FEMIP

Study on PPP Legal & Financial Frameworks in the Mediterranean Partner Countries

Volume 3 – Best Practices and Lessons Learned: Selected Experiences from Other Countries

European Investment Bank

Operational since October 2002, the Facility for Euro-Mediterranean Investment and Partnership (FEMIP) brings together the whole range of services provided by the European Investment Bank in the Mediterranean partner countries (Algeria, Egypt, Gaza/West Bank, Israel, Jordan, Lebanon, Morocco, Syria and Tunisia).

The study is financed under the FEMIP Trust Fund. This Fund, which was established in 2004 and has been financed – to date – by 15 EU Member States and the European Commission, is intended to support the development of the private sector via the financing of studies and technical assistance measures and the provision of private equity.

MAZARS Pinsent Masons SALANS

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[1] Please note: This Volume is part of a three-volume Report: "Volume 1 - A Regional Approach", "Volume 2 - Country Analysis" and "Volume 3 - Best Practices and Lessons Learned – Selected Experiences from Other Countries". See Introduction below for further detail.

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Comparator countries:

France

- Salans
- Mazars France

Mexico

- COMAD, S.C.
- Mazars Mexico

Poland

- Salans
- Mazars Poland

South Africa

- Webber Wentzel
- Mazars South Africa

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GLOSSARY

BEA: bail emphytéotique administrative (France)

BEE: Black Economic Empowerment

BSF: Building Schools for the Future (England)

CBT: Central Bank of Tunisia

Comparative Assessment: the comparison of PPP frameworks in the Mediterranean partner countries with the PPP frameworks in the comparator countries as set out in Volume 1 of the Report

Comparator countries: England, France, Mexico, Poland and South Africa

Consortium: the consortium of Pinsent Masons LLP, Mott MacDonald Limited, Mazars LLP and Salans LLP appointed by the EIB to carry out the Study and the Report

Cross Country Assessment: the assessment of PPP frameworks in the Mediterranean partner countries

EC: European Commission

ECA: Export Credit Agency

EIB: European Investment Bank

EPC: Engineering Procurement and Construction

EU: European Union

EUR: Euro

FARAC: Fideicomiso de Apoyo al Rescate de Autopistas (Commission for Financial Assistance to Rescue Highways)

FDI: Foreign Direct Investment

FEMIP: Facility for Euro-Mediterranean Investment and Partnership

FONADIN: Fondo Nacional de Infraestructura (Mexico)
GDP: Gross Domestic Product

GMWDA: Greater Manchester Waste Disposal Authority (England)

ICC: International Chamber of Commerce

ICE: In-Country Experts

IFI: International Financial Institution

IPP: Independent Power Plant/Project

IT: Information Technology

IU: Investment Unit (Mexico)

IUK: Infrastructure UK (England)

JV: Joint venture

LCIA: London Court of International Arbitration

MAPPP: Mission d'Appui à la Réalisation des Contrats de Partenariat (France)

MEAT: Most economically advantageous tender

Mediterranean partner countries: Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia and the West Bank

MOD: Ministry of Defence (England)

MXN: Mexican Peso

NHS: National Health Service (England)

NIP: National Infrastructure Plan (Mexico)

OECD: Organisation for Economic Co-operation and Development

OGC: Office of Government Commerce (England)

OJEU: Official Journal of the European Union

PFI: Private Finance Initiative (England)

PFMA: Public Finance Management Act 1999 (South Africa)

PfS: Partnerships for schools (England)

PFU: Private Finance Unit (England)

PLN: Polish Zloty

PPO: Public Procurement Office (Poland)

PPP: Public Private Partnerships

PRG: Project Review Group (England)

Project SPV: Project Special Purpose Vehicle

PUK: Partnerships UK

Regulations: The Public Contracts Regulations (SI 2006/5) and The Utilities Contracts Regulations (SI 2006/6) (England)

RFP: Request for Proposals

SoPC4: Standardisation of PFI Contracts version 4 (England)

TIFU: Treasury Infrastructure Finance Unit (England)

UK: United Kingdom

UNCITRAL: United Nations Commission on International Trade Law

US: United States

USD: United States Dollar

ZAR: South African Rand

Introduction

Background and objectives

The European Investment Bank (EIB) has commissioned a review of the Private Public Partnership Legal & Financial Frameworks in the Facility for Euro-Mediterranean Investment and Partnership (FEMIP) Region (the Study). The Study was carried out by Pinsent Masons LLP, Mazars LLP and Salans LLP.

The Study is financed under the Facility for Euro-Mediterranean Investment and Partnership (FEMIP) Trust Fund. This Fund, which was established in 2004 and has been financed to date by 15 European Union (EU) Member States and the European Commission (EC), intends to support the development of the private sector via the financing of studies, technical assistance measures and the provision of private equity.[2]

The objective of the Study is to assess and promote the prospects for successful PPP programmes in the Mediterranean partner countries. The Report involves a detailed Cross Country Assessment of the legal and financial frameworks, and readiness, for Public Private Partnership (PPP) projects of each of the Mediterranean partner countries (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia and the West Bank) and a Comparative Assessment of the legal and financial frameworks in the Mediterranean partner countries against good practice in five comparator countries (England, France, Mexico, Poland and South Africa).

Structure of the Report

The Report comprises three Volumes:

Volume 1: A Regional Approach

Volume 1 presents a detailed analysis of the financial and legal issues affecting PPP in the Mediterranean partner countries and compares them with key aspects of the experience in the comparator countries.

Volume 2: Country Analysis

Volume 2 reports on the key elements of the legal and financial framework of each of the nine Mediterranean partner countries.

Volume 3: Best Practices and Lessons Learned – Selected Experiences from Other Countries (the present Volume)

This Volume summarises key elements of the legal and financial frameworks of the five comparator countries, explaining why these countries were selected and the financial and legal issues identified from their experience.

Methodology

The Consortium surveyed five comparator countries outside the Mediterranean partner countries. The comparator countries are:

- England
- France
- Mexico
- Poland
- South Africa

These countries were chosen on the basis of their successful PPP environment, their unique experience of PPP and/or the lessons learned from their experiences that could inform good practice in less developed markets. The purpose of the research was to highlight the typical characteristics of PPP in the five comparator countries and to identify the reasons for the successes in their PPP regimes, as well as any shortcomings that have arisen.

The survey of the comparator countries identified key issues under seven main headings:

- funding capacity and availability;
- institutional issues;
- the legal and regulatory framework;
- bidding process;
- contract design and risk allocation;
- financial risks and payment terms;
- PPP/project finance investment readiness for lenders and investors.

The Consortium also undertook a detailed analysis of the Mediterranean partner countries (the Cross Country Assessment), organised in terms of each of these headings. This was based on information derived from a standard questionnaire devised by the Consortium. The responses, together with interviews held with key contacts in each Mediterranean partner country, formed the basis of the analysis undertaken by the Consortium. This process lasted approximately eight months (from February to September 2010) and produced detailed country reports that will be delivered to the nine Mediterranean partner countries individually. The executive summaries of the nine individual country reports form Volume 2 of the Report.

The Mediterranean partner countries and the comparator countries were then compared. The features of a successful PPP regime in relation to each issue were identified and recommendations have been made in relation to improvements to the legal and financial frameworks of the Mediterranean partner countries based on successful practice and lessons learned in the comparator countries.

The Report identifies success factors and makes initial recommendations in respect of introducing or developing a PPP programme in each of the Mediterranean partner countries. In each case this is concurrent with international best practice whilst taking into account specific issues affecting their country such as the relative stage of development of PPPs and particular country context.

The Report and all references in it are accurate as at 1 October 2010, unless otherwise stated. Whilst the potential for significant political change will impact upon the appetite of the international community to invest in PPP projects, it has been assumed that there will be no substantial change to the key requirements for a successful PPP programme. These political aspects are outside the scope of the Report and the Consortium believes that the description of the legal and financial environment and recommendations remain valid subject to resolution of political issues.

[2] Further information about the FEMIP Trust Fund is available at www.eib.org/ftf

Scope of projects covered in the Report and the usage of the term "PPP"

There are a number of procurement and service delivery structures which are commonly labelled PPP. The Report is concerned primarily with project financed infrastructure projects. The definition of PPP for the purposes of the Report is a partnership between the public and private sectors pursuant to a long term contractual agreement and covering, in most instances, the design, construction, financing and ongoing operation and maintenance of an infrastructure asset.

In a PPP the public sector usually establishes the service and output requirements (quality/quantity), and enters into contractual arrangements that ensure these requirements are respected. This is based on the principle that payment to the private partner is related to success in meeting the service and output requirements of the project. The long term agreements also include obligations on the part of the public contracting authority.

Project financing is a method of structuring debt finance for capital intensive projects. In such structures lenders are primarily concerned with the cashflows to be generated by the project for the repayment of the loan and with the assets of the project including rights arising under the project contracts (most particularly revenue flows). Accordingly, lenders look to these cashflows, project receivables and assets, rather than primarily to the general creditworthiness of the private sector sponsors, as collateral for the loan. Lenders' involvement in project structuring creates a discipline that is often beneficial for the project, as it creates the appropriate incentives for the private sector to deliver on time and within budget.

Examples of PPPs covered by the Report include:

- power and water treatment projects;
- roads and other transport projects;
- social infrastructure projects such as schools or hospitals.

In each case, payment to the private partner is related to meeting the project's output specification. However, this may be defined in terms of either:

- Availability – in other words, making the services of the asset available for use (this would be typical in a school project, for example, where the authority agrees to pay for the school to be appropriately maintained and serviced over the contract length);
- Demand – for example, where a concessionaire relies entirely on fees from users such as a toll road or an airport; or
- Availability and demand – for example, where a public authority agrees to pay a service fee for the development and maintenance of a road based on the road being available but there is also an element of demand fees (related to toll payments).

Projects often described as 'concessions', under which the private sector receives end user payments and takes demand risk, are addressed in the Report where they involve project financing structures.

Traditional procurement and privatisation are not within the scope of the Report. The Report does not focus on projects where the authority has procured an asset independently from its operation or a service independently from the construction of the asset (often referred to as 'traditional' procurement) or where the private entity provides the service independently of the public authority subject only to the general law or regulation rather than contract (for example, privatised utilities). Excluding such projects from the ambit of the Report is not to suggest they are not suitable methods of procurement. On the contrary, some projects (for example those involving the use of particularly innovative or complex technology for which the private sector may not be ready or capable of assuming the risk) may represent better value if procured wholly by the public sector. Part of the process of successful project selection/procurement is to ensure that the most appropriate method of procurement is utilised.

Note:

Exchange rates

Where not originally expressed in Euro (EUR), monetary amounts throughout this Volume have been converted to EUR at the exchange rates as of 5 January 2011 (and not at the rates prevailing at the time of the relevant transactions).

US	USD/EUR	1.3213
UK	GBP/EUR	0.8483
Poland	PLN/EUR	3.8973
Mexico	MXN/EUR	16.1978
South Africa	ZAR/EUR	8.9071

1. ENGLAND

Why a comparator?

The United Kingdom (UK) was the first European country to develop a new method of procurement commonly known as the 'Private Finance Initiative' (PFI). PFI is a form of PPP. The majority of these projects have involved UK central government departments, municipalities and statutory bodies.

The UK is widely recognised as a rich repository of experience in successfully developing this form of public tendering, with over 600 individual projects successfully signed involving capital expenditure in excess of Euro (EUR) 67 billion.

The process for completing the tendering process for a new project is in principle clearly defined but delays have often occurred due to changes imposed by political authorities at both national and local level and changes in market conditions.

HM Treasury (the UK's ministry of finance) has been active in developing standard form contracts and in facilitating knowledge transfer to other jurisdictions.

The UK PFI experience has been well documented and a large number of detailed case studies, literature and specific guidance prepared by government departments, advisers, consultants and specialist publications are available in the public domain. In addition, various UK government departments have published detailed reports examining the successes and failures of PFI from a number of different perspectives. Reports published by the National Audit Office are particularly helpful in examining where PFI has been beneficial and demonstrated value for money.

Overview

Economically, the UK is classified as a high income country by the World Bank with an estimated Gross Domestic Product (GDP) of EUR 1,560 billion and GDP per capita of EUR 25,235 in 2009[3]. GDP fell by 4.9% in 2009[4]. Government debt equated to 57% of GDP at the end of 2009 and annual consumer price inflation as at the end of 2009 stood at 2.12%. The UK is rated AAA and Aaa by Standard & Poor's and Moody's respectively.

The current constitutional structure (since 1999) of the UK means that particular constituent parts (Scotland, Wales and Northern Ireland) are, to different extents, self-governing on certain matters (including infrastructure procurement). Central government and central legislative functions are exercised by the institutions of the UK government and the UK government remains the government for the purposes of England which accounts for 85% of the UK population. Whilst making references to PPPs as applicable across the UK, the primary focus of this section is on the PFI experience in England. Certain aspects of the PPP market and decision-making processes in Scotland, Wales or Northern Ireland now differ from those in England.

The UK has been at the forefront of the PPP market since the concept was introduced in the 1990s. HM Treasury defines PFI projects as a subset of PPPs being those projects which require the private sector to construct the project assets (typically a building) and to raise the required funding separately on a project finance basis (i.e. where contract payments represent the exclusive security for funders). The capital value of the signed projects to date is circa GBP 57 billion (EUR 67 billion). PFIs have been procured by a range of procuring authorities including central government departments and their executive agencies, local government, hospital trusts and universities.

Central to PFI procurement is the use of private capital. Long term contracts (typically 20-35 years) with government departments and authorised agencies permit the delivery of infrastructure by private companies on behalf of the public sector. By contracting in this way, the aim is to ensure that whole life costs associated with such assets are minimised and required associated services are provided competitively. Wherever possible, contracts specify the outputs rather than inputs associated with a particular project. The use of the UK PFI model has attracted significant private sector involvement. Key features have been relatively highly geared projects (80-90% funded by bank debt) and project revenues starting only when the facility is complete. Combined, these features provide incentives for timely delivery to the authorities' output specifications and to budget.

The PFI model is unique in the way in which project payments are structured. Project sponsors receive a unitary payment which is calculated to include both the cost of construction, associated funding and services provision. The public authority generally pays for availability and there will be deductions made to the payments where performance falls below the required standard. Only a small number of PFI projects have involved private sector sponsors taking external market demand risk. These projects are generally road projects where a notional usage charge is scaled according to usage (referred to as shadow tolls). The payment mechanisms are designed to ensure financial risk is correctly apportioned between the parties and the project remains financially attractive to the private sector.

A wide range of debt and equity funders are active in the PFI market. UK PFI projects are almost always funded on a project finance basis. A wide-range of UK and other European-based banks have developed considerable expertise in specialist PFI lending. A limited number of projects have been funded in the capital markets using bond finance. However, in most cases, this funding solution required a special guarantee from a monoline insurance provider, which has permitted the bonds to trade with a AAA rating, but which is no longer available due to the credit downgrading of monolines since the financial crisis. Equity for PFI projects was originally only provided by the project sponsors. With the expansion of PFI, a number of specialised infrastructure equity funds have emerged that inject funding into the Project SPV and have served to reduce the cost of equity capital for PFIs. Table 1 outlines the recent PFI project activity demonstrating a particularly strong presence for social infrastructure projects in a diverse range of areas with healthcare and education particularly well represented.

[3] Data sources: IMF Government Finance Statistics Yearbook and data files, and World Bank and OECD national accounts data files
[4] Source: World Bank national accounts data, and OECD National Accounts data files

Table 1: Recent UK wide PFI project financing, January 2006–November 2010, in terms of loan values and number of projects relative to the key PFI sectors

UK		Loan amounts (EUR millions)	Number of Projects
Power (included renewables)		not included	
Water & Sewage (England and Wales)		not included	
Social Infrastructure –	of which	33,276	274
	Healthcare	*10,704*	*91*
	Education	*10,192*	*112*
	Defence	*7,079*	*8*
	Waste/Recycling	*2,856*	*16*
	Municipal	*2,041*	*24*
	Housing	*1,492*	*11*
	Justice	*452*	*5*
	Leisure	*205*	*7*
Water & Sewage (Scotland and Northern Ireland)		379	2
Total		37,524	285

Power projects throughout the UK (of all types, including renewable power) and water projects in England and Wales are not included in the PFI programme. The UK privatised most of its utilities in the late 1980s. The public sector's role in these sectors is limited to regulation, licensing and permitting. New investments are the responsibility of private companies operating under a strict regulatory regime that defines returns on capital and service levels. In the power sector, power generation and transmission assets are either financed directly by the utility or (as is typical for renewable energy projects) as independent projects using ring-fenced project financing. This position contrasts with the Mediterranean partner countries and other comparator countries (except France and, prospectively, Poland), where these utilities remain State-owned and controlled. In these contrasting centres, PPP remains an important option for funding new asset procurement for utilities.

The experience of PFI has provided valuable knowhow and expertise to PPP markets in other countries. In particular, the policy and guidance produced by HM Treasury, notably Standardisation of PFI Contracts (currently in Version 4) (SoPC4), has proved to be a useful reference point for PPP investors, lenders and advisers in the international PPP market. SoPC4 represents a synthesis and culmination of much detailed negotiation by advisers acting for government and private sector sponsors.

The new UK coalition government that took power in May 2010 has questioned the use of PFI. The recent change in government in the UK has heralded a review of the use of PFI. In some sectors (for example, the Building Schools for the Future (BSF) programme, waste projects and the street lighting programme), the government has cancelled some projects in the light of spending cuts. However, in sectors such as transport the government has affirmed that PPP will remain an important method of infrastructure development in the UK and projects will be procured as PPPs where appropriate. Box 1 below highlights the role PPP may play in forthcoming significant infrastructure projects.

The recent changes in the PFI market highlight that the ways in which strategic shifts in policy are handled by a change in government can affect participants and investors. The government is exploring whether other models can deliver better value for money and provide greater flexibility. The current stance has also been strongly influenced by government spending constraints which disincentivise any long term contract commitments whether or not they provide value in the long term.

Box 1: PPP models for the future

Mersey Gateway

In December 2010 the GBP 431 million Mersey Gateway Project was granted planning approval by the government after an 18-month public inquiry into the project. The 30 year greenfield project involves the building of a new six lane toll bridge over the River Mersey between the towns of Runcorn and Widnes. It is estimated that the project will generate an estimated GBP 61.9 million a year in gross value added by 2030 to boost the regional economy. The project includes modifications to the existing Silver Jubilee Bridge that would improve facilities for public transport, walking and cycling across the river. The UK Government will fund GBP 86 million of the total costs and the remaining will be provided through PFI credits and private finance. Construction funds by the private concessionaire, about 77%, will be repaid in the form of toll revenue for a concession period of 30 years. The government will contribute GBP 123 million in PFI credits over the concession period to maintain lower toll costs.

High Speed 2

The use of PPP has also been contemplated for the GBP 33 billion High Speed 2 project for a new rail route between London and Birmingham. Enabling works for the initial London-Birmingham phase should begin in 2015 with the high speed network opening in phases from 2026. Although a funding model for the project has not yet been finalised, the government has stated that the proposed route will provide GBP 15 billion worth of greater transport benefit and some GBP 10 billion greater revenue. The recent spending review of the project includes approximately GBP 773 million to fund the rail development. A full public consultation will start in early 2011 on the strategic roll-out of a high-speed rail network and due to the current financial constraints on the government the project will be completed in phases. PPP as a source of funding is likely to be considered due to the high cost of the project and the limited finance available to the government in the current economic climate.

Health Sector

The UK health service has made extensive use of PFI to build more than 100 new hospitals. Continued use of PPP is contemplated. The Cambridge University Hospitals' National Health Service (NHS) Foundation Trust along with Addenbrook Hospital are planning a new specialist children's hospital in Cambridge. Although the plans for this hospital are still being finalised, creation of this hospital would be key for the East of England which lacks such a facility. It is likely that approval for PFI will be sought to part fund this GBP 120 million project. A decision on funding is expected in early February 2011. In addition private hospital operator Circle Health has won a contract to takeover a struggling NHS hospital (Hinchinbrooke). Unlike all PFI hospitals to date, this involves the private provision of clinical services. Although this is not a full privatisation, it consists of a ten-year franchise agreement whereby the private firm has been awarded a contract to manage and operate an NHS hospital.

Different PPP models (in contrast to PFI) are emerging. Local authorities have also explored alternatives to PFI in recent years. In 2008, the first Local Authority Asset Backed Vehicle partnership was established. The project was based on a 50/50 joint venture (JV) company between the local authority and the private sector partner that was set up to implement the regeneration of major sites within the local authority's portfolio. This project attracted interest because it was the first PPP to include the development of sustainable community strategies and master plans; and create practical strategic service partnerships. The structure of this project allowed the local authority to enter into profit sharing arrangements, which are of particular value in the current economic climate.

The PFI experience in England provides some valuable lessons on how the workings of government, legislation and policy can be developed to provide a strong institutional, legal and regulatory framework for PPPs.

Institutional Issues

The early introduction of PFI involved a significant amount of 'learning by doing'. For example, many hospitals pursued PFI projects in the early 1990s that were subsequently found to be unaffordable and had to be withdrawn, leading to confusion in the market and abortive bid costs for the private sector consortia that had tendered. In 1997, the new Labour government created a more stable institutional framework in order to standardise contracts and streamline the procurement process. A special private finance unit was created by HM Treasury (the Treasury Taskforce). Subsequently, Partnerships UK (PUK) was created, an entity that includes private sector investment with 51% of the shares in the venture owned by several PPP funders and investors with the remaining 49% owned by HM Treasury. PUK has been influential in advising other countries on setting up new PPP programmes, for example Mexico and Egypt. It has more recently been subsumed into a new entity, Infrastructure UK (IUK).

The role of PUK (now IUK) has been to standardise PPP/PFI contracts and to advise procuring authorities on the most effective means of procuring projects. IUK operates a help desk which is free of charge to procuring authorities. It also advises directly on large and complex procurements, notably those procured directly by central government departments where it receives a fee for its services. Examples include major defence and transport projects.

PUK was also instrumental in setting up specialist arms for PFI projects in specific sectors. This includes Partnerships for Schools (PfS) for the education sector. Programmes have also been established in relation to health under NHS LIFT (Local Improvement Finance Trust) and to develop long term public-private partnership vehicles that can deliver a stream of PFI projects within an overarching local programme. Each of these initiatives is supported by a government-funded body to promote good practice and to approve individual transactions.

The allocation of budgets is carried out by central government departments mainly through specific PFI credits. These are subsidies issued to the procuring authority by HM Treasury. Normally this is done on the basis of PFI credits. Authorities compete for PFI credits, and are required to produce expressions of interest and outline business cases to obtain these credits. Budget allocation for PFI credits is announced annually as part of the governmental budgeting cycle.

Individual PFI projects are approved by the Project Review Group (PRG). This is an inter-departmental body set up under the chairmanship of HM Treasury. It reviews and approves all large PFI projects that are submitted for approval by government departments.

Government departments and the PRG rely on the Office of Government Commerce (OGC) to scrutinise procuring authority business cases. The OGC is part of central government and advises on all aspects of government procurements. In the case of PFI, it will scrutinise business cases through a series of "Gateway reviews". Procuring authorities will need to obtain OGC approval before PFI credits can be released at the early, middle and late stages of project approval, i.e. at the expression of interest; outline business case and full business case stages.

Business cases must be technically well argued to pass the Gateway review process. Guidance has been issued for several sectors of the economy to enable procuring authorities to prepare strong business cases. These will include an appraisal of procurement options with justification for the choice of PFI as against other means of procurement; an analysis of affordability to the authority; and the development of a public sector comparator to demonstrate that PFI represents value for money. All guidance and documentation is made available on HM Treasury's website and also from the relevant government departments. These initiatives promote a standard approach to PFI project design and procurement.

Standardisation and transparency are considered to be of upmost importance throughout the procurement process. In order to support this, documentation relating to PFI procurement is widely available, most notably through government websites[5]. The main prescriptive 'handbook' for structuring PFI projects – SoPC4 – is freely available on the HM Treasury website. In addition guidance notes on how relevant legislation is implemented and enforced are available. In 2009 SoPC4 was amended in some respects and the updated version is available together with a guidance note on the principle changes. Other relevant material includes the principles and procedures which authorities may wish to consider when using SoPC4. There are important variations relevant for schools and hospitals that are issued as sector specific standard forms. Government websites also provide supporting information such as statistics on PFI projects that have been procured, concluded or terminated. The National Audit Office, which is responsible for scrutinising public spending on behalf of Parliament, has a specific private finance division that has produced over 80 reports (since 1997) assessing activities including PFIs and PPPs, privatisations and acquisitions. The reports cover individual deals and programmes and thematic issues such as financing and tendering. The more recent reports are available for download[6].

Legal and regulatory framework

The legal system in England provides a sound legal framework for PPP/PFIs. England has a common law system, which means that legislation and case law influences all commercial transactions and principles underpinning the allocation of risk. Under the common law system, interpretation of legislation (where its meaning is unclear) is also based on judicial precedent. Decisions of the superior courts are binding on the judges in the lower courts. This framework provides clarity, consistency and flexibility, which are important to investors. Investors and lenders are content with the application of English law to their contracts and indeed it is often the governing law of contracts in respect of project financing in other countries. Scotland (and to an extent Northern Ireland) have distinct legal systems.

The absence of an overarching PPP/PFI law has not been a hindrance to PPPs as there is a sound legal framework which permits PPP/PFIs. England does not have a single law which applies to all PPPs – there is no "PPP law". However, there is sufficient flexibility and certainty within the statutory and common law framework to recognise and permit PPPs.

There is clear legal authority for public bodies to procure PPP projects and enter into PPP contracts. Given the absence of a PPP specific law, there is no general overarching provision in the law which gives all public bodies the power to enter into PPP arrangements. Powers tend to be derived from a public body's constitutional documents or from specific legislation. Local authorities are given the power to enter into contracts with private entities by the Local Government (Contracts) Act 1997. A local authority is permitted to enter into a contract with another person for the provision of assets or services or both for the purposes of, or in connection with, the discharge of the functions of the local authority. A local authority thus has the power to enter into a contract to both build a school and to procure the non-educational services required. There is specific legislation in the health sector giving the government additional powers to guarantee PFI liabilities entered into by NHS hospital trusts (which are run as separate statutory bodies). The new coalition government has been exploring ways in which hospitals could enter into contracts without such a guarantee. However, this has so far received adverse market reaction.

PPP/PFI contract disputes will, unless the parties agree on alternative dispute resolution, be subject to the civil courts. The English court system is well developed and provides specialist forums with specialist judges for specific disputes. For example, disputes relating to the construction of an asset being developed under a PFI contract would be heard in the specialist construction court (the Technology and Construction Court). Investors in PPP contracts in England tend to have confidence in the court system. There may, however, be other overriding factors as to why parties to PPP contracts agree other methods of dispute resolution.

[5] http://www.hm-treasury.gov.uk/ppp_standardised_contracts.htm;
http://webarchive.nationalarchives.gov.uk/+/www.dh.gov.uk/en/Aboutus/Procurementandproposals/Publicprivatepartners;
[6] http://www.nao.org.uk/sectors/private_finance1.aspx

Parties are free to agree the means by which disputes should be resolved and may opt for arbitration. Investors and lenders are particularly keen on this as arbitration hearings are held in private and arbitration may be more appropriate for complex disputes involving technical issues (for example those relating to solid waste incinerator technology) which are more efficiently resolved by arbitrators who will in these cases be technically qualified. The parties may agree, in the arbitration clause in the project agreement, to refer disputes to arbitration. The arbitration agreement refers disputes to domestic arbitration rules and arbitrators are typically sourced from the Chartered Institute of Arbitrators or similar bodies. The arbitration will be governed by the mandatory provisions of the Arbitration Act 1996 which is part of a supervisory legal framework that is supportive of private arbitration processes.

Other means of interim dispute resolution, such as adjudication, may also be relevant. Parties often agree to a tiered system of dispute resolution, such that there is an attempt to resolve disputes amicably first without resorting to more formal (usually final) methods. A typical process might be (i) direct negotiation between the parties (or their senior representatives); (ii) adjudication; and (iii) arbitration/litigation. Intermediate methods such as adjudication provide a mechanism for resolving disputes quickly. This will enable the parties to move on with contract performance. In England, a statutory scheme of adjudication, under the Housing Grants, Construction and Regeneration Act 1996, applies to all contracts under which "construction operations" are carried out: whilst a PPP project agreement is expressly excluded from the operation of these provisions, these provisions do apply to the construction and life cycle subcontracts.

Related disputes can be heard together. The PFI guidance allows disputes at different levels of the supply chain to be heard together where the subject matter of the dispute is similar. This ensures consistent treatment of the matter, means that all relevant parties are given a fair hearing and means that the remedies are appropriate to the matter in its entirety.

Bidding process

PPP/PFI procurement procedures are regulated and standardised, ensuring that the key principles of fairness, transparency and competition are preserved. Procuring authorities are now generally familiar with the processes involved in the procurement of major infrastructure and they and bidders usually have ready access to experienced advisers in the technical, legal and financial aspects of a particular project. Tender notices must be published in the Official Journal of the European Union (OJEU) and must follow the standard form required by EU law. Procurement processes are structured with clear stages. All bidders are notified of the timetable and provided with the same information. Evaluation criteria must be published. The process for challenging any aspect of the tendering process is clearly defined. For example the authority is prevented from entering into the contract during the standstill period, which starts when the authority announces its intention to award the contract to the successful bidder. This is currently a ten day period pursuant to the Alcatel[7] ruling of the European Court of Justice and the Public Contracts Regulations 2006, as amended in 2009.

Procurement under the EU framework for public sector procurement. The UK has implemented the Public Sector Directive (2004/18/EC) (this applies to public works contracts, public supply contracts and public service contracts) and the Utilities Directive (2004/17/EC) (for entities operating in the water, energy, transport and postal services sectors) into national legislation as the Public Contracts Regulations (SI 2006/5) and the Utilities Contracts Regulations (SI 2006/6) (the Regulations). Provided the project value is above specified thresholds, its procurement must comply with the Regulations.

The Regulations specify four procurement procedures: the open procedure; the restricted procedure; the negotiated procedure; and the competitive dialogue procedure. The open procedure is not used for PFI projects in England. It is used in procurements where any interested party can bid in response to a tender notice. It is not appropriate where there is likely to be a complex evaluation process, which is the case for most PFIs. The restricted procedure may be used where the authority can adequately specify its needs, as bidders (who have passed a pre-qualification exercise) must respond to the tender without any form of discussion or negotiation. This is not used widely for PFIs in England. The negotiated procedure now also has limited application and can only be used in certain specified circumstances (for example where another procedure has failed to produce any acceptable tenders). Until 2006, the negotiated procedure was used more widely (competitive dialogue is currently the most widely used procedure). The negotiated procedure offers a flexible process by which the procuring authority consults with bidders and negotiates the terms of the contract. The key features of the four procurement procedures specified in the Regulations are summarised in Table 2 below.

Since 2006, it has been government policy that PFIs should be procured under the competitive dialogue procedure. The purpose of this procedure is to enhance value for money and promote innovation by maintaining a competitive element throughout the bidding phase of procurement. The procedure is designed for complex projects where the procuring authority is not objectively able to define the technical means to satisfy its needs or is unable to identify in advance the legal or financial make-up of a project. Bidders are invited to participate in dialogue concurrently with the authority with a view to developing one or more solutions that meets the authority's needs. Dialogue is typically by meetings. All bidders must be treated fairly. When an appropriate solution has been identified, the procuring authority will conclude the dialogue phase and invite final tenders. In principle, no negotiation or further dialogue is permitted after the submission of final tenders. This is limited to clarification of tenders submitted and a finalisation of terms after tenders have been evaluated.

More recently, use of the competitive dialogue procedure has come under increasing scrutiny and its routine use on all PPPs is questioned. A recent review by HM Treasury[8] has criticised the use of the procedure as a default procedure. Used correctly, competitive dialogue should foster discussion and co-operation and can allow the procuring authority to fine-tune its requirements as bidders bring their practical experience to bear on the process enabling both parties to derive best value from

[7] Alcatel Austria AG v Bundesministerium fur Wissenschaft und Verkehr (C-81/98) [1999] E.C.R. I-7671
[8] HM Treasury Review of Competitive Dialogue, November 2010.

the process: the bidder is able to refine its understanding of the procuring authority's requirements; and as a result, the procuring authority is more likely to obtain the optimal solution. In theory, the process is rigorous and should assure competition. However, the procedure requires significant investment by bidders and there is a perception that the resulting bid costs for both the procuring authority and the bidders do not represent value for money. Competitive dialogue places more demands on the procuring authority which needs to ensure waste is minimised through better management of the process. There may be a case for using the negotiated procedure more widely as this would address some of the concerns relating to excessive bid costs.

EU law specifies only two possible award criteria – lowest price and most economically advantageous tender (or MEAT). PFI projects are awarded on the basis of MEAT. This considers not only the bidder's financial offer, but also enables the authority to put a price on any risks that the bidder tries to transfer back to the authority. The factors which may be used to establish the most economically advantageous offer must be linked to the subject matter of the contract and include: "quality, price, technical merit, aesthetic and functional characteristics, environmental characteristics, running costs, cost-effectiveness, after sales service, technical assistance, delivery date and delivery period and period of completion." (Regulation 30, Public Contracts Regulations). The factors chosen (if the contract is being awarded on the MEAT basis) must be set out in either the OJEU notice or the tender documents (for example, Invitation to Tender or Invitation to Participate in Dialogue). The criteria chosen should be allotted weightings to reflect what is most important in any particular procurement. Weightings may be exact percentages or a specified range, where this is appropriate in view of the subject matter. The weighting assigned to each factor should be stated in the OJEU notice or in the tender documents. The MEAT approach ensures that financial and technical aspects of the bid are taken into consideration and that an overall grading is made. This avoids the situation where a technical bid is merely scored from a pass/fail perspective and is not given due consideration in terms of an overall value for money assessment.

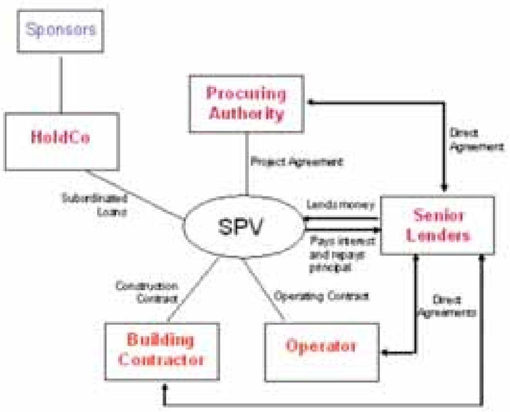
Table 2: Procurement procedures

Procedure	Description
Open	1. All interested parties submit a bid to the contracting authority (without a need to express an interest beforehand). 2. The contracting authority has discretion as to which bids and how many of them it chooses to evaluate. 3. No negotiation by the contracting authority is permitted with any of the bidders. This procedure is often used for procuring commodity products which do not require a complex tender process in order to be purchased. There are no restrictions as to when this procedure can be used although it is not suitable for the procurement of complex infrastructure.
Restricted	1. All interested parties may express an interest in bidding for the contract. 2. Those parties which fulfil the authority's selection criteria will be invited to submit a bid. 3. No negotiation/dialogue by the contracting authority is permitted with any of the bidders. There are no restrictions as to when this procedure can be used. Whilst providing for a pre-selection process so that only suitable bidders are evaluated, the procedure has limited application to procuring complex infrastructure under PPP/PFI because it does not permit negotiation.
Competitive Dialogue	1. All interested parties may express an interest in bidding for the contract. 2. Those parties which fulfil the authority's selection criteria will be invited to submit a bid. 3. During the dialogue, bidders are able individually to discuss all aspects of the contract with the contracting authority with a view to working up solutions based on the bidder's submission within a structured schedule of meetings. 4. The authority shortlists the bidders whose solutions best meet its requirements: each bidder submits a final bid based on its negotiated solutions. Following submission of final bids, no further negotiation is permitted. 5. The authority selects the bid which best fits its requirements. This procedure is widely used in PPP/PFI procurement as it allows the development and scrutiny of solutions within a competitive environment.
Negotiated	There are two types of negotiated procedure: A. Negotiated procedure without prior advert: The contracting authority is not required to issue a notice and may negotiate directly with the supplier of its choice. B. Negotiated procedure with prior advert: 1. All interested parties may express an interest in bidding for the contract. 2. Those parties which fulfil the authority's selection criteria will be invited to submit a bid. 3. Bidders are invited to negotiate the terms of the advertised contract with the contracting authority. 4. The contracting authority can, within certain parameters, establish its own procedures for the negotiation and tender stage. Whilst historically the usual procedure for the procurement of complex infrastructure, since 2006 this procedure is now less commonly used for procuring PPP/PFI in England. This is because EU law requires it only to be used in exceptional cases and the more recent introduction of competitive dialogue has presented an alternative process.

Contract design, risk allocation and financial terms

Contract structure and key agreements

Figure 1: A typical PFI structure



The diagram in Figure 1 above shows a typical PFI structure.

The project company or Project Special Purpose Vehicle (Project SPV) is generally a limited liability company, incorporated for the sole purpose of delivering the project. The project agreement is the key contract which sets out rights and obligations in relation to the project. The principle underpinning the resulting allocation of risks is that risks should be the responsibility of the party best able through access to knowledge, skills or expertise to manage them most effectively. The allocation of risks under the project agreement is key to ensuring that a PPP/PFI represents value for money.

The project company then "passes down" most of the risk it has assumed to the construction and services subcontractors. As the Project SPV is a new company and will have no initial material assets, lenders place strict controls on it to ensure that they are not exposed to further liability or risk than those of the project itself. This is typically achieved by the Project SPV entering into a number of subcontracts with the providers of construction and operational services. Given the highly geared project structure, such subcontracting has to include provisions satisfactory to providers of long term debt funding. In principle since the only collateral that the Project SPV has is the project agreement with the authority, very few, if any, risks associated with the project can be held at the level of the Project SPV. Subcontracts therefore have to be drafted carefully to ensure that such risks as do exist under the project agreement are properly flowed down.

The form of project agreement used in PFI projects in the UK is based upon SoPC – a standard form contract developed by HM Treasury. The current version (Version 4) was issued in March 2007 and provides standard wording to be used by public sector bodies when drafting PFI contracts. Application of SoPC4 has been mandatory for all PFI projects in England and Wales since 1 May 2007. Derogations from SoPC4 (or approved sector specific contracts – see below) are only made in exceptional circumstances on project specific grounds and must be approved, either by a sector specific body or by IUK. SoPC4 also includes guidance on the key issues that arise in PFI projects, in order to promote the achievement of commercially balanced contracts and deliver best value for money. Standardisation has generally been considered to provide a major benefit by allowing for a wide dissemination of information on permitted risk allocations, based on familiarity and market acceptance. This has helped to shorten bidding processes. Standardisation could usefully be replicated in other countries, particularly those with significant project pipelines. The UK experience has been that standardisation works well, particularly if the project being procured is 'tried and tested' for example, a standard accommodation PFI where the authority pays for availability. However, for those PFI projects which involve specific issues that fall outside the main remit, specific derogations can be time consuming and difficult to negotiate.

Sector specific standard forms

In some sectors, sector specific standard form documents have also been developed, building on SoPC4, including:

- In the health sector: the NHS hospital PFI standard form project agreement, developed and overseen by the Private Finance Unit (PFU) of the Department of Health has formed the basis for new hospital PFIs. The PFU must approve any derogation from the standard form;
- In the defence sector: the Ministry of Defence (MOD) PFI project agreement has been developed by the MOD PFU; and
- In the education sector: the BSF standard form documents, developed and overseen by PfS. PfS must approve any derogation from the standard form.

Derogations

The rigour of the derogation regime has had the effect that PFI projects procured to date in England have been based around relatively uniform project agreements. Authorities wishing to derogate from SoPC4, or their sector specific standard form, must obtain approval from the relevant body. In some cases more than one body may have to authorise any derogations - for example in street lighting projects approval must be sought from HM Treasury/IUK and the Department for Transport. Rather than developing its own sector specific standard form, the waste sector has published approved derogations from SoPC4, which seek to provide practical solutions to issues specifically arising in the waste sector that can be readily applied on projects currently in development or procurement.

Risk allocation

The principle developed and implemented for the UK PFI model is that risk should be allocated to the party best placed to manage it. In other words there is a need to assess whether it represents value for money for a risk to be transferred to the private sector rather than retained by the authority. Generally, most operational risks are transferred to the private sector, however some risks, including demand risk and the risk of a change in service by the authority and authority damage are retained by the public sector. Some risks are also usually shared, including change in law, force majeure, benchmarking and compensation on termination. The contractor's principal means of managing risk are:

- pricing for it;
- passing it down to subcontractors;
- insuring against it; and
- holding the risk in the Project SPV (for example in obligations to meet life cycle maintenance requirements and change in law risk).

Financial terms and payment mechanisms

A key component of PFI in the UK is the "unitary charge", linked to availability of the facility or services. The authority makes a single monthly payment for availability of the project facility and all of the services offered, irrespective of whether or not the available project facility is fully utilised. The unitary charge is subject to pre-specified deductions for unavailability of any part of the facility, and for sub-standard service provision. A contractor default occurs if, due to underperformance or specific poor service, such deductions exceed certain thresholds.

Availability-linked payments are particularly suitable where the public sector determines the volume and demand risk and where the Project SPV is providing the service to the authority, rather than directly to the public. These sectors include health (where Project SPVs provide hospital facilities but not medical or nursing services to the National Health Service), education (where Project SPVs provide school facilities but not teaching or educational services to local authorities), and defence (where Project SPVs provide specific support services to the military).

Volume-linked payments have been applied in PFI sectors where costs (such as maintenance or consumables) are partly volume related. These sectors include road transport, where shadow tolls have been applied in the majority of PFIs. The tolls are typically banded, with the toll reducing in stages to zero as traffic volumes increase. This mechanism compensates for increased wear and tear up to a certain capacity, and prevents excess profits by capping revenues. Similar payment mechanisms have been applied in water treatment projects in Scotland and Northern Ireland (whose water sectors have yet to be privatised).

Very few PFI projects have transferred demand risk to the private sector. Use of pay-toll roads in the UK is limited. A minority of the urban light rail PPP projects include transfer of demand risk. One such project (Croydon light rail) experienced significant financial difficulties and had to be restructured due to insufficient passenger numbers. Subsequent projects have been let on an availability basis.

Depending on the manner in which budgets are allocated to authorities, project payments are either fully indexed or partially indexed for inflation. Full indexation occurs where central government budget allocations to ministries or authorities are not split between capital and revenue accounts, for example in the health sector. Partial indexation typically is applied where budget allocations are split between capital and revenue accounts, for example in the local authority-controlled education sector. In such projects, only the component of unitary charge corresponding to the estimated cost of some of the ongoing services is indexed.

Availability-based unitary charges are also subject to other adjustments, to reflect elements of the Project SPV's cost base which cannot be fixed for the duration of the contract, and which are outside its control:

(a) Direct labour services such as cleaning, catering and portering (but not major maintenance) are subject to benchmarking or market-testing of their costs usually every three to five years. If the benchmarking or market testing identifies that costs for a service component have changed by more than a certain threshold (for example plus or minus 5% after inflation), the unitary charge is adjusted.

(b) Energy and utility costs are also subject to benchmarking, but over a shorter period such as two years to reflect the greater volatility in energy prices. Utility charges are typically passed through with the private sector responsible for an element of volume usage but not price. Since the facility is used entirely by the public sector, it controls energy and water usage in the building. As a result, adjustments cover both volume and price of utilities, subject to the Project SPV achieving pre-specified performance levels for energy efficiency and water usage.

(c) Local and business taxes (but not income tax) are generally treated as a pass-through on top of the unitary charge.

These adjustment mechanisms largely determine the financial risk allocation in the PFI contract. The net effect of the unitary charge adjustments is that, in the operating period, the Project SPV takes performance risk (of deductions), inflation risk, major maintenance risk, change of law and service cost risk between benchmarking dates. With the exception of change of law and life cycle maintenance, the Project SPV typically passes all these risks to the operator subcontractors.

Granting and enforcement of security

Lenders to PPP projects in England can avail themselves of a robust security package. This will protect the lenders by providing security and enforcement rights in the case of default by the Project SPV under the project agreement. The security will be a requirement of the senior lenders and generally includes:

- security over all the assets (including contractual rights) of the Project SPV and security over the shares in the Project SPV;
- a direct agreement with the public authority, providing rights for lenders to step into the role of the Project SPV in the event of insolvency or other default;
- a direct agreement with the subcontractors, providing rights for the lenders to step into the role of the Project SPV in the event of insolvency or other default;
- performance guarantees or bonding of the subcontractors' obligations under the subcontracts (which may be provided to the Project SPV and secured in favour of the lenders); and
- direct collateral warranties from lower tier subcontractors or consultants, such as the designer of the facilities.

The lenders may also seek additional support in the form of sponsor support. For example, there may be an agreement between the lenders and the sponsors obliging the sponsors to inject equity into the Project SPV in specified circumstances.

The ability to enter into these types of security arrangements and documents makes English law an attractive governing law for financing contracts. Lenders to projects in the Mediterranean partner countries may insist that their financing documents are governed by English law although enforceability of the security will be subject to the law of the country in which the assets are situated.

Authorities can demand bonds, guarantees and collateral warranties in order to secure performance and protect themselves against non-performance by the Project SPV. This protection will be sought from the Project SPV and its subcontractors. The authority will have rights to step-in to subcontracts where the Project SPV has defaulted (for example, non payment to the subcontractors) and the authority will also have the right, in the event of serious breach by the Project SPV, to take charge of the works or operations and charge the costs back to the Project SPV (authority step-in). However, such rights will usually take a lower priority to similar rights that the senior lenders may have.

Foreign direct investment

There are very few regulations affecting foreign direct investment (FDI) in the UK and PPP investment can be sourced domestically or internationally. Intra-EU FDI flows are unrestricted, and there are minimal restrictions on inflows from non-EU countries. In 2009, the UK held on to its position as the number one destination for FDI in Europe, second only to the United States (US), in the world. The source of finance for PPPs in the UK can either be domestic or international. The UK PFI programme has attracted many participants originally based overseas and is funded by the international banking community. The improved competition and better value that has resulted from international participation in the UK market ultimately translates into better value for the public sector.

England's response to the global financial crisis

PPP projects are typically based on terms of 20 years or more and therefore require long term debt funding. In late 2008 and 2009, the turmoil in the international financial markets created uncertainty and placed significant restrictions on the ability of commercial banks to provide funds on the terms that had been enjoyed in the previous five year period. However, PFI projects continued to be successfully financed during this period albeit at much higher margins and more stringent terms and conditions. Certain contractual provisions have emerged as being of particular importance to lenders and are typically negotiated to include compensation on termination, relief events, termination events and remedy periods.

SoPC4 and other HM Treasury guidance specify how far the public sector authority is entitled to share in any windfall resulting from refinancing. Some of the early PFI projects were able to significantly enhance returns to investors in this way. Current regulations require an equal sharing that is usually tilted in favour of the authority.

The Treasury Infrastructure Finance Unit (TIFU) was created in March 2009 to provide direct government funding for projects. It was created at a time when there was concern that commercial banks would be unable to provide sufficient long term financing. TIFU has only lent money to one PFI project, the Greater Manchester Waste PFI project (see Box 2 below). In November 2010 the coalition government announced that while TIFU will meet its current obligations, no new funding will be made available and the staff are to be redeployed into IUK. IUK has been set up to advise government on the long term infrastructure needs of the UK and provides commercial expertise to support major projects and programmes. It has in addition taken over a number of the functions of PUK that was also disbanded in 2010.

Box 2: Case study – The Greater Manchester Waste PFI Project

The GBP 4.7 billion Greater Manchester Waste PFI Project was the largest PPP to close in Europe and the first to receive lending from TIFU. The project involved the development of waste disposal facilities for one of England's largest cities through a PFI contract worth GBP 3.8 billion to the contractors. The procuring authority was the Greater Manchester Waste Disposal Authority (GMWDA).

The project was first procured in 2005 and the tender for a Design, Build, Finance, Maintain and Operate arrangement was issued in February 2005. Financial close was expected within two years. However the preferred bidder, Viridor Laing (a Joint Venture between Viridor and John Laing), was not selected until January 2007. In total the procurement took four years and at financial close the capital value of the project was GBP 640 million.

The delays in selecting the preferred bidder meant that securing financing for the project was greatly affected by the onset of the financial crisis. Lenders that were confirmed prior to the change in the economic climate pulled out and those that were left were either unable or unwilling to provide the extra funding necessary.

This shortfall in financing for the project resulted in TIFU providing loans for the project. The funding provided by TIFU, in addition with the other non-commercial debt provided by the EIB and GMWDA, resulted in the total non-commercial debt outstripping that provided by commercial lenders by GBP 92 million. In total the debt financing came to GBP 582 million.

The TIFU funding also had an impact on how risk was shared between the contracting parties. In most PFI projects, the majority of risk is allocated to the private sector with the aim of limiting risk exposure for the public sector. However, by providing debt for the project, the public sector was forced to take on far more financial risk exposure than it would otherwise have done through both the loan provided by TIFU and the GBP 35 million loan provided by the procuring authority.

A report published by the National Audit Office in 2010[9] has stated that the setting up of TIFU played an instrumental part in stimulating the lending market for PFI projects during the financial crisis and preventing the stalling of numerous government projects. The Greater Manchester Waste PFI Project revived market confidence.

[9] HM Treasury: Financing PFI projects in the credit crisis and the Treasury's response (Report by the Comptroller and Auditor General, HC 287Session 2010–2011, 27 July 2010).

England – key strengths and lessons learnt

- An established PPP infrastructure process through the PFI scheme making PFI a routine method of public procurement.
- Establishment of a PPP unit to help disseminate experience and encourage best practice.
- Development of specialist expertise in relevant line ministries.
- The role of HM Treasury as an independent reviewer in the PFI process.
- Development of standard form contracts and procedures to increase efficiencies in the procurement process.
- Transparent procurement process.
- Strength of GBP means that private sector will take currency risk.
- Availability of interest rate swaps enables private sector to take long term interest rate risk.
- Well established and predictable dispute resolution procedure using arbitration or the courts.

2. FRANCE

Why a comparator?

France is an established civil law jurisdiction – many emerging markets (particularly those connected historically to France) base their legal systems on the French civil code model.

France has developed recent legislation prescribing availability payment forms of Public Private Partnership (PPP), contracting in such sectors as roads, hospitals, prisons and sports stadiums. This builds on a more established heritage of concession-based procurement models which have been used successfully for the development of major infrastructure in France. These models have heavily influenced the development of infrastructure in countries connected historically to France, such as Algeria, Morocco and Tunisia.

There have been recent announcements of ambitious infrastructure growth through PPP for high-speed rail and universities are attracting interest from the major international companies as well as highly developed local players and are likely to provide rich case studies for similar economies.

Overview

Economically France is classified as an high income country by the World Bank with an estimated Gross Domestic Product (GDP) of Euros (EUR) 1,901 billion and GDP per capita of EUR 29,459 in 2009[10]. GDP fell by 2.6% in 2009. Government debt equated to 72 % of GDP at the end of 2009, and annual consumer price inflation as at end 2009 stood at 0.1%. France is rated AAA and Aaa by Standard & Poor's and Moody's respectively.

A cultural tradition that is open to private finance, a clear legal framework enabling project financed projects, wide public investment flows and the political will to develop more modern forms of public procurement have been the key factors of success. France has a long tradition of privately financed public infrastructure projects including railways, water and sewage facilities, highways and electricity networks. Historically these have been built and financed under concession schemes. Although concessions remain the rule in some sectors (e.g. water and waste-water, highways), legislation has been adapted to enable other types of PPP in the last decade. Projects in new sectors, where only availability payments (as opposed to user payments) can be envisaged tend to be increasingly financed under PPP schemes. Billions of Euro have been spent in recent years in sectors such as railways, sports stadia, schools, universities, hospitals and prisons. PPPs are seen as a method of fostering substantial investment and are not used in sectors where capital expenditures are not needed.

Box 3: Definition of PPP under French law

Concessions (public service delegations)

Public service concessions have historically had a significant role in the development of French infrastructure and public service delegation agreements are the basis of most forms of PPP in France.

The December 11, 2001 Law provides a definition of public service delegation, the two defining characteristics of such agreements being: (i) its purpose (the delegation of a public service); and (ii) the method of remuneration of the private party (which must essentially come from the operation of the service). *The Conseil d'Etat* has expressly made a link between this notion of remuneration and the notion of the risk assumed by the private contractor[11]. This definition is in line with the definition of concessions according to European Union Case Law[12].

French concessions are relevant to the Report to the extent that they involve project finance structures.

Other PPP models

Other PPP models emerged in the mid 1980s and the June 17, 2004 Ordinance No. 2004–559 created the contrat de partenariat. These models are more flexible than concessions in respect of structuring payments as, for example, they do not require user payments. These models are described below.

1. *The "give and take" schemes (or lease schemes)*
   Under these schemes the public authority authorises a private operator to erect on its land a building which the operator continues to own subject to significant reservations. The authority rents this building upon its completion and the rent includes an amount representing the construction cost and intermediate funding. These schemes will also provide for the private operator's obligations regarding the operation and maintenance of the building. This "give and take" mechanism allows the public authority in particular to spread out the construction cost and to circumvent the general prohibition under law forbidding payments for capital investment to be spread over a long term contract.

There are two kinds of "give and take"/lease schemes:

- The temporary occupancy authorisations of the public domain created by the July 25, 1994 law No. 94-631 makes it possible to grant temporary occupancy authorisation on the State's public domain.
- The administrative long term lease (bail emphytéotique administrative) (BEA), introduced by Article 13 of the January 5, 1988 law No. 88-13 stipulates that authorities' property may be the subject of a long term lease.

"Give and take" schemes can be used for a variety of projects - they have been used in the security, justice and health sectors.

2. *The contrat de partenariat*
   The June 17, 2004 Ordinance introduced the *contrat de partenariat*. It is possible through the *contrat de partenariat* to entrust to a third party the funding, construction, operation and maintenance of investments, works or equipment necessary for public services.

The agreement itself determines the conditions under which these works are made available to the government authority. Thus, the *contrat de partenariat* specifies, among other conditions, obligations prior to service commencement (i.e. construction), the date of service commencement and the consequences of and protection against late service commencement.

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[10] Data sources: IMF Government Finance Statistics Yearbook and data files, and World Bank and OECD national accounts date files
[11] CE November 7, 2008, Département de la Vendée. http://www.legifrance.gouv.fr/affichJuriAdmin.do?oldAction=rechJuriAdmin&idTexte=CETATEXT000019737263&fastReqId=28269271&fastPos=1
[12] CJUE, 10 September 2009, « Eurawasser », C-206/08

French PPP projects are typically funded using project finance techniques, based on a high proportion of project costs being funded with long term debt raised from banks and (less frequently) the bond market and the balance of project cost funded by sponsor or institutional equity. Table 3 below outlines PPP project activity in France from January 2006 to November 2010, indicating that the particularly active sectors are social infrastructure and transport.

Table 3: French PPP project financing, January 2006 – November 2010

France	Loan amounts (EUR millions)	Number of Projects
Power (incl renewables)	not included	
Social Infrastructure	4,548	45
Transport	3,778	11
Water & Sewage	13	1
Total	8,338	59

Source: *Infrastructure Journal* online database

Power projects (of all types, including renewable power) are not included in the French PPP programme, since, in the case of France, the electricity sector is substantially privatised and so the public sector role is limited to regulation, licensing and permitting. New electricity generation and transmission assets are financed either by the utility on its own balance sheet, or (as is typical for renewable energy projects) as independent power projects which obtain their own ring-fenced project financing. This contrasts with the position in other comparator countries (except the UK) and in the Mediterranean partner countries where power distribution and supply and most power generation is carried out by State-owned monopolies.

The institutional, legal and regulatory framework in France supports PPP. There are established bodies, such as Mission d'Appui à la Réalisation des Contrats de Partenariat (MAPPP) and pre-procurement processes in respect of project selection and feasibility, which ensure that projects are properly scoped and prepared. The legal framework for concessions is built on long established, widely recognised and flexible case law that forms the basis of a business friendly legal environment. The legal system provides a sound basis for PPP procurement and provides mechanisms by which lenders can protect their investment in projects (through the creation and enforcement of security). In addition, France enjoys a reputable and high quality civil service at national and local level. Civil servants including both engineers and administrative personnel have the ability to monitor the launch of PPP procedures and oversee the operators' performance once the projects have been awarded.

Notwithstanding that PPP has some critics, it is a widely practiced procurement method. Critics of PPP believe that they do not bring value for money and are more expensive, in the long term, than traditionally procured projects. Such criticism should not be over-emphasised, as PPP has become a widely practiced procurement process not only by the State but also by local communities and to date, there is no example of a PPP project that is considered to have failed.

Project finance schemes are used for infrastructure development in France. While private financed projects such as water and other municipal facilities have been financed historically on the balance sheet of operators, increasingly, new projects are structured as PPPs and are based on project finance schemes. This may be for reasons of financial efficiency or to avoid overloading corporate balance sheets.

The PPP experience in France provides some valuable lessons on how the workings of government, legislation and policy can be developed to provide a strong institutional, legal and regulatory framework for PPPs. Strong points of the French PPP experience and framework are:

- Political will from central government and local communities to develop PPPs as an alternative to traditional procurement, leading to a yearly investment flow that should be close to EUR 10 billion in 2010 and 2011 (depending on the closing of important high speed train projects);
- A far-reaching tradition of private financing of public infrastructure under the form of concessions;
- A clear and flexible legal framework that has already been modified twice on the basis of experience and in order to accommodate the needs of private sector operators;
- Robust security instruments (cession Dailly assignment of receivables);
- A predictable and responsive judicial system;
- The recognition by public entities that experienced consultants and advisers are key to achieving successful project delivery; and
- Quality of public authorities from a technical viewpoint and their ability to manage bidding processes with complex dialogues.

Institutional issues

Under the French constitution, local authorities have significant autonomy to enter into contracts to develop local infrastructure. Local authorities must obtain approval from their local assembly before launching a procurement of either a concession or a contrat de partenariat.

Procuring authorities entering into PPP contracts must obtain approvals before signing the contract. Approval is required from both the Ministry of Finance and State Reforms and the line ministry responsible for the particular sector, for example the Ministry of Education must approve university PPP projects.

All PPP projects (even those approved by the local assembly) must be approved by MAPPP, which is part of the Ministry of Finance. MAPPP was set up in 2005 to support the implementation of the new PPP procedure established under the contrat de partenariat legislation. MAPPP also supports projects in procurement with technical advice, guidance and help with the appointment of advisers. This institution has an important role in publicising PPP through its interactive website, conferences, newsletters and the compilation and dissemination of lessons and best practice.

Several sectors also have specific agencies to support infrastructure development and PPP. These include justice (prisons and courts) and health. The higher education sector has also recently launched a large EUR 5 billion PPP programme to redevelop university campuses.

Budgeting for PPPs

Central government has made funds available in support of PPP programmes in general. These include special assistance under the Economic Recovery Programme to help close projects following the 2008 financial crisis, whereby a EUR 10 billion fund was established, originally time limited until December 2010 and then extended for a number of projects.

PPP credits are available as part of the annual budget, regardless of sector. These take the form of investment credits to assist with planning and developing project proposals; and operating credits to help authorities to defray the costs of entering into a long term PPP contract. The French PPP credit system is similar to that used in the United Kingdom (UK) in that it provides financial support to projects that would otherwise not be affordable to procuring authorities.

Legal and regulatory framework

French law recognises a number of PPP models. The notion of PPP as it applies in France is complicated. The distinction between concessions (public service delegations), "give and take" schemes and *contrats de partenariat* (partnership contracts) is described in Box 3 above.

France's legal system provides a sound legal framework for PPPs. France has a developed civil law system, based on written law. Sources of interpretation – case law and doctrine – are also influential. As a Member State of the European Union (EU), EU legislation takes primacy over French national law. European legislation is particularly important in the context of PPP procurement procedures and rules (see below). The wide availability of written laws and published decisions provides clarity, consistency and flexibility. French law has in recent years introduced amendments/acknowledgements to encompass a broader range of PPP models (notably, the *contrat de partenariat*) (see Box 3 above).

Public authorities are empowered to procure PPP projects and enter into PPP contracts. PPPs are administrative contracts under French law and can only be concluded by public legal entities. Procuring/contracting authorities include a broad spectrum of bodies from the public administration, for example ministerial departments, territorial authorities (departments, regions, local authorities) and public institutions (universities/public hospitals). The procuring authority (other than territorial communities) must obtain an authorisation from the minister responsible for the budget prior to signing the PPP contract. For some sectors such as roads or railway concessions, concession contracts must be approved by ministerial decree after prior consultation with the Conseil d'Etat (in the latter's capacity as a legal adviser to the government).

Dispute resolution

The French court process can deal with PPP contract disputes. PPP contracts are required to include dispute resolution provisions, including interim procedures before resort to the courts. Disputes are resolved by the courts as the final forum. As public law contracts, they will be subject to the jurisdiction of the administrative courts. Judges have extensive powers which allow for flexible and commercially appropriate decisions to be made. The judge can reverse a decision of the contracting authority made in relation to a contract, for example by modifying a date or modifying the amount or applicability of a contractual penalty. The judge can also requalify the measure taken by the government authority, for example transform a termination for fault into a termination on the grounds of public interest – this can have significant consequences in terms of compensation. The judge can also award compensation for the consequences of unlawful measures taken by the authority. These wide powers must however be exercised in the context of the overall French legal system. In particular, the judge must take into account the relationship between the parties and the principle of good faith, i.e. a party will not be entitled to seek a nullification of the contract or amendment or waiver if the party was the author of the claimed irregularity or was aware of it. This provides an element of certainty to contractual parties.

Arbitration is rarely the chosen method of dispute resolution for PPP contracts in France. Recourse to arbitration is, in general, prohibited for public entities. There has been a derogation from this principle in relation to the contrats de partenariats (although this derogation is rarely if ever applied). If arbitration is to be agreed, the June 17, 2004 Ordinance sets out, for both contrats de partenariat of the State and local authorities, mandatory clauses relating to recourse to arbitration. Any such arbitration must be governed by French law. Where arbitration is used, this does not pose problems for international investors because commercial parties operating in France will be familiar with the developed system of international commercial arbitration available with the support of bodies such as the International Chamber of Commerce (ICC) and within the supervisory jurisdiction of the French courts which are generally supportive of private arbitral processes.

Bidding process

PPPs in France are subject to EU procurement law. National case law has specified that all PPPs ("give and take" schemes and contrats de partenariats) are public contracts within the meaning of EU law. The Public Sector Directive (2004/18/EC) (this apples to public works contracts, public supply contracts and public service contracts) and the Utilities Directive (2004/17/EC) (for entities operating in the water, energy, transport and postal services sectors) are directly applicable to PPPs. (See England report in relation to the procurement procedures under EU legislation).

French law applies these rules and distinguishes between the different types of PPP schemes. The procedures defined by the June 17, 2004 Ordinance on *contrat de partenariat* are becoming the standard for all PPPs. The procedures applicable to other schemes are very similar. In some cases (particularly the BEA and the "give and take" schemes mentioned above), the procurement procedure is not formally regulated under national law and, in the absence of French legislation, the European directives must be applied directly.

The procurement procedure applicable to contrats de partenariat is structured and involves a number of stages. The stages are:

- advertisement of the tender – this will be in the Official Journal of the European Union (OJEU) in accordance with EU requirements;
- qualification for the bid – candidates who have expressed an interest will be selected to proceed to the next stage. During this stage, the procuring authority will consider the

professional and financial standing of the interested candidates;

- issue of bidding documents (includes the rules of the procedure, the authority's project specification, a draft agreement, a risk matrix and technical documents);
- consultation, negotiation or dialogue (depending on the applicable procedure (see below);
- evaluation; and
- contract award.

Most PPPs are awarded after a competitive dialogue procedure, subject to the project being sufficiently "complex", as defined under EU law. This form of negotiation and discussion with the bidders is widely seen as a progressive development in public procurement and indeed the availability of such dialogue procedures is one of the perceived advantages of PPP. It should be noted that, as in the UK, bidders have criticised competitive dialogue procedures for being costly and time consuming. In utilities sectors falling under the 2004/17 Directive, such as railway infrastructure, the negotiated procedure is possible, in accordance with EU law and is currently used in two high speed rail projects.

Contrats de partenariat **are awarded on the basis of the most economically advantageous tender (MEAT).** As mentioned in the England report above, EU law dictates that there are only two possible award criteria – lowest price and MEAT – and the latter is the preferred basis for contract award in France. The factors that will inform which is the MEAT must be defined in the call for competition and their relative weighting should be specified. The factors are varied and include price, performance targets, construction programme, innovation, equipment and architectural, aesthetic and functional qualities. A typical weighting would be as follows:

- The global cost of the bid – 30%;
- Performance targets – 20% (construction date, number of services, unit cost of the services, speed of interventions, sustainable development);
- Part of the performance of the agreement entrusted to small and medium-sized companies and craftsmen – 5%;
- Solidity of the legal and financial scheme, in particular the transfer of risks – 15%; and
- Quality of the architecture or functional quality – 30%.

This approach ensures that financial and technical aspects of the bid are taken into consideration and that an overall grading is made. This avoids the situation where a technical bid is merely scored on a pass/fail basis and due consideration is not given to the overall assessment of value for money. Most criteria are objective and based on the technical appraisal of the bid. The only criteria that gives room for a more subjective approach is the quality of aesthetic design in the case of projects for public buildings. This criteria is the subject of expert advice and evaluation.

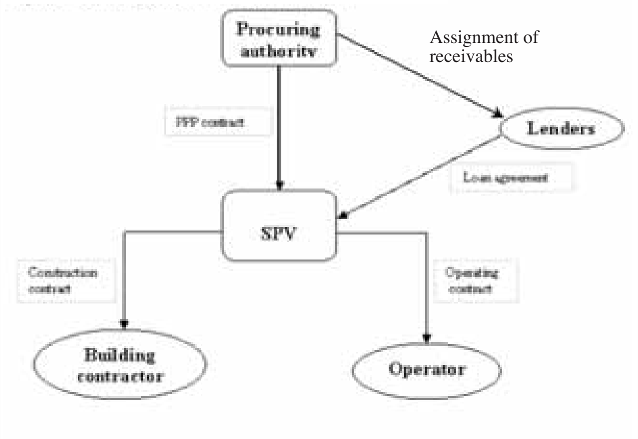
Unsuccessful bidders have clear rights of challenge. The timetable for signature of the PPP contract must build in a stand-still period of time prior to contract signature during which unsuccessful bidders can challenge the contract award (*référé précontractuel*). This can result in suspension or cancellation of decisions taken by the procuring authority or modification of the rules of the procedure. Unsuccessful bidders can also seek a review (*recours de pleine jurisdiction*) contesting the validity of the contract or some of its clauses and can seek compensation. Such an action must be brought within two months of the publication of contract award.

Unsolicited proposals can be introduced under contrats de partenariat procurement, although overall they remain rare. Unsolicited proposals if entertained and developed are then subjected to competition with other bidders according to normal procurement rules. No special advantage is afforded to the promoter of the unsolicited proposal. In the past, unsolicited proposals have been accepted in cases where a PPP scheme in itself has been seen as particularly innovative. For example, an unsolicited proposal was been accepted for the procurement, commissioning and maintenance/upgrading of the IT systems of all 41 secondary schools in a Département (a Département is an administrative division in France). The experience of using unsolicited proposals suggests that they have been used sparingly but with the benefits of fairness and transparency that can be derived from the public procurement processes.

Contract design

A distinguishing feature of French PPP structures is the assignment of receivables by the procuring authority to lenders. Figure 2 below shows a typical PPP structure in France. The principle difference between the French PPP structure and the English structure is the assignment of receivables to lenders (see below for further information on *cession Dailly* and lender security in France).

Figure 2: A typical PPP structure



In France (as in other countries) it is typical for a project company to be a limited liability company, incorporated for the sole purpose of delivering the project. The project agreement (PPP contract) is the key agreement. It formally delegates the particular public service to the private operator and sets out the respective rights and obligations of the Project Special Purpose Vehicle (Project SPV) and the authority in relation to the project and allocates risks between the public and private parties.

The Project SPV then "passes down" most of the risk it has assumed to the construction and services subcontractors. As the Project SPV is a new company and it has no material assets, lenders usually seek to ensure that it does not expose itself to risk and liability by performing obligations itself.

Standardisation

French legislation does not prescribe standard forms for PPPs and parties are free to contract as they please. However, the previous experiences of projects and of specific bodies dedicated to PPPs has led to the creation of standard provisions in specific areas. For example, it is now very common to introduce provisions regarding “relief events” or specific and general change in law. Furthermore, the requirements of project financed PPPs tend to impose certain standard provisions, mainly addressing the risk of judicial review against the contract and the refinancing of the project. Certain contractual provisions have emerged as being of particular importance to lenders and are typically negotiated, including compensation on termination, relief events, termination events and remedy periods. Signed PPP contracts are publicly accessible in accordance with French law. They are also published on the website of the MAPPP. The role of private sector consultants, particularly in relation to available legal expertise has also been influential in the development of PPP standardisation. The legal market for major projects is concentrated on half a dozen Paris based firms, which through experience have developed consensus in respect of some of the key risk allocations and this has led to a certain level of standardisation in contracts.

Risk allocation

In line with the principle that risk should be allocated to the party best able to manage it, PPP projects in France have apportioned risk in a consistent manner. Generally, most operational risks (such as construction and design risk, interface, price increase, technical risks in the operation phase) are transferred to the private sector. However, risks that are beyond the control of the private party – notably the risks of a general change in law – tend to be retained by the public sector. Other risks are usually shared, including specific change in law, archaeological risks, force majeure or judicial challenge of the contract.

Contracts under project financed schemes tend to leave little room for interpretation by courts by adopting precise definitions of force majeure or imprévision. This avoids the potential for conflict with the jurisprudence of the Conseil d'Etat which would impose its interpretation of such terms if the contractual provisions were ambiguous. Provided that contractual drafting is sufficiently precise to reflect the agreed risk apportionment, investors and lenders are content with the applicability of French law to their contracts and indeed, French law is often the governing law of contracts in respect of project financing in other countries.

Financial terms and payment mechanisms

French PPPs adopt similar principles to the UK in structuring PPP payment mechanisms, but apply them more flexibly. The 17 June 2004 Ordinance specifies that project payments are to be made throughout the duration of the PPP contract, with payments linked to project performance targets. Unlike in the UK, where the PPP contract is silent as to most of the costs of the Project SPV, in France the PPP contract identifies separately the construction, design and development and financial expenses, as well as operating costs and financing costs. Box 4 below highlights this practice. This allows French PPP projects to apply payment mechanisms in which variations in payments made (other than deductions for underperformance) more closely match variations in the cost base of the Project SPV – for example, through applying specific sectoral price and wage indices, as opposed to relying solely on a general price index, as in the UK. This gives greater certainty to the private sector, but exposes authorities whose budgets may be linked to general inflation, to specific inflation risk in the relevant sector.

Box 4: Case study – accommodation PPP in France

The following case study illustrates the precise nature of the calibration of payment mechanisms in France. The project in question is the construction, operation, maintenance and management of a network of service centres from which the pubic sector carries out certain services throughout France. The semi-annual project payments specified in the project agreement (contrat de partenariat) are split into elements which are precisely linked to components of the Project SPV's capital and operational cost base, as specified in the financial model for the project:

First, there is a fixed price element to recover, over the life of the project, the construction, development, design and transaction costs of the project. This is split into sub-elements corresponding to different sub-groups of service centres being built under the project.

Secondly, another fixed price element to recover over the life of the project is the financing costs of the project – again allocated between sub-groups of service centres and also split as between the senior debt finance costs and expected interest and dividends on sponsor risk capital.

Thirdly, there is an indexed element to cover operating, regular maintenance and management costs. There is a separate element to cover major life cycle expenditures – the periodic amounts create a reserve for the future major life cycle expenditures. Both these elements are indexed annually by reference to specific building and maintenance industry cost indices and service and industrial labour cost indices – with different weightings attached to each index for the annual and life cycle costs.

Fourthly, an element to cover energy and raw materials costs, with unit prices re-invoiced by the Project SPV to the authority. Energy and raw material consumption risk is split, with the Project SPV responsible for 100% of the cost of consumption in excess of a threshold 10% above base case and savings from consumption below a threshold 10% below base case being split 70:30 as between the authority and the Project SPV.

Finally, an element to cover taxes and duties incurred by the Project SPV.

As well as providing for deductions for unavailability, French PPP contracts may also include bonus payments to incentivise strong performance in certain parts of the service provision. These "bonus" payments are designed to ensure that the contractor goes beyond the minimum level of service required by the project specification in key areas such as energy efficiency. The bonus payments are affordable by the authority since they are paid from savings which have accrued to the authority due to the superior performance of the Project SPV.

Granting and enforcement of security

Lenders to PPP projects in France can avail themselves of a robust security package. This will protect the lenders by providing security and enforcement rights in the case of default by the Project SPV. The security normally required by financiers includes:

- security over all the assets of the Project SPV (including by way of mortgage over assets and land) including: (i) an assignment by way of security (*cession Dailly*), pledge (*nantissement*) or assignment of debtors (*délégation*) with respect to all receivables against, inter alia, the public authority, the subcontractors, the hedging counterparties, the insurance companies and the tax authorities and (ii) a pledge over bank accounts and security over the shares in the Project SPV. Moreover, under the cession Dailly (a mechanism whereby the lenders may request a direct payment from the public authority), lenders enter into a direct relationship with the procuring authority and the increased comfort for lenders arising from a government counterparty can result in lower financing costs for the project. Most financing of French PPPs incorporate such cession Dailly assignments and these are familiar to lenders;

- a direct agreement with the public authority, providing rights for lenders to step into the role of the Project SPV in the event of insolvency or other default;

- a direct agreement with the subcontractors, providing rights for the lenders to step into the role of the Project SPV in the event of insolvency or other default; and

- performance guarantees of the subcontractors' obligations under the subcontracts (which may be provided to the Project SPV and secured in favour of the lenders).

The lenders would also seek additional support in the form of sponsor support. For example, there may be an agreement between the lenders and the sponsors obliging the sponsors to inject equity into the Project SPV in specified circumstances.

The ability to enter into these types of security arrangements and documents makes French law an attractive governing law for financing contracts. This may be of particular benefit to the civil law jurisdictions within the Mediterranean partner countries as it complements the existing basket of securities available in those countries and can have a positive effect on the project in terms of assuring bankability.

As is usual, authorities demand bonds and guarantees in order to secure performance and protect themselves against non-performance by the Project SPV. This protection will be sought from the Project SPV and/or passed on to its subcontractors.

Foreign direct investment

France has a liberal regime for foreign direct investment and foreign exchange in so far as they might affect PPP procurement and implementation. There are no exchange controls and no restrictions on foreign companies contracting with government entities. Whilst there is a legal regime applicable to foreign direct investment in particular defined sectors (particularly those relating to national security), regulations in relation to foreign direct investment do not ordinarily apply to PPPs (although there may be implications where the subject matter of the PPP is for example defence related and a participant is from outside the EU).

France – key strengths and lessons learnt

- A track-record of concession based procurements as a means of delegating public services.
- A modern PPP programme with a pipeline of projects across key sectors, particularly social infrastructure and transportation.
- Procurement by central government and regional and local authorities.
- An institutional apparatus receptive to project financed infrastructure.
- A legal framework designed specifically to cater for PPPs in a civil law context.
- Recognition of effective security packages.
- Liberal foreign direct investment regime.
- Well established and predictable dispute resolution procedure using arbitration or the courts.

3. MEXICO

Why a comparator?

Mexico has a federal legal system based on the civil law tradition and has huge growth potential and a large number of Public Private Partnerships (PPPs) projects in development. Mexico is currently implementing its National Infrastructure Program 2007-2012 with a major national road-building initiative, which is implementing lessons learnt from earlier road building concessions.

Mexico's use of its online portal Compranet to disseminate information on procurement processes and projects promotes transparency and efficiency in the procurement of PPP and promotes Mexican PPPs to a wider market, ensuring greater competition. Mexico has also experimented with the use of intranets in order to conduct procurements more efficiently. Mexico's experience is likely to provide a rich knowledge base for other countries particularly with expanding populations and an urgent need for infrastructure renewal.

Overview

Economically, Mexico is classified as an upper middle income country by the World Bank with an estimated Gross Domestic Product (GDP) of Euros (EUR) 628 billions and GDP per capita of EUR 5,844 in 2009[13]. GDP fell by 6.5% in 2009. Government debt equated to 28.2% of GDP at the end of 2009, and annual consumer price inflation as at 2009 stood at 5.3%. Mexico is rated A and Baa1 by Standard & Poor's and Moody's respectively.

Mexico's federal system has resulted in a multiplicity of laws applicable to PPPs. There are laws for procurements at the federal level, within the capital city (Mexico City) and in each of the 31 states. Currently, PPPs are procured at the federal level in accordance with general public procurement law (the *Ley de Adquisiciones, Arrendamientos y Servicios del Sector Publico* (enacted in 2009) and the *Ley Organica de la Administracion Publica Federal*) or sector specific-laws (for example, for highways PPPs, the *Ley de Caminos Puentes y Autotransporte Federal*). This section outlines issues in PPP procurement at the federal level unless indicated otherwise.

Mexico has an ambitious plan for the development of its infrastructure through PPP and given the size of the country, opportunities are significant. The 2007-2012 National Infrastructure Plan (NIP) contains projects in several sectors, including energy, ports, airports, water, waste, rail and roads. The NIP includes approximately 400 projects with a combined value of Mexican Peso (MXN) 2.5 trillion (EUR 154 billion). Infrastructure development is considered in Mexico to be a signal of strong economic growth and the federal government wishes to leverage infrastructure developments to realise wider social and economic benefits. The NIP, *Fondo Nacional de Infraestructura* (FONADIN) and *Fideicomiso de Apoyo al Rescate de Autopistas* (Commission for Financial Assistance to Rescue Highways) (FARAC) are strong indicators of the federal government's intentions and political will to pursue a structured and strategic infrastructure development programme. They are indicators of a policy of infrastructure development and a programme of support which is a sound basis from which to start to launch PPPs.

Mexican PPP projects are typically funded using project finance techniques, namely with a high proportion of project costs being funded with long term debt raised from banks on the basis of project risk or the bond market and the balance of project cost funded by sponsor or institutional equity. To date, road transport and energy projects have predominated. Whilst previously energy projects were primarily conventional gas or oil fired power plants, increasingly renewable energy projects are being procured, by means of the State electricity monopoly, the *Comisión Federal de Electricidad* (CFE), offering feed-in tariffs. Table 4 shows the mix of recent Mexican PPP projects, indicating the continued dominance of the transport sector but with a growing mix of projects in diverse sectors.

Table 4: Mexican PPP project financing, January 2006–November 2010

Mexico	Loan amounts (EUR millions)	Number of Projects
Power excl renewables	1,608	5
Renewables	218	2
Social Infrastructure	210	6
Transport	5,328	17
Water & Sewage	186	2
Total	7,550	32

Source: *Infrastructure Journal* online database

Improvements have been made to the financial framework in order to increase private sector investment. The national infrastructure fund FONADIN was created in 1994 through the combination of revenues from toll roads and a pre-existing fund, the Fondo de Inversion en Infraestructura. FONADIN's aims are to increase private sector involvement in infrastructure development. It can achieve this by assuming a role that private investors and lenders are not willing to take. Thus, it can assume risks that the market will not, it can inject subordinated debt, provide financial guarantees and provide subsidies: FONADIN authorised MXN 59.4 billion (EUR 3.5 billion) of investment in 2009 and MXN 83.5 billion (EUR 5 billion) in 2010 – 53% and 49% of which (for 2009 and 2010 respectively) was committed in order to make projects profitable.

Mexico's experience of stabilising and then expanding its road investment programme mirrors the improvements in Mexico's domestic capital markets and its access to international financial markets. Between 1989 and 1994, over 50 toll road concessions were granted in Mexico, many of which failed in the economic collapse of 1994. Many of these projects suffered from poor project scoping and design, over-estimation of traffic volumes, no control over competing roads and in some cases construction cost overrun and delay. To rescue these projects, the federal government established FARAC. FARAC funds are provided from private, federal and State resources and are

[13] Data sources: IMF Government Finance Statistics Yearbook and data files, and World Bank and OECD national accounts data files

awarded to projects at both national and local levels, with the ratio of public to private contributions to projects calculated so as to deliver the best rate of return for the public sector. By 1997, FARAC had assumed control of 23 projects. Since then, the Mexican economy, its public debt position and openness to foreign trade and investment have steadily improved and contributed to increasing investor confidence in Mexico: its Standard & Poor's sovereign credit rating improved from BB in 1997 to BBB+ in 2009 (it is currently BBB with stable outlook). From 2005 onwards, FARAC has been able to steadily re-let the viable road projects on revised terms (typically 30 year concessions) and at the same time the federal transport ministry and State governments have been awarding concession contracts or PPP contracts for new roads. These projects are increasingly funded by domestic banks, but still are able to attract private foreign capital (with less reliance on International Financial Institution (IFI) funding) on competitive terms.

Nevertheless, in common with other countries, Mexico's infrastructure investment in new projects stalled due to the international financial crisis in 2008. Gross domestic product contracted sharply, in part due to the falling oil price. Project sizes (notably in the road sector) were scaled back to match the reduced available funding and higher cost of capital, particularly higher loan interest margins and reduced loan tenors. However, credit conditions are easing and access to funding has largely been restored, albeit at a higher cost compared to before the international financial crisis.

Additionally, progressing PPPs could be made easier if other aspects of the PPP framework were amended. This would enable the achievement of some of the ambitions of the NIP. In particular, project and PPP feasibility should be assessed prior to the launch of projects and clear and consistent processes need to be introduced in order to achieve this. The legal and procurement framework should also be amended to allow for the complexities in procuring, implementing and negotiating PPPs. Mexico's successful experience in developing contractual structures for Independent Power Projects (IPP) can serve as a useful example of the benefits to be derived from allowing contractual provisions to evolve along with the market, as well as demonstrating the utility of learning from past experience and developing robust, but not unduly onerous feasibility requirements to test future assumptions.

Institutional issues

Mexico has established an Investment Unit (IU) in the Ministry of Finance, with responsibility for PPP as well as other forms of national investment. All PPP projects have to be approved by the IU. The IU also has responsibility for co-ordinating all government investment programmes and for ensuring that the necessary rules and procedures are followed. The IU's role includes planning future investment programmes and thereby contributing to the federal budgeting process and maintaining an information database of investment projects across the country.

Before a PPP project can be approved by the IU, a business case must be presented by the procuring authority. This takes the form of two linked cost-benefit analyses (CBA): a general CBA and a feasibility CBA. The general CBA includes a description and justification for the project, as well as a detailed risk analysis, affordability appraisal and legal and environmental studies. The feasibility CBA is a detailed net present value appraisal of the project cashflows.

Approved PPP projects are allocated a budget before they are competitively tendered. If the bids are above the cost of the project, then the scheme will be re-considered or withdrawn. It can be re-scoped and re-tendered at a later date. However, all projects are specifically approved by the legislature and budgets cannot be re-allocated to other projects without legislative approval or specific administrative procedures.

Once the tender process is underway, the Ministry of Public Function may take responsibility for ensuring that the procurement rules and regulations are followed. The Ministry of Public Function provides the contracting authority with guidance and support. It is also responsible for ruling on challenges to the procurement process and can act as a mediator. The Ministry of Environment also plays an important role in ensuring that the necessary consultations and studies are carried out and environmental approvals obtained.

The Mexican institutional framework for PPP at the federal level has several positive features, including clarity, technical rigour and fairness. The use of a detailed CBA as a basis for project selection and justification is a particularly rigorous approach to the development of business cases.

Legal and regulatory framework

The legal framework for procuring federal PPPs is currently fragmented and would benefit from the enactment of specific legislation to cater for PPP procurement and implementation. Proposals for a specific federal PPP law were introduced to the Mexican legislature in late 2009 and early 2010, and are still under discussion. Whilst some States have laws which cater for PPPs, there is no single framework at the federal level. Currently, PPPs are procured in accordance with general public procurement law (the *Ley de Adquisiciones, Arrendamientos y Servicios del Sector Publico* (passed in 2009) and the *Ley Organica de la Administracion Publica Federal*) or sector specific-laws (for example, for highways PPPs, the *Ley de Caminos Puentes y Autotransporte Federal*). In addition guidance on the procurement of projects in certain sectors is contained in previous draft laws relating to PPPs and issued by the Ministry of Public Function. Investors will wish to determine that the legal basis for their projects is sound and that there are no unduly restrictive or unreasonable legal requirements. By simplifying the legal framework, the due diligence that will need to be performed by investors and lenders will be easier.

There is an existing initiative to introduce a PPP law, which will improve the legal framework for PPPs and advance the process for their procurement and implementation. The draft PPP law proposed in 2009/2010 should overcome difficulties which have arisen to date, including lack of clear regulation of private participation in infrastructure projects, complications in the acquisition of rights of way and unclear risk allocation methods. Once adopted, the provisions of the law will address specifically matters such as PPP procurement, the PPP contract terms and dispute resolution. The objective of the new law is to provide legal certainty to private investors in relation to PPP schemes, to enhance the framework in which the public and private sectors will co-operate and to improve consistency in and the efficiency of project development.

Key features of the proposed PPP law are the following:

- Sets out a process for assessing feasibility of a project;
- Provides for unsolicited proposals;
- Excludes application of the existing procurement laws;
- Specifies the procurement procedure;
- Requirement for the preferred bidder to establish a Project Special Purpose Vehicle (Project SPV);
- Guidance for bid challenges;
- Provides for contract terms; and
- Disputes to be resolved either by courts or by arbitration.

The bodies responsible for drafting the law should work or consult with advisers involved in international PPPs so that the provisions of the law will have the benefit of experience and real issues that arise. Other national and international stakeholders should also be consulted.

One of the benefits of a new law could be to introduce an appropriate procedure for the resolution of PPP disputes. Currently, PPP contracts typically provide for informal and formal methods of dispute resolution. However, these processes will not necessarily have access to the expertise required for the resolution of complex issues that may arise under the PPP contract. Arbitration, under rules such as the rules of the International Chamber of Commerce (ICC), is permitted but the seat of arbitration is required to be Mexico and the arbitral law will be Mexican. Investors are likely to be reassured as Mexico's Commercial Code has largely adopted the United Nations Commission on Trade Law (UNCITRAL) model law on arbitration, with which they will be familiar.

Bidding process

The principles of efficiency, honesty and transparency of public procurement are enshrined in the Federal Constitution (Article 134). As such, all public procurements must go through a public tender (public bid) process, save in respect of very narrowly defined circumstances (for example if the need to award a contract is urgent or where the use of third party patents or trademarks is required) in which case contracts can be concluded through restricted tendering or through direct award. Mexico's public procurement system includes use of electronic tools – a dedicated website ('Compranet') – which has been pivotal in improving transparency. The features of Compranet are described in Box 5 below.

The public bid procedure is structured and involves a number of stages. These are (i) invitation to bid; (ii) question and answer sessions: (iii) bid submission; (iv) bid evaluation; and (v) contract award. Whilst these stages can be adapted for a PPP procurement process, other aspects of the procurement law mean that current procedures are not wholly suitable in all cases.

Contracts are awarded on the basis of most advantageous conditions. This involves an assessment of the financial terms for the project, technical proposals and contracting history. In reality, price is a significant factor. As long as the evaluation and award criteria are transparent and applied properly, the criterion of "most advantageous conditions" is suitable. Compranet has an important role to play in this as it is the source of information such as evaluation criteria and also regulates procedures such as opening of bids (see Box 5 below).

By introducing a procurement procedure in law which is designed for PPP procurement using some elements of the current processes, procuring authorities will maximise the potential for securing optimal solutions and value for money. The current procedures do not permit free negotiation of the draft PPP contract issued by the authority, although amendments may be proposed through a clarifications process in accordance with the relevant procurement rules. Historically, changes accepted by the procuring authority through such process have been reflected in subsequent, similar projects (for example in power purchase agreements in IPP procurements). Bidders therefore have very limited influence over the terms of the project agreement for the current procurement. This difficulty is compounded by the prohibition on withdrawing proposals once submitted. This process could mean that the procuring authority is closing the door to a solution which more effectively manages or transfers risk and which responds more appropriately or beneficially to the authority's requirements.
If procurement procedures designed for PPPs were to be introduced in the new PPP law, this would improve the legal and practical framework for the delivery of PPPs.

Box 5: Case study – Transparency in public procurement

Together with fairness and competition, transparency is one of the fundamental principles of public procurement. Government bodies can be open to criticism if procurement procedures that they run are not transparent and the willingness of bidders to participate will be adversely affected. By pursuing approaches that ensure information is transparent, available to all and there is a level playing field, procuring bodies will instil confidence in bidders that they intend to follow fair procedures.

Mexico has developed an efficient system of public procurement. The government has an official website, established in 1996, dedicated to its contracts and public procurement called Compranet. Compranet applies to all federal PPPs, since projects are procured under the public procurement law. It also applies to all international bids. It is administered by the Ministry of Public Function, which is in charge of anticorruption and the public government management matters. Although the Ministry of Finance IU intervenes in the process of selecting a project, it is not directly involved in Compranet. There is, however, an interface between the procuring authority and the Ministry of Public Function as the procuring authority must communicate all relevant information to be included on Compranet.

Compranet has substantially improved the transparency of procurement procedures in Mexico. Compranet is widely considered to be beneficial since interested companies can access all information required. Since the enactment of the Ley de Adquisiciones, Arrendamientos y Servicios del Sector Publico in 2009, it has been the government's intention to make electronic bid procedures a general rule. This is a centralised electronic procurement system, containing all the information necessary to achieve transparency.

Compranet includes all information relating to public procurement in Mexico, including project specific information and more general information. Compranet is a database comprising comprehensive information relating to public procedures (invitation to bid; questions and answers meetings; opening bids events), awarded contracts, bid protests and any other information concerning the procurement procedures.

The information available on Compranet in relation to projects being tendered includes:

- Public registration of suppliers and contractors;
- Applicable law and rulings;
- Scope of works to be tendered;
- Budget authorisation (in the contract);
- Instructions to bid;
- Technical specifications;
- Model contract; evaluation criteria and any other aspect related to the procedure;
- Debarred contractors and suppliers;
- Statistics of buy and sale of goods, construction and services; and
- Information related to framework agreements, consolidated buys and reverse auctions.

Compranet was updated recently on its Version 5 to include other relevant information relating to public procurement such as all public procurement laws and regulations (at a federal and State Level), tender notices, tender databases, follow-up to each stage of the procedure, notices of award, results of procedures including non-compliance, annual programmes for procurement of goods, services and public works, directory of procurement agencies.

Information contained in Compranet is intended to be a real on-line and live source of what the government is buying or contracting, at what cost and to whom. This includes public tenders (including PPPs), frameworks agreements and electronic reverse auctions. Compranet is a sophisticated system and also enables contracting authorities and private entities to carry out electronic public procurement procedures.

Compranet is useful to national and international bidders who wish to gain an understanding of public procurement (including PPPs) in Mexico. Compranet publishes information on award decisions and compliance, as well as evaluation and award criteria. This encourages the procuring authority to act in a transparent manner to avoid the likelihood of challenges and delays to its procurement programme.

Similar approaches could be developed in the Mediterranean partner countries to enable the use of the internet as an immediate way of accessing information. Web portals, or data rooms, provide a means of raising questions and ensuring that all bidders are notified of clarifications. The Mexican experience shows that confidence amongst the contracting community in the procurement process can be improved by using a single system for electronic public procurement procedures, to make information available and to ensure the same information is available to all bidders.

Contract design, risk allocation and financial terms

Procuring authorities have their own internal, model contracts which are modified according to the needs of the particular project. In practice, this has sometimes meant that projects have utilised successful risk allocations from previous, similar projects, albeit adapted to the circumstances of the current project. These successful, "evolved" adaptations would then be rolled forward to the next project. There are no legally prescribed standard forms for contracts.

PPP contracts make provision for some of the usual terms, such as termination rights and standards of works but many of the key terms that regulate the relationship between the parties and construction and operational risk are left at large. For example, specific contractual mechanisms are not included which govern the process for claiming compensation on the occurrence of certain events (compensation events such as delay and disruption) and in such cases the project company would have to initiate a dispute resolution method to seek its remedy. This could have an adverse impact on programme and partnering. Some of these issues will be rectified if the proposed PPP law is enacted.

Financial terms and payment mechanisms

In Mexico, the toll road PPP concessions are let either on a real toll (user pays) or a shadow toll (authority pays) basis.

Projects are let either on a traditional concession basis transferring full construction, operations and traffic risk (with minimum revenue guarantees in certain cases) and Service Provision Contracts (*proyectos para prestación de servicios* (PPS)) where the State retains control of toll collection, or does not charge motorists any tolls. In the concessions where all operations are transferred, the operator is free to set tolls at the levels it chooses and takes the demand risk – other than where a minimum revenue guarantee applies, there is no payment by the State.

In the Service Provision Contracts, a "shadow toll" is paid comprising an availability element (subject to deduction for unavailability) and a traffic volume element. However, the volume component of the shadow toll is tapered or banded, such that full cost recovery occurs providing traffic volumes reach a very prudently forecast level.

Payment mechanisms have provided satisfactory coverage of financial risks such as exchange rate, inflation and fuel price risk. Payment mechanism adjustments for exchange rate movements matching the resultant change to foreign currency debt service and investor return have been an established feature of road and energy projects in Mexico since the 1990s. A number of more recent projects have been funded in MXN avoiding the need for currency adjustments in the payment mechanism. Mexican PPPs provide for cost inflation adjustments reflecting the particular cost base (including labour) of the project and in energy projects (other than renewable wind or solar power) the tariff is likewise adjusted for input fuel (oil or gas) price movement, except to the extent that the project has obtained a long term fixed price fuel supply contract.

Foreign investment

The foreign investment regime in Mexico is liberal, with the intention of creating a positive business environment for PPP investors. PPPs that have been concluded to date in Mexico (hospitals, universities, highways, cultural centres) have not been subject to restrictions on foreign investment. Some sectors are, however, caught by private investment (foreign and national) regulations for example the oil and electricity sectors. If PPPs are pursued in these sectors with a view to attracting foreign participation, the regulatory framework will need to be reviewed and amended by liberalising the rules on foreign participation. There are no foreign exchange controls and investors are free to repatriate profits. This can be favourable to foreign direct investment. Mexico is a member of NAFTA (North American Free Trade Agreement) and Mercosur which place Mexico respectively within the free trade areas of North and South America. Membership of these trading blocks improves conditions of participation in Mexican infrastructure from both the north and south, thus improving levels of competition and the prospects of value for money in procurement.

State guarantees

Lenders and contractors undertake due diligence on the budget and allocation of the budget to determine that their project will be funded and payments will be made. However, the creditworthiness of sovereign and sub-sovereign bodies must be assessed at an early stage. Mexican law prohibits the issuing by public authorities of guarantees. Thus, contractors and lenders look to the availability of public funds and their allocation to determine that their project will be funded. In the energy sector, this has included contractual commitments to future payments under the PIDIREGAS (*Proyectos de Inversión Diferida En El Registro del Gasto*) scheme. In "direct" PIDIREGAS projects, the private sector funds construction of an asset contracted for by the procuring authority and the procuring authority either purchases the asset from the private partner at the contracted time, or assumes responsibility for the financing originally mobilised by the private partner at the same time as the asset is transferred. In a "conditioned" PIDIREGAS project the asset is only transferred to the procuring authority if the private partner breaches the terms of its concession, or if a force majeure event prevents its performance. Both approaches have advantages for the private sector (a commitment of funds from the government) and the public sector (resource allocation and cashflow management). These are particularly important safeguards for the private sector where long term credit worthiness of public bodies would otherwise be a major disincentive to capital investment.

Granting and enforcement of security

A range of security is available in respect of Mexican PPPs such that the lenders' and authorities' interests are protected. Lenders usually have the benefit of security in the form of assignment of collection rights, performance bonds and parent company guarantees. The authority's interests in due performance and provision of services is protected through on demand performance bonds and parent company guarantees. The authority will be able to call on this security if the project company defaults on performance. This represents a standard package recognised internationally.

The security package for project financed PPPs could be improved for the lenders by giving them step-in rights. Although lender step-in rights are permitted in IPP projects, their wider application to PPPs will enable the lenders to intervene in the project operations if the project company has defaulted with a view to getting the project back on track so that the project company can continue. If this is not possible, the project can be transferred to a suitable substitute contractor.

Mexico – key strengths and lessons learnt

- An extensive programme underpinned by a PPP friendly institutional structure at federal level.
- A progressive approach to PPPs in which the federal institutions have drawn valuable lessons from earlier PPP procurements.
- A transparent internet based procurement portal with access to key project documents.
- A diverse range of projects but with a particular focus on roads.
- A track-record in the successful delivery of PPP projects.
- A rigorous approach to developing project business cases.

4. POLAND

Why a comparator?

Poland's experience of Public Private Partnerships (PPPs) demonstrates the importance of having a clear, overarching enabling legal framework for the delivery of PPPs which strikes the right balance between regulation and permitting the market to deliver viable solutions.

Poland, a civil law country, provides useful recent experience on legislating for PPP in public projects (with two recent legislative enactments, one in 2005 and a further one in 2009 – the latter widely considered to be more conducive to the development of a PPP market). Consequently, the Polish experience for legislating for PPPs demonstrates the positive effect that can be achieved by a legislature that is responsive to market experience when designing appropriate legislative frameworks for PPPs. Although this framework need not be contained in a single PPP law (see for example, England), the need for clarity and responsiveness to market realities is paramount.

As an emerging European market and one of the former Eastern Bloc States recently acceded to the European Union (EU), Poland has a recognition of its urgent need for rapid infrastructure renewal to meet western European standards.

Poland represents an interesting example of the empowerment of local authorities to plan and procure projects, rather than having PPP driven mostly by the line ministries.

A growing number of projects in sectors such as roads and wastewater provide ample opportunity for further market development as Poland seeks to benefit from EU modernisation funding and exposes its public sector to the cultural shift of increased private participation.

Overview

Economically Poland is classified as a high income country by the World Bank with an estimated Gross Domestic Product (GDP) of Euros (EUR) 309 billion and GDP per capita of EUR 8,090 in 2009[14]. GDP increased by 1.7% in 2009. Government debt equated to 48% of GDP at the end of 2009, and annual consumer price inflation as at 2009 stood at 3.4%. Poland is rated A and A2 by Standard & Poor's and Moody's respectively.

With EU funding becoming less plentiful, PPP is becoming an attractive alternative for infrastructure development and the provision of services. EU funding for the period 2007–2013 has been allocated almost in full and it is presumed that in the next budgetary period, Poland will receive reduced funding as compared to the current amounts (circa EUR 67 billion). The government recognises the value that the private sector can add in terms of technical expertise and efficiency (time and cost) through the appropriate use of PPP structures. Of the 41 projects announced under the new PPP legislation in 2009, 16 have been cancelled and only a small number have so far reached the procurement stage. If Poland continues with its PPP programme by tendering a small number of “pathfinder” projects under the new legislation, recognising the progressive reduction in availability of public (EU) funds, investors may begin to consider Poland as a good investment opportunity.

The Polish experience of PPPs demonstrates the importance of a suitable legal framework. The original Public Private Partnership Act of 29 July 2005 (the 2005 Act) was highly criticised. The 2005 Act limited PPPs to the provision of "public tasks", which has no specific meaning in Polish administrative law and consequently the 2005 Act lacked clarity as to its application. This lack of clarity meant that procuring authorities had to undertake detailed analyses of the provisions governing the competence of public bodies, to see whether the task intended to be performed by the private partner would qualify as a "public task". If it was not, the procurement might be invalid. The 2005 Act also required procuring authorities to carry out mandatory feasibility studies prior to launching the PPP project, but procuring authorities often lacked the capability to carry out these studies successfully. The requirements were widely considered to be costly and overly complex. As an example: projects were only permitted to proceed as PPPs if they would deliver a greater "public benefit" than any other procurement method; but "public benefit" was not clearly defined. For those projects that met the feasibility requirements, the 2005 Act required the use of pre-existing, general public procurement procedures that were often inappropriate for the procurement of legally and technically complex PPP structures. If the project made it through to the contracting stage, the 2005 Act imposed detailed contractual requirements that severely restricted the ability to allocate risks to the party best able to manage them and thus severely restricting the freedom to contract.

The subsequent Euro 2012 Act (enacted in 2007), which was a special measure to prepare infrastructure for a major football tournament, also contained flaws that impeded its ability to promote private participation. The Euro 2012 Act, a framework for the development of the essential infrastructure for the 2012 European Football Championships (to be held in Poland), was intended to finally open the door to private involvement in Polish public procurement. Projects were to be funded from central and municipal budgets (and EU subsidies) and operated by private contractors. However, this framework proved unpopular because it only permitted private parties to participate as subcontractors to Project Special Purpose Vehicles (SPVs) established by the State Treasury, which in practice meant that the public sector continued to take a lead in project delivery with the private sector unwilling to invest in projects. This was in effect a form of 'traditional' procurement with the government contracting to take full construction risk. The private sector's lack of interest in these arrangements hindered both Euro 2012 projects and other, pre-existing projects – including Polish Zloty (PLN) 22 billion (EUR 5.5 billion) of new roads – that had been rolled into the Euro 2012 programme.

The introduction of new PPP laws (the PPP Act and the Concession Act) to replace the 2005 Act has shown early promise in the announcement by several municipalities of their intention to engage in the procurement of PPPs. The Public Private Partnership Act of 19 December 2009 (PPP Act) and the Concession Act of January 9, 2009 (Concession Act) are perceived to remedy the deficiencies of the 2005 Act (see Box 6) and their enactment resulted in a resurgence of interest in PPPs as a delivery method in Poland. The PPP Act and Concession Act have improved the PPP environment by removing many of the constraints imposed by the 2005 Act, notably:

[14] Data sources: IMF Government Finance Statistics Yearbook and data files, and World Bank and OECD national accounts data files

- Demanding and overly complex feasibility studies are no longer prescribed in law;
- Pre-existing procurement procedures have been replaced with procedures more suitable to PPPs;
- Overly prescriptive requirements for contractual terms have been removed; and
- The range of permitted funding options has been increased.

There is some concern however of further uncertainty in the interaction between each of the two new laws and the circumstances in which each applies. Any legal uncertainty could negatively affect the development of a PPP market.

As a result of its accession to the EU, Poland became eligible for support from European structural funds. In 2007, the European Commission (EC) approved the "Infrastructure and Environment Operational Programme" (I&EOP) which covers the period 2007-2013 and mobilises EC Cohesion and Regional Development funding streams. The total budget of I&EOP is EUR 28 billion for projects in the environment, energy, transport, health, education and culture sectors. As an indication of the PPP Act's relevance to the current market conditions, amongst its other provisions, the PPP Act specifically enables PPPs to be funded through a blend of PPP and financing from European structural funds. Indirectly, as a method of performing "public tasks" (see below), PPPs may also be co-financed by the Operational Programme Innovative Economy, which has a budget of EUR 16.5 billion in fields such as teleinformatics and education. Further, the Operational Programme Development of Eastern Poland provides financing for PPP projects concerning car parks, schooling, recreation, tourism, sports and transport. All of the 16 regional operational programmes (each *voivodeship* runs its own operational programme) define PPPs as beneficiaries of EU funds.

Overall, Poland's limited track record to date in PPP reflects the fact that it has been used only occasionally as a procurement tool. Procuring authorities and private partners have historically sought to avoid application of the flawed 2005 Act by cooperating on a basis other than PPP – for example under general civil law, the Municipal Services Act, the Commercial Companies Code, the Real Estate Management Act and the Public Procurement Act. Since January 2006, just 13 PPP projects have reached financial close, including ten renewable energy projects. The projects have been mainly funded using project finance techniques. However, the renewable energy projects have not been promoted as PPPs – they have been led by the private sector developers, who procured the relevant permits, consents and licenses and entered into power sale agreements with utilities under separate energy sector legislation as opposed to any PPP programme. The electricity sector in Poland is in the process of being privatised in stages and when this process is complete power projects will no longer be considered as PPPs, but as discrete independent power projects. Table 5 outlines the recent mix of PPP projects in Poland indicating that activity to date activity has been largely in the renewable and transport sectors.

Table 5: PPP project financing in Poland, January 2006–November 2010

Poland	Loan amounts (EUR millions)	Number of Projects
Power excl renewables	0	
Renewables	641	10
Social Infrastructure	0	
Transport	2,671	3
Water & Sewage	0	
Total	3,312	13

Source: *Infrastructure Journal* online database

The introduction of the new legislation and the initiatives to launch projects are both positive indicators of the government's intention to use PPP as a means of updating infrastructure and public services. Despite setbacks in obtaining private sector funding for, inter alia, the Euro 2012 programme, the Polish government continues to advocate PPPs as a viable procurement method in other arenas[15].

Institutional issues

As in many other European countries, Poland gives a high degree of autonomy to public authorities that wish to undertake PPP projects. Any public authority can undertake a PPP procurement. However, if the project requires funding from the State budget by more than PLN 100 million (approximately EUR 25 million), approval must be obtained from the Ministry of Finance. This limit does not affect the EU funding allocated in the Operational Programmes which does not contribute to the PLN 100 million limit.

The Ministry of Regional Development is now playing an increasing role in PPP procurement, particularly in relation to those projects that are expected to be financed through a combination of EU and private funds. At present, the PPP Act places responsibility for promoting PPPs and analysing the market on the Minister of the Economy, but does not give him any centralised powers to assess the need for or approve particular PPPs. For projects that are expected to be financed with EU funds, the Ministry of Regional Development has begun to fulfil a facilitative role enabling co-operation and interaction between the public and private sectors. Currently, this role is particularly evident in the municipal solid waste sector where the Ministry of Regional Development is active in the procurement process. The fact that PPP projects are mostly procured by local authorities may mean that PPP expertise will develop in geographic clusters, to the detriment of other regional authorities which, for one reason or another, may have less exposure to PPP practice. The Ministry of Regional Development could play a role in disseminating PPP expertise more widely.

[15] A Charter for Change (Issue 69, PPP Journal, 1 September 2010) – http://www.publicservice.co.uk/article.asp?publication=The PPP Journal&id=446&content_name=Country Focus: Poland&article=14803

The Polish PPP programme would benefit from a formal PPP unit that could provide a centralised pool of knowledge and experience. It could be used to help projects reach successful close and to develop knowledge and capacity within procuring authorities. The existence of a centralised PPP unit could ensure a more unified approach to procurement of PPPs. This would reassure international investors who might otherwise be concerned about the effect of regional politics on the procurement and implementation of PPPs. In December 2010 a new, cabinet-level task-force met to discuss formation of a centralised PPP unit. Discussions are scheduled to continue in 2011.

Historically, recognising the need for capacity building, the Polish government has worked with private foundations in PPP promotion, training and education. These foundations include Centrum PPP and Instytut Partnerstwa Publiczno–Prywatnego. Cooperation is generally ad hoc, although a long term agreement for closer collaboration between the government and Centrum PPP was once under discussion. Currently the role being developed by the Ministry of Regional Development (outlined above) is being undertaken in collaboration with JASPERS (Joint Assistance to Support Projects in European Regions) which is managed by the EIB and co-sponsored by the European Commission), the European Bank for Reconstruction and Development (EBRD) and Kreditanstalt für Wiederaufbau (KfW). All of these measures reflect the government's understanding of the need for institutional capacity building, a centralised expert resource and a demonstration of an active interest in obtaining one.

Poland's PPP institutional framework is organised to help local authorities develop and finance projects, to promote best practice and to disseminate knowledge. Many PPP projects are undertaken by municipalities which also bid for funding support from the EU. Municipalities can also issue bonds to pay for infrastructure projects in some circumstances. These various sources of funds can be used to support PPPs as well as traditionally procured infrastructure projects.

Although guidance for undertaking PPP feasibility studies is no longer as prescriptive as under the 2005 Act, procuring authorities still (rightly) undertake feasibility studies before undertaking a PPP procurement. These studies include economic, financial and technical analyses (taking into account the risks that are related to particular forms of support from public sources). Particular attention is given to allocation of risks and between public and private sector parties. International experience has shown that there is a need for robust project planning and scoping in advance of launching a procurement, in order to determine whether a PPP will deliver the best value for money solution for the procuring authority. Equally, Poland's experience under the 2005 Act has demonstrated that overly prescriptive feasibility requirements imposed by law can not only hinder the development of individual projects, but also the development of a viable PPP market. It is too early to say whether Polish procuring authorities have found the right balance between sound planning and over-regulation.

Procurements of PPP projects in Poland is also regulated by the Public Procurement Office (PPO). This is an independent unit within central government reporting directly to the Prime Minister. The PPO has a strong role to play in establishing and policing the national public procurement regime and also advises and trains procurement authorities. The PPO liaises with other countries to ensure that the best international practice is followed in Poland.

Legal and regulatory framework

The Polish legal system supports PPP procurement. Poland has a civil law system, which means that the legal allocation of certain risks is provided for in written codes. Other project risks are allocated through the commercial negotiations of the parties and therefore the end risk allocation will usually reflect market norms. The new PPP Act is intended to protect the parties' freedom to contract on the terms they think fit, in contrast to the 2005 Act's regulation of almost every aspect of risk allocation. This allows the parties to allocate risks to the party best able to manage them, although the relatively early stage of development of the PPP market in Poland means it is too early to assess whether this happens in practice. The restrictions on the type of project that were eligible for PPP procurement under the 2005 Act have also been removed, widening the sectors to which and circumstances in which projects may be procured as PPPs. Finally, rigid feasibility and approval requirements have been replaced with a much more pragmatic regime that satisfies EU and international norms without undue bureaucracy.

PPPs will usually be procured under the PPP Act or the Concession Act. In exceptional cases, sector specific legislation or internal procurement rules may apply. The question as to which is the correct law for the procurement is resolved according to the way the project is structured and in particular how demand risk is allocated, as summarised in Table 6. The difficulty faced by both procuring authorities and potential private partners is that there is a degree of subtle overlap between the two laws and no clear determinant as to which should be used for which projects. This has the potential to undermine the clear advances made by the PPP Act by substituting over-regulation with confusion as to which regulations apply in each case. This confusion could deter international investors, who prefer certainty on the applicable legal rules in light of the potential for challenges to the validity of the procurement. Recently, the President of the PPO issued a non-binding legal opinion on selected aspects of the PPP Act and Concession Act, which addresses some of these issues, but greater legal certainty is desirable.

Table 6: Applicability of PPP legislation in Poland

	Concession Act	PPP Act
Project structure	Private partner implements the project (unlikely to involve a Project SPV)	Project implemented jointly under either a contractual joint venture (JV) or through a Project SPV
Purpose of contract with private sector	Mandate the provision (delegation) of services, deliveries, public works	A partnership between the public and private sector to deliver a service based on a clear allocation of risks
Ownership of project assets	Public entity retains ultimate ownership of the asset but grants the private partner the right to exploit it	Assets may be transferred to the private partner or the Project SPV
Risk allocation	Private partner assumes operational risk (operation of a service may be the only purpose of the concession)	Risk division between parties. Operating of services must include operation of assets
Payment	Private partner may be remunerated by the procuring authority in part, but may not recover the whole of its expenditure in this way (i.e. end user payments are required)	100% of the private partner's remuneration may come from the public entity, but must primarily depend on actual use or actual availability of the asset
Contract period	Concessions are limited to 15 years (services) or 30 years (construction) unless extended to allow cost recovery	No time limit
Applicable procurement procedures[16]	Has its own procurement procedure	Will use general public procurement procedures unless remuneration is mainly derived from exploitation of the asset, in which case the procedure under the Concession Act will apply.

Procurement rules under the PPP Act and Concession Act theoretically satisfy international norms, but it is too soon to say how the PPP Act and Concession Act will work in practice. Box 6 highlights some of the features of the new PPP Act versus the legislation it replaced. Despite the issue of possible overlap between the PPP Act and the Concession Act, the market views the PPP Act as a vast improvement on the 2005 Act.

Box 6: The PPP Act – old and new

In 2008, the new PPP Act was enacted into Polish law. This replaced the heavily criticised Public Private Partnership Act 2005 (the 2005 Act).

Criticisms of the 2005 Act

Prescriptive legal requirements for pre-implementation project feasibility studies and contracting procedures and the executive regulations were widely considered to be onerous, unsuitable and had the effect of deterring the realisation of projects. Compliance by the procuring authorities with these requirements increased their costs.

Investors and private entities were discouraged from investing within the available framework due to uncertainties caused by whether individual projects could proceed, due to the onerous obligations on the public sector as regards pre-procurement feasibility.

Advantages of the PPP Act

The aim of the new PPP Act is to create a clear legal basis for the commitment of public resources to projects which involve a partnership with the private sector and to outline the general framework for such partnerships and to relax the preparatory and implementation procedures for PPP initiatives.

The PPP Act is considered to be more flexible than the 2005 Act, applying to a broader range of projects. The reduction in unnecessary and costly regulations has incentivised both the public and private sector to engage in PPP projects.

[16] Note, if neither the Concession Act nor the PPP Act are relevant, then the principles of transparency, proportionality, equal treatment and non-discrimination will be applied.

The parties are free to decide their own methods of dispute resolution in the project agreement. Foreign investors should take comfort that arbitration agreements between commercial parties in the supply chain frequently incorporate institutional arbitration rules, such as those of the International Chamber of Commerce (ICC). Although public sector parties tend to insist upon domestic arbitration (which is a common demand of the public sector internationally) the Polish Code of Civil Procedure implements the United Nations Commission on Trade Law (UNCITRAL) Model Law on International Commercial Arbitration of 1985, which provides a local legislative framework for arbitration with which investors will be familiar. Investors will need to work with advisers to consider whether the local framework meets their requirements.

Bidding process

PPP procurement procedures are regulated and standardised, ensuring that the key principles of fairness, transparency and competition are preserved. Competitive dialogue/negotiation procedures are available for PPP procurements. These procedures, when used in appropriate circumstances would allow bidders to fine-tune their understanding of the procuring authorities requirements and enable the procuring authority to refine its needs and achieve best value for money as the market develops a range of possible solutions. The Polish procurement and evaluation procedures are consistent with those adopted in other EU countries.

Tenders are selected based on pre-specified award criteria that favour value for money over price. The PPP Act requires selection of the offer that presents the most advantageous balance of remuneration and other criteria applicable to the project, such as division of tasks and risks related to the project, dates and amounts of projected payments, division of revenues, effectiveness of project implementation and other criteria that refer directly to the PPP project.

Contracting authorities owe bidders an enforceable duty to comply with procurement legislation. Procurements must not violate the rules of fair competition. Any bidder who is harmed, or who may suffer harm as a result of a breach of the procurement process, may take action against the procuring authority. This can halt or even invalidate the public procurement procedure and damages may be recoverable. There is a standstill period during which the contract may not be awarded.

Awarding the contract during the relevant standstill period can invalidate the contract and give rise to a claim for damages. In the EU, the recent case of *Uniplex*[17] established that the limitation period for a damages claim or an action to establish infringement of the procurement rules should begin to run from the date on which the claimant knew, or ought to have known, of the breach of the procurement rules. The effect of this is that the end of the standstill period does not necessarily mark the last point at which a challenge may be brought. This mutually incentivises investors, contractors and contracting authorities in Polish PPPs to ensure clear, documented compliance with the procurement rules throughout the process.

Contract design and risk allocation

The PPP Act stipulates issues to be addressed in the project contract but generally does not prescribe risk allocations or provide mandatory terms. This gives the parties flexibility to allocate risks to the parties best able to manage them in the context of the particular project, rather than the government imposing a pre-determined risk allocation on them in a vacuum. At the same time, the minimum stipulations of the PPP Act ensure that the fundamentals (project description, remuneration, an allocation of risk, non-performance and compensation) are dealt with, without being overly prescriptive. This is supported by minimum standards of performance prescribed by the Polish Civil Code, which are consistent with international best practice.

Risk is generally allocated to the party best able to manage it and is consistent with international practice. It is too early in Poland's experience of PPP to say whether this risk allocation has standardised, but the prevalence of this allocation internationally suggests that it is acceptable to procuring authorities and investors and will facilitate partnering in Polish PPP. The private partner will bear the risks associated with design and operation, delay in completion of construction or increase in construction costs, non-compliance with legal conditions and relevant contractual standards. The private partner will be responsible for obtaining financing for the PPP project and procuring necessary insurances. The procuring authority will be required to procure any necessary real estate. The private partner will be responsible for obtaining any necessary building or zoning permits.

As is standard in most countries, liquidated damages are also available in Poland to incentivise performance during the life of the contract. The level of liquidated damages follows the usual practice in civil law jurisdictions (where the stress is on the fairness of the arrangements as the primary consideration).

During the service delivery period under a contract, the alternative performance incentive mechanism is for the procuring authority to deduct penalties from the unitary charge. This is an effective and standard method of ensuring quality of output in PPP contracts.

The project agreement will usually provide for termination in scenarios considered as standard internationally such as: (i) material breach by either party; (ii) failure to meet project milestones; and (iii) convenience of the authority. These termination events have differing financial consequences dependent on the reasons for early termination.

Compensation mechanisms are used to incentivise the parties to consider termination only in appropriate circumstances. If early termination results in the constructed PPP facility being transferred to the authority, the contractor will be paid the value of the asset at the time of the transfer. This incentivises the authority to exercise termination rights – including for convenience – only when the termination can be justified in light of the resulting payment.

[17] Case C-406/08 – Uniplex (UK) Limited v NHS Business Services Authority

Financial terms and payment mechanisms

The use of different payment mechanism structures and approaches to risk allocation would be dependent upon the sector concerned. Practice as to framing of payment mechanisms is in flux currently, due to the large number of projects which have been launched since the enactment of the PPP Act and the Concession Act. Municipal authorities have announced projects including airport upgrades, motorways, underground rail, sport stadia, waste and water treatment, education and health. The diversity of sectors in which PPP is contemplated means that different payment mechanism structures can be applied. Nevertheless, whilst these projects are likely to apply payment mechanism principles applied in similar sectors in other EU PPP markets, use of standard guidance would help streamline procurements and foster a more active PPP market.

Although project payments in Polish PPP are denominated in PLN, payments are adjustable to ensure that Project SPVs' debt service payments in EUR remain fully covered. Unlike in other comparator countries, funding for Polish PPP is often in foreign currency (the EUR). This represents an exchange rate risk for procuring authorities, but is consistent with the government's policy of maintaining the PLN-EUR exchange rate within a narrow band pending Poland joining the Eurozone.

Foreign investment

The Polish foreign investment regime encourages foreign investment as historic restrictions have been abolished over the past two decades. Restrictions on the ability of foreigners to buy real estate or shares in Polish companies do not apply to purchasers domiciled in the European Economic Area (EEA) and other purchasers can obtain a waiver from the Minister of Internal Affairs and Administration, known as an MIAA permit. Non-EU entities may only do business in certain legal forms (e.g. limited liability company) but these do not cause difficulty in practice because they are consistent with international norms, for example the use of a Project SPV.

State guarantees

The State Treasury or local municipalities may issue guarantees in respect of the contracting authority's obligation to make payment under the PPP contract (although lenders would have to satisfy themselves as to the capacity and creditworthiness of individual guarantors). In any case, procuring authorities may formally reserve the necessary funds for development of the PPP to ensure funding availability. Lenders and contractors are expected to undertake due diligence on the budget availability and budgetary allocation procedures to obtain the necessary comfort that their project will be funded and payments will be made in the long term. Due diligence by participants is particularly important in the context of projects with municipalities to mitigate risks relating to the creditworthiness of municipal institutions.

Granting and enforcement of security

A range of security is available in respect of Polish PPPs such that the lenders' and authorities' interests are protected. Step-in rights are available to lenders and assignment of contracts is permitted in accordance with their terms. Other typical forms of security include: cash collateral; bank guarantees; insurance guarantees[18]; parent company guarantees; performance bonds; pledge over securities issued by State or local government units; and registered pledge over assets of the project company or a third party. Mortgages of real estate are also permitted. The effectiveness of these instruments has yet to be tested in practice in relation to PPP projects. However, the range of securities meets international norms.

Poland – key strengths and lessons learnt

- A case study in legislative responsiveness and the effects that the quality of legislation can have on a market.
- A recognition of the difficulties in over-prescriptive legislation and the benefits of an accommodating and practical (rather than over-prescriptive) legal regime.
- A major programme of procurement involving a mix of public and private funds.
- A diverse range of projects in the pipeline.
- A good model for encouraging development of PPPs by local authorities.

[18] Insurance guarantees are similar to bank guarantees, but are instead issued by insurance companies.

5. SOUTH AFRICA

Why a comparator?

South Africa is the most developed Public Private Partnership (PPP) market in sub-Saharan Africa with strong government backing for its further development and a dedicated PPP unit providing expertise.

A difficult start with PPP procurement in the 1990s provided useful lessons on project preparation pre-procurement and in particular in calculating and committing to long term affordability.

A recent history of legislation will provide an interesting insight into how the United Kingdom (UK) experience has influenced infrastructure delivery in a very different market.

Recent experience of PPP delivery has included the Gautrain Rapid Rail Link – in value, the largest light rail system currently under construction worldwide.

Well documented experience of implementing PPP at both the central government and municipal level, from which wider lessons can be drawn for similar emerging market jurisdictions.

Overview

Economically South Africa is classified as an upper middle income country by the World Bank with an estimated Gross Domestic Product (GDP) of Euros (EUR) 205 billion and GDP per capita of EUR 4,152 in 2009[19]. GDP fell by 1.8% in 2009. Government debt equated to 29.7% of GDP at the end of 2009, and annual consumer price inflation as at 2009 stood at 7.1%[20]. South Africa is rated A+ and A3 by Standard & Poor's and Moody's respectively.

South Africa is the most experienced PPP nation in sub-Saharan Africa. Since 1997, there have been over 50 PPP schemes in development or in implementation at national or provincial level and more than 300 projects at municipal level. This section focuses on PPPs at the national level, which are governed by Treasury Regulation 16 issued pursuant to the Public Finance Management Act 1999 (PFMA). PPPs (at both central and municipal level) have been implemented across a range of sectors including healthcare, schools, tourism, civil service infrastructure (for example administrative buildings), toll roads, prisons and a high speed light rail system. Examples include the EUR 176 million Louis Trichardt prison, which was the first South African PPP project to close; the N4 Platinum Highway, which in 2003 was South Africa's largest project financing, involving a South African Rand (ZAR) 350 million (EUR 36 million) loan from the European Investment Bank (EIB) and winning Private Finance Initiative Europe, the Middle East and Africa (PFI EMEA) "Infrastructure Deal of the Year 2002"; and the Gautrain Rapid Rail link, which closed in 2006 and is in terms of value, the largest light rail system currently under construction in the world and won the "Best Global Project to Sign" at the Public Private Finance Awards 2008.

The South African government has been encouraging PPPs actively since pilot projects were procured in 1997. Infrastructure development is a key policy goal for South Africa, and sectors that have been specifically targeted for future development include healthcare and transport. Future PPPs are expected to include fleet management for the Eastern Cape Department of Roads and Transport, eco-tourism sites, water and sanitation projects, emergency call centres and pharmaceutical supply chain management functions for the Eastern Cape Department of Health.

The South African PPP programme had a difficult start, brought about by funding constraints and institutional challenges. Highlighting the need for better pre-project planning and affordability assessments, the PPP prison programme originally included four prisons. In 1999, affordability concerns caused the government to halve the number of facilities to be delivered. Procurements of schools, hospitals and government buildings suffered from similar problems, and the cost of the Gautrain increased from the original budget of circa ZAR 4 billion (EUR 415 million) in 2002 to circa ZAR 25 billion (EUR 2.5 billion) in 2010. Some private sector participants suggested that planning failures were exacerbated by public funding constraints which had also resulted in restricted budgets for advisers and by the high staff turnover at the National Treasury's PPP Unit[21]. The affordability concerns raised in these early projects highlight the extent of development that was required in the thinking within government with regard to budgetary planning for long term funding commitments through the contract period.

In the current financial climate there are concerns about the availability of local private sector funding. There are a small number of local banks participating in South African PPPs – only four or five even as recently as September 2009[22]. The result has been a slow deal flow (with only 20 PPPs being procured in the decade 2000-2010) and long, expensive procurements which, in 2006, were cited as major disincentives for private sector sponsors and funders[23].

However, there has been an apparent increase in momentum since the start of 2010. PPPs received strong political endorsement when the President, in his State of the Nation address, celebrated a revitalised partnership between the government and the region’s primary development finance institutions (the Development Bank of South Africa and the Industrial Development Corporation) in providing much needed financing for health PPPs. This is a priority sector for development. In October 2010 there were over 20 PPP projects in various stages of preparation. Ten of these were in active procurement, half of which had progressed to negotiations. A further seven PPPs were at feasibility stage with an additional 26 at inception.

The scale of many of South African PPPs to date has been relatively small, such that (outside the power sector) most have required funding from just one sponsor and one bank. However, since January 2006, eight PPPs have been project financed in amounts requiring more than one bank to

[19] Data sources: IMF Government Finance Statistics Yearbook and data files, and World Bank and OECD national accounts data files
[20] IMF World Economic Outlook Database – Inflation, average consumer prices for the year
[21] South African PPPs' Road to Success (Dunning M, Issue 258 Project Finance International, 5 February 2003)
[22] Out of Africa (Nicholls A, Partnerships Bulletin, 22 September 2009)
[23] PullingTogether (Janks J, The lawyer, 13 March 2006)

participate in the loan. Of these, large-scale power projects have been important, since the country faces a significant electricity generation shortage. South Africa is also implementing a renewable energy programme (using a PPP model) so larger scale projects may be expected. Table 7 outlines the recent mix of PPP projects in South Africa, indicating that activity to date has been in the non-renewable power sector, transport and social infrastructure.

Table 7: South African PPP project financing, January 2006–November 2010

South Africa	Loan amounts (EUR millions)	Number of Projects
Power excluding renewable	829	3
Renewables	0	
Social Infrastructure	44	2
Transport	553	3
Water & Sewage	0	
Total	1,426	8

Source: *Infrastructure Journal* online database

South Africa has sought to regularise PPP procurement to avoid the issues associated with past, less well structured projects (such as project scoping and pre-procurement planning), and to develop its PPP Unit to better address historic challenges. A strategic framework for PPPs was endorsed by the Cabinet as long ago as December 1999, and in 2000 the National Treasury issued Treasury Regulation 16 under the PFMA to regulate PPPs at a national and provincial level. The National Treasury's PPP Unit has also expanded so that it now has five cross-functional desks providing specialist support in different disciplines, and has benefitted from its knowledge exchange with Partnerships UK. In 2004, it published a PPP Manual and the Standardised PPP Provisions.

Institutional issues

The PPP Unit has two main roles: (i) technical assistance for developing PPP projects in government departments, provinces and municipalities; and (ii) regulatory oversight and approval of PPP projects at various stages of planning and procurement. The PPP Unit was established in 2000, although its history can be traced back to an inter-departmental task team established by the South African Cabinet in 1997 to develop policy, legislative and institutional reforms on enabling PPPs. It achieves these functions through five cross-functional desks specialising in "Financial", "Legal", "Business Development", "Project Evaluation" and "Municipal Project" disciplines.

The approvals process takes place over four key stages, with the PPP Unit acting as a representative of the National Treasury. The first stage of approval is the feasibility study, which must be completed before the project can go to market so as to avoid many of the affordability issues encountered in the early stages of the PPP programme. The second stage is a review of documentation before it is issued to tenderers as a Request for Proposals (RFP). A further stage of approval occurs just before selection of preferred bidder to ensure that the key criteria for a PPP project will be fulfilled, including appropriate risk transfer, affordability to the procuring authority and value-for-money for the public. The last stage is prior to financial close, again to ensure that the project is affordable and will be managed effectively once it is operational.

There is a high standard of analysis and documentation of PPP projects. Drawing on the lessons of prior, unsuccessful procurements, the PPP Unit requires a thorough assessment of technical feasibility and project affordability, and uses a public sector comparator to demonstrate project viability. This is based on recent experience and realistic cost estimates, adjusted for risk transfer to the private sector partner.

PPP projects can be initiated by provinces, municipalities or government departments. Most projects originate from government departments and the provinces. Although the provinces have their own regional institutions replicating those of central government and can in principle act using their own resources, in practice they are reliant upon the PPP Unit for advice and technical support in the PPP procurement process. There are plans to establish provincial PPP units to improve delivery capacity.

Legal and regulatory framework

South Africa's legal system provides a sound legal framework for PPPs. South Africa has a hybrid legal system, containing elements of a common and civil law system. Public authorities are empowered to procure PPP projects and enter into PPP contracts at both national and municipal levels. There are no restrictions on PPP agreements in particular sectors, although certain sectors are being prioritised above others.

Disputes are generally resolved in the courts. The Standardised PPP Provisions require disputes to be resolved in the courts but also encourage interim and more informal methods such as mediation. This approach is dictated by policy aimed at enabling the South African courts to develop PPP expertise and cultivate a body of case law that can develop and refine the drafting of standard provisions over time. The requirement to resolve disputes in public enhances transparency in the South African PPP process.

The Standardised PPP Provisions discourage the use of international commercial arbitration as unsuitable and likely to impede the development of PPP. In addition, the legislative framework for arbitration in South Africa is widely considered to be outdated and in need of reform so commercial parties are unlikely to agree to arbitration under the supervision of the South African arbitral legislation.

Investors can take comfort that the Standardised PPP Provisions permit alternative dispute resolution in the circumstances commercial parties will be most concerned about – i.e. where the matter is urgent or does not require particular legal expertise (e.g. questions as to whether certain repairs were required or carried out cost-effectively). The Standardised PPP Provisions also permit tiered, direct negotiation to achieve amicable resolution.

Bidding process

The Constitution requires procurements to be fair, equitable, transparent, competitive and cost-effective. Non-binding Treasury Regulations set out best practice for procurement procedures that are consistent with the Constitutional requirement and international norms, although only the preferred bidder is allowed to negotiate with the procuring authority. Enhanced market participation (e.g. through a well-managed competitive dialogue procedure allowing for negotiations with competing bidders prior to contract agreement) may allow procuring authorities to refine their requirements and obtain value for money by developing solutions in partnership with the private sector.

Tenders are selected based on pre-specified award criteria that favour value for money over price. The evaluation criteria are specified in the RFP document and usually comprise: (i) technical; (ii) financial; (iii) legal; and (iv) legally mandated broad based black economic empowerment (BEE) and socio-economic criteria.

Contracting authorities owe bidders an enforceable duty to comply with procurement legislation. Section 217 of the Constitution requires all goods and services to be procured by the State or State-owned enterprises to be tendered in accordance with a system that is fair, equitable, transparent, competitive and cost-effective. A failure to comply may be challenged in the High Court. Tenders are often challenged and are regularly set aside by the courts, with no compensation for the successful bidder whose award is set aside. There is also a positive legal duty on the private sector (according to the Supreme Court of Appeal) to ensure that the tender process complies with the legislation. This mutually incentivises investors, contractors and contracting authorities in South African PPPs to ensure clear, documented compliance with the procurement rules throughout the process.

Contract design and risk allocation

The Standardised PPP Provisions allocate risk to the party generally considered best placed to manage it, consistent with international norms. The Standardised PPP Provisions are contractual terms for PPPs issued by the PPP Unit and are to be used by public bodies listed in the PFMA. Design and construction risk are borne by the private party, including the risk of latent defects. Generally delay risk is shared by the parties. It is usually the procuring authority's responsibility to obtain planning and zoning permits, except in the electricity sector. The private party will usually be responsible for obtaining environmental permits. The risk of discriminatory changes in law or any other unforeseeable acts or omissions by public authorities can sometimes be passed on to the users of the project, if they are not dealt with in the project agreement. Risk of a general change in law is borne by the private party. The private party will be obliged to take out insurance to mitigate the risks transferred to it.

The Standardised PPP Provisions provide for termination in scenarios considered standard internationally such as default by the procuring authority or contractor; or force majeure.

Payment and compensation mechanisms are used to incentivise the parties effectively and to protect investments in PPP. Liquidated damages are permitted. The procuring authority may also deduct payments from the unitary charge in the event there is no performance or performance is poor. This will incentivise performance by the contractor during the life of the contract. Termination of the project contract prior to its expiry date may entitle the private party to compensation. The value of the compensation payable to the private party will depend upon the reason for termination. Where the termination is a result of default by the procuring authority, the value of the compensation payable is usually greater than that payable in the event of force majeure termination or as a result of default by the contractor. Compensation is designed to cover all amounts due from the private party to third parties in relation to the contract, including subcontractor costs, shareholder loans, debt financing (and a return on equity only for procuring authority default), which should provide a great deal of comfort to investors

Financial terms and payment mechanisms

Payment mechanisms in South Africa have largely adopted the payment mechanism principles established in availability based PPPs in the UK. The most common form of project payment mechanism applied is the "unitary charge" – a single monthly payment for usage of the project facility and all of the services provided by the Project Special Purpose Vehicle (Project SPV). The unitary charge is subject to pre-specified deductions for unavailability of any part of the facility, and for sub-standard service provision. A contractor default occurs if such deductions exceed certain thresholds. It is also subject to annual adjustment for price inflation.

The unitary charge is also subject to other adjustments, to reflect elements of the Project SPV's cost base which cannot be fixed for the duration of the contract, and which are outside its control:

(a) **Direct labour services** such as cleaning, catering, portering (but not major maintenance) are subject to benchmarking or market-testing of their costs every three to five years. If the benchmarking or market testing identifies that costs for a service component have changed by more than a certain threshold, the unitary charge is adjusted.

(b) **Energy and utility costs** are also subject to benchmarking, but over a shorter period to reflect the greater volatility in energy prices. Since the facility is used entirely by the public sector, it controls energy and water usage in the building. As a result, adjustments cover both volume and price of utilities, subject to the Project SPV achieving pre-specified performance levels for energy efficiency and water usage.

(c) **Local and business taxes** (but not income tax) are generally treated as a pass-through on top of the unitary charge.

The net effect of the unitary charge adjustments is that, in the operating period, the Project SPV takes performance risk (of deductions), inflation risk, major maintenance risk and service cost risk between benchmarking dates. Other than inflation risk and long term major maintenance risk, the Project SPV typically passes these risks to the operator subcontractors.

Foreign investment

The foreign investment regime in South Africa is liberal, creating a positive business environment for PPP investors. There are still some exchange controls, but there are no restrictions regarding foreign companies contracting with the government or specific regulations affecting joint ventures (JVs) or special purpose vehicles.

BEE criteria arising out of South Africa's history of apartheid are significant in procurements and can be a determining factor in the selection process[24]. This is particularly relevant for international bidders whose organisations, for historical or other reasons, will not necessarily meet the BEE requirements of South African law.

State guarantees

State guarantees are rarely provided, although the relevant ministry/government department could theoretically provide a guarantee which guarantees the contracting authority's payment/performance obligations, as could the State.

The government has continued to guarantee or provide funds for certain elements, where the circumstances of the project require this. On the Gautrain Rapid Rail Link, the government provided support to the project as described in Box 7 below.

Box 7: Case study – South Africa Gautrain Rapid Rail Link

The 2007 South African Gautrain Rapid Rail Link project is, to date, the largest and most complex transport infrastructure PPP to be procured in sub-Saharan Africa with a project value in excess of ZAR 27 billion (EUR 2.2 billion). It was procured by the Gauteng Provincial Government (GPG) and was awarded to the Bombela consortium (comprising Bombardier, Bouygues, Murray & Roberts and the Strategic Partnership Group).

An important and unique feature of this landmark light rail PPP project is the level of State support, at national and provincial levels. Some of the factors leading to such a high level of State funding include:

- The size and complexity of the project;
- Its greenfield nature, making it difficult to forecast patronage and revenue; and
- Factors such as the depth of funding available in the South African market, the perceived volatility of the Rand and the increase in commodity prices.

All of these factors would have contributed to lenders demanding excessively high margins and for this reason the government provided funding sourced from the provincial and national treasuries. This support was provided in the construction and operational phases as follows:

- The first is a provincial grant in the amount of 80% of the construction costs. This high level of State funding allowed the government to keep adequate control over the development of the project through various measures including independent certification, payment on specified milestones, retention monies and control over the security granted to the banks by Bombela.
- The second is a patronage guarantee. Therefore, where actual ridership is less than the forecast ridership, the government will make payments to Bombela, thereby providing a form of minimum revenue guarantee.

South Africa – key strengths and lessons learnt

- An established PPP programme at national, provincial and municipal level.
- PPP has required a change of mindset within government to considering long term project spending commitments.
- Highlights the benefits of knowledge transfer in PPP from comparatively advanced PPP countries, particularly in the development of standard form contracts and procedures.
- Demonstrates the benefits of early investment in institutional capacity building.
- Project structuring has been improved by the active role played by institutions developed for PPP (such as the PPP Unit) which over time have become increasingly adept at managing projects efficiently.

END

[24] An analysis of the preferential procurement legislation in South Africa (Bolton P, 2006 PPLR 36)

European Investment Bank

By bringing together public and private resources, Public-Private Partnerships (PPPs) can improve the supply, provision and maintenance of infrastructure facilities and services. The potential of PPPs to address the social and economic challenges facing Mediterranean Partner Countries requires certain preconditions to be met. The purpose of this study is to assess the legal and financial frameworks that are necessary for a country to successfully select, prepare and deliver PPP projects in the region.

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