use, it decreases the likelihood that the legislature would fail to appropriate sufficient funds to ensure continued availability of such asset. Lastly, some investors have been successful in negotiating certain contractual protections that serve as mitigants to this risk. For example, a concession can include the covenant that the authority will request appropriations on a timely basis and will use its best efforts to secure the funds necessary to meet its contractual obligations. Further, a concession could include a covenant to include the authority’s obligations for the next five years in the state’s budget, thereby ensuring that the legislature is taking appropriate fiscal measures for such period of time.

Ultimately, the level of appropriations risk will vary from state to state and project to project, but with the appropriate protections, this risk is normally accepted, after due diligence, by bidders and their funders.

5.5 Tax Issues

PPPs can be structured in various ways, and depending on the type of structure and the type of project, different tax issues may arise. For example, many infrastructure PPPs provide the concessionaire with a long-term lease on the relevant land, which can render the concessionaire liable for tax burdens related to interests in real property. Specifically, non-US holders of a governmental permit to lease certain types of toll infrastructure projects (such as roads or bridges) may be subject to US tax on their direct or indirect sale under the Foreign Investment in Real Property Tax Act of 1980, as amended.

When negotiating which party will bear the tax burden and the risk of tax code changes, there are a number of issues to consider. For example, the concessionaire may be able to offset its tax burden with depreciation benefits over the life of the property. However, the various state and federal tax benefits that may be available to private lessees are unstable, since private sector involvement in public infrastructure is a point of political debate and the tax regimes governing these projects are subject to change. The parties often address the risk of property tax changes by explicitly providing compensation to the concessionaire or permitting increases in user fees if there are changes in state or local property tax law.
6. Conclusion

Due to budgetary constraints, political effects and other factors, Federal, State and local governments in the US have fallen dramatically behind in the provision and maintenance of the public’s major infrastructure needs. As a recognition spreads of the imperative for a new model for the provision of these formerly publicly financed works, the individual states have increasingly taken the initiative. It must be remembered that the US PPP market is relatively new compared to the European markets, subject to the specifics of state or local legislation and with commercial norms that substantially evolve with every agreed deal. However, the growing appetite in the US for private investment in infrastructure and PPPs has already drawn the committed interest of key private sector players and is likely to grow substantially as a destination for infrastructure investment in coming years.
Middle East and Asia
India

You must be the change you want to see in the world.

Mahatma Gandhi (1869-1948)
1. Introduction

For a long time after independence in 1947, the infrastructure sector was dominated by the public sector with hardly any private sector participation. Financial and technological constraints, combined with the slow pace of progress of infrastructure projects, paved the way for private participation.

Governments began focusing on and actively promoting the PPP model for infrastructure projects about ten years ago. Since then, there have been more than 300 PPP projects (in various sectors) for which concessions or other forms of contract have been awarded and further work is either underway or projects are in operation.

The states most open to the adoption of the PPP model are Rajasthan, Maharashtra, Gujarat, Andhra Pradesh, Karnataka and Tamil Nadu. Other states have taken steps such as enacting specific PPP legislation, but it is political will which is the key driver behind the use of PPP projects for the development of infrastructure.

As in other countries, the global economic recession has had an impact on the Indian infrastructure market and various bank and governmental authorities have taken steps to mitigate the effects.

2. Legal and regulatory framework

2.1 Background

India is a common law jurisdiction. The constitution of India divides law-making powers between the government of India (GoI) and the various state governments. The state governments and the GoI have the power to legislate over different infrastructure sectors. For example, while airports are reserved for the GoI, both the GoI and state governments may legislate on roads and ports. If there is a conflict between the laws formulated by the state government and the GoI in a sector over which both have the power to legislate, the GoI legislation will prevail. As a consequence, there is no single legislation that governs public-private partnership (PPP) projects in India and mechanisms for the implementation of PPP projects exist at both state and central levels.

The term government in this chapter refers to both the GoI and state governments and, (depending on the functions, powers and rights delegated by the state governments to the local authority (known as a municipal corporation) of an urban area), also the local government.
2.2 Capacity to contract

PPP projects may be implemented by the central, state or local authorities (including municipal corporations) under the relevant enabling legislation passed by the GoI or the state government. The constitution of India requires every state to incorporate a municipal corporation for every urban area. Their functions include urban planning, building and maintenance of roads and bridges, water supply, waste management and providing other public amenities. These municipal corporations are empowered to act as institutions of self-governance and must comply with the relevant state government policies.

Depending on the functions, powers and rights delegated to a municipal corporation by the state government, the municipal corporation may enter into a concession agreement with a private third party. For example, a notification was specifically issued by the Maharashtra government to enable the Mumbai Metropolitan Regional Development Authority to grant a concession for development of the Versova-Andheri-Ghatkopar metro line in Mumbai.
2.3 Central legislation

(a) Central guidelines

As mentioned above, there is no central legislation governing PPP projects in India. However, there are guidelines and regulations which outline a mechanism for identifying, approving and developing PPP projects. The PPP Cell of the Department of Economic Affairs (DEA) of the Ministry of Finance is the main agency for all PPP projects involving the GoI. The DEA has set out a detailed mechanism for PPP projects, covering all issues from project identification to implementation. Some important guidelines and regulations are briefly set out below.

(i) Guidelines issued by DEA in 2008

These guidelines are mandatory for all PPP projects promoted or sponsored by the GoI, or other authorities under the GoI’s control, for example, Airports Authority of India (AAI), National Highway Authority of India (NHAI), and trusts and authorities created under the Major Port Trust Act, 1963. These guidelines apply to projects with a capital cost exceeding INR1000 million (approximately USD20.83 million). They set out the procedure for identification of a proposal in relation to an infrastructure project and its further appraisal and approval.

(ii) Guidelines issued by DEA in 2008

These guidelines are mandatory for all PPP projects promoted or sponsored by the GoI or other authorities under its control. They set out the procedure to be followed for identification, appraisal and approval of projects with a capital cost of less than INR1,000 million (approximately USD20.83 million).

(iii) Scheme for financial support to PPP projects – Viability Gap Funding

This scheme was introduced in 2004 and is applicable to projects proposed by the GoI, state governments or statutory authorities. It aims to make financially less attractive infrastructure projects undertaken on a PPP model commercially viable by providing financial support in the form of Viability Gap Funding (VGF). VGF is provided during the construction period of the project, and may be for up to 20% of the project cost, though in exceptional circumstances it may extend to 40%.

(b) Ministry of Finance bidding criteria

In an attempt to boost greater investment in infrastructure projects by private developers and address some of their concerns with respect to bidding criteria, the Ministry of Finance substantially revised and revamped its bidding criteria in May and November 2009 by removing many of the bottlenecks that have plagued the process for awarding infrastructure projects. For example, previously the bidding criteria did not permit a member of a bidding consortium to hold more than a 1% interest (directly or indirectly) in any member of another bidding consortium for conflict of interest reasons. This severely limited the number of eligible bidders for a particular infrastructure project. Many bidders were often unaware of the interest or common shareholding of a group company in another bidder. The revised criteria have addressed the issue by increasing the cross-holding limit first from 1% to 5% in May 2009, then to 25% in November 2009. The other main amendments introduced most recently are:

(i) once a road developer has qualified for a particular project, it no longer needs to go through the qualification process for every successive project that it bids for, for a period of 12 months from the date of qualification;

(ii) the technical threshold capacity criteria for bidding have been relaxed and are now equivalent to the project cost;

(iii) an empowered group of ministers, including the Finance Minister, has been set up to resolve all procedural and financial impediments and to expedite the implementation of the National Highway Development Plan; and

(iv) a developer is barred from bidding for new projects if it has failed to achieve financial closure of three or more projects.
2.4 State legislations and guidelines

State legislations and guidelines function in parallel to the GoI schemes and guidelines. States such as Bihar, Punjab, Andhra Pradesh and Gujarat have enacted specific PPP legislation. These laws set out the regulatory framework for all aspects of infrastructure development on a PPP basis. For instance, the Punjab Infrastructure (Development and Regulation) Act 2002 (PIDA Act) provides for the identification, selection and prioritisation of infrastructure projects for private participation within the state. A body has also been established under the PIDA Act for funding infrastructure projects. This funding is granted to private developers under a scheme similar to the VGF.

For states which do not have specific legislation for PPP projects, the DEA facilitates PPP projects through a technical assistance (TA) programme initiated by the Asian Development Bank. The TA programme is intended to serve as the starting point for the state governments to create an enabling framework for the PPP model. States wishing to take advantage of the TA programme are required to enter into a memorandum of understanding (MoU) with the DEA. The MoU requires the state governments to:

(a) set up a single agency for processing PPP projects within the state;
(b) develop and implement a robust plan for the development of a minimum number of projects on the PPP model in various sectors; and
(c) commit to establishing regulatory and governance frameworks for identified infrastructure sectors.

Rajasthan, Kerala and Assam are among the states which have opted for this programme. States which opt for the TA programme are not precluded from receiving VGF assistance from the GoI.

2.5 Sector-specific guidelines

In addition to guidelines/regulations of the GoI and state governments, there are certain sector-specific guidelines such as the Greenfield Airport Policy 2008 (Greenfield Policy), which deals with development of new airports. These guidelines must be complied with in addition to the GoI and state government guidelines.

2.6 Foreign direct investment policy

Foreign direct investment of 100% is permitted in most infrastructure sectors other than for projects relating to the improvement of existing airports, where GoI approval is required for foreign investments over 74%.

2.7 PPP project procurement

PPP projects are executed on either a BOT or BOOT basis and concessions are granted for a fixed term. Developers are selected by a competitive bidding process which follows the principles of fairness and natural justice. The bidding process carried out by the government or statutory bodies is subject to limited scrutiny by the courts.

3. Active sectors

India acknowledges the importance of the development of infrastructure in all sectors but the current emphasis is primarily on sectors relating to transport, both for GoI and state government-backed projects.

3.1 Roads

The development and maintenance of national highways is the responsibility of the GoI. The NHAI regulates the road sector in India and is the main agency with responsibility for implementing the National Highway Development Programme (NHDP). The NHAI is developing highway projects based on the PPP model and has so far awarded 37 PPP projects under the NHDP in 2008-9 and 2009-10.
NHAI has formulated a model concession agreement which has been in use for almost a decade. In November 2009, the NHAI amended certain clauses of this model concession agreement with a view to making highway projects more attractive for private developers and removing obstacles in procuring finance. The main amendments are:

(i) under the amended exit clause, a developer can exit after construction completion, as opposed to two years after construction completion; and

(ii) unlike under the earlier model concession agreement where the concession agreement could be terminated by the NHAI once a developer had recovered its investment (irrespective of whether the concession period had expired or not), the concession agreement cannot now be terminated even if the developer has recovered its investment.

Depending on the traffic projections and revenue-earning potential of a particular PPP road project, the NHAI will adopt one of the following models:

(a) **BOT model**

This is preferred for commercially attractive projects. Concessions granted on this model are typically for a period of 30 to 35 years. The successful bidder is selected on the basis of: (i) the VGF bid (whether positive or negative); or (ii) the level of revenue-sharing proposed. In this model the concessionaire collects the toll charges from the end-users.

(b) **Annuity model**

The annuity model is used by NHAI when the project is not commercially attractive without authority funding and the NHAI does not wish to use its own funds for such project. Typically, concessions granted on the annuity model are for a period of 15 to 20 years.

Here the concessionaire bears the construction cost of the project and in turn, during the operations period, NHAI pays the concessionaire a regular fixed quoted payment (Annuity). Further, the concessionaire collects toll charges from the users on NHAI's behalf. Early completion or delay by the concessionaire will result in a bonus or penalty respectively, by way of adjustment to the Annuity. Thereafter, during the operation period, payment of the Annuity is subject to the concessionaire meeting the specified performance criteria. The assets revert to the NHAI on the expiry of the operation phase.

(c) **EPC model**

The EPC model is used primarily for development of less commercially attractive projects. The project is funded by NHAI and it appoints contractors for construction. The NHAI then operates such road projects itself or appoints an operation and maintenance (O&M) contractor.

Over the years, several highway projects have experienced significant delays, as a result of which the GoI is contemplating de-centralising the NHAI to maximise supervision over and to ensure timely implementation of projects. Projects which are not considered viable under the BOT model may be procured under the Annuity and EPC models.

The NHAI has set the following potential targets for development of national highways, although it remains to be seen how many of these projects will ultimately be procured using the PPP model:

(i) developing 1,000km of express roads;

(ii) developing 8,737km of roads, including 3,846km of national highways in the North-East of India;

(iii) widening 20,000km of national highways and 6,736km of the North-South and East-West corridors to four lanes;
(iv) widening 6,500km of the Golden Quadrilateral\(^1\) and selected national highways to six lanes; and
(v) widening 20,000km of national highways to two lanes.

The preferred model for executing these projects is BOT, followed by the Annuity and EPC models. About 60% of the proposed 12,000km are to be procured on the BOT model and 20% each on the Annuity and EPC models.

The state governments have jurisdiction over state highways and other roads within the state. Some states such as Gujarat and Maharashtra have taken the initiative to appoint O&M contractors for existing state highways built by the state governments or to grant concessions on the BOT model.

The key players in India in the roads sector include Larsen & Toubro, GMR, Isolux, Nagarjuna Constructions, Tata-Autostrade per l’Italia S.p.A., Hindustan Construction and IL&FS. While domestic players have a strong presence, foreign players are typically involved as joint-venture partners.

### 3.2 Rail

**Freight rail and railway stations**

India has the largest and busiest rail network in the world. Indian Railways, a GoI undertaking, owns and maintains the rail network in India and the Ministry of Railways (MoR) oversees its functioning.

Traditionally, this sector has not seen many PPP projects. One of the first initiatives of the MoR was to privatise container rail freight services in 2007 through a policy that effectively ended the monopoly of the state-owned rail hauler of containers. Thereafter, the GoI has granted concession rights to operate container trains on various routes to thirteen private operators and three government companies on a PPP basis.

More recently, the modernisation of the New Delhi railway station is underway on a PPP basis. The MoR is now focusing on developing other greenfield railway stations in the peripheral areas of New Delhi using the PPP model. The MoR has also decided to initiate the modernisation of another 25 identified stations on the PPP model.

In this sector, apart from Indian Railways, a special purpose vehicle called the Rail Vikas Nigam Limited (RVNL) has been set up to oversee and execute the National Rail Vikas Yojana (NRVY) to strengthen major routes and enhance port connectivity.

The GoI has set the following potential targets for development of railways, although, as with the NHAI’s highways targets, it is hard to ascertain at this stage how many will be procured as PPPs:

(i) gauge conversion and doubling of tracks in both the freight and passenger sectors;

(ii) developing, amongst other things, new routes, railway stations, logistics parks, cargo aggregation and warehouses on a PPP basis; and

(iii) constructing a dedicated freight corridor in the Western and Eastern high density routes.

The key players in the container freight rail sector include Gateway Distriparks, DP World, Boxtrans, Hind Terminal, Adani Logistics and APL.

**Metro rail**

State governments have jurisdiction over development of metro rail projects. These rail projects are being executed on the EPC model as well as the PPP model (typically involving VGF). Dedicated government companies such as the Delhi Metro Rail Corporation and the Bangalore Metro Rail Corporation have been established to implement metro projects, while other metro lines, for instance the airport express line in New Delhi and the Versova-Andheri-Ghatkopar line in Mumbai are being developed as PPPs.

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\(^1\) Highway network connecting the cities of Delhi, Mumbai, Kolkata and Chennai.
The Bangalore airport express line is also proposed to be undertaken on a PPP basis. Despite conflicting views regarding the preferred model for executing metro projects, the current trend demonstrates a preference for the PPP model.

In addition, the following new metro rail projects are in planning or feasibility phases: (i) Lucknow; (ii) Kochi; (iii) Hyderabad; (iv) Pune; (v) Ahmedabad; and (vi) Chandigarh.

Reliance Infrastructure is the majority shareholder in the special purpose vehicles executing the two lines of the Mumbai Metro (Versova-Andheri-Ghatkopar (Line-1) and Charkop-Bandra-Mankhurd (Line-2)) and also the New Delhi airport metro express line. Reliance Infrastructure has entered into a consortium for these projects with, respectively, Veolia Transport, SNC Lavallin and Construcciones y Auxiliar de Ferrocarriles, S.A.. As the other metro rail projects are still in the tender phase, this sector is open to involvement from both other domestic and international metro rail players.

3.3 Ports

The GoI has identified 12 ports as major ports (Major Ports) which it administers through the Ministry of Shipping (MoS). Ports other than Major Ports, ie, intermediate and minor ports, are administered by the respective state governments. Both the GoI and the state governments are undertaking the expansion and modernisation of ports as a priority.

The MoS has formulated the national maritime development programme (NMDP) to promote infrastructure development at the Major Ports. The success of past projects for the operation of berths at the Major Ports through PPPs has given the MoS the confidence to develop the NMDP aggressively. The MoS announced a 100-day agenda in July 2009, identifying key targets, including six PPP projects to be executed at an estimated cost of USD687.5 million. Pursuant to this, the MoS signed its first (of six) concession agreements for the Paradip Port for the development of an iron ore berth.

To streamline the shipping industry and ensure the smooth development of the Major Ports, it is also proposed to replace the existing tariff regulator (Tariff Authority for Major Ports) formed under the Major Port Trusts Act, 1963, with a new Major Port Regulatory Authority which will have comprehensive powers to determine tariffs, prescribe norms and standards and decide disputes.

The following types of projects are envisaged:

(a) allocation of new berths (to be constructed as PPPs);
(b) ten major port expansion projects to be launched by the MoS with an estimated investment of USD1.06 billion; and
(c) up to 276 projects structured as PPPs for the development of the Major Ports with an overall investment of USD13.5 billion.

The state governments of maritime states such as Gujarat, Maharashtra, Kerala, Tamil Nadu, Andhra Pradesh and Orissa have policies for the development of minor and intermediate ports on a PPP basis. These states are also required by the GoI to co-operate and ensure the efficient development of India's coastline under the NMDP.

The key players in the ports sector are APM Terminals, PSA, DP World, Reliance Industries, IL&FS, Essar group, Larsen & Toubro and Adani group.

3.4 Airports

The Airports Authority of India (AAI), a statutory body under the GoI, is entrusted with developing and maintaining airports. It is permitted to develop, finance, operate and maintain airports using the PPP model.
There are a number of potential projects in this sector. Greenfield airport projects are in the pipeline for Goa, Pune, Navi Mumbai, Greater Noida and Kannur. Additionally, 35 airports in smaller cities are proposed to be upgraded using the PPP model for which an investment of USD357 million is being considered over the next three years.

The present legislative framework permits private participation in both greenfield and brownfield airports. The Greenfield Policy provides that greenfield airports set up by the AAI should preferably be constructed as PPPs. The Greenfield Policy also provides for the establishment of greenfield airports by entities (other than AAI) in consultation with the state governments.

The GoI has targeted the modernisation and privatisation of airports in major Indian cities as a priority. Two greenfield international airports at Bangalore and Hyderabad, were developed using the PPP model and were among the first initiatives of the GoI to privatise airports. The airports commenced operations in 2008 and the existing airports in Hyderabad and Bangalore were closed. The projects for the modernisation and expansion of the existing Delhi and Mumbai airports were also awarded on a PPP basis in January 2006.

The majority Indian shareholder in the Delhi and Hyderabad airports is GMR. The Mumbai and Bangalore airport projects are being developed by GVK and Larsen & Toubro, respectively. They have partnered with various international contractors and airport operators for these projects.

3.5 Summary of estimated investment

The table below summarises the planned investment in infrastructure under the eleventh five year plan until 2012.

<table>
<thead>
<tr>
<th>Sectors</th>
<th>INR Crore</th>
<th>USD billion @ INR40/USD</th>
<th>Sectoral Shares (%)</th>
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<tr>
<td>Electricity (incl. NCE)</td>
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<td>Roads and bridges</td>
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<td>Telecommunications</td>
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</tr>
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<td>Railways (incl. MRTS)</td>
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<td>12.32</td>
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<tr>
<td>Water supply &amp; sanitation</td>
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</tr>
<tr>
<td>Ports</td>
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<td>16,855</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>2,056,150</strong></td>
<td><strong>514.04</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
4. **Future sectors**

4.1 **Water and waste management**

The Government of India (GoI) issued the National Water Policy (NWP) in 2002. The NWP recommends the development of the water sector by PPP and requires state governments to formulate their respective state water policies along the same lines within two years: the states of Orissa, Himachal Pradesh, Madhya Pradesh, Kerala, Karnataka, Andhra Pradesh and Maharashtra have formulated state water policies. Some PPP projects have been undertaken for water treatment, supply and distribution in cities and towns such as Chennai, Bangalore, Tirupur, Vishakapatnam and Alandur.

Municipal authorities in various cities and towns are not equipped to handle the highly technical operations of waste disposal and treatment. The PPP model is therefore gradually gaining prominence in these sectors. The municipalities of various cities such as Chennai, Bangalore, Ahmedabad and Surat have entered into concession agreements with private developers for the construction of compost plants or treatment plants for solid waste.

4.2 **Agriculture**

It is only very recently that the GoI and state governments have started exploring the development of agriculture facilities using the PPP model.

The Food Corporation of India is a statutory corporation formed under the Food Corporations of India Act 1964, with the objective of regulating the supply and regulation of food grains and food stuffs. Recently, the Food Corporation of India commissioned bulk and conventional warehouses as PPPs in the states of Punjab and Haryana. The state government of Punjab has also taken steps to develop silos for storage of food grains in Punjab using the PPP model.

4.3 **Education**

In India only non-profit organisations can undertake activities in the education sector, which severely limits private sector involvement. However, the GoI announced in June 2009 that a policy framework for the involvement of private entities in the expansion of educational facilities in the country will soon be formulated.

4.4 **Healthcare**

At a central level there is no framework for PPP projects in healthcare. However, some states have undertaken projects using the PPP model. The contracts that have been entered into are relatively small and relate primarily to contracting with the private sector for specific services, eg ambulances, anaesthetics and consultants.

5. **General structure of concessions**

The concession agreement is the main document that sets out the rights and obligations of a concessionaire, together with the bid documents. The Indian Contract Act 1872 is the relevant legislation for interpreting the terms and conditions of a concession agreement. A brief analysis of the structure and provisions of a concession agreement typically used in the roads and metro rail sectors is set out below.

5.1 **Grant of concession**

The concession agreement typically grants exclusive rights to the concessionaire in relation to the project for construction, operation, ownership, design, financing, maintenance and revenue collection. These rights are typically granted for a fixed concession period. The contracting authority (the Authority) provides
a site free of encumbrances to the concessionaire for the project. The Authority safeguards its interests by
imposing performance standards and regular reporting requirements on the concessionaire.

5.2 Payment mechanisms

In general, for projects which are less commercially attractive to the private sector, the concessionaire
may receive VGF or Annuities from the Authority. On the other hand, on commercially attractive projects,
the concessionaire either pays a concession fee (up-front or during the operation of the project) to the
Authority or shares revenue from the project.

Although it is too early to distinguish trends in different sectors or regions, the developers of port and
airport projects are usually required to recoup their capital cost and earn returns from fees/tariffs charged
to users, whilst in the metro rail sector and roads sector, VGFs and Annuities are used respectively, as the
capital cost is high and service charges are subsidised. Non-revenue generating sectors such as water and
waste management are currently developing a limited number of projects on a PPP basis. The development
of PPP projects for non-revenue generating social infrastructure such as prison facilities has not yet
commenced in India.

5.3 Variations and Authority delays

If a change in the scope of works under the project results in an increase or decrease in project cost
beyond an agreed threshold, payments under the concession agreement will be adjusted accordingly.
Similarly, if the Authority delays handing over the site or there is a governmental delay in granting
required permits and consents, the concessionaire may be entitled to compensation. In each case,
the concessionaire's compensation may be in the form of an extension of the concession period or
payment of monetary compensation.

5.4 Change in law

The main events entitling a concessionaire to extensions of time and/or monetary compensation are
changes in law and force majeure. As regards changes in law, the concessionaire will be entitled to
compensation for any change in law with an adverse financial impact on the project cost or revenue.
In India, change in law typically includes:
(a) the enactment of any new Indian law;
(b) the repeal, modification or re-enactment of any existing Indian law;
(c) the commencement of any Indian law which has not entered into effect by the date of the bid; and
(d) a change in the interpretation or application of any Indian law by a court of record which has become
final, conclusive and binding, as compared to such interpretation or application by a court of record
prior to the date of the bid.

It specifically excludes changes with regard to corporate tax or a change in the manner of calculating tax
of any type or any change in the rates of any existing tax. Further, concession agreements typically provide
a threshold amount of approximately INR10 million (per financial year) for claiming change in law, and a
concessionaire is entitled to claim the benefit of change in law only if it has suffered an increase in cost
above such threshold.

The Concessionaire is not, however, entitled to any extension of time. Any change in law that is not capable
of being financially compensated will be treated as a political force majeure event (except if specifically
excluded, such as an increase in corporate tax).
5.5 Force majeure events

The force majeure consequences below are based on the provisions of metro rail concession agreements. Concession agreements for other sectors may have slightly different provisions.

(a) Force majeure events are:

(i) non-political events (e.g., an act of god, flood, landslide or strikes);

(ii) indirect political events (e.g., war, civil commotion or industry-wide strike); and

(iii) political events (e.g., a change in law or compulsory acquisition in the national interest).

(b) If a force majeure event occurs during the construction period, the concessionaire is entitled to an extension of time for a period equal to the duration for which the force majeure event subsists. If a force majeure event occurs during the operations period, the concession period is extended for a period that will allow the concessionaire to recover the revenue loss suffered.

(c) If a force majeure event occurs prior to financial close, the parties bear their respective costs, but the time for fulfilment of the concessionaire’s conditions precedent is extended. If a force majeure event occurs after financial close, costs are dealt with as follows:

(i) on a non-political event: the parties bear their respective costs;

(ii) on an indirect political event: any costs in excess of sums covered by insurance are shared equally. If insurance claims are not paid in full by the insurers, then the sponsors and lenders will bear some risk in respect of indirect political events; and

(iii) on a political event: the Authority reimburses all costs to the concessionaire.

In each case, admissible costs are limited to O&M and interest costs. Revenue losses and principal amounts due to lenders are not reimbursed by the Authority.

(d) If a force majeure event continues for over 180 days, both parties have the right to terminate the concession agreement.

5.6 Termination and compensation

The following analysis of termination compensation payable by the Authority is based on the provisions of metro rail concession agreements. Concession agreements for other sectors may have different provisions.

(a) Termination due to the concessionaire’s default would include events such as: (i) failure to achieve project milestones; (ii) failure to achieve financial close; (iii) failure to submit and maintain performance security or insurance policies; (iv) default under financing documents; (v) breach of project agreements which have a material adverse effect; (vi) an uncured default under the concession agreement having a material adverse effect on the Authority; and (vii) insolvency of the concessionaire.

(b) Termination due to the Authority’s default would include: (i) a failure to make payments; (ii) an uncured material default with a material adverse effect on the concessionaire; and (iii) a repudiation of the concession agreement.

(c) For termination due to the Concessionaire’s default prior to the completion date, no termination payment is paid. For termination after the construction completion date, termination payment of 90% of the debt due, less insurance cover is paid.

(d) For termination due to the Authority’s default, whether prior to or after the completion date, 100% of the debt due and between 130 and 150% of the adjusted equity is paid.

(e) The termination payments due to force majeure events are as follows:

(i) for a non-political event, 90% of debt due, less insurance cover;

(ii) for a indirect political event, 100% of debt due, less insurance cover and 110% of adjusted equity; and
(iii) for a political event, 100% of debt due and between 130 and 150% of adjusted equity.

(f) The debt due and adjusted equity under termination payments are calculated as follows:

(i) Debt due refers to the outstanding principal, accrued interest, financing fees and charges due to lenders, but does not include: (A) principal or interest amounts falling due prior to the termination date; (B) penal interest; and (C) pre-payment charges (other than due to the Authority's default). Lenders do not include political risk insurers or hedge providers and, therefore, amounts due to them may not be fully covered by termination payments.

(ii) Insurance cover refers to the maximum sum assured and payable to the concessionaire under insurance policies. For the purpose of determining the debt due, only 80% of unpaid insurance claims are considered. Lenders and sponsors will bear the residual risk of loss.

(iii) Adjusted equity refers to the capital invested by the sponsors prior to the construction completion date, as may be adjusted partially/wholly due to inflation.

(iv) In all cases, the termination payment will not exceed the lowest of: (A) the actual capital cost incurred prior to the construction completion date; (B) the projected capital cost in the financial model approved by the lenders; and (C) the Authority's estimation of the capital cost, without taking into account the VGF or other financial support provided. If the Authority's estimation of capital cost is much lower than the actual or projected capital cost, the lenders may not be fully covered. Break costs may also not be covered.

(g) After receiving the termination payment, the concessionaire must transfer all project assets (including cash and other financial assets) to the Authority. Prior to transfer, the concessionaire may be required to refurbish the assets and put them in good working condition.

5.7 Step-in and substitution rights of lenders

Under the metro rail concession agreements, the concessionaire, Authority and lenders execute a tripartite substitution agreement, setting out the rights of the lenders to substitute the Concessionaire under the Concession Agreement.

Upon the occurrence of a Concessionaire default, the Authority may issue a termination notice to the concessionaire with a copy to the lenders. The lenders may choose to either:

(a) exercise their rights to substitute the concessionaire under the substitution agreement. If this right is exercised, the substitution must be completed within 270 days. The substitution is effected by way of a novation in favour of the new concessionaire or termination of the existing concession agreement and execution of a new concession agreement; or

(b) step-in and cure the concessionaire's default, instead of exercising their substitution rights. If the lenders exercise this right, the Authority grants an additional cure period of 270 days.

The extent and scope of lenders’ step-in and substitution rights may differ in other sector concession agreements.

6. Insolvency and security position

The (Indian) Companies Act, 1956 (Companies Act) contains provisions relating to insolvency. Insolvency proceedings are ordinarily referred to as winding up under the Companies Act.

Any creditor of a company may at any time initiate proceedings against the company for recovery of monies owed. When a court passes a winding-up order or appoints a liquidator, all pending legal proceedings against the company are stayed and no new proceeding can be initiated without the permission of the creditors. The creditors may initiate recovery proceedings at any time before or during the winding up proceedings. After the passing of a winding-up order or appointment of a liquidator, these can only be initiated with the approval of the court.
A secured creditor may realise sums due from a company in insolvency either by participation in the insolvency proceedings or by staying outside such proceedings. Where a secured creditor decides to take the latter course of action, he may realise his money by selling the assets over which he has a charge. Where a secured creditor chooses to participate in an insolvency proceeding, such secured creditor gives up the right to the security and is treated at par with other unsecured creditors.

A foreign creditor has the right to initiate insolvency proceedings against the company, like any other creditor, under circumstances mentioned under the Companies Act and the rights and privileges of a foreign creditor are at par with an Indian creditor under the Companies Act. There are no separate procedures established for protecting the interests of a foreign creditor in an insolvency situation.

7. Employment issues

The developer bears responsibility for all employment issues that may arise in relation to the execution of a project. The developer is responsible for complying with all applicable labour laws subject to any agreement as to cost in the context of a change in law and is required to indemnify the Authority if the Authority suffers any loss or damage.

For modernisation of brownfield infrastructure projects, the concession agreement requires the retention of employees for a stipulated period by the concessionaire, after which the concessionaire is obliged, under the terms of the concession agreement, to retain only a certain percentage of the workforce on a permanent basis on the same terms. Indian labour laws provide for compensation to be payable to employees whose employment is terminated pursuant to a business transfer.

8. Impact of the credit crunch

The global economic recession has resulted in higher interest rates and lower credit availability. These factors, as well as the stringent tender requirements of the NHAI, have resulted in a lower level of interest and fewer bidders for road projects, eg only one bidder tendered for the Charkop-Bandra-Mankhurd metro line project in Mumbai.

In a bid to mitigate the effects of the credit-crunch, various authorities have taken mitigation measures since mid-2008:

(a) the Ministry of Roads along with NHAI is currently considering amendments to the model concession agreement and bidding criteria for the roads sector;

(b) the Reserve Bank of India has eased the external commercial borrowings guidelines for lending to the infrastructure sector;

(c) the GoI has set up a scheme for the India Infrastructure Finance Company Limited to inject up to USD10 billion into the Indian infrastructure sector; and

(d) the GoI has reduced excise duties and VAT in order to bring down cement and steel prices.
Japan

*Fear not failure, but the failure to try at all.*

Soichiro Honda
(1906-1991)

**Contact**

**Tokyo**

Aled Davies  
Adam Moncrieff

Allen & Overy Gaikokuho Kyodo  
Jigyo Horitsu Jimusho  
38F Roppongi Hills Mori Tower  
6-10-1 Roppongi, Minato-ku  
Tokyo 106-6138  
Japan

Tel: +81 (0)3 6438 5200  
Fax: +81 (0)3 6438 5100  
aled.davies@allenovery.com  
adam.moncrieff@allenovery.com
1. Introduction

The market for PPPs in Japan has grown considerably in the past few years and the financial climate has not had as much of an impact on project activity as it has in some other jurisdictions. According to the PFI Promotion Office of the Cabinet Office of Japan, the number of PFI projects in Japan has risen to 361, of which 231 had reached the operation stage as of 30 September 2009. Roughly 75% of PFI projects are administered by local governments, and the remainder are administered by central government and other public entities.

PFI has been promoted by the Japanese government as a way to utilise the private sector’s resources in funding, management, and transfer of technology for the efficient delivery of social infrastructure and public services. The main policy goal has been to stimulate the economy by expanding the business opportunities for the private sector and to deliver quality public services at low cost.

Although there are many successful PFI projects to date, there is some criticism that the majority of Japanese PFI projects are weighted too much towards construction with only minimal maintenance works during the operational phase, and thus do not effectively utilise the private sector’s ability or innovation and as a result do not provide adequate value for money.

In the rest of this chapter, the terminology used will be Authority for the public sector entity procuring the service and Contractor for the private sector entity providing the service (which is usually a special purpose vehicle set up by the sponsors).

2. Legal and regulatory framework

2.1 Specific enabling legislation

Japan is a civil law jurisdiction, governed by the Japan Civil Code. The Act on Promotion of Private Finance Initiative (PFI Law) was enacted in 1999 in order to provide the legal and regulatory framework for PFI projects. The PFI Law was revised twice, in December 2001 and in August 2005, mainly to facilitate the land lease of government properties in connection with PFI projects. The PFI Law also required the establishment of the Committee for Promotion of PFI within the Cabinet Office to study and deliberate on basic policies regarding the promotion of PFI in Japan.

Under the PFI Law, the types of public facility for which PFI transactions may be used include: (a) roads, railways, ports and harbours, airports, rivers, parks, water and sewage services; (b) government buildings and other official facilities; (c) public housing, educational and cultural facilities, waste treatment facilities, medical facilities and other public interest facilities; (d) IT facilities, new energy facilities, recycling facilities, etc; and (e) other facilities equivalent to facilities listed in (a) to (d), as specified in the Cabinet Order.

Although there are no major obstacles to conducting PFI projects under the Japanese Civil Code, there are various administrative or sector-specific laws which apply to public facilities in Japan. Some of these laws contain restrictions on providing security over those facilities, or on the management of those facilities. For example, the Medical Care Act applies to hospital projects, the Waterworks Act applies to water projects and the Act on Penal Detention Facilities and Treatment of Inmates and Detainees applies to prison projects. There is usually limited guidance on how these sector-specific laws apply to PFI projects, so specialist advice is required.

2.2 Guidelines and standardised PFI contracts

Five practical guidelines have been released by the Committee for Promotion of PFI in respect of the project process, risk-sharing, value for money, contracts and monitoring. Although these offer guidance to ministries of the central government and are without any legally binding power, most authorities, including local governments, have followed them when administering PFI projects.
Although no standardised PFI contracts have been published to date, the need for such standardisation, to minimise the cost associated with the drafting of PFI contracts for each project, is recognised by the PFI Promotion Office, and its 2007 report mentions that it will promote standardisation of PFI contracts\(^1\). In addition, the PFI Promotion Office recently published a drafting guide in relation to PFI contracts\(^2\).

### 2.3 Tendering process

The governmental framework in Japan is composed of a central government (the National Diet) and local governments. Japanese local government is fundamentally structured as a two-layer system, with the municipal governments below the prefectural governments. Japan has introduced a presidential system for local governments whereby governors are elected by the local electorate at each level. Central, municipal and prefectural governments may each act as the procuring Authority on PFI projects, as may certain other quasi–public bodies such as National University Corporations. Central government contracts via the relevant ministries, such as the Ministry of Land, Infrastructure, Transport and Tourism.

Under Japanese law, generally an open tendering procedure should be pursued with respect to government procurements, but limited tendering procedures are permitted in certain circumstances. However, in most PFI projects in Japan, the sponsors are selected through an open tendering procedure. It should also be noted that under Japanese regulations, which reflect current World Trade Organisation rules, Japanese central and certain local governments are required to use an open tendering procedure. The terms of the PFI contract with the winning bidder are essentially unchangeable once the tendering process is completed.

According to the PFI Promotion Office, the number of bidders per project has been falling year by year, and recently almost all projects have had four or fewer bidders. The usual tendering process is relatively simple, involving only a one-round evaluation process. Although evaluation of proposals in most projects is done by reviewing only the tender documents submitted by bidders, without involving any substantial dialogue between the Authority and each bidder, some recent projects have tried to introduce a quasi-competitive dialogue process to better evaluate each bidder’s proposal. Bidders are also usually required to submit evidence during the tendering process of the funding arrangements supporting their proposal.

### 2.4 Government approval

The necessary governmental approvals required for PFI projects differ depending on whether the project is conducted by central or local government. If a local government wishes to undertake a PFI transaction, it must obtain a resolution approving the project from its local assembly, provided that the type and cost of the project fall within the criteria set forth in the relevant Cabinet Order. Resolutions of the National Diet or local assemblies, as the case may be, are also required for approving budgets for payment by the Authorities under the PFI contract.

### 3. Active sectors

The Appendix sets out the number of PFI projects in Japan announced after the enactment of the PFI law as of 30 September 2009. They are categorised into relevant fields.

Until recently, most Japanese PFI projects have been more akin to real estate financing than to the long-term provision of services which is a feature of PFI projects in the UK. However, there are some signs of change in the Japanese PFI market, with the appearance of projects with more emphasis on the operation rather than the construction of facilities; for example, prison projects such as the Mine Rehabilitation Program Center project and hospital projects such as the Tama Regional Hospital project.

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2. Basic viewpoint regarding various issues in relation to PFI contracts (3 April 2009).
4. Future sectors

Some of the likely active future sectors are water and wastewater facilities and schools which require the significant renovation of older facilities.

Operation-weighted projects such as hospitals and waste disposal facilities are also sectors in which the number of PFI projects could increase in the near future.

Although there is no specific legal obstacle to road projects under Japanese law, there have been no PFI road projects in Japan to date. The reason for this is not clear, but one of the reasons seems to be an unwillingness on the part of Authorities due to doubts about whether value for money will be attained by simply introducing PFIs into road projects.

5. General structure of concessions

5.1 Structure

The most commonly used structures in Japanese PFI projects are build-transfer-operate (BTO), build-operate-transfer (BOT), build-own-operate (BOO) and rehabilitate-operate (RO). The BTO structure accounts for approximately 70% of all projects. One of the main reasons why BTO is more common in Japan is because BTO projects are generally able to enjoy more favourable treatment in relation to taxation and government subsidies. However, the Japanese government is gradually introducing measures to put BTO and BOT structures on a more equal footing by amending relevant laws. The diagram below shows the typical transaction structure and documents in Japanese PFI transactions.

5.2 Scope of services

The services to be provided by the Contractor are specified by output rather than by service specification. As in other jurisdictions, the aim here is to allow the Contractor to provide the services required in a way which maximises the efficiency and quality of the services provided throughout the project term by utilising the business methods, technology and know-how of the private sector. However, as the services were traditionally determined by the specification in Japanese public procurement, most Authorities
are still not used to specifying the services by output. For that reason, there have been some projects for which the Authorities have set excessive or unclear output requirements, and thus left the Contractor facing difficulties in understanding the services required or pricing its bid. To address this issue, the 2007 report by the Committee for Promotion of PFI states the need to create detailed guidance on how to prepare output specifications, to promote the standardisation of output specifications according to project type and to incorporate such guidance into the PFI process guideline.

5.3 Payment mechanisms

Payment mechanisms can be structured with the Contractor gaining income from the Authority by way of service charges, or from end-users, or from both the Authority and end-users. Nearly 70% of all projects have payment structures based solely on an Authority service charge and, until recently, there were only a limited number of projects structured on the basis of income from end-users only. However, there have been a few projects in which the Contractor is required to take full usage risk. For example, the Tokyo International Airport Passenger Terminal project adopted a payment mechanism by which the Contractor gains income only from end-users such as passengers by way of passenger facility charges.

Any payments to be made by the national or local government under the PFI contract can only be made to the extent that such payment is provided for in the annual budget adopted by the National Diet (in the case of central government projects) or the relevant local assembly (in the case of local government projects). Under the Japanese Local Autonomy Law, if after the approval of a PFI contract the local assembly was to fail to adopt a budget providing for the necessary payments to be made under it, the governor must again present the budget to the relevant local assembly. If the local assembly was to reject the budget again, then the governor may opt to prepare a special budget for such payments and make such payments. However, it should be noted that it is the governor’s choice whether such a special budget is to be prepared. There is some argument that the relevant government body could be sued for damages for failing to honour its obligations under a PFI contract, but this issue remains untested under Japanese law.

5.4 Change in law

The typical provision in Japanese PFI contracts dealing with changes in law categorises changes in law into specific changes in law and general changes in law. Specific changes in law are those which have a direct influence on the facilities or services comprising the PFI project. General changes in law apply to any kind of facility or service. Typically, increased costs caused by a specific change in law are borne by the Authorities and those caused by general changes in law are borne by the Contractor.

5.5 Supervening events

In most Japanese PFI contracts, supervening events are normally dealt with in the force majeure provision. Typical force majeure provisions define a force majeure event to cover a broad scope of events which cannot be attributed to either party. Under these typical provisions, the parties will consult with each other about how to deal with the event for a specific period and if the parties fail to reach an agreement during such period, the Authority may choose to require the Contractor to continue its services under conditions stipulated by the Authority. However, where the Contractor is permanently unable to continue its provision of services, or requires excessive payment to continue its provision of services, the Authority has the right to terminate all or part of the PFI contract after consultation with the Contractor. Except in cases where the PFI contract is terminated, the force majeure provisions typically provide that the increased cost of providing the services will be borne by the Contractor up to 1% of the total construction cost (if the event occurs during the construction phase) or 1% of the total operation and maintenance cost (if during the operation phase), and that the remainder of the costs be borne by the Authority.

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5.6 Termination and Compensation

PFI contracts contain provisions relating to termination events and their consequences. Typically, termination events are categorised into three categories: Contractor default; Authority default; and change in law and force majeure.

In the case of termination due to Contractor default, typically the Authority may choose to buy out the partly built facility (in the case of termination during the construction phase) or the completed facility (in the case of termination during the operation phase). Typically, in the case of termination during the construction phase, the PFI contract provides only in vague terms that the purchase price for the partly built facility will be a price proportionate to the progress of the construction, thereby giving only limited guidance for the Contractor to estimate the actual purchase price. In the case of termination during the operation phase, the purchase price will typically be the construction cost of the completed facility (deducting any payment for the construction already paid by the Authority as part of the service charge). These provisions usually contain a penalty clause as well as requiring the Contractor to pay liquidated damages in the amount specified in the contract (e.g. 10% of the construction cost).

In the case of termination due to Authority default, the Authority is typically obliged to buy out the facility\(^4\) by paying the construction cost of the same together with any break funding costs and any other damages suffered by the Contractor.

In the case of termination due to change in law or force majeure, the Authority will typically buy out the facility in exchange for paying the Contractor the unpaid construction cost (the construction cost incurred up to termination in the case of termination during the construction phase), either in accordance with the payment schedule which applied before termination or as a lump sum payment.

Unlike UK contracts, Japanese PFI contracts usually contain only vague provisions regarding the scope of recovery upon termination (allowing for the recovery of unpaid construction costs including interest up to the date of payment and other costs incurred by the Contractor as a consequence of termination). In addition, as there are virtually no precedent cases in which these termination provisions have actually been applied, there is currently no clear guidance as to how these provisions will be construed by the court (or especially whether the recoverable costs will include all break costs and equity return).

5.7 Remedies

Typical remedies under Japanese PFI contracts for failure to meet performance standards are reduction of the service charge and termination of the PFI contract. Under the so-called penalty point mechanism, which is frequently contained in Japanese PFI contracts, the Authority will impose a penalty point on the Contractor if the Contractor fails to meet any specific service requirement. These penalty points are converted into a yen amount according to a specific formula specified in the contract, and such yen amount will be deducted from the service charge to be paid to the Contractor. In the event of recurring failure to meet service requirements or material default on the part of the Contractor, the Authority will have the right to terminate the PFI contract.

\(^4\) Under Japanese law, the facilities are considered to be owned by the Contractor during the construction phase until construction completion.
6. Insolvency and security position

In most Japanese PFI projects utilising a project finance scheme to fund project costs, the lender requires both security interests in the assets of the Contractor and a pledge over the shares of the Contractor. The aim of these security interests is to protect the lender’s interest in extraordinary circumstances by foreclosing on its pledge to remove the sponsor as shareholder of the Contractor and install a new sponsor to manage the project. However, it is unclear under Japanese law whether a new bidding procedure and government approval process are required to approve a new sponsor replacing the original Authority-selected sponsor. The Legislative Guidelines on Privately Financed Infrastructure Projects published by UNCITRAL recommend providing, as a matter of law, an acknowledgement of the Authority’s right to enter into agreements with the lender which provide for the appointment of a new concessionaire to perform the obligations of an existing project agreement. However, the Japanese government has not yet made any special provision in the relevant laws to cover these circumstances, so the procedures that would be required in a step-in scenario remain unclear.

7. Employment issues

In most PFI projects to date, employment has not become a serious issue as most projects are construction-weighted and do not require significant manpower during the operation phase. However, the number of projects which encounter employment issues might increase in the future as the number of operation-weighted projects requiring restructuring of government employees or transfer of government employees to the Contractor increases.
Appendix

Number of Projects in Each Field

<table>
<thead>
<tr>
<th>Fields</th>
<th>Administrator</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>State</td>
<td>Local</td>
<td>Other</td>
</tr>
<tr>
<td>Education and Culture (schools, libraries, etc)</td>
<td>1</td>
<td>80</td>
<td>31</td>
</tr>
<tr>
<td></td>
<td>(1)</td>
<td>(49)</td>
<td>(27)</td>
</tr>
<tr>
<td>Life and Welfare (facilities for social welfare for the aged, etc)</td>
<td>0</td>
<td>16</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(14)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health and Environment (hospitals, waste disposal facilities, etc)</td>
<td>0</td>
<td>63</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>(42)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry (sightseeing facilities, etc)</td>
<td>0</td>
<td>13</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(8)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Town Development (parks, etc)</td>
<td>6</td>
<td>31</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(3)</td>
<td>(26)</td>
<td></td>
</tr>
<tr>
<td>Public Safety (police offices, prisons, etc)</td>
<td>7</td>
<td>14</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(6)</td>
<td>(9)</td>
<td></td>
</tr>
<tr>
<td>Government buildings and accommodation</td>
<td>48</td>
<td>7</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>(18)</td>
<td>(3)</td>
<td>(1)</td>
</tr>
<tr>
<td>Other (complex facilities, etc)</td>
<td>4</td>
<td>37</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(24)</td>
<td></td>
<td></td>
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<tr>
<td><strong>Total</strong></td>
<td>66</td>
<td>261</td>
<td>34</td>
</tr>
<tr>
<td></td>
<td>(28)</td>
<td>(175)</td>
<td>(28)</td>
</tr>
</tbody>
</table>

* Number of facilities (number of projects in service) (As at 30 September 2009)
* Extracted from material published by the Cabinet Office
United Arab Emirates

Certainty shall not be removed by a doubt.

Article 35 UAE Civil Code
1. Introduction

PPP projects are taking off in the United Arab Emirates (the UAE) and, in particular, the emirate of Abu Dhabi (Abu Dhabi). Whilst the availability of capital is arguably less constrained in Abu Dhabi than in most other economies around the globe (particularly in the current economic climate), more international private funding is nevertheless considered desirable in order to import new economic models, expertise and skills, as well as providing the most efficient use of capital. There has also been more willingness recently amongst the international private sector to participate in the UAE where once it would have been more committed to its home markets.

The UAE holds nearly 10% of the world’s proven oil reserves and the world’s fifth-largest natural gas reserves, with Abu Dhabi holding 94% of the UAE’s oil reserves – predicted to last another 100 years. In the 1970s, the UAE’s activities relating to the production of oil accounted for over 66% of the UAE’s GDP. In recent years this figure has been reduced to less than 33%, as a result of the Government strategy of economic diversification. This diversification is driving the development of infrastructure, including PPP, in Abu Dhabi.

The Government’s publication “Plan Abu Dhabi 2030 – Urban Structure Framework Plan” sets out what Abu Dhabi expects to achieve by 2030. The underlying rationale is to ensure that the exploitation of its oil and gas reserves creates a legacy and sustainable economy for its future generations of Emiratis once the oil and gas has run out.

2. Legal and regulatory framework

2.1 Constitutional and legal overview

The UAE is a federal state made up of seven emirates (Abu Dhabi (the capital), Dubai, Sharjah, Umm Al Quwain, Ajman, Fujairah and Ras Al Khaimah). The legal system is based on a constitution (the Constitution) and the legal framework centres around Federal Law No. 5 of 1985 (the Civil Code) and Federal Law No. 18 of 1993 (the Commercial Code). Primary legislation is contained in the Civil Code and the Commercial Code and is supplemented by various other laws, regulations, decisions, instructions and guidelines issued by relevant ministries and the UAE Central Bank as well as royal decrees. UAE law is broadly based on the French civil code, but heavily influenced by other sources (eg the Egyptian and Jordanian civil codes). Therefore, statutes are the primary source of law and precedents are not binding.

Additionally, Shari’ah law is incorporated into UAE law by reference in the Constitution. The Civil Code is construed and interpreted in accordance with the principles of Islamic jurisprudence or fiqh. However, contractual relations which do not comply with Shari’ah are unlikely to be deemed to be invalid provided that they fall within the categories of transaction contemplated under the Civil Code, Commercial Code or other specific legislation.

Contracts must be performed in good faith. Additionally, UAE law recognises the concept of implied terms, which are imposed by law and custom and by the nature of the transaction when interpreting contracts.
2.2 Institutional background

(a) Federal system of the UAE

The Constitution provides the legal framework for the UAE and is the basis of all legislation promulgated at a federal and emirate level. Legislation passed at a federal level has primacy over the local legislation of each emirate except in the areas in which an emirate has exclusive jurisdiction. The local government of each emirate is permitted to regulate all local matters which are not subject to federal legislation or matters which are not expressly reserved in the Constitution to the federal union (e.g., foreign affairs, defence and health). As such, each ruler of an emirate retains substantial powers to regulate commercial activities within his emirate.

(b) Structure of government

The key government institutions are set out below.

(i) **Supreme Council of Rulers** – The highest governing body of the UAE consists of the rulers of each of the seven emirates.

(ii) **Federal Council of Ministers/Cabinet (includes the Prime Minister)** – Appointed by the President, it is responsible for implementing policy decisions of the Supreme Council (e.g., promulgation of legislation, preparation of draft laws, and the drawing up of the annual federal budget) and has the executive authority of the UAE vested in it.

(iii) **Federal National Council** – Consists of 40 members nominated by the ruler of each emirate and is responsible for, among other things, considering and reviewing draft federal laws and bills before they are submitted to the President and the Supreme Council for consideration and subsequent enactment. Whilst it can monitor and debate government policy, it has no power to veto, amend or initiate legislation.
(iv) **Legal and court system** – Each emirate may maintain its own judiciary independent of the federal judiciary but only Dubai, Ras Al Khaimah and more recently, in relation to commercial matters, Abu Dhabi have elected to do so. All courts, however, must first apply federal law.

(v) **Ruler** – All powers of government not set out in the Constitution are vested in the ruler of each emirate although, in practice, these are delegated to the various ministries and agencies of each emirate’s government. The laws of an emirate, however, are passed by decree of the ruler, although in some circumstances it appears that the deputy ruler can pass certain laws when the ruler is unavailable.

(vi) **Executive Council** – Responsible for implementing policy decisions of the relevant ruler in, and has the executive authority of, the relevant emirate vested in it. Only Abu Dhabi, Dubai and Sharjah have set up Executive Councils.

(vii) **Local governmental bodies** – Charged with regulating and administering the law and policy of each emirate (eg courts, the department of finance and municipalities). In some cases, such bodies can issue instructions and guidelines.

(c) **Free Zones**

Various “free zones” have been set up in the UAE. These designated areas have been established within a business-friendly environment (eg relaxation of the foreign ownership rule (see paragraph 2.7), streamlined processes and guarantees of tax-free periods) to encourage development and investment. They are subject to their own laws, although federal laws and the laws of an emirate may apply where they do not contradict the law of a relevant free zone. Some free zones, eg the Dubai International Finance Centre, have their own court systems and arbitral tribunals.

2.3 **Cultural differences**

Foreign investors should take into account cultural differences in the way in which business is transacted in the UAE and other countries. Understanding these is key to understanding the reason for many of the laws and regulations in the UAE.

2.4 **Specific PPP enabling legislation**

There is no specific enabling legislation in the UAE relating to PPP projects. The legislative and regulatory regime has key differences from those in most European countries and, generally, the ruler’s word goes without question. Therefore, an approval of the budget for a PPP project from the Executive Council is seen as all that is required as a matter of law. Although permitted, questioning the approval or authority of the Executive Council should be carefully considered in light of the difference in culture. However, international sponsors and finance parties appear to have accepted this on the Abu Dhabi PPP projects.

2.5 **Anti-corruption and procurement**

A number of general laws are intended to prevent all forms of corruption by individuals and/or entities, including bribery, fraud and other unscrupulous practices.

Additionally, Abu Dhabi Law No. 6 of 2008 concerning procurements, tenders, auctions and warehouses (the *Procurement Law*) requires government departments to tender contracts rather than appoint counterparties on a “best friends” basis and sets out basic requirements governing the procurement process. There does not, however, appear to be any right to challenge the execution of a document where the procurement procedure is not followed. Neither would it appear that any contract executed following a breach of the Procurement Law would be void or voidable. There is as yet no judicial guidance on the application of this law. The Procurement Law is drafted in very general terms in many areas and has had relatively little impact on the way in which PPP projects are procured. In practice, however, there appears to be a willingness on the part of the procuring authorities in the UAE to emulate international procurement best practice.
2.6 Government support arrangements

Although market confidence is growing in the UAE, as illustrated by the level of interest of international sponsors, investors and finance parties in recently tendered PPP projects, there is no long history of PPPs. Additionally, the approach to legislation in the UAE is fundamentally different, eg whilst a person’s obligation to follow the law is important, his word to agree to pay is more important to him. Therefore, it is more important for the private sector to analyse the strength of the public sector payment obligation than would be the case in a more mature market.

In the first Abu Dhabi PPP projects, the Abu Dhabi government entered into a tripartite agreement with the relevant authority entering into the project agreement (the Authority) and the project company, whereby it effectively guaranteed the payment obligations of the Authority under the project agreement by agreeing to pay an agreed budget into a budget allocation account. Whilst the key mechanics of the tripartite agreement continue to live on, for non-governmental bodies the payment mechanics are now included in the project agreement rather than in a tripartite agreement, meaning that the government no longer undertakes to pay such amounts to the project company. Instead, in such cases the project company (and finance parties) are asked to rely on an application by the Authority to the government for a budget allocation and a confirmation by the government that the application has been approved. This mechanic has been accepted as bankable on at least two recent PPP projects in Abu Dhabi. As credit rating agencies have generally extended the Abu Dhabi sovereign rating to closely connected entities, finance parties appear comfortable with this approach, although this is something that will again have to be tested on new deals in the region. Market participants will appreciate that this reliance on this “implicit state guarantee” is being reconsidered in light of the restructuring of Dubai World, although there is reason to look more favourably on Abu Dhabi’s guarantee given its involvement in ensuring that Nakheel (a subsidiary of Dubai World), even though owned by a different emirate through Dubai World, did not default on its payments under its sukuk (an Islamic bond).

2.7 National ownership requirements

The project company is likely to be a special purpose company incorporated in the UAE under Federal Law No 8 of 1984 regarding commercial companies (as amended) (the Companies Law) which requires every UAE company to have one or more national partners whose share capital in a UAE company is no less than 51% of the share capital of that company. As a consequence, sponsors who are non-UAE nationals may not (directly or indirectly) hold more than 49% in a UAE company. There are certain criteria for deciding whether a project company complies with the national ownership requirements.

With the exception of real estate interests, the UAE authorities will “look through” companies to assess whether the national ownership requirement has been satisfied. However, certain activities (eg ownership of real estate) are restricted to corporate entities which are 100% owned by UAE nationals.

Management structures have been put in place in certain projects (eg the IWPP projects in Abu Dhabi) to minimise the effects of the national ownership requirements for the non national sponsor. To date these structures do not appear to have been tested in the courts.

3. General structure of concessions

3.1 Project agreement

The Abu Dhabi version of the project agreement has generally been developed for accommodation projects, specifically for universities. Whilst it includes all the key concepts typically seen in the UK, it is much simpler. There are two principal reasons for this approach.
First, there is no central government authority with control over the provisions of the documentation. Instead, the Authority and the project company are left to agree the commercial terms themselves. Often a shareholder of the project company is an entity owned by the Government and, therefore, the value to the “taxpayer” is derived in ways other than ensuring that the Authority only accepts those risks that are strictly necessary.

Secondly, the market is still young in Abu Dhabi and so international and domestic PPP participants need time to understand the principles, concepts and risk allocation involved. Having simple statements of intent is one of the ways in which this is achieved. Given the nascent nature of the market, the projects released to the market to date have been relatively low-risk, availability-based projects. In our experience, the simplified form of the project agreement has been well received by potential finance parties.

3.2 Inflation generally

There are currently no regular official indexation figures that reliably track a project company’s exposure to inflation. Accordingly, project agreements typically provide for the service charge, a component of the unitary charge (see paragraph 3.3), to be increased by reference to the increase in the cost of a basket of relevant industry goods and labour costs until such time as an index that reliably tracks the project company’s exposure to inflation is regularly published.

As the service charge is designed to be passed on in its entirety to the operator (see below), this mechanism should present minimal risk to finance parties and sponsors, if the selected basket truly reflects the increase in the operator’s costs.

3.3 Payment mechanism, inflation risk, debt service and life cycle

The project agreement unitary charge is split into two main components. The service charge is passed onto the operator, and the availability charge is used by the project company to pay debt, life cycle costs and shareholder distributions.

In the UAE, only the service charge is inflated, leaving the availability charge constant for the whole term of the project. This generally removes the inflation risk and, therefore, the requirement for an index-linked hedge or bond. However, there is still minimal inflation risk in relation to life cycle costs, which the private sector mitigates by ensuring that the project company has control over life cycle expenditure (i.e., responsibility for managing the life cycle fund is not passed on to its subcontractors) and that the reserving mechanism in the finance documentation and the financial model is appropriate.

3.4 Private sector involvement

The sponsors may be owned by one or more government entities which, given the foreign ownership rule, assist the project company in complying with the national ownership requirements (see paragraph 2.7).

In some cases, rather than spend time negotiating a shareholders’ agreement with a private sector party, the public sector will own all of the shares in the project company and sell-down part of the equity to a private sector partner after financial close. Therefore, the project agreement may impose restrictions on the percentage of equity which the government sponsor must maintain at any time (as opposed to restrictions on any sale of equity in the project company prior to the actual completion date).

In other cases, 51% of equity in the project company is reserved for government entities, with the remainder of the equity subject to competition. This can create a challenge for foreign sponsors, who generally wish to have a high degree of control over the project company. In practice, delegating the day-to-day management of the project company to a director appointed by the foreign sponsors has addressed this concern. This structure follows the approach in IWPP projects in Abu Dhabi and, whilst these are not PPPs in the European sense, this structure has provided a suitable precedent for the UAE market.
3.5 The USD/AED peg

In the UAE the local currency is pegged to the US Dollar and funds are typically lent in US Dollars even where the construction costs or revenues are in the local currency. The peg removes the need for any currency hedging, but there is a risk that de-pegging may occur during the project agreement’s term. In Abu Dhabi, the Authority typically takes de-pegging risk by (a) including a Compensation Event for de-pegging during the construction phase to ensure that the project company has sufficient AED-denominated funds following conversion of any USD-denominated loans in order to meet its AED-denominated payment obligations under the construction contract and (b) by adjusting revenues under the project agreement to take into account any fluctuations in exchange rates following a de-pegging to ensure that the project company has sufficient USD-denominated funds following conversion of its AED-denominated revenues under the project agreement in order to meet its USD-denominated payment obligations under the finance documents.

3.6 Variations

The variation regime follows the principles one would expect in European PPP projects but only a short form regime is included in the project agreement. A key point of difference is that there is no obligation on the project company to implement a variation where it cannot obtain financing or where the sub-contractors are unable to perform the variation.

3.7 Supervening events

Generally, the principles relating to Compensation Events, Delay Events and Force Majeure Events follow those in the UK, although they also include de-pegging of the USD/AED exchange rate (as set out in paragraph 3.5). Additionally, if force majeure supervenes and makes performance of:

(a) the whole of a contract impossible to perform, the corresponding obligation ceases and the contract is automatically terminated; or

(b) part of the contract impossible to perform, only that part of the contract shall be extinguished.

Further, under UAE law a contractual right expires if the performance of it becomes impossible following an extraneous cause in which that party played no part. Any Compensation Events regime should also include a genuine pre-estimate of actual loss, although paragraph 3.10 describes the consequences if it does not.

However, the process by which supervening events are agreed is fundamentally different due to the process of procuring projects in the UAE.

Government support for the construction means that the construction will usually go ahead, whether in the form of a PPP project or traditional government procurement. Therefore, to date, construction contracts have been negotiated and signed by the sponsor much earlier than the project agreement and then novated to the project company when the project agreement has been finalised and the financing obtained. Consequently, instead of a pass-down of the rights and obligations under the project agreement to the construction contractor, there is a pass-up to the Authority of the rights and obligations under the construction contract. It remains to be seen whether this will continue, given the recent downturn in the construction industry in both Abu Dhabi and Dubai and the increased competition between construction contractors.

Additionally, the FIDIC silver book, or derivatives thereof, are currently the preferred approach for construction contracts in the Middle East. As a consequence the pass-through analysis is more involved than a simple flow-down from the project agreement into a bespoke construction contract.

As there is neither a market standard operating contract nor a reason to sign the operating agreement prior to the project agreement, the same issues do not arise in relation to the operating agreement. As such, the treatment of the operating agreement more closely follows the UK approach.
3.8 Change in law

The change in law regime in the UAE generally provides more relief to a project company than would be expected in European PPP projects since there is no distinction in the UAE between general changes and discriminatory or specific changes in law and the project company is effectively protected from the impact of all changes in law. This also reflects the predictable process and time required for enacting legislation in the UK (and the consequent foreseeability of legislative change) when compared to the UAE, where laws can be changed virtually overnight by royal decree.

3.9 Termination and compensation

The compensation on termination regime is more favourable to finance parties than would be the case in the UK, mainly because the calculation for project company default is based upon a “debt outstanding” calculation rather than a “liquid market” calculation.

Compensation on termination for Authority default and force majeure generally follows the same principles as in the UK, ie senior debt, sub-contract breakage costs, equity and (other than in the case of force majeure) equity return for around five years following termination. Since this is calculated on an aggregate and not a discounted basis the payment in respect of equity can be more or less than the discounted basis used in the UK depending on the timing of termination. Whether this approach will continue or whether there will be a move towards a discounted basis over the whole project life remains to be seen.

3.10 Remedies

As in the UK, parties tend to fix the amount of compensation for the failure to perform a contract by specifying liquidated damages. However, either party may challenge this amount and a UAE court can vary the agreed amount to make it equal to the actual loss. Specific performance may be available, at the discretion of the court.

Unlike the UK, if the amount specified in the contract is not a genuine pre-estimate of loss (or indeed equal to the actual loss) it does not render the liquidated damages clause unenforceable for being a penalty. Notwithstanding this, parties may wish to ensure that liquidated damages clauses still try to ascertain a genuine pre-estimate of loss in order to mitigate the risk of lengthy and expensive litigation if the clause is required to be called upon.

3.11 Construction defects

In relation to the construction of buildings and some other fixed installations (muqawala), where the plans are made by an architect and constructed under his supervision, both the architect and the construction contractor are jointly liable for at least ten years to compensate the employer for any total or partial collapse of the construction.

If the defective manner of construction makes it impossible for the defect to be remedied, the employer may immediately terminate the construction contract. If it is possible to remedy the defect, the employer may require the construction contractor to do so within a reasonable period. If such reasonable period expires without the remedial work being carried out, the employer may apply to the court for the cancellation of the construction contract or for leave to engage another construction contractor to complete the work at the expense of the initial construction contractor.

3.12 Refinancing

The position on refinancing broadly follows the UK approach but rather than including formulae relating to the sharing of gains, the project agreement simply sets out the principle that gains be shared in a stated proportion.

However, as is the case with most PPP projects trying to obtain financing at the moment, current discussions around refinancing are focussed on the tenor of financing that finance parties are able to
make available, with an emphasis on who bears the cost should refinancing end up being more costly than the initial financing. At the time of writing, this issue has just been resolved on one project by building in certain incentives and protections, but it is still to be seen whether the solution will be repeated in future projects and whether it will have any effect on the Authority’s typical approach to sharing any refinancing gains.

3.13 Governing law and language

Under UAE law, where all contract parties are entities resident in the UAE, agreements will be construed by the UAE courts as governed by the laws of the UAE regardless of any express provision to the contrary. However, where this is not the case, the parties’ choice of law will remain valid (although, in the event of a dispute, we expect that a UAE court would not call for expert evidence as to the relevant foreign law but would instead, as a matter of practice, apply UAE law). As a general rule, the project documents are governed by the laws of the relevant emirate and the UAE, and the finance documents are governed by English law.

Documents to be produced before the courts or a notary public must be in Arabic and, where translations are required, the Arabic translation is treated as being definitive.

4. General UAE law considerations relevant to PPP

4.1 Employment

If an entity has more than 50 employees, 2% of employees must be UAE nationals. Additionally, “Acquired Rights directive” type considerations are not applicable in the UAE.

4.2 Interest

Although the giving and receiving of interest is forbidden by Shari’ah law, UAE federal law makes specific provision for the payment of interest. If the rate of interest is not specified in a contract, it is computed according to the rate of interest in the market at the time of dealing, but may not exceed 12%. If a payment is late, interest is calculated pursuant to Article 76 of the Commercial Code.

4.3 Assignments and transfers

“Assignments” require notice to the counterparty as well as the consent of the counterparty to be effective. However, it is unclear whether “assignment” refers to transfers of obligations only or to transfers of both rights and obligations and therefore whether consent is required for the transfer of rights. We adopt the approach that:

(a) notice to (but not the consent of) a counterparty is required to perfect an “assignment” of rights; and
(b) notice to and the consent of a counterparty is required to perfect an “assignment” of rights and obligations.

4.4 Recognition and enforcement of foreign judgments

Finance documents under UAE PPPs are generally governed by English law. They also provide, for the benefit of the finance parties only, that the English courts have exclusive jurisdiction. The UAE has acceded to the New York Convention in respect of arbitral awards and is party to international agreements which effectively oblige courts in the UAE to recognise judgments and awards made in France, Gulf Cooperation Council (GCC) countries and Arab non-GCC countries, but there is no such agreement with the United Kingdom. In essence, given the lack of recognition of an English court judgment in enforcing the judgment against assets in the UAE, finance parties may choose not to enforce the finance documents in the English courts. Finance parties generally get comfortable with this on the basis that they can choose
to arbitrate, the decisions of which should be enforced by the UAE courts. Additionally, where assets are located outside of the UAE, limited additional comfort can be obtained from establishing a robust “offshore” security package against which the judgments of the English courts will be recognised.

4.5 Insurance

Insurance is viewed by most Shari’a commentators as being void for uncertainty (and a form of gambling). UAE law, however, recognises a commercial need for insurance and has legislated accordingly. A number of categories of risk are recognised as insurable, including (a) accident and liability (eg industrial accidents, motor insurance, civil liability insurance and buildings insurance), (b) fire and (c) transportation risk. Other risks are specifically recognised by way of a “sweep-up” provision. Compulsory insurance must be taken out against certain risks and there are requirements for certain insurances to be placed only with UAE companies. As a result, finance parties will typically require:

(a) the insurances to be re-insured with internationally reputable insurers having a suitable credit rating;
(b) the reinsurances to be assigned by the direct insurer to the project company; and
(c) the project company’s interest in the reinsurances to be secured in favour of the finance parties (as referred to in paragraph 5.1(b)).

5. Security

5.1 Types of secured assets

Any liabilities lawfully arising can be secured but contracts designated under the Civil Code as gharar (contracts of hazard or uncertainty such as gambling contracts) are prohibited and cannot give rise to valid security interests. Neither is it possible to create security over future acquired assets, although mortgages over land include buildings erected on the land, even if erected after the date of the mortgage. Any new assets acquired by a debtor must be separately charged under a separate or supplementary security document. Registration requirements must be complied with, where applicable.

A typical security package in a UAE PPP project consists of:

(a) onshore security comprising:

   (i) a legal mortgage over the musataha, usufruct or lease (depending upon the location of the project) or, to the extent a mortgage over the lease cannot be registered, an assignment of the lease agreement;

   (ii) a commercial mortgage over all of the project company’s commercial assets (other than the onshore project accounts) to the extent possible and enforceable under UAE law, including (by addendum) all subsequently acquired tangible and intangible assets (it provides no step-in rights and a sale by public auction is the only remedy on enforcement);

   (iii) a UAE law assignment agreement covering the project documents (other than the security covered by the mortgage over the musataha or lease) and any material insurances (these are typically perfected on enforcement so only provide finance parties with security at that point);

   (iv) share pledges in respect of the shareholders’ shareholdings in the project company (again, the only remedy on enforcement is to offer the shares for sale by public auction – title cannot be transferred to the security agent for a ‘work out’ – attempts to circumvent this are likely to be ineffective); and

   (v) an onshore account pledge in respect of the onshore project accounts (although there is doubt over whether this works due to re-pledging requirements for fluctuating amounts); and

(b) offshore security in the form of an English law security agreement covering a charge over the offshore project accounts and an assignment of the reinsurance assignment.
The registering of documents (e.g., security documents or documents relating to land) with government entities can take time in the UAE. As such, we are of the opinion that reduced costs (e.g., legal fees and registration taxes) and increased deal-efficiency can be achieved by the project company not having any real-estate or similar rights (i.e., a musataha, usufruct, or lease) over which to register or secure, but for such rights to be vested in the Authority (as is the case in most UK PPP projects) with a licence to use the land being included in the project agreement instead. Such a licence, being a personal right, would not require registration with the land registry and security over the licence would be perfected under the UAE law assignment agreement (as is the case with the project agreement), also negating the need to be registered with the land registry, the need for a direct agreement separate to the direct agreement with the Authority and for translation into Arabic.

We also note that, whilst security over the shares in the project company is granted, to date security over the right of the shareholders to receive payments under any subordinated shareholder loans does not appear to have been granted, potentially reducing the return to finance parties on a distressed sale. This feature is also common in the IWPP projects in Abu Dhabi.

5.2 Secured parties

UAE law makes no distinction between domestic and foreign creditors for the purposes of taking security. However, in Dubai, mortgages are only available to local finance parties. Furthermore, differences of interpretation between registrars and practitioners have given rise to doubt as to whether foreign banks and financial institutions can benefit from certain registrable forms of security interest, in particular mortgages over a commercial business.

Owing to restrictions and/or uncertainty as to whether foreign creditors can hold onshore security, onshore security is held by an onshore security agent. As under UAE law, there is no concept of trust, and finance parties cannot rely upon onshore security being held on their behalf by a security trustee, each finance party should therefore ideally execute any documentation creating a security interest over onshore assets in its favour, although in practice in PPP projects the onshore security agent appears to be the only party holding onshore security on behalf of the finance parties. This is also usual practice in non-PPP projects in the UAE.

It may also be possible to use “parallel debt” arrangements to overcome the absence of a security trustee but the efficacy of this approach does not appear to have been tested yet.

5.3 Enforcement

As a general rule, a court order is needed to enforce against secured property (other than original rights). Obtaining an enforcement order can be a lengthy process. The courts will generally have regard to whether the security has been properly constituted when assessing the secured party’s entitlement.

6. Bankruptcy

6.1 General

A new federal “insolvency law” is anticipated in early 2010, but it is not yet clear what its scope will be. However, under existing legislation, there are three regimes that could apply to a “bankrupt” project company:

(a) liquidation under the Companies Law;
(b) protective composition under the Commercial Code; and
(c) bankruptcy and judicial composition under the Commercial Code and Civil Code.

These regimes are largely untested and are not as sophisticated as the regimes in more developed jurisdictions such as the UK. There is therefore considerable uncertainty as to how UAE bankruptcy laws operate in practice.
6.2 Liquidation

Under the Companies Law, the project company can be dissolved for any of the following reasons:
(a) expiry of the time period specified in its constitutional documents (unless renewed);
(b) exhaustion of the objects of the project company;
(c) depletion of all or most of the project company’s assets which makes the beneficial investment of the remainder impossible;
(d) amalgamation; or
(e) unanimous approval of the shareholders of the project company (unless a lower majority is specified in its constitutional documents).

Immediately following its dissolution, the project company is placed into liquidation, a liquidator is appointed to wind the project company’s affairs up and all of the project company’s deferred debts fall due. The costs of the liquidation are required to be paid in priority to all other debts of the project company. Once all liquidation expenses have been paid, the remaining debt is required to be settled in proportionality between the remaining creditors and in accordance with the rights of any priority creditors.

6.3 Protective Composition

A person may apply to court for a bankruptcy ruling and the court may also issue a ruling without any petition. Bankruptcy in the UAE includes a protective administration procedure broadly analogous to Chapter 11 proceedings in the US. Under this procedure, a company may apply for a moratorium on all debt proceedings against it whilst it applies to court for a “protective arrangement from bankruptcy”. If granted, the court will assume protective custody of the project company’s assets but permit the project company to continue to run the business whilst details of the arrangement are worked out with creditors. The Commercial Code does not provide any guidance as to the nature of the provisions that may be included in any arrangement entered into between the project company and its creditors. Such matters are to be agreed between the court, the project company and its creditors. Protective arrangements may only take effect with the approval of creditors holding at least two-thirds of the project company’s debts.

6.4 Bankruptcy and Judicial Composition

There is no formal definition of “bankruptcy” under the Commercial Code, but the bankruptcy will be determined by a court decision issued on the basis that the project company is unable to pay its debts as they fall due. However, a court has no power to issue such a decision without being requested to do so by a person. Further, the Commercial Code provides that the project company must apply for bankruptcy within 30 days from the date of cessation of payment of due debts.

As a result, if a bankrupt project company fails to reach agreement with its creditors it may be forced into bankruptcy by its creditors, whereupon it is immediately barred from discharging or recovering its debts and a moratorium is placed on the bringing of claims by or against it (subject to certain exceptions, including criminal proceedings). Certain transactions prior to bankruptcy are susceptible to claw-back. There is no concept of receivership under UAE law. Directors and managers of a project company can in certain circumstances be ordered to pay its debts if a court finds they have not exercised the appropriate standard of care.

The Commercial Code recognises and gives effect to the priority of secured creditors although they may only enforce their security with the permission of the court. Unsecured creditors share in the remaining proceeds pro rata with the residual claims of the secured creditors. Certain governmental claims (eg tax) and the claims of the employees for their labour law entitlements have preference and rank ahead of secured creditors.
7. Current and future active sectors

7.1 Active sectors

The Appendix sets out details of recent PPP activity.

The most active PPP sectors to date have been in the higher education sector, with three university projects having closed (UAE University, Paris-Sorbonne University-Abu Dhabi and Zayed University) and at least one more being structured (New York University).

Elsewhere, the first PPP road project (Mafraq-Ghweifat Highway) is in the tendering phase. There is also the possibility that Abu Dhabi’s light rail projects (Abu Dhabi Metro and Abu Dhabi Tram), whilst still at the feasibility study stage, may be structured as PPP projects. At the time of writing, it is uncertain whether the Tawam hospital project will be the first health PPP project in Abu Dhabi.

7.2 Future Sectors

As the PPP model has only recently been introduced, all of the active sectors appear to have a future in the short and medium term. Additionally, there are a number of schools projects in the pipeline which also look as though they will follow the PPP model. One notable point of interest in the education sector is that the lack of any trade unions in the UAE means that it is possible for teaching staff and clinical staff to be outsourced, with the value of the outsourced contract tested according to the delivery of results. In Abu Dhabi, the Abu Dhabi Education Council has recently outsourced oversight of the training of teachers. Whether or not this outsourcing will extend to the teaching itself and whether it will be procured at the same time as the construction and operation of new schools to create a full service PPP structure (which has certainly not been the traditional approach to schools procurement around the world to date) remains to be seen. One barrier that certainly will need to be overcome before this can become a reality is the certainty of educational results that finance parties will have to be comfortable with before they are willing to take the risk of educational performance.

Appendix

Active Sectors

<table>
<thead>
<tr>
<th>Project Name</th>
<th>Sector</th>
<th>Location</th>
<th>Capital Expenditure (USD)</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial City of Abu Dhabi Phase 1</td>
<td>Social Infrastructure</td>
<td>Abu Dhabi</td>
<td>152.8m</td>
<td>Closed 2006</td>
</tr>
<tr>
<td>Ajman Wastewater Refinancing</td>
<td>Waste</td>
<td>Ajman</td>
<td>140m</td>
<td>Closed 2006</td>
</tr>
<tr>
<td>Al Ain Industrial City</td>
<td>Social Infrastructure</td>
<td>Al Ain, Abu Dhabi</td>
<td>51.3m</td>
<td>Closed 2006</td>
</tr>
<tr>
<td>Jumeriah Golf Estates Sewage</td>
<td>Waste</td>
<td>Dubai</td>
<td>652m</td>
<td>Closed 2007</td>
</tr>
<tr>
<td>UAE University</td>
<td>Higher Education</td>
<td>Al Ain, Abu Dhabi</td>
<td>476.7m</td>
<td>Closed 2007</td>
</tr>
<tr>
<td>ICAD Industrial Wastewater Abu Dhabi</td>
<td>Waste</td>
<td>Abu Dhabi</td>
<td>96.5m</td>
<td>Closed 2007</td>
</tr>
<tr>
<td>Project Name</td>
<td>Sector</td>
<td>Location</td>
<td>Capital Expenditure (USD)</td>
<td>Status</td>
</tr>
<tr>
<td>--------------------------------------------------</td>
<td>----------------------------</td>
<td>-------------------</td>
<td>---------------------------</td>
<td>----------------------</td>
</tr>
<tr>
<td>Industrial City of Abu Dhabi Phase 1</td>
<td>Social Infrastructure</td>
<td>Abu Dhabi</td>
<td>223.96m</td>
<td>Closed 2007</td>
</tr>
<tr>
<td>Dubai Emirates Waste Recycling Facility</td>
<td>Waste</td>
<td>Dubai</td>
<td>150m</td>
<td>Closed 2007</td>
</tr>
<tr>
<td>Dubai Metro (O&amp;M only)</td>
<td>Transport</td>
<td>Dubai</td>
<td>500m</td>
<td>Closed 2008</td>
</tr>
<tr>
<td>Abu Dhabi Sewage Treatment</td>
<td>Waste</td>
<td>Abu Dhabi</td>
<td>408m</td>
<td>Closed 2008</td>
</tr>
<tr>
<td>Paris-Sorbonne University, Abu Dhabi</td>
<td>Higher Education</td>
<td>Abu Dhabi</td>
<td>384m</td>
<td>Closed 2008</td>
</tr>
<tr>
<td>Yah-Sat</td>
<td>Defence</td>
<td>Abu Dhabi</td>
<td>1,800m</td>
<td>Closed 2009</td>
</tr>
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<td>Zayed University</td>
<td>Higher Education</td>
<td>Abu Dhabi</td>
<td>1,100m</td>
<td>Closed 2009</td>
</tr>
<tr>
<td>Tawam Hospital (Project 21)</td>
<td>Health</td>
<td>Abu Dhabi</td>
<td>2,000m – 3,000m</td>
<td>Under review</td>
</tr>
<tr>
<td>Abu Dhabi Airport Terminal 3</td>
<td>Transport</td>
<td>Abu Dhabi</td>
<td>6,800m</td>
<td>Short Listed</td>
</tr>
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<td>Mafraq – Ghweifat Highway</td>
<td>Transport</td>
<td>Abu Dhabi</td>
<td>2,000m – 3,000m</td>
<td>Tender</td>
</tr>
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<td>New York University</td>
<td>Higher Education</td>
<td>Abu Dhabi</td>
<td>TBD</td>
<td>Tender</td>
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<td>Transport</td>
<td>Abu Dhabi</td>
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<td>Feasibility studies</td>
</tr>
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<td>Abu Dhabi Tram</td>
<td>Transport</td>
<td>Abu Dhabi</td>
<td>TBD</td>
<td>Feasibility studies</td>
</tr>
<tr>
<td>Abu Dhabi – Dubai Highway</td>
<td>Transport</td>
<td>Abu Dhabi</td>
<td>TBD</td>
<td>Feasibility studies</td>
</tr>
<tr>
<td>Mid Island – Parkway Highway</td>
<td>Transport</td>
<td>Abu Dhabi</td>
<td>TBD</td>
<td>Feasibility studies</td>
</tr>
<tr>
<td>Abu Dhabi Grouped Schools</td>
<td>Education</td>
<td>Abu Dhabi</td>
<td>TBD</td>
<td>Feasibility studies</td>
</tr>
<tr>
<td>Critical National Infrastructure Training Facility</td>
<td>Accommodation</td>
<td>Abu Dhabi</td>
<td>TBD</td>
<td>Feasibility studies</td>
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<td>Rehabilitation Centre</td>
<td>Health</td>
<td>Abu Dhabi</td>
<td>TBD</td>
<td>Feasibility studies</td>
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</tbody>
</table>
Institutions
PPP: the European Investment Bank and European PPP Expertise Centre

The European spirit signifies being conscious of belonging to a cultural family and to have a willingness to serve that community in the spirit of total mutuality, without any hidden motives of hegemony or the selfish exploitation of others.

Robert Schuman (1886-1963)

Contact

Luxembourg
Andy Carty
Special Advisor

EPEC
European Investment Bank
98-100, Boulevard
Konrad Adenauer
L-2950 Luxembourg
Grand Duchy of Luxembourg
Tel: +352 43 79 77 012
Fax: +352 43 79 67 292
a.carty@eib.org
1. Introduction

The European Investment Bank (the EIB) is the financing institution of the European Union. The Bank, which is owned by the EU’s 27 Member States, provides long-term finance to eligible projects supporting EU policy objectives.

The EIB is Europe's leading funder of PPP projects and has invested around EUR25 billion in at least 120 PPP projects.

2. Background on the EIB

2.1 Structure

Owned by the 27 Member States of the European Union (EU), the EIB is the EU's long-term lending institution. As a public bank with objectives driven by EU policies, its leading priority is to promote European economic development and integration. The EIB's lending activities are mainly funded via bond issuance in the international capital markets. Thanks to the EIB's ownership by all EU sovereigns, EIB bonds offer top-quality diversified sovereign-class exposure. The share of EIB capital assigned to a member country is broadly in line with a country's share of GDP within the EU. EIB bonds have always been considered of the highest credit quality with an AAA rating and a 0% risk weighting under Basle II.

The Bank enjoys its own legal personality and financial autonomy within the EU. It operates in keeping with strict banking practice and in close collaboration with the wider banking community, both when borrowing on the capital markets and when financing capital projects. The EIB's mandate is to assist with the integration, balanced development and economic and social cohesion of EU member countries. Over time, the Bank's mandate has been refined or expanded to include other EU priorities, usually by creating special lending facilities or specific policy targets. All EIB activities finance investments consistent with, and in support of, EU policies and priorities, including engagements outside the EU. The importance of EIB financing to EU countries underpins the strong shareholder support for the institution and is a critical credit strength.

2.2 Operational Strategy

(a) Corporate Operational Plan

Within the EU, the EIB has six priority objectives for its lending activity which are set out in the Bank's business plan, the Corporate Operational Plan (COP). The Bank lends to both public and private sector promoters in those six priority areas, which include priority transport projects – the Trans European Networks – Transport (TEN-T; EUR10.7 billion in 2009); investments in health and education; and projects to protect or enhance the environment (EUR13.6 billion in 2009). PPP structures have been used in a number of the operations supported by the EIB in these three areas. The Bank's other priority lending objectives are research and innovation, support to small and medium sized enterprises (EUR12.5 billion in 2009) and regional development.

The COP is approved by the Board of Directors and defines medium-term policy and operational priorities for objectives given to the Bank by its Governors. It is also an instrument evaluating the EIB's activities. The Bank is increasingly emphasising 'Value Added' projects based on three main pillars:

- consistency with EU priority objectives;
- quality and soundness of the project and technical, economic and financial viability; and
- the financial and non-financial contribution made by the EIB.
Greater Value Added and an increasing emphasis on innovation will allow the EIB to accept a gradual increase in risk. That is why the Bank has refined its credit risk policy to help improve its risk-taking capacity.

(b) Growth Initiative

In October 2003, the European Council invited the Commission and the EIB to explore how best to mobilise public and private sector financing in support of the Growth Initiative – the key goal of which is strengthening the long-term growth potential of the enlarged European economy, and how to give further consideration to a number of initiatives which should assist the development of PPPs. The proposals focused on the creation of the right regulatory, financial and administrative conditions to boost private investment, as well as the mobilisation of Community funding, coupled with an invitation to Member States to continue refocusing public expenditure towards growth-enhancing areas without increasing public budgets. The EIB’s proposals to the Council focused on the two key sectors covered by the Growth Initiative:

- the provision of substantial additional resources both for TENs\(^1\); and
- the Innovation 2010 Initiative\(^2\).

Specifically, the EIB undertook to use its best endeavours to expand the range of financial instruments used, including in particular financing for PPPs, in support of these two key sectors. The EIB provides (i) a Structured Finance Facility to fund projects with a higher risk profile and enable indirect equity financing; (ii) guarantee operations for large-scale infrastructure schemes; and (iii) the Loan Guarantee Instrument for TEN-T projects, funded by the EIB and EU budget and managed by the EIB, which takes the revenue ramp-up risk in the early years of traffic risk projects.

Equally importantly, the EIB undertook to develop its institutional links with the Commission, Member States and specialist financial institutions, as well as with the banking and capital markets, in support of increased private and public sector financing of these high-priority sectors.

The EIB’s commitments made under the Growth Initiative were a natural evolution and step up of measures already taken by the Bank over the previous ten years to encourage greater private sector financing of public infrastructure. The EIB’s role, therefore, is to support the increasing drive in Member States towards the improvement of public services through increased private sector participation, structuring its own participation in PPP projects in ways that optimise the ability of the public sector to meet EU policy objectives.

(c) Climate action and renewable energy package

The Bank is also working with the European Commission to define how it will contribute to the implementation of the Climate action and renewable energy package. Both institutions are committed to reducing EU’s overall emissions to at least 20% below 1990 levels by 2020, and ready to scale up this reduction to as much as 30% under a new global climate change agreement when other developed countries make comparable efforts. A complementary goal is to increase the share of renewables in energy use to 20% by 2020.

An early example of this commitment has been the launch of the Marguerite 2020 Fund, a EUR600 million initiative which aims to act as a catalyst for infrastructure investments implementing key EU policies in the areas of climate change, energy security, and trans-European networks.

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1 Trans-European Networks of transport, energy and telecommunications underpinning the developmental and integration goals of the European Union.

2 The Innovation 2010 Initiative was launched by the EIB in response to the EU Lisbon Agenda, in which the European Union set itself the strategic goal of establishing a competitive, innovative and knowledge-based European economy, capable of sustainable economic growth with more and better jobs and greater social cohesion by 2010. i2i objectives are: improving access to quality education and training; supporting excellence in research, development and innovation; promoting the diffusion of information and communications technology networks, including audiovisual activities.
3. The EIB and PPPs

3.1 The EIB approach to PPP

The EIB considers PPP to be an important additional instrument available to complement, where appropriate, other public sector procurement methods; it does not have a policy preference for PPPs but it invests in PPP projects which meet the Bank’s lending objectives and are financially, economically, environmentally and technically sound. However, many of the EIB’s shareholders, the Member States, use PPPs to improve project management and delivery for large infrastructure projects thanks to the private sector skills, analysis and expertise involved in PPP. The EIB began funding projects in the late 1980s when the first operations were developed in the UK. Since then it has become one of the most important financiers of PPPs in the European Union, boasting a portfolio of around 120 projects to which the Bank has committed in the region of EUR 25 bn.

![EIB Annual Loan Signatures for PPPs](chart.png)

The UK currently accounts for around one third of the EIB’s PPP project portfolio, with Spain, Portugal and Greece each approximately 15%. France, Germany, Italy, Poland and Turkey have ambitious programmes to increase the proportion of public investment financed by PPP and EIB lending to PPPs in these countries is expected to increase in the future.

3.2 Features of EIB-financed PPP projects

The majority of EIB-financed PPP projects come from the transport sector (around 80%), with the remainder supporting the health, education, energy, water and wastewater treatment sectors. The EIB has funded a range of innovative and nationally strategic PPP transport projects. Flagship projects include high-speed rail in the Netherlands, urban transport in France and Spain and bridges and tunnels in France and Greece among others. Furthermore, the Bank has financed water and environmental PPPs in Belgium, the Netherlands and Spain, health projects in Italy, France, Spain and the UK and education investments in Ireland and the UK.

In some of these projects the private sector’s revenue is directly related to actual use of these facilities. In others, payment is related to maintaining the facility in good condition and making it available for use. The EIB has also financed motorway projects in which a proportion of the payment due to the private sector partner relates directly to congestion avoidance and safety performance, demonstrating how PPP can enable the public sector to incentivise its private partner to achieve other policy objectives.
3.3 Benefits of EIB involvement

The EIB offers financial terms and conditions to projects which enable the Bank to play a catalytic and stabilising role in the PPP market. Long loan maturities and attractive grace periods complement flexible funding structures, including loans for low or non investment-grade projects, and new products such as revenue guarantees for large transport projects. As an AAA rated institution, the EIB can offer attractive lending rates to project promoters. Significantly for the large infrastructure projects for which the PPP model is often used, the EIB is committed to being a long-term investor, providing projects with stability not only during construction, but also in the operational phase. The substantial credit capacity provided by the EIB and the risk-based, not-for-profit pricing it adopts facilitates greater stability at times of market turbulence – particularly important in 2008/09’s tightened credit conditions. The EIB’s involvement in projects becomes increasingly valuable when the reduction of liquidity in parts of the banking market is taken into consideration. As the EIB does not need to syndicate, or sell down, its debt stakes in PPP projects, its investments are not dependent on overall market conditions.

3.4 Wider EIB activity

The growing importance of partnerships with the European Commission, bilateral financial institutions and other International Financial Institutions (IFIs), including the European Bank for Reconstruction and Development (EBRD), The World Bank and the Council of Europe Development Bank (CEB) has given rise to new, joint initiatives, substantially increasing the Bank’s contribution to the achievement of overall EU policy objectives.

Although the majority of EIB lending is allocated to promoters in the EU countries (about 90% of the total volume), the Bank contributes outside the Union through a series of mandates from the EU in support of development and cooperation policies in partner countries. Current EIB external mandates include the enlargement area of southern and eastern Europe; the Mediterranean Neighbourhood; Russia and the Eastern Neighbourhood; development and cooperation policies for Partner Countries (Africa, Caribbean and Pacific; South Africa; Asia; and Latin America). In those regions, the EIB may support viable public and private sector projects in infrastructure, industry, agro industry, mining and services. Special emphasis is given to projects that contribute to environmental sustainability and to the security of the EU energy supply. EIB loans are project oriented and linked to the financing of the fixed-asset components of an investment.

The Bank is also reinforcing its non-financing activities, through the recent creation of the European PPP Expertise Centre (EPEC), providing network facilitation and programme/policy support services to public sector involvement in PPP investments.

4. EIB responses to the financial crisis

4.1 Market conditions

The effects of the global financial crisis are still being felt in the PPP market. Project finance lending is continuing to have to compete for scarce regulatory capital allocations with more attractive corporate opportunities. The opportunity cost of lending to PPP projects has undoubtedly increased as the returns on other lending have improved. Although margins have eased somewhat from their 2009 peaks, tenors remain restricted and, in the UK at least, the hole in the market from the loss of capacity of the capital markets to fund PPP is still to be addressed.

On the demand side, however, the need for major European infrastructure programmes remains undiminished. Indeed, infrastructure investment has a key role to play as an anti-crisis measure. With the pressure on public resources set to increase for the foreseeable future, unlocking the potential of private finance becomes ever more urgent.
4.2 New EIB instruments

To complement initiatives taken by national authorities, the EIB has stepped up its lending activities and put in place a number of new instruments. (see paragraph 2.2(b) above)

4.3 Increased EIB Lending

The EIB is also rising to the challenge of the economic downturn by increasing its lending to further its support for Europe’s economic recovery. In 2008, total lending rose by 21% to EUR57 billion. In December 2008, the EIB undertook to contribute to the European Economic Recovery Package by increasing its financing operations by some 30% to EUR60 billion in 2009 and 2010 – EUR15 billion more than the EUR45 billion of its previous year. The EIB exceeded those expectations and, with a total lending volume of EUR79.1 billion in loan signatures, which by the end of the year had translated into disbursements of EUR54 billion (2008: EUR48.6 billion), it set another record.

In order to meet the new lending targets, as of 1 April 2009 the EIB’s subscribed capital was increased by some EUR67 billion to EUR232.4 billion. This increase was effected through a transfer from the EIB’s additional reserves to its capital.

5. European PPP Expertise Centre

5.1 EPEC as part of the EIB’s public policy role

The EIB’s ‘Value Added’ is not purely financial. The Bank’s public policy role for PPPs has gained in importance in recent years, as the European Commission and EU Member and Candidate States regularly call on the EIB to share its experience. The Bank has advised public authorities on a number of projects, working alongside public sector promoters and their legal, technical and financial advisory teams. Despite considerable knowledge and experience in parts of Europe’s public sector, a series of authoritative reports confirm that failure to share lessons and best-practice is limiting the economic efficiency and growth of the EU PPP market.

In collaboration with the Commission and EU Member States, the EIB created the European PPP Expertise Centre (EPEC) in September 2008 as a direct response. EPEC’s main task is to help the public sector to overcome shortfalls in PPP expertise. Adopting supportive legal frameworks, equipping public bodies with relevant new skills and, perhaps most importantly, disseminating PPP lessons and best practice within and across countries are all factors which can ensure that EU countries establish effective PPP programmes.
5.2 Membership

EPEC currently has 30 Members (as shown in the map above), who all have policy responsibility for PPP in their jurisdictions. Members include central government, regional administrations and public/private entities with a wholly public sector mission. The private sector is ineligible for membership, although EPEC maintains a strong link with the private sector PPP community.

Good practice guidance is disseminated among EPEC’s members with the clear aim of enhancing public sector management, reducing PPP costs and increasing deal flow. By making public authorities more effective participants in PPP transactions, EPEC’s work benefits both the private sector and the public sector authorities that make up EPEC’s membership.

5.3 EPEC’s Scope of Work

EPEC carries out three main types of activity:

(a) **Collaborative work** – a structured approach to identifying best practice in issues of common concern to members who implement PPP policies and programmes. EPEC draws extensively on the experience and expertise of its membership.

For example, as part of its work on the credit crisis, EPEC has:

(i) produced a paper examining potential remedies that the public sector could put in place (*The Financial Crisis and the PPP market – Potential Remedial Actions*³).

(ii) looked at the role of capital markets in PPP financing, while exploring potential solutions to revive and expand capital market financing.

EPEC is also carrying out collaborative work with Members on “Wider benefits of PPPs”, “Eurostat balance sheet requirements” and PPP procurement, in particular when Competitive Dialogue is used.

(b) Helpdesk – which members can email or phone up with queries;

(c) Institutional Strengthening is available to Members – covering a wide range of non-project specific support for PPP development, typically to help countries set up a PPP programme and policy or to analyse blockages in the processes or institutions. EPEC does not however provide consultancy services to support the procurement or negotiation of individual PPP transactions.

EPEC is already working with certain members to improve their PPP structures and delivery with several more finalising how best to engage with EPEC in the future.

5.4 Importance of EPEC

EPEC’s first year has clearly demonstrated that there is a great desire across most of Europe to design and implement PPP programmes to deliver the level and breadth of infrastructure investment that has been delivered by this approach in the UK. However, in the midst of the current economic environment, EPEC has adapted its priorities to enable it to look at the main issues coming out of the financial crisis and to provide a framework for analysing some potential responses. In effect, the unique financial conditions have meant that even the most mature PPP programmes are experiencing difficulty in closing deals largely due to lack of liquidity. While the EIB as an organisation is helping at the institutional level, EPEC can also play its part. This is done not only by sharing market information on how and when deals close, but also by giving PPP units the chance to share and explore possible solutions before they are in the public domain. Indeed, the current problems being experienced in the market appear to heighten the need for an organisation such as EPEC.
What improves the circumstances of the greater part can never be regarded as an inconvenience to the whole. No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable.

Adam Smith (1723-1790)
1. Introduction

The involvement of Export Credit Agencies (ECAs) and Multilateral Agencies (MLAs) in PPP projects is not a new development, but as the financial landscape makes it much harder for sponsors, borrowers and the public sector to resort to traditional forms of commercial bank lending, both the public and private sector are increasingly coming to the view that ECAs and MLAs need to be part of the funding solution for PPP projects. This is particularly the case with projects being implemented in emerging markets, where there is a need to secure long-term financing and also in many cases to provide protection against political risk.

This chapter provides an overview of the role which ECAs and MLAs have traditionally played in financing PPP projects, and how that role has expanded since the recent liquidity crisis. In particular, this chapter covers the following:

- what and who ECAs and MLAs are and what products they typically provide for project financings;
- the key advantages of having ECAs or MLAs as part of the funding solution;
- the extent to which ECAs and MLAs have traditionally been involved in PPP projects, with a particular focus on PPP projects in the emerging economies of Central and Eastern Europe (CEE) and the Commonwealth of Independent States (the CIS);
- if and how the role of ECAs and MLAs in PPP projects has evolved to face the liquidity crisis, again with a focus on their activities in CEE and the CIS;
- the future outlook for involvement of ECAs and MLAs in PPP projects; and
- the particular activities of the European Bank of Reconstruction and Development (EBRD), the International Finance Corporation (IFC) and the European Investment Bank (the EIB) in relation to the above.

2. Setting the scene

2.1 What and who are ECAs?

ECAs are governmental or quasi-governmental institutions: some are government departments whilst others are private companies operating on behalf of the government or private companies with a private-sector business model (but with the government as the main shareholder).

ECAs origins lie in national movements to promote exports by supporting exporters from the country of the relevant ECA. Exporters who can avail themselves of support from their national ECA are likely to enjoy a clear advantage over exporters from countries without an ECA. Broadly, an ECA's mandate is to provide finance, whether by direct loans or providing cover whether by way of guarantee or insurance, to enable other countries to buy the goods and services produced in that ECA's home country. Funding or ECA cover is therefore typically “tied” to the purchase of goods or services from the ECA's home country.

Today, 27 member countries of the OECD and a large number of other countries have ECAs (see below for a list of some of the major ECAs active in project finance transactions) and all except three of the OECD countries have agreed to co-ordinate and to a large extent standardise the financial support that

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1 The decline of the monolines has also meant that the capital markets are now less of a viable funding source for PPP projects. MLAs such as the EIB have indicated that there is now a bigger role for the MLAs in the capital markets (see Chapter 22 PPP: EIB and EPEC).

2 Although this is not always the case, as, for example, JBIC offers “untied” loans to projects which are not conditional on the inclusion of Japanese equity in the transaction or the procurement of equipment and materials from Japan. These loans finance projects and programmes primarily in developing countries with the aim, amongst others, of sustaining and expanding trade and direct investment from Japan and promoting Japanese business activities.
their ECA(s) offer. The idea is to foster an orderly export credit market so that export orders are won not on the basis of who offers the most advantageous financial terms but on who provides the best goods and services for the lowest price. To this end, the relevant OECD countries participate in the “Arrangement on Guidelines for Officially Supported Export Credits” (the Arrangement). The original Arrangement was entered into in April 1978 and it has been amended and updated on a regular basis since. The most recent version of the Arrangement at the time of print is 5 August 2009. The Arrangement is a “gentlemen’s agreement” and is intended to set a level playing field for the financial support which the ECAs can offer their respective exporters. The Arrangement, therefore, sets out the most generous terms and conditions (including repayment periods and pricing) on which ECAs may provide credit support to project finance transactions which satisfy certain eligibility criteria set out in the Arrangement (the Basic Criteria). It is envisaged that most project finance transactions will satisfy the Basic Criteria although there may be project specifics which take a limited recourse financing outside the scope of the Basic Criteria. The Arrangement provides more restrictive conditions for project financing transactions in High Income OECD Countries. The Arrangement also provides more generous terms and conditions (including longer repayment periods) for certain types of projects such as nuclear power projects and renewable energy projects.

The general principle that ECAs should offer broadly standardised financial support is bolstered by provisions in the Arrangement which not only require an ECA to notify all the other ECAs in the event it wishes to offer support to a particular project on different terms from those set out in the Arrangement, but also allows the other ECAs the opportunity to match its terms. In our experience, ECAs are reluctant in the context of a project finance transaction to consider utilising the notification procedure and instead prefer to adhere strictly to the terms and conditions set out in the Arrangement.

### Some of the major ECAs active in project finance

<table>
<thead>
<tr>
<th>Country</th>
<th>ECAs</th>
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<tbody>
<tr>
<td>China</td>
<td>SINOSURE/China Exim</td>
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<tr>
<td>South Korea</td>
<td>K-EXIM and KEIC</td>
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<tr>
<td>France</td>
<td>COFACE</td>
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<td>Netherlands</td>
<td>Atradius</td>
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<td>Germany</td>
<td>Hermes</td>
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<td>Sweden</td>
<td>EKN</td>
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<tr>
<td>Italy</td>
<td>SACE</td>
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<tr>
<td>UK</td>
<td>ECGD</td>
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<tr>
<td>Japan</td>
<td>JBIC and NEXI</td>
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<tr>
<td>US</td>
<td>EXIM BANK</td>
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</tbody>
</table>

#### 2.2 What and who are MLAs?

MLAs are governmental institutions which are owned and funded by a number of governments (as opposed to an ECA which is owned by a single government) and their mandate is to further economic development in developing countries by encouraging the growth of productive private enterprise (rather than promoting national exports). Funding provided by the MLAs is not tied to any goods or services produced by its member states.
MLAs include what are known as:

(a) Multilateral Development Banks (MDBs) – the World Bank Group⁵ and the following four Regional Development Banks:

- The African Development Bank;
- The Asian Development Bank;
- The European Bank for Reconstruction and Development; and
- The Inter-American Development Bank Group; and

(b) Multilateral Financial Institutions (MFIs) – which differ from MDBs in that they have a more narrow ownership/membership structure or focus on specific sectors or activities. MFIs include:

- The European Investment Bank;
- The Islamic Development Bank;
- The Nordic Development Fund and The Nordic Investment Bank; and
- The OPEC Fund for International Development.

### Some of the major MLAs active in project finance

<table>
<thead>
<tr>
<th>Principal mandate</th>
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<tbody>
<tr>
<td><strong>International Finance Corporation (IFC) (part of the World Bank Group⁶)</strong></td>
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<tr>
<td>The IFC is the World Bank’s arm for supporting projects in the private sector. IFC’s Articles state that its purpose is to “further economic development by encouraging the growth of productive private enterprise in member countries, particularly in the less developed areas”.</td>
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<tr>
<td><strong>European Bank for Reconstruction and Development (EBRD)</strong></td>
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<tr>
<td>The EBRD was established in 1990 pursuant to an “Agreement Establishing the European Bank for Reconstruction and Development”⁷ signed by its member states⁸, which states⁹ that EBRD’s purpose is to “foster the transition towards open market oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multi-party democracy, pluralism and market economics”.</td>
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<tr>
<td><strong>European Investment Bank (the EIB)</strong></td>
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<td>The EIB¹⁰ is essentially the European Union’s bank. It was set up in 1958 under Article 129 of the Treaty of Rome.¹¹ Its constitutional document is annexed to the Treaty and its role is to “contribute...to the balanced and steady development of the common market in the interest of the Community” facilitating the financing of specified classes of project.¹²</td>
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Other major MLAs active in project finance transactions include the Asian Development Bank, the Islamic Development Bank and the African Development Bank.

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⁵ The World Bank Group consists of five institutions which include the International Finance Corporation (IFC), the International Bank for Reconstruction and Development (IBRD) and the Multilateral Investment Guarantee Agency (MIGA). IBRD was founded in 1944 to aid post-WWII reconstruction and primarily works with middle-income and creditworthy poorer countries to promote sustainable growth and the reduction of poverty by the provision of direct IBRD loans to developmental activities within those countries. MIGA’s mandate is closely aligned with that of IBRD’s and principally aims at facilitating foreign direct investment in its developing member states in order to help create jobs, promote economic growth, and reduce poverty. MIGA offers political risk insurance (in the form of guarantees) against expropriation, currency inconvertibility, breach of contract, war and civil disturbance, with the aim of aiding those developing economies in attracting and retaining foreign investment in their countries.

⁶ See above.

⁷ For a copy of this agreement, please see http://www.ebrd.com/pubs/insti/basics.pdf.

⁸ For a list of the EBRD’s member states, please see: http://www.ebrd.com/about/basics/members.htm.
2.3 Nature of ECA financing support

Whilst certain ECAs (such as JBIC and K-EXIM) offer direct loans in certain circumstances (usually where there is a Japanese or Korean equity component), the usual cover provided by the ECAs is an insurance policy or guarantee provided to the lenders covered by the ECA (who are the commercial banks providing financing to the project company purchasing the eligible goods and services from that ECA's country of origin). The usual guarantee or insurance protection provided by the ECAs in relation to projects in today's market is “comprehensive”, meaning that it covers non-payment by the borrower as a result of both commercial and political risks\(^9\) (and not just political risk). Despite the “comprehensive” label, the financing support provided by ECAs will be limited to a certain amount of the loans taken out by the project company, a percentage of the project risks and to certain types of payments made by the project company in respect of the project.

In terms of the amount eligible for cover by an ECA, the guiding principle is that ECAs must not provide official support in excess of 85% of the value of goods and services exported. This 85% threshold includes any third country supplies (i.e., not from the ECA’s country or the country where the project is situated) but excludes any financing support for local costs in the country where the project is situated. The Arrangement provides that ECAs may provide support for local costs provided that official support for such costs does not exceed 30% of the export contract value (and, if such ECA support exceeds 10% of the export contract value, such support shall be subject to prior notification to the other ECAs participating in the Arrangement in relation to the nature of the local costs being supported\(^10\)). It is worth noting that there is no “common line” taken in the Arrangement with respect to the coverage that ECAs may provide in respect of third country supplies and each ECA will have varying policies in respect of the percentage of the main contract value that third country suppliers may represent in order for either the main contract itself still to be eligible for financing or for third country supplies (or a proportion of them) to be eligible for cover\(^11\). Some ECAs will also only cover third country supplies as an alternative to covering local costs, although an ECA of any European Union Member State may cover subcontracts where the subcontractor is from another Member State so long as the aggregate amount of such subcontracts (together with any subcontracts with non-European Union third country suppliers) does not exceed 30% of the export contract value (or higher percentages for smaller contracts).

In addition to its rules relating to the amount of loans and the costs it will cover, each ECA has different rules about the percentage of the amount eligible for cover for which it will assume the risk. The percentage of risk typically ranges from 90-100%, depending on the ECA and the project. Most ECAs prefer to leave a portion of risk uncovered so as (among other things) to incentivise the commercial lenders to do proper due diligence and to have some exposure throughout the life of the project.

Another important point to note is that in addition to the percentage restriction limiting the ECAs’ cover, the cover provided by an ECA is not all-embracing. ECAs typically only cover repayment of principal and payment of interest and default interest at a specified rate. An increase in interest rate through provisions such as the market disruption clause is covered by certain ECAs, but where it is covered it is typically subject to a cap. In addition, repayment of principal is only covered on an unaccelerated basis, i.e., as and when repayment would have fallen due under the original credit agreement irrespective of any intervening acceleration of the loans (although the ECAs will typically have a discretion to pay on an accelerated basis if they wish to do so). Costs such as breakage costs, fees and indemnity payments are usually not covered by ECAs.

2.4 Nature of MLA financing support

There is not the same need to create a level playing field for MLAs by virtue of their mandate to promote economic development rather than national exports so the same competition issues do not exist. Therefore, there is no common set of rules comparable to the Arrangement which apply to the scope and nature

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\(^9\) Typical political risks include events of political violence, war, nationalisation, currency transfer restrictions or embargo.

\(^10\) See Article 10 of the Arrangement.

\(^11\) Ranging from 10% in the case of Hermes to 70% in the case of K-EXIM.
of financing support that MLAs may offer to eligible projects. It is up to each individual MLA (and their constituent member states) to determine the strategy and policy which they hold towards any particular sector, region or type of project.

The EBRD, for example, funds up to 35% of the total project cost for a greenfield project or 35% of the long-term capitalisation of an established company. Direct investments generally range from EUR5 million to EUR230 million and may take the form of direct loans, equity or guarantees. The criteria which the EBRD uses to determine if a project is eligible for EBRD support include the following:

(a) the project has to be located in an EBRD country of operation;
(b) it must have good prospects of being profitable;
(c) significant equity contributions in cash or in kind are required from the project sponsor; and
(d) the project must benefit the local economy.

The IFC, on the other hand, will typically participate in a project by taking a small equity participation and by making loans available pursuant to an Investment Agreement (although they can do either independently of the other). The IFC has similar investment criteria to EBRD, although it will typically only fund up to 25% of the total estimated project cost, or, on an exceptional basis, up to 35% in small projects. For expansion projects, IFC may provide up to 50% of the project cost, provided its investments do not exceed 25% of the total capitalisation of the project company.

2.5 Key advantages of ECA and/or MLA participation

(a) Making projects viable

Involving ECAs and MLAs increases liquidity either by the ECAs and MLAs providing direct loans or by providing cover for commercial banks and, therefore, allowing banks to provide long-term debt. In the current economic environment with liquidity constraints and low appetite for risk, funding for many projects simply would not be available in the commercial bank market (or at least not available on economically viable terms) without the ECAs’ and MLAs’ funding and support. This is especially true for projects in emerging markets and mega projects.

Another traditional advantage of involving ECAs and MLAs is that they provide comfort against political risks. They typically provide funding or cover against political risk by making the loans to the project company themselves or by guaranteeing to commercial lenders the repayment of their loans (and the payment of interest on those loans) if the reason for non-payment is a political risk. Where the cover provided is for political risk only, the political risks covered will be specified in the policy and the cover will only respond to the extent the non-payment is as a result of a specified political risk. Although commercial banks can assess and accept commercial risks, they have a much more limited capacity to accept political risks. The acceptance by ECAs and MLAs of political risks will, in many cases, make a non-viable project viable – this is especially true in the current liquidity crunch but was already the case in certain emerging markets.

Another significant advantage of ECA support is that, where an ECA provides comprehensive risk cover, commercial banks can book the loans so covered as a credit risk on the government of the relevant country of the ECA and not a credit risk on the actual borrower or its country. This allows commercial banks to avoid “country limits” and is not only advantageous in obtaining internal credit approvals but is also beneficial from a capital adequacy standpoint. This is a significant advantage to commercial lenders as they grapple increasingly with constraints on their balance sheets and heightened scrutiny by their risk committees.
(b) Better financing terms

A major advantage that MLAs and ECAs can bring to a project is long-term fixed rate funding. MLAs such as EBRD and the EIB are able to do this because they are able to use their credit standing to raise long-term fixed rate funds in their own name in the international bond markets which they then on-lend to borrowers at a modest margin intended to cover their own costs and the creation of statutory reserves. MLAs and ECAs can also lend on a traditional floating rate basis as well as on a fixed rate basis and in many cases have developed or are developing various interest rate options.

The EIB, for example, offers what it refers to as revisable fixed rate loans and variable convertible rate loans. With revisable fixed rate loans, the interest rate is initially fixed for only part of the duration of the loan (for example, the first four years) and is fixed again for a further period on the expiry of this initial period (and so on). The new fixed rate is proposed by the EIB and, if the borrower does not accept it, the EIB’s documentation provides that the borrower must prepay the loans. With variable convertible rate loans, the interest rate is initially floating but the borrower has the option to convert all or part of the loans to a fixed interest rate at specified times. The fixed rate will again be proposed by the EIB but, in this case, if the borrower does not accept it, the loans will remain on a floating rate basis.

Repayment periods offered by MLAs and ECAs (or ECA covered loans) are often longer than those available in the commercial bank market. This facilitates increasing the “debt capacity”\(^\text{12}\) of a project and thereby increases shareholder returns.

3. Historic ECA and MLA support for PPP projects

Before considering the role of ECAs and MLAs in PPP projects moving forward, it is important to understand the role which such entities have historically played in this sector.

3.1 ECAs

ECAs have been active in PPP projects although the proportion of their investments in the infrastructure sector is relatively small when compared to their investment in the energy sector or MLA investment in the infrastructure sector. ECAs in export-oriented countries (such as JBIC and K-EXIM) have traditionally focused their investments on the import/export of goods/services which are designated as strategically important, for example, the import of natural resources and commodities such as oil and LNG and the export of plant, ships and technology. ECAs have also historically been more active in funding projects in the energy sector in emerging economies, where their inclusion in the funding solution has often been regarded as crucial in making those projects viable.

ECA involvement in PPP and infrastructure projects has therefore been predominantly in the transportation sector, in particular in relation to roads and rail. A few notable projects with current and proposed ECA involvement include:

- a USD95 million unsecured financing in 2008 implemented under JBIC’s untied guarantee programme in connection with the further construction and expansion of the São Paulo metro line 4, Brazil;

- a USD535 million unsecured financing in 2008 implemented under JBIC’s untied guarantee programme to finance the acquisition of Companhia Paulista de Trens Metropolitanos’ (CPTM) trains and systems;

\(^{12}\)

\(\text{ie the amount of debt as opposed to equity that can be used in financing a project.}\)
- a EUR776 million financing in 2008 for Istanbul’s Kadikoy-Kartal metro line project which has a 14-year, EUR250 million facility guaranteed by SACE, and the commercial facility partially underwritten by MLAs, the Black Sea Trade and Development Bank and the IFC; and
- the proposed financing of the EUR1 billion Moscow to St Petersburg road PPP (which reached contractual close in 2009) with the proposed involvement of EBRD, the EIB, COFACE and Vnesheconombank (VEB).

Another reason for ECAs’ less active involvement in PPP projects in the past is largely because demand for ECA support in PPP projects has historically been much lower than demand in other sectors (such as in the power, oil and gas, petrochemical and trade finance sectors). One reason for this is that MLAs have traditionally plugged the gaps left by commercial lenders on infrastructure projects (in particular PPP projects in the emerging economies or mega projects) which commercial lenders did not regard as viable or were only willing to fund on terms which the projects’ economics could not support.

It is also worth noting that, until the onset of the credit crunch, the more mature PPP market in Western Europe (and to some extent, Central & Eastern Europe) had enjoyed a healthy level of interest from the commercial lending market and the consequent benefit of relatively competitive pricing terms. The sponsors’ ability to access low interest rates on long-term committed funding therefore meant that there was often little need to include ECAs in the funding solution.

3.2 MLAs

MLAs have traditionally always played an active and very important role in PPP projects, in particular in the emerging economies of CEE and the CIS, not least because the integration with and transition of those economies to market-oriented economies is an important priority and infrastructure development is considered key to the economic and structural reforms taking place within those countries.

MLAs have encouraged PPP projects as a means of procurement on the basis that PPP projects tend to foster an accountability and transparency in operation which is frequently absent from state sector transactions. Given that many emerging economies have been grappling with the concepts of public accountability and the establishment of civic institutions that hold their governments to account, PPP projects are regarded as a way forward in giving private investors a sense of confidence in the public sector.

The assistance provided by MLAs in supporting PPP projects is threefold: (i) helping to establish PPP programmes within those countries; (ii) assisting with the reform of the legal framework under which PPP projects can be implemented; and (iii) participating/investing in PPP projects which are being procured in those countries.

(a) Laying the foundation for PPP projects

MLAs play an instrumental role in educating governments about the benefits of PPP as a means of procurement, the role of PPP projects in their country’s economic development and the identification of PPP opportunities within their country. Aware that a major barrier to the development and implementation of PPP projects can be the lack of skills within government to design, develop, finance and implement such projects (which often translates into excessive bid costs, delays and risks for those projects), MLAs such as the EBRD, IFC and the EIB have established and participated in various initiatives aimed at providing technical assistance to authorities who are committed to undertaking the reforms needed to facilitate PPP.

The EBRD is involved in the Public Private Partnership (PPP) Alliance, which is an initiative of the United Nations Economic Commission for Europe, established in March 2002. The key objectives of the PPP Alliance include promoting PPP in the European transition countries and helping them acquire expertise, assisting governments in establishing PPP units (which may be empowered to act

13 The EIB has established the European PPP Expertise Centre whose main task is to help the public sector to overcome shortfalls in PPP expertise. Please see Chapter 22 PPP: EIB and EPEC.
for the financing arm of the government, as well as managing and prioritising procurement), promoting co-operation between such units and the public, as well as assisting in the formulation of PPP policies, promoting education and know-how transfer, identifying pilot projects and facilitating access to finance. The EBRD plays an active part, particularly in the Alliance's legal working group.

The IFC, on the other hand, established its Advisory Services in Infrastructure (ASI) in 1989 which offers direct advisory services to governments on implementing private-sector participation transactions, undertaking studies within each relevant country to identify and analyse potential PPP transactions in sectors such as transport, social infrastructure, water and sanitation, and power. The ASI aims to advise governments on how to structure and implement projects that meet their needs, as well as those of the public and investors, including formulating long-term agreements with the private sector to provide specific investments and services using strict performance-driven criteria. The ASI has so far seen considerable success in the Middle East and Africa, where countries such as Egypt, Jordan, Morocco and Saudi Arabia have each signed a Memorandum of Understanding (MoU) with the IFC mandating it to provide advisory assistance in connection with the development of PPP projects in their respective countries.

(b) Developing a legal framework for PPP projects

The MLAs have also played an important role in laying down a legal framework for PPP projects by helping to develop and promote internationally acceptable concession laws and practices, in particular in the emerging markets of CEE and the CIS, as well as participating in national initiatives to set up the rules and institutions that regulate and facilitate the implementation of such laws.

The EBRD, for example, offers technical assistance for the legal reform of concession laws in the emerging economies in CEE and the CIS through its Legal Transition Programme. At the request of the Ministry of Finance in Slovenia, it undertook a project to upgrade Slovenia’s concession legal framework in line with EU requirements ahead of Slovenia’s accession in 2004. A working group was created, comprising external consultants, local lawyers, the Slovene Ministry of Finance, and various EBRD departments, whose purpose was to consult and arbitrate between groups with disparate and sometimes conflicting interests. The EBRD undertook a similar initiative in Lithuania where it assisted with the reform of Lithuania’s legal framework in order to make it more attractive to the private sector and to inject more flexibility into its administrative rules governing concession granting, negotiation and implementation.

Through its Legal Transition Programme, the EBRD has benchmarked national concession legislation against international best standards and examined how those laws work in practice. It has also provided advisory services to the governments of a number of countries in their efforts to upgrade national PPP legislative and regulatory regimes. Key evidence of this is the EBRD’s work in 2007-2008 with the Federal Anti-Monopoly Service of the Russian Federation, which it advised on establishing guidelines (with respect to the requirements for tenders and auctions to be held by municipal authorities) on how to ensure that all leases of municipal assets would be awarded on a transparent and non-discriminatory competitive basis.

(c) Direct investments in PPP projects

Major MLAs such as EBRD, IFC and the EIB consider investments in infrastructure a strategic priority, not least because poor infrastructure is often perceived as one of the major impediments to the development of a free-market economy. The MLAs have, to date, invested heavily in PPP projects, in particular in the transportation sectors of the emerging economies of CEE and the CIS.

The IFC, for example, has invested more than USD5 billion in private infrastructure, health, and education projects, whereas the EBRD has invested to date over EUR9.6 billion in the infrastructure sector in countries of its operation.

It is also interesting to note that investments made by MLAs have typically taken the form of direct loans to project companies (rather than guarantees) and, in 2009, reportedly all but one MLA-backed
deal in the emerging markets involved direct loans, with MLAs making a total of USD2.5 billion in direct loans to project financings as opposed to just USD60 million in guarantees. Examples of project financings which include a debt element provided by the MLAs are set out in paragraph 4.2 below.

(d) A focus on transportation

MLAs such as the EBRD and the EIB have given the transportation sectors strategic priority. The EIB for example estimates that around 80% of its investments take place in the transport sector (with the remainder supporting the health, education, energy, water and wastewater treatment sectors). The EBRD has also had substantial involvement in establishing PPP projects in the roads sector in CEE, having invested in the first PPP projects in the roads sector in Hungary, Poland and Slovakia and has maintained dialogue with the PPP units in those countries to develop the use of PPP projects in their transportation sector.

Although the EBRD has adopted a broad concession policy which sets out the Bank’s approach to selecting and approving concession-based projects, it has adopted specific policies on what it considers are strategic sectors of importance, and this includes discrete policies on (a) Municipal and Environmental Infrastructure and (b) transportation. Its policy on transportation emphasises how key an efficient transport sector is in the operation of regional markets and as a key driver to achieving integration of the CEE economies. The EBRD aims to cooperate with the EU on the development of the Trans-European Network (TEN) corridors and implementation of regional initiatives, such as the REBIS (Regional Balkans Infrastructure Study) initiative in the Western Balkans and the TRACECA (Transport Corridor, Europe – Caucasus-Asia) initiative in Central Asia and the Caucasus, as well as continuing co-operation with other IFIs, such as the IMF, the IFC and the regional development banks as part of its strategic approach on transportation.

4. Effect of the liquidity crisis on ECAs and MLAs

4.1 An increasing role for the ECAs?

The squeeze in the credit markets has meant that ECAs have become a crucial source of funding, in particular to borrowers in emerging economies, and they are facing unprecedented demand for their support, even from borrowers who had traditionally not sought export credits. Political pressure has also been placed on ECAs to undertake a wider range of initiatives to bolster trade finance, as was seen in the 2009 G20 summit and round of World Trade Organisation (WTO) meetings.

Against that backdrop, there has not yet been a dramatic shift of focus by the ECAs towards infrastructure although there are signs that this may slowly be changing. As political focus now shifts to the regeneration and development of infrastructure as one of the ways out of the global recession, there may be a growing impetus for ECAs to support infrastructure projects. There is also a growing recognition by ECAs that the promotion and development of infrastructure underpins the successful promotion of their national exports.

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15 For details on the EIB and its focus on the Trans-European Network (TEN), please see Chapter 22 PPP: EIB and EPEC.
16 The M1/M15 and M5 motorway projects.
17 The A1 Roads project, for details see paragraph 4.2 below.
18 The R1 Motorway project, for details see paragraph 4.2 below.
19 Some of the key requirements articulated by this policy are competitive procedures, fairness of contracts and effective and balanced risk sharing between the public and private sectors.
JBIC, for instance, recognises that even if Japanese firms seek to expand business into foreign countries, their projects will not succeed without sound infrastructure at the national and/or local level\(^{20}\). There is therefore an acknowledgement that it is essential for countries, in particular, the emerging economies, to develop their basic physical infrastructure such as roads, telecommunications networks, power, water supply and port facilities and ECAs, such as JBIC, have begun to take active steps to support the involvement of their exporters in infrastructure development and PPP projects.

By way of example, on 14 May 2009, JBIC signed an MoU with the African Development Bank (\textbf{ADB}) aimed at strengthening cooperation between the two banks in supporting economic development in Africa. They undertook to cooperate in mutually important areas for both Japanese and African countries, and infrastructure projects were regarded as one of the key investment areas vital to improving the investment environment for the private sector.

JBIC also entered into an MoU with the Inter-American Development Bank (\textbf{IDB}) on 31 March 2009 which forms the foundation for the two institutions’ cooperative efforts in responding to the international financial crisis via the JBIC-IDB Cofinancing Framework (\textbf{JICF}). The JICF aims to contribute to the sustainable development of the Latin American and Caribbean region by supporting infrastructure development projects and investment projects that are essential for the economic and social development of the region.

In March 2009, JBIC also provided an untied loan of up to JPY35 billion to Transnet, a 100% South African state-owned freight rail, ports and pipeline company in South Africa for the widening of the entrance channel at the Port of Durban. This loan was co-financed with three commercial Japanese banks and JBIC also provided a guarantee for the portion co-financed. Although this project was not strictly a PPP, JBIC’s investment in the project (as well as its entry into the MoUs with the IDB and ADB) is perhaps an encouraging indication of ECAs’ growing willingness to support infrastructure projects\(^{21}\).

Although not ECAs, institutions such as KfW and DEG (the German development financing institution) and Proparco (the French development financing institution) have also demonstrated an increased commitment to PPP projects in this recent crisis. KfW in particular has, in conjunction with the Private Infrastructure Development Group, raised EUR4 billion of commitments for their jointly-owned Infrastructure Crisis Facility Debt Pool, which is aimed at providing direct funding to PPP projects and privately-financed infrastructure in emerging markets. KfW has set aside EUR500 million for the debt pool, while DEG has earmarked EUR271 million to co-finance programmes that have difficulty reaching financial close, and Proparco has pledged EUR200 million for projects in Africa, after earlier committing EUR800 million in co-financing programmes under the Infrastructure Crisis Facility.

### 4.2 MLAs stepping up to the challenge

MLAs have taken on a renewed significance in the financing of PPP projects against the backdrop of weak growth, falling credit ratings of emerging economies, increasing constraints on the availability of long-term liquidity and the withdrawal of certain lenders from the PPP market. As MLAs offer the advantage of being able to provide untied direct loans, their financial products may be considered to be a more effective solution to the liquidity crisis, particularly as they typically offer competitive pricing and terms and conditions.

In response to this increasing demand for financing as a result of the continuing effects of the global financial crisis, EBRD, for example, has increased its investments to EUR8 billion in 2009. Its Board of Directors agreed to use its reserves to increase its annual investment volume by EUR1 billion, bringing the target for 2009 to 52% more than the Bank had invested in 2008. The EBRD

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\(^{21}\) JBIC, in its press release for the Transnet project, referred to the Port of Durban as having become an important export and import base for Japanese auto-related affiliates operating in this region and the loans provided by JBIC for the project would help improve the operating environment for those Japanese companies.
President’s Thomas Mirow was quoted\textsuperscript{22} as saying: “The economic environment continues to pose a challenge for many in our region, but the EBRD is well-equipped and ready to continue to provide support where it is most needed. Our investments so far this year underscore that commitment”.

Additionally, and consistent with the appeal from the G20, the shareholders of EBRD are reviewing the long-term capital requirements of the EBRD to ensure that it has adequate funding for the years to come.

The EIB has taken similar measures to increase its level of investment\textsuperscript{23} in response to the increasing demand for liquidity and has been involved in all the large (and significant) PPP projects which have reached financial close in the last 12 months. Notable projects in which the EIB has been involved to date include:

- modernisation of transport infrastructure in Serbia\textsuperscript{24} with a EUR150 million sovereign loan to finalise the construction of the E-80 motorway in Serbia. This project has a total cost of approximately EUR795 million and is co-financed by the World Bank, the EIB and the Republic of Serbia;
- the EUR1.1 billion Polish A1 motorway project linking Gdansk and Torun (which is part of the Trans-European road network (TEN)), which reached financial close in December 2008. Tenor on the EUR1.1 billion loan is 28 years and the EIB and the Swedish bilateral SEK provided EUR575 million and EUR345 million respectively (with the Nordic Investment Bank funding the remaining EUR150 million);
- Berlin’s EUR2.4 billion Brandenburg International Airport PPP which was funded by a consortium of seven banks and the EIB providing EUR1.4 billion of funding for the deal. The deal had a tenor of ten years and marked Europe’s largest infrastructure finance project. The loan was fully secured by the Federal Republic of Germany and the federal states of Berlin and Brandenburg;
- The EUR1.6 billion Polish A2 toll road with the EIB funding more than 50% of the debt; and
- The UK’s GBP2 billion M25 PPP road widening project on which the EIB is providing a GBP1.4 billion debt package with a tenor of 27 years with debt and margin ratchets in year seven and year ten to incentivise refinancing and persuade short-term lenders to view the debt term as a ‘short-term’ loan.

Other MLAs have similarly been active in several large scale projects in CEE, notably the EUR1.8 billion R1 PPP Motorway project in Slovakia, in respect of which EBRD provided a EUR200 million direct loan, and the EUR1 billion Bosphoros Tunnel PPP which is expected to involved several MLAs, including EBRD and IFC.

The appearance of the MLAs in almost every large scale PPP in Europe during this liquidity crisis raises the question whether long-term debt financing of those projects would have been possible without the involvement of MLAs in the project. There has as yet been no large-scale PPP that has closed without MLA participation and the indication is that governments are now eager for MLAs to take as big a role as possible in order to reduce the level of funding required to be sourced from the commercial lending market.

\textsuperscript{22} Press release of 8 September 2009 by EBRD in relation to its response to the global financial crisis.
\textsuperscript{23} For details on what the EIB have done to respond to the liquidity crisis, please see Chapter 22 PPP: EIB and EPEC.
\textsuperscript{24} Since the beginning of its operations in Serbia, the EBRD has committed over EUR1.6 billion to the Serbian economy, of which more than EUR610 million is in the infrastructure sector.
5. Future role of ECAs and MLAs in PPP

Whilst we believe we will see an increase of ECA activity in the infrastructure and PPP sectors, the traditional focus of ECAs is still unlikely to dramatically shift in the short term. Despite the ever-increasing demand for ECA cover from all types of borrowers, it is important to bear in mind that ECAs themselves have finite resources and the demands on them in the energy sector and trade finance sector are already extremely high. It is also important to bear in mind that ECAs are essentially public entities to whom internal changes may not come easily or fast enough to respond to the liquidity crisis. Not only may ECAs first have to consult with the exporting community and the banks, and then seek approval of their governments, but in many cases, a change in their programmes may require a change in legislation.

As ECAs focus their attention on reconciling existing competing demands made by their governments to bolster trade finance (by providing much needed short-term liquidity) against the need for supporting long-term financing in their key strategic sectors (including energy), increasing their support for infrastructure (and indeed PPP projects) is unlikely to be top priority for now and MLAs will continue to take a more significant role in funding and supporting PPP projects, especially in emerging economies.

Moreover, the MLAs appear to be rising to the challenges posed by the credit crunch for development in the infrastructure sector. The EIB and the EBRD have increased their investments significantly in 2009. Together with the World Bank Group they have also committed themselves to investing EUR24.5 billion over the next two years to strengthen both the banking networks and the real economy in their country of operations.25

Nevertheless, with ever increasing demands for infrastructure and a commercial bank market unlikely to regain the full extent of its pre-credit crunch appetite in the short to medium term, the support of MLAs and ECAs will remain critical to infrastructure projects moving forward. Only time will tell whether MLAs will be able to maintain the same level of commitment to infrastructure and PPP projects in the emerging markets as they have demonstrated over the last 18 months and to what extent ECAs will emerge as much bigger players in future infrastructure and PPP projects.

Press release of 27 February 2009 by EBRD with respect to the joint initiatives of the EIB, EBRD and the World Bank Group to tackle the global economic crisis.

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Contributors

Unless otherwise indicated, the contributors to this publication are all lawyers located in Allen & Overy’s offices.

Editors
David Lee
Fleur Clegg
Meg Roper

Foreword
Thomas C. Barrett (EIB)

Introduction
David Lee
Fleur Clegg
Andrew Digges
Roger Lui

United Kingdom
David Lee
Fleur Clegg

Belgium
Helga van Peer
Filip Tanghe
Valentijn De Boe

The Netherlands
Zeeger de Jongh
Bart Meesters
Arent van Wassenaer

France
Tim Scales
Noël Chahid-Noura’
Romaric Lazerges

Germany
Peter Stenz
Karen Cellarius

Italy
Stefano Sennhauser

Portugal
Ian Ingram-Johnson
Michael Diosi

Spain
Borja Fernández de Trocóniz
Noemi Alonso

Austria
Tim Arnheim
Erika Pircher
Wolfram Huber (Wolf Theiss)

Czech Republic
Václav Valvoda
Robert David
Lucie Sarochova

Hungary
Balázs Sahin-Toth
Miklós Kádár

Poland
Tomasz Kawczyński
Kamil Jankiewicz
Karol Brzoskowski

Romania
Victor Pădurari
Iana Tui
Cosmin Tilea

Russia
Andrei Baev
Elena Popova
Veronika Kondruseva

Slovak Republic
Renátus Kollár

Brazil
Bruno Soares
Bianca Dias Soares
Roberta Bassegio (of Veirano Advogados, currently at Allen & Overy’s New York office)

Canada
David Slade
Charles Williams
Dan Cocker

United States of America
David Horner
Samí Mir

India
Akshay Jaitly (Trilegal)
Dinesh Pardasani (Trilegal)
Sanjeev Dhuna
Kayal Sachi

Japan
Aled Davies
Yuichi Watanabe

United Arab Emirates
Ibrahim Mubaydeen
Ian Ingram-Johnson
Anil Mehta
Bimal Desai
Stephen Knight

PPP: the EIB and EPEC
Andy Carty (EIB/EPEC)
Mathieu Nemoz (EIB/EPEC)

PPP: ECAs and MLAs
Lorraine Ball
Amanda Chen

Marketing and Publication
Charles McNeil
Carolyn Andrews
Fleur Rondelez
Marie Kodýtková
Jana Kloudová
Laurence Bazerbes
Barbara Weber
Ankica Dronjic-Zymelka
Rita Zámbo
Elisa Costantiello
Andrea Fugmann
Rhian Parker
Dominik Tłuchowska
Katarzyna Hołod
Violeta Serban
Monika Nagyová
Sannam Majidi
Ryan Loren
Sarah Stuart
Key PPP Contacts

Europe
Austria
Tim Arnheim
Allen & Overy LLP
One Bishops Square
London E1 6AD
United Kingdom
Tel: +44 20 3088 0000
Fax: +44 20 3088 0088
tim.arnheim@allenovery.com

Belgium
Antwerp
Filip Tanghe
Allen & Overy LLP
Bte 2600 Antwerp
Belgium
Tel: +32 04 378 7222
Fax: +32 03 078 2744
filip.tanghe@allenovery.com

Czech Republic
Prague
Helga Van Peer
Allen & Overy (Czech Republic) LLP
V Celnici 4
110 00 Prague 1
organizační složka
Fax: +420 222 107 107
Tel: +420 222 107 111

Czech Republic
Brussels
Helga Van Peer
Allen & Overy (Czech Republic) LLP
V Celnici 4
110 00 Prague 1
organizační složka
Fax: +420 222 107 107
Tel: +420 222 107 111

France
Paris
Tim Scales
Rod Cork
Allen & Overy LLP
Edouard VII
26, boulevard des Capucines
75009 Paris, France
Tel: +33 (0)1 40 06 54 00
Fax: +33 (0)1 40 06 54 54
tim.scales@allenovery.com
rod.cork@allenovery.com

Germany
Frankfurt
Peter Stenz
Allen & Overy LLP
Haas am Oper Turm
Bockenheimer Landstrasse 2
60306 Frankfurt am Main
Germany
Tel: +49 (0)69 2648 5500
Fax: +49 (0)69 2648 5800
peter.stenz@allenovery.com

Düsseldorf
Allen & Overy LLP
Breite Straße 27
40213 Düsseldorf, Germany
Tel: +49 (0)211 2806 7000
Fax: +49 (0)211 2806 7800

Hamburg
Allen & Overy LLP
Kehrwieder 12
20457 Hamburg, Germany
Tel: +49 (0)40 82 221 20
Fax: +49 (0)40 82 221 2200

Mannheim
Allen & Overy LLP
AM Victoria-Turm 2
68163 Mannheim
Germany
Tel: +49 (0)621 3285 6300
Fax: +49 (0)621 3285 6400

Munich
Allen & Overy LLP
Maximilianstraße 35
80539 Munich, Germany
Tel: +49 (0)89 71043 3000
Fax: +49 (0)89 71043 3800

Greece
Athens
Yannis Manouilides
Allen & Overy LLP
One Bishops Square
London E1 6AD
United Kingdom
Tel: +44 020 3088 0000
Fax: +44 020 3088 0088
yannis.manouilides@allenovery.com

Hungary
Budapest
Balázs Sahin-Toth
James Graham
Morley Allen & Overy Irodó
Mádách Trade Center
Mádách Imre út 13-14
H-1075 Budapest
Hungary
Tel: +36 1 483 2200
Fax: +36 1 268 1515
balazs.sahin-toth@allenovery.com
james.graham@allenovery.com

Italy
Rome
Stefano Sennhauser
Allen & Overy
Studio Legale Associato
Cono Vittorio Emanuele II, 284
00186 Rome, Italy
Tel: +39 06 684 2771
Fax: +39 06 684 2733
stefano.sennhauser@allenovery.com

Luxembourg
Luxembourg
Dominique Bormet
Allen & Overy Luxembourg
33 avenue J.F. Kennedy
L-1855 Luxembourg
PO Box 5017
L-1050 Luxembourg
Tel: +352 44 44 55 1
Fax: +352 44 44 55 222
dominicque.bormet@allenovery.com

The Netherlands
Amsterdam
Bart Meesters
Zeeuwe de Jongh
Arent van Wassenaer
Allen & Overy LLP
Barbara Strozstarza 101
1083 HH Amsterdam
The Netherlands
Tel: +31 20 674 1000
Fax: +31 20 674 1111
bart.meesters@allenovery.com
zeeger.dejongh@allenovery.com
arent.vanwassenaer@allenovery.com

Poland
Warsaw
Tomasz Kawczyński
Kacper Samplawski
Kamil Janielewicz
Allen & Overy, A. Pędzich sp. k.
Rondo ONZ 1, 34 floor
00-124 Warsaw
Poland
Tel: +48 (0)22 820 6100
Fax: +48 (0)22 820 6199
tomasz.kawczyinski@allenovery.com
kacper.samplawski@allenovery.com
kamil.janielewicz@allenovery.com

Portugal
Ian Ingram Johnson
Allen & Overy LLP
Level 2 Gate Village Building No.8
Dubai International Centre
PO Box 506678 Dubai
United Arab Emirates
Tel: +971 4 426 7115
Fax: +971 4 426 7199
ian.ingram.johnson@allenovery.com

Romania
Bucharest
Victor Padurari
Radu Tăracăul Padurariu Reteveoscu S.A.
in association with Allen & Overy LLP
60 Dacia Boulevard
202061 Bucharest 2
Romania
Tel: +40 31 405 7777
Fax: +40 31 405 7778
victor.padurari@rtprallenovery.com

Russia
Moscow
Edwin Tham
Anton Konnov
Veronika Konduseva
Elena Popova
Allen & Overy LLP
Dmitrovsky Pereulok 9
107031 Moscow, Russia
Tel: +7 495 725 7900
Fax: +7 495 725 7949
edwin.tham@allenovery.com
anton.konkov@allenovery.com
veronika.konduseva@allenovery.com
elena.popova@allenovery.com

Slovak Republic
Bratislava
Martin Magál
Renátus Kollár
Allen & Overy Bratislava, s.r.o.
Europea Central 1
Pribinova 4
811 09 Bratislava
Slovak Republic
Tel: +421 2 5920 2400
Fax: +421 2 5920 2424
martin.magal@allenovery.com
renatus.kollar@allenovery.com

Spain
Madrid
Pablo Mayor
Ignacio Ruiz-Cámara
Juan Barona
Allen & Overy
Pedro de Valdivia 10
28006 Madrid, Spain
Tel: +34 91 782 98 00
Fax: +34 91 782 98 99
pablo.mayor@allenovery.com
ignacio.ruiz-camara@allenovery.com
juan.barona@allenovery.com

UK
London
Anne Baldock
David Lee
Allen & Overy LLP
One Bishops Square
London E1 6AD
United Kingdom
Tel: +44 (0)20 3088 0000
Fax: +44 (0)20 3088 0088
anne.baldock@allenovery.com
david.lee@allenovery.com

Romania
Bucharest
Victor Padurari
Radu Tăracăul Padurariu Reteveoscu S.A.
in association with Allen & Overy LLP
60 Dacia Boulevard
202061 Bucharest 2
Romania
Tel: +40 31 405 7777
Fax: +40 31 405 7778
victor.padurari@rtprallenovery.com

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Elena Popova
Allen & Overy LLP
Dmitrovsky Pereulok 9
107031 Moscow, Russia
Tel: +7 495 725 7900
Fax: +7 495 725 7949
edwin.tham@allenovery.com
anton.konkov@allenovery.com
veronika.konduseva@allenovery.com
elena.popova@allenovery.com

Slovak Republic
Bratislava
Martin Magál
Renátus Kollár
Allen & Overy Bratislava, s.r.o.
Europea Central 1
Pribinova 4
811 09 Bratislava
Slovak Republic
Tel: +421 2 5920 2400
Fax: +421 2 5920 2424
martin.magal@allenovery.com
renatus.kollar@allenovery.com

Spain
Madrid
Pablo Mayor
Ignacio Ruiz-Cámara
Juan Barona
Allen & Overy
Pedro de Valdivia 10
28006 Madrid, Spain
Tel: +34 91 782 98 00
Fax: +34 91 782 98 99
pablo.mayor@allenovery.com
ignacio.ruiz-camara@allenovery.com
juan.barona@allenovery.com

UK
London
Anne Baldock
David Lee
Allen & Overy LLP
One Bishops Square
London E1 6AD
United Kingdom
Tel: +44 (0)20 3088 0000
Fax: +44 (0)20 3088 0088
anne.baldock@allenovery.com
david.lee@allenovery.com

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