FEMIP

Study on PPP Legal & Financial Frameworks in the Mediterranean Partner Countries
Facility for Euro-Mediterranean Investment and Partnership

FEMIP

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

Volume 1 – A Regional Approach
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.

The contents of this Volume have been prepared by external consultants. The opinions expressed are those of the consultants and do not necessarily reflect the view of the European Investment Bank.

This Volume is not designed to be professional advice in respect of any particular matter and should not be relied upon in the making of any legal, commercial or financial decision.
CONTENTS

GLOSSARY 1
EXECUTIVE SUMMARY 2
INTRODUCTION 6
1. FUNDING CAPACITY AND AVAILABILITY 9
2. INSTITUTIONAL ISSUES 15
3. LEGAL AND REGULATORY FRAMEWORK 22
4. BIDDING PROCESS 28
5. CONTRACT DESIGN AND RISK ALLOCATION 33
6. PAYMENT MECHANISM & FINANCIAL RISKS 44
7. PPP / PROJECT FINANCE INVESTMENT READINESS FOR LENDERS AND INVESTORS 47
APPENDIX 1: PPP PROJECT RISK ANALYSIS 53

ACKNOWLEDGEMENTS

In preparing the Report, the Consortium has been assisted by Paloma Perez de Vega, Francesco Totaro and Nicholas Jennett from the European Investment Bank, Willis Limited (in relation to insurance matters) and the following in-country experts:

Mediterranean partner countries:

**Algeria**
- Ghellal & Mekerba Law Firm
- Mazars Hadj Ali

**Egypt**
- Sharkawy & Sarhan Law Firm
- Mazars Mostafa Shawki

**Israel**
- Glusman Shem-Tov Chowers Broid & Co – Law Offices
- MBT Consultants

**Jordan**
- J.C. Law Firm
- Mazars (UAE)

**Lebanon**
- Takla, Trad, Daouk Law Firm
- Mazars (Lebanon)

**Morocco**
- UGGC & Associés Law Firm
- Mazars Masnaoui

**Syria**
- Syrian Legal Bureau
- Mazars (UAE)

**Tunisia**
- Ferchiou and Associés
- Mazars (Tunisia)

**West Bank**
- A, F & R Shehadeh Law Office
- El Wafa Company

Comparator countries:

**France**
- Salans
- Mazars France

**Mexico**
- COMAD, S.C.
- Mazars Mexico

**Poland**
- Salans
- Mazars Poland

**South Africa**
- Webber Wentzel
- Mazars South Africa

The Consortium is grateful for the support that has been given.
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 this 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)
OEJEU: 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)
Report: A report comprising three volumes titled "Volume 1 – A Regional Approach", "Volume 2 – Country Analysis" and "Volume 3 – Best Practices and Lessons Learned – Selected Experiences from Other Countries"; this being Volume 1
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
EXECUTIVE SUMMARY

PURPOSE AND STRUCTURE OF THE REPORT

This is Volume 1 of the Report which is the product of a FEMIP (Facility for Euro-Mediterranean Investment and Partnership) Trust Fund Study analysing the legal and financial frameworks for Public Private Partnerships (PPP) in each of the Mediterranean partner countries. 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 the design, construction, financing and ongoing operation and maintenance of an infrastructure asset. These projects are project financed, i.e. lenders take project risk and are mostly concerned with cashflows generated by the project for the payment of the loan applied to construction of the asset and with the assets of the project, rather than relying primarily on the general creditworthiness of the private sector sponsors.

PPP IS A VIABLE OPTION FOR THE MEDITERRANEAN PARTNER COUNTRIES....

It is clear from the Study that PPP can provide, in many of the Mediterranean partner countries and sectors, a cost-efficient means of delivering infrastructure projects, with appropriate risk transfer for the benefit of the public sector. A key advantage of well structured project financed PPPs, as opposed to traditional procurement methods, is the project discipline they create. Most Mediterranean partner countries already have had some success with PPPs and others are preparing to introduce structural reforms necessary for PPPs to work. There are, however, a number of conditions which need to be satisfied and PPP is not suitable for all projects. Careful selection and delivery of projects in the context of a well understood and appropriate legal and regulatory and financial environment is essential.

.... AND THEIR PROGRESS ALONG THE PPP MATURITY CURVE IS VARIED.

Historically Algeria has developed a successful PPP model for water desalination and has a track-record in IPP procurement. However, relying on its hydrocarbon income, the country currently has a policy of procuring infrastructure through alternatives to PPP. Whilst Algeria is preparing to implement a major and sustained investment programme, it does not currently actively encourage international participation.

The successful close of the New Cairo Waste Water project (NCWW) in Egypt indicates the potential for future PPP procurement. Whilst the capacity of domestic banks to fund PPPs is limited, government support and a PPP enabling environment (including a recently enacted PPP Law), make Egypt a potentially vibrant PPP market, capable of attracting foreign investment in sectors such as waste water, transport and healthcare.

Israel has a successful track record of PPP projects developed across a number of sectors by various procuring authorities. Projects have been implemented in the roads, light rail and desalination sectors. This, combined with a sophisticated domestic banking sector with a track-record in PPP lending and the capacity of the Israeli government to commit to PPP payments, make Israel a mature PPP market.

Successful procurements and project financings of recent high profile projects in Jordan (such as the Queen Alia Airport project) have demonstrated the potential for future market development. Jordan has established PPP-specific central government institutions and is in the process of enacting a PPP law. Projects are currently under procurement in the power, roads and rail sectors. A test for the new institutional framework will be how successfully it selects and scopes future projects.

Lebanon has adopted elements of a pro-PPP policy at official level with attempts to enact a PPP law to institutionalise PPP as a procurement option. Lebanese banks could have PPP lending capacity but they as well as government institutions, lack experience of PPP. This is because there is no PPP project precedents to date in Lebanon to draw upon.

Morocco has a track-record in delivering concession based projects where the user/demand risk is carried by the private sector. The procurement of availability-based PPPs has built on that existing track-record and has successfully maintained the interest of local and international investors. Although additional support is provided by several infrastructure funds, the market would benefit from a more unified approach at an official policy and institutional level (particularly with regard to a central PPP unit and PPP specific legislation).

Syria has taken initial steps to create a PPP friendly environment. However, there is as yet no practical PPP experience in Syria. So far only two foreign currency earning privately operated port projects have been developed and no PPP (or concession-based) project experience which includes the financing of construction currently exists in Syria. The country has recently tendered its first PPP in the power sector (Al Nassereih), and has prequalified 16 bidders which is a sign of success. Without sufficient local bank capacity, the initial phase of Syria’s PPP programme is likely to be debt funded in foreign currency primarily through IFIs and Export Credit Agencies (ECAs).

Tunisia has a history of user based concession projects and a potentially attractive environment for PPP investment. Whilst the domestic banking sector has limited capacity, long-term foreign currency funding may be a viable option for funding the projects currently being proposed in the water and electricity sectors. A stronger strategic direction with the role of PPP placed in the context of wider infrastructure priorities would benefit the development of the market in Tunisia.

The West Bank has no project financed PPP experience or programme, as infrastructure development relies predominantly on grant-funding. Although there are some positive signs of private-sector participation in the procurement of infrastructure, political stability and institutional development are prerequisites to the development of a PPP market.

The political developments in 2011, affecting a number of Mediterranean partner countries, are likely to cause investors to be cautious regarding PPP opportunities in those countries, pending clarification of their outcome. These political aspects and their consequences are outside the scope of the Report. This Volume discusses how the PPP frameworks in the

---

1 “Traditional procurement” includes, for instance, projects in which there is no long term partnership between the public and private sector and where the assets are not financed through project finance (e.g. the procurement of the construction of an asset, where financing is assumed by the public sector procuring entity).

2 The Report is accurate as at 1 October 2010 and does not take into account the recent political events taking place in the country since March 2011. These events are likely to cause investors to be cautious regarding PPP opportunities in the country, pending clarification of their outcome. These political aspects and their consequences are outside the scope of this report.
Mediterranean partner countries could be further developed to meet infrastructure needs and facilitate increased use of the PPP model where appropriate for the country to do so.

**PPP MAKES NEW DemANDS ON THEPUBLIC SECTOR....**

The selection of appropriate projects for development as PPPs requires an understanding of the features of, and environment required for, a successful PPP project. This may be based on experience gained within a country, but also from wider experience in other countries. Volume 3 looks at the PPP experience in England, France, Mexico, Poland and South Africa (the comparator countries). A common feature for all countries is that PPPs make new demands on public servants, as skills are needed to specify outputs, to understand complex financial structures and to allocate and manage risks in the most efficient manner. In most comparator countries this has been, or is being, achieved, by the creation of a central PPP advisory unit which draws on that experience and understanding of best practice. The Report draws upon such track record and provides concrete recommendations for such units to be established and appropriately resourced.

**.... WITH PARTICULAR CHALLENGES IN PROCUREMENT....**

Experience in different countries demonstrates that PPP procurements must be structured so as to:
- clearly identify the output required by the authority;
- be transparent;
- rely on evaluation criteria which recognise the complexity of the authority’s requirements.

Such an approach should encourage greater competition amongst a wider range of suppliers and should therefore help improve quality and deliver competitive prices. Whilst principles of good procurement practice apply equally in ‘traditional’ procurement, they are still more important in a PPP. The procurement of a PPP project draws together the skills of designing, financing, constructing, operating and maintaining complex infrastructure assets. Private sector providers take the risk of not being paid until an asset is ready (and reduced revenues if there is a shortfall in performance). For this reason, issues often left open in ‘traditional’ procurements need to be finalised before PPP contract signature. Box 1 below left identifies some different procurement practices in Mediterranean partner countries.

**Box 1: Bidding processes in the Mediterranean partner countries**

To enable the procuring authority to achieve a specification at the desired price, it may be appropriate in some instances (for complex projects or projects in which there is no established track record of similar transactions) to enter into discussions with the bidders. This is in contrast to procedures whereby bidders are requested simply to bid against predetermined contracts. The process of discussing solutions during a procurement process helps the authority to fine-tune its requirements and identify the solution that presents the best value for money.

Amongst the Mediterranean partner countries, there is varied practice in the approach to bidder participation during the procurement process.

**Box 2: PPP laws in the Mediterranean partner countries**

The majority of the Mediterranean partner countries are civil law jurisdictions. Israel is not an exclusively civil law country and has no specific PPP law but PPP procurement is relatively advanced and has not been hindered by the absence of PPP.
specific legislation. The other countries, where the legal tradition is to rely on written laws, would benefit from a specific PPP law if PPP procurement is a priority. The recent enactment of a PPP specific law in Egypt and initiatives to introduce PPP laws in Jordan, Lebanon and Syria reflect this approach. PPP laws should address key issues such as procurement processes and the ability to issue sovereign guarantees if/when needed, to cover the contracting authority’s payment obligations, and further detailed regulation can be in the form of secondary regulation (for example, implementing decrees to detail procurement procedure stages and time periods), but laws should not “over-legislate” by providing the detail of matters that are typically set out in PPP contracts where they can be more finely attuned to the particular transaction.

Morocco and Tunisia have “concession laws”, but their applicability to PPP projects where the private sector does not take demand risk lacks the certainty which international funders are, as a rule, likely to seek. Should these countries wish to continue pursuing alternative PPP models (i.e. those based on availability payments), introducing clear laws applicable to these structures will benefit investment as they will provide greater certainty as to the ability of the public sector to make payments during the operational phase of a project.

Given the relatively early stages of PPP in the region overall, the enactment of PPP laws can be a means of demonstrating political commitment to PPPs. However, this is not essential where the current legal framework is clear and comprehensive and has proven itself to work in practice (as is the case in Israel, for example).

Box 3: Dispute resolution in Mediterranean partner countries

In the Mediterranean partner countries, contracting authorities should consider using international arbitration as this is likely to be a key requirement for foreign investors and lenders. They will seek to be satisfied that the ultimate dispute resolution forum is able to deal with the complexities of PPP contracts.

To date, project contracts in Algeria, Morocco, Jordan and Tunisia have selected international arbitration (under rules such as International Chamber of Commerce (ICC), London Court of International Arbitration (LCIA) or United Nations Commission on International Trade Law (UNCITRAL)). This has encouraged international private sector sponsors, contributing to increased competition during bidding. In Israel and Egypt, the more common approach is to make disputes subject to domestic arbitration. In Syria, international arbitration has been identified as the preferred final resort of dispute resolution. If PPPs are to be pursued in Lebanon and the West Bank, it is recommended that international arbitration rules apply to the contracts.

.... AND LENDERS’ LEGITIMATE REQUIREMENTS RECOGNISED.

Experience of both successful and unsuccessful projects in the comparator countries and some of the Mediterranean partner countries shows that there are certain key features of a PPP contract which the legal framework should permit. These include:

- absolute clarity as to an authority’s legal power to enter into the contract;
- the ability of the Project SPV to grant effective security over its assets, shares and revenue streams;
- the ability of funders to step into the project and rescue it;
- payment of appropriate compensation on termination;
- the ability of the State to secure the contractual obligations of a contracting authority, should this authority not have sufficient creditworthiness on a standalone basis;
- certainty as to contractual rights (including liquidated damages and termination rights).

The appropriate laws exist in most of the Mediterranean partner countries although developing standard contract approaches would improve a country’s ability to achieve required objectives.

RISK ALLOCATION IS CENTRAL TO PPP....

Any contract must allocate risk and experience demonstrates that the temptation to allocate too much risk to either the private or public sectors, when they cannot properly manage those risks, will not provide best value for money or cost-efficiency and may lead to project failure. Worldwide, the project finance PPP market is well enough established for there to be a good deal of certainty about how key risks are allocated in successful PPP projects. These international norms should be applied in the Mediterranean partner countries in order for successful PPP programmes to be established and maintained.

.... WITH A FOCUS ON THE MANAGEMENT OF RISKS BY THOSE BEST PLACED TO DO SO.

Not all risks the private sector partner cannot control should be allocated to the public sector. Thus, where an event occurs outside the private sector’s control, it could be fairly compensated (in time and money), by defining principles such as “relief events” or “compensation events” in the contract or identifying relief which the parties agree should be available in the event of the application of the civil law concept of “imprévision” (economic rebalance). The private sector partner can often manage its risks through insurance – for this reason, the availability of insurance on commercial terms is a key requirement for an active PPP market. Related to this, the public sector should take great care before conceding unnecessarily wide definitions of force majeure in PPP contracts – again, international standards and norms are a useful guideline here but specific regard should be had to insurability.

THE PAYMENT MECHANISM UNDERPINS RISK TRANSFER....

Whilst all PPP projects place the risk of performance largely on the private sector partner, the allocation of demand risks and the payment mechanisms to remunerate the delivery of an output or service vary. There are two basic types of payment mechanisms: availability based and demand based. The availability based mechanism has been used in the comparator countries in many sectors. In this system, the public sector
authority only pays for the services or output provided and the payment is subject to deductions for unavailability or poor performance in accordance with the pre-set formula. Thus the private sector partner takes risk in the construction and ongoing operation of the infrastructure asset but does not take volume or usage risk. Under a demand risk scenario, the private sector assumes the market risk. The willingness of the private sector to accept such risks will depend upon its analysis of market forecasts.

... AND THERE MAY BE IMPORTANT SECTORAL DIFFERENCES IN WHAT IS APPROPRIATE.

It is more common for demand risk to be taken in the transport sector although in many cases the authority provides a minimum payment guarantee thus absorbing all or some of the demand risk. Most of the Mediterranean partner countries have experience of procuring independent power projects using capacity/availability payments where output is purchased at a specified tariff per unit with long term purchase agreements to provide security of revenue flow. Availability payments have also been used in a number of Mediterranean partner countries, notably in the water treatment and desalination projects in Algeria, Egypt and Israel.

**HOW PROJECTS ARE FUNDED WILL ALSO IMPACT ON RISK ALLOCATIONS...**

The capacity and depth of capital markets in most of the comparator countries permit projects to be funded in local currency (with the exception of Polish projects which tend to be funded in Euros (EUR) and the earlier Mexican projects which were funded in United States Dollars (USD)). However, in the majority of the Mediterranean partner countries (other than Algeria and Israel) local currency capital markets are not sufficiently deep to fund a substantial portion of potential PPP programmes. As a result, in most cases and especially for larger projects, PPPs in the Mediterranean partner countries are likely to have to be funded predominantly in foreign currency, with the procuring authority absorbing exchange rate risk. This is mainly due to the difficulty for the private sector to hedge this risk in the market at a reasonable price. However, having foreign currency denominated debt, such as in EUR or USD, interest rate risk can be transferred to the Project SPV which can hedge this risk in the market. Domestic inflation risk (on the domestic cost element of delivering the services during operations) is likely also to remain with the authority, since bidders and investors see this risk being outside their control, being primarily a macroeconomic or policy-determined variable.

**....WITH USE OF INTERNATIONAL FUNDING SOURCES (ESPECIALLY FROM INTERNATIONAL FINANCIAL INSTITUTIONS (IFIS)) BRINGING BENEFIT OF KNOWHOW.**

The international project finance community has considerable experience which can be applied to assist in developing optimal funding structures and risk allocations, and in transferring know-how to domestic financial institutions. IFIs and ECAs act as important catalysts for attracting other funders to support projects, since their rigorous requirements regarding open procurement, economic viability and risk evaluation, help create confidence in the creditworthiness and robustness of the projects.

**AND IT IS CLEAR THAT SOME CHANGES WILL BE NEEDED TO MAKE PPP AN EFFECTIVE DELIVERY METHOD.**

The viability of PPP in many Mediterranean partner countries can be enhanced so as to improve the delivery of infrastructure to meet social and economic needs by concentrating on relatively few key requirements. These would most notably include:

- the development of local financial markets so that local funding is sustainable (alongside foreign currency lending);
- the establishment of clear PPP laws which meet international norms;
- the establishment of institutions to develop best practice, ensure consistency and ensure a pipeline of projects as part of a sustained programme;
- the development of an approach to risk allocation which ensures value for money for the public sector by allocating to the private sector only those risks which it is best able to manage;
- addressing lenders’ requirements for security packages and protection of their investments, for example by permitting and recognising lenders’ step-in rights and providing sovereign guarantees of authority obligations when there are concerns regarding the latter’s creditworthiness.

The key to an effective PPP project is partnership, in which both the public and private sectors recognise their shared interests. A well-designed, comprehensive project that is part of a wider country strategy; transparent and competitive procurement; and balanced contract risk allocation are all crucial factors for a successful PPP project.

---

**Box 4: Exchange rate risk allocation in PPP – general principles:**

To the extent that a project has raised debt or equity funding in foreign currency, the authority is likely to have to bear exchange rate risk in the payment mechanism in order to maximise cost-efficiency of the project. In such cases, project payments (other than to cover any local currency costs or local currency funding share) need to be adjusted for exchange rate variations, either by denoting project payments directly in foreign currency, or through indexation of payments in local currency. In all Mediterranean partner countries, there is no market in which the Project SPV can hedge local currency exchange rate risk for the duration of the project. Bidders and lenders will see this risk as outside their control, being a largely macroeconomic or policy determined variable, particularly when exchange rates are centrally managed or controlled, as is the case of many Mediterranean partner countries.
**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.\(^{4}\)

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, South Africa).

**Structure of the Report**

The Report comprises three Volumes:

**Volume 1: A Regional Approach (the present Volume)**

This Volume 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**

Volume 3 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. 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 took 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.

**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.

---

\(^{4}\) Further information about the FEMIP Trust Fund is available at [www.eib.org/ftf](http://www.eib.org/ftf)
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 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.

Comparative Assessment

The Comparative Assessment at sections 1 to 7 below of this Volume 1 presents a detailed comparative analysis of PPP legal and financial frameworks in the Mediterranean partner countries and the five comparator countries. It also identifies the most significant lessons learned from the review of the comparator countries and the ‘best practice’ implications for the Mediterranean partners.

The key issues from the study of the comparators can be classified under seven broad headings. Each, in turn, has been broken down into the most important questions or issues which appear to determine the success, or failure, of PPP programmes. These are:

- Funding capacity and funding availability – how countries can secure finance for infrastructure investment
  - How attractive is a country and its PPP programme to (domestic and foreign) investors and lenders?
  - Is a country’s lending capacity sufficient to finance its long term PPP programme?
  - Does a country’s financial sector have sufficient expertise to structure complex PPP transactions and if not, how can it be improved?

- Institutional issues – how countries establish the right policy framework for PPP
  - Does the government have a clear policy which identifies PPP as an important tool for the procurement and development of infrastructure?
  - Which bodies are involved in project identification and how is project identification linked to budgets? Is there a clear process for allocating budgets for PPP project development and ongoing operational payments?
  - Has the government taken steps to support the PPP path by the creation of specialist institutions and advisory units with sufficient financial and human resource?
  - Are different levels of government (local and municipal as well as national) involved in PPP procurement or is there potential for this?
  - Are PPP candidate projects thoroughly researched and assessed for feasibility prior to their launch to the market?
  - How can projects be implemented and monitored effectively?

- Legal and regulatory framework – the legal prerequisites for effective PPP programmes
  - Why should a country build a sound and attractive PPP legal framework?
  - Does the legal framework sufficiently define the roles and powers of awarding authorities?
  - Would lenders and investors be comfortable with the country’s law governing project and finance documents?
  - Would lenders and investors be comfortable with the judicial system and commercial dispute resolution system in the country?
Introduction

**Bidding process** – the role of procurement in ensuring competition and best value for money

- Does the law set out clear procurement processes which are suitable for PPP structures?
- Is the procurement process structured to reflect the complexity of the project?
- Does the procurement procedure respect the key principles of fairness, transparency and equality?
- Are unsuccessful bidders duly notified and do they have rights of challenge?
- Is the public sector accountable for its decisions?

**Contract design and risk allocation** – securing optimal risk allocation specifically in relation to:

- Design and construction and technical specification risk
- Planning and approvals
- Extensions of time and compensation events
- Operational performance
- Change in law
- Termination and compensation on termination

**Financial risks and payment terms**

- How do authorities create the right incentives for the private sector to deliver a service or output at the least cost to the authority whilst ensuring the project is bankable?
- Are macroeconomic risks of inflation, exchange rate and interest rate allocated efficiently?

**PPP/Project finance readiness for lenders and investors** – the incentives and protections needed by lenders and investors

- What are the key incentives and restrictions to foreign investment?
- Are appropriate guarantees provided when necessary?
- Is there a robust security package?
- How do tax and accounting issues affect the affordability of PPPs?
- Are there any general business regulations or practices which might affect the smooth implementation of a PPP?

The questions are answered in respect of those comparator countries whose experience is most relevant and in respect of each Mediterranean partner country. Preliminary recommendations and identification of success factors are set out in boxes at the end of each section.
1. Funding Capacity and Availability

The macroeconomic condition of a country, its investment climate, lending capacity, as well as institutional and financial expertise, are crucial elements to attract and sustain long term infrastructure investment. These factors impact a government’s capacity to sustain a Public Private Partnership (PPP) programme and the domestic and international financial markets’ ability to finance it.

It is clear that some countries have funded and may continue to fund projects entirely or primarily domestically. Based on the analysis shown in this section, it is to be expected that in many cases expansion of a PPP programme (or any infrastructure programme) will require greater demand for finance from the international community in addition to financing and project delivery expertise from within the country. This section looks at the issues affecting both domestic and international funding.

This section addresses the following issues, in order to examine the sustainability and bankability of a PPP programme:

- How attractive is a country and its PPP programme to (domestic and foreign) investors and lenders?
- Is a country’s lending capacity sufficient to finance its long term PPP programme?
- Does a country’s financial sector have sufficient expertise to structure complex PPP transactions and if not, how can it be improved?

How attractive is a country and its PPP programme to (domestic and foreign) investors and lenders?

Comparator countries

Stable macroeconomic conditions and investment-grade credit ratings have enabled comparator countries to access domestic and foreign capital markets. France and the United Kingdom (UK), both with AAA sovereign credit ratings, have readily attracted debt and equity investors for their multi-billion Euro (EUR) PPP programmes. Mexico, with a BBB credit rating and member of the Organisation for Economic Co-operation and Development (OECD), has now successfully implemented PPPs in a number of sectors, including roads, energy, airports, healthcare, education and water infrastructure. For example, a substantial toll road investment programme was successfully carried out following a need to rescue failed toll road projects in the 1990s. South Africa (rated BBB+) has succeeded in using domestic private commercial banks for smaller PPP projects and has required international commercial bank funding backed by export credit agency guarantees for large power project financings. Similarly, Poland (A-rated), has financed its limited PPP programme predominantly through a mix of commercial banks, International Financial Institutions (IFIs) and Export Credit Agencies (ECAs). See Table 1 below for a detailed list of credit ratings in comparator countries.

Comparator countries have designed specific PPP programmes to attract a sufficient number of investors that are now strategically committed to them. In most of the comparator countries this has been a two-way process in which: the government first designed a PPP programme to attract investors; the success of pilot projects then attracted further funders, which widened private sector competition for PPP projects and improved pricing and terms for public authorities. The UK and France, for example, whose PPP programmes have been at the vanguard of developing PPP markets and expertise in Europe, demonstrate the importance of having a significant pipeline of projects without being overly ambitious either in scale or project complexity. Project bidders and investors will be attracted to a country’s PPP programme if they see that there is a potential to recoup their investment (in terms of time and money) from a losing bid in future bids for similar projects.

The early PPP programmes in some countries such as England and France were partly motivated by governments to secure funding for infrastructure projects that would not be included in public sector debt statistics. It was initially argued that because construction and operational risks had been transferred to the private sector, financial obligations of the government in respect of PPP projects should not be capitalised and added as assets and liabilities to the public sector balance sheet. There have since been discussions and clarifications of the accounting treatment which has led to some projects being reclassified as on-balance sheet for the public sector (i.e. the capital component of the PPP payments is counted as public debt). Whether or not the project is considered to be off- or on-balance sheet should not be the determinant of whether to structure it as a PPP. The key issue is to determine that payments for PPP contracts are affordable and are justified economically by delivering sufficient economic returns and social benefits to offset their costs, irrespective of their accounting treatment.

Table 1: Sovereign credit ratings, 3 February 2011

<table>
<thead>
<tr>
<th>Country</th>
<th>Credit Rating</th>
<th>Rated by</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>Aaa/AAA</td>
<td>Moody’s/Fitch/S&amp;P</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Aaa/AAA</td>
<td>Moody’s/Fitch/S&amp;P</td>
</tr>
<tr>
<td>Israel</td>
<td>A1/A</td>
<td>Moody’s</td>
</tr>
<tr>
<td>Poland</td>
<td>A2/A-</td>
<td>Moody’s/Fitch/S&amp;P</td>
</tr>
<tr>
<td>South Africa</td>
<td>A3/BBB+</td>
<td>Moody’s/Fitch/S&amp;P</td>
</tr>
<tr>
<td>Tunisia</td>
<td>Ba3/BBB</td>
<td>Moody’s/Fitch/S&amp;P</td>
</tr>
<tr>
<td>Mexico</td>
<td>Baa/BBB</td>
<td>Moody’s/Fitch/S&amp;P</td>
</tr>
<tr>
<td>Morocco</td>
<td>Baa/BBA-</td>
<td>Fitch/S&amp;P</td>
</tr>
<tr>
<td>Egypt</td>
<td>Baa/BB</td>
<td>Moody’s/Fitch/S&amp;P</td>
</tr>
<tr>
<td>Jordan</td>
<td>Baa/BB</td>
<td>Moody’s S&amp;P</td>
</tr>
<tr>
<td>Lebanon</td>
<td>B1/B</td>
<td>Moody’s/Fitch/S&amp;P</td>
</tr>
<tr>
<td>Algeria</td>
<td>n.a.</td>
<td>Not rated</td>
</tr>
<tr>
<td>Syria</td>
<td>n.a.</td>
<td>Not rated</td>
</tr>
<tr>
<td>West Bank</td>
<td>n.a.</td>
<td>Not rated</td>
</tr>
</tbody>
</table>

Most comparator countries have succeeded in creating a credible PPP programme by first embarking on relatively straightforward projects before applying that experience to more contractually complex projects. This is the case, for example, in Mexico where the contractually more complicated social infrastructure PPP programmes such as hospitals and universities were only introduced after the country had successfully launched PPP programmes in internationally well understood sectors (e.g. roads and power generation). Poland’s PPP transactions to date are limited – most of them are.
renewable energy projects with elements of PPP (see report on Poland in Volume 3) but not fully fledged PPPs as understood in the Report. Table 2 below provides an overview of the PPP projects closed since 2006 in the comparator countries.

Table 2: Project finance lending to PPPs in the comparator countries, January 2006–November 2010 (EUR)⁶

<table>
<thead>
<tr>
<th>COMPARATOR COUNTRIES</th>
<th>France</th>
<th>Mexico</th>
<th>Poland</th>
<th>South Africa</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total lending volume (EUR million)</strong></td>
<td>7,093</td>
<td>7,214</td>
<td>1,069</td>
<td>1,264</td>
<td>32,363</td>
</tr>
<tr>
<td>Of which; power projects including renewable (EUR million)</td>
<td>Not included in PPP</td>
<td>1,674</td>
<td>547</td>
<td>829</td>
<td>Not included in PPP</td>
</tr>
<tr>
<td><strong>Number of transactions</strong></td>
<td>59</td>
<td>32</td>
<td>13</td>
<td>8</td>
<td>286</td>
</tr>
<tr>
<td>Of which; power projects including renewable (number of transactions)</td>
<td>Not included in PPP</td>
<td>7</td>
<td>10</td>
<td>3</td>
<td>Not included in PPP</td>
</tr>
</tbody>
</table>

Mediterranean partner countries

Relatively strong real GDP growth rates and improving fiscal discipline in many Mediterranean partner countries, have contributed to increased access to funding for infrastructure investments over recent years. This trend can be seen in Figure 1 which illustrates that most Mediterranean partner countries have succeeded in maintaining economic growth while reducing government borrowing; slight deteriorations in the public finances of certain Mediterranean partner countries in 2008 and 2009 generally reflect fiscal stimuli as a result of the financial crisis.

Six out of the nine Mediterranean partner countries are externally rated by well-known international rating agencies and three of them are investment grade; improving or establishing international credit ratings would contribute to increasing investor appetite. Table 1 provides a summary of the international credit ratings by country as at February 2011. As the rating opinion encapsulates a combination of financial, economic, political and institutional risk factors, it is a significant indicator of a country’s relative ability to honour its obligations. Of the Mediterranean partner countries, Israel, Tunisia and Morocco are investment grade, thereby providing comfort to potential bidders and lenders. Egypt, Jordan and Lebanon are all rated below investment grade. Algeria, Syria and the West Bank are not externally rated. In the case of Algeria and Syria, the relatively low levels of public debt provide a certain degree of comfort on the sovereign’s ability to repay its loans, despite the absence of a rating. However, obtaining positive credit ratings would be of great benefit in attracting funders to their PPP programmes, as the ratings factor in a number of considerations affecting a country’s creditworthiness.

⁶ Source: Infrastructure Journal online database
Figure 1: Mediterranean partner countries – selected economic comparisons

Population (millions, 2010 estimates)

Source: IMF estimates for 2010 except for West Bank: IMF estimate for 2008

GDP/capita (US Dollars, 2010)

Source: IMF estimates

Real GDP (USD billions at 2010 exchange rates)

Source: IMF estimates for 2010 GDP in current prices discounted by real growth figures

Consumer price indices (2005 = 100)

Source: IMF data

Government Debt Total/GDP

Source: Central Bank or Ministry of Finance data of each country

Government Foreign Debt/GDP

Source: Central Bank or Ministry of Finance data of each country
Political stability and strong civil institutional frameworks are essential preconditions for attracting long term investment to PPPs. In some Mediterranean partner countries, notably the West Bank and, to a lesser extent Lebanon, PPP prospects are affected by the political situation. The political developments of early 2011 in a number of Mediterranean partner countries are likely to cause investors to be cautious regarding PPP opportunities in those countries, pending clarification of their outcome. This is a consequence of increased uncertainty and instability. Moments of political change can also represent an opportunity to reinforce or improve already existing institutional frameworks. Although under different circumstances, two comparator countries, Poland and South Africa, underwent major political change during the 1990s, and effectively maintained and reinforced the institutional framework for investment.

The strength of underlying civil institutions helps determine long term investment attractiveness, depending on the degree to which they withstand and are restored following political crises. Analysis of political risk in particular countries is outside the scope of this study. Investors’ perception of political risk is a complex judgement of whether, in their view, they will be permitted to earn a reasonable investment return over the long term without arbitrary interference or confiscation by governments (in whatever form) or by excessive bureaucracy or corruption; and whether an institutional framework exists to protect such rights. Physical security for personnel and assets are, naturally, also essential.

The Mediterranean partner countries have designed different PPP programmes to attract investors, although the number of PPP projects closed to date is relatively low. As shown in Table 3, which provides a list of project financed PPPs closed in the region, Israel and Egypt are the countries with larger lending volumes, reflecting the relative maturity of their PPP markets. The total number of deals for the whole region (21 projects between 2006 and 2010) is however low. Prior to establishing a formal PPP policy, the majority of the Mediterranean partner countries gained experience in PPP techniques through independent power projects (IPPs), ports and airport concessions. For example, Israel has developed PPP programmes in the transport, water desalination, sewage treatment and energy sectors, with a mixed track record: some transport projects have taken a long time to reach financial close, while the water desalination projects have been procured efficiently, applying standardised terms and correct risk allocation, and have therefore attracted domestic and international (IFI and commercial) funding. In 2010, Egypt signed its first PPP outside of the ports and power sector: the New Cairo Wastewater (NCWW) treatment plant and enacted its PPP law. Following the success of the NCWW project, using accepted PPP practices and working with international advisers, Egypt has attracted a large number of expressions of interest in the PPPs it has announced in the water, roads and power sectors. Countries like Morocco, Tunisia and Algeria have a history of concession projects used in sectors such as water treatment and transport. A significant number of foreign investors responded favourably to Algeria’s first PPPs for desalination projects in 2003-2004, as the government announced a considerable pipeline of projects. This trend might be reversed in the coming years, as Algeria has recently introduced laws (Complementary Finance Law 2009, confirmed in 2010) that may deter foreign sponsors and lenders from being active in its PPP programme. Tunisia’s cancellation of an IPP procurement in 2010, in favour of traditional procurement and after receipt of priced bids, is likely to deter future PPP bidders until such time as a clear policy commitment to PPP is finalised. Syria, Lebanon and the West Bank have not closed any project financed PPPs to date, although Syria and Lebanon are taking important steps to create an attractive PPP framework and programme.

<table>
<thead>
<tr>
<th>Country</th>
<th>Total lending volume (EUR million)</th>
<th>Number of transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>830</td>
<td>5</td>
</tr>
<tr>
<td>Egypt</td>
<td>1,369</td>
<td>5</td>
</tr>
<tr>
<td>Israel</td>
<td>1,089</td>
<td>5</td>
</tr>
<tr>
<td>Jordan</td>
<td>440</td>
<td>4</td>
</tr>
<tr>
<td>Lebanon</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Morocco</td>
<td>108</td>
<td>1</td>
</tr>
<tr>
<td>Syria</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Tunisia</td>
<td>446</td>
<td>1</td>
</tr>
<tr>
<td>West Bank</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>


In seeking to attract investors to PPP programmes, the Mediterranean partner countries need to ensure that announced programmes are followed through consistently and transparently. This consistency of approach creates a core of expertise amongst early entrants to the market. Their success then attracts further funders, which widens private sector competition for PPP projects and improves pricing and terms for public authorities. Whether they are domestic or foreign entities, debt or equity providers, funders need to be convinced of the long term investment potential and economic viability of the country’s PPP programme, otherwise they will not invest the human and financial resources to bid for and finance projects.

Is a country’s lending capacity sufficient to finance its long term PPP programme?

Comparator countries

Comparator countries’ access to efficient and liquid capital markets has ensured the bankability of well structured projects. Well-functioning capital markets are characterised by a diversity of financial institutions (domestic and foreign owned) active in private sector lending (including large syndicated loans), bond markets in which the government and major corporations can raise long term debt and an active equity market. Within the European Union (EU), financial markets are highly integrated so that, for example, Polish PPP projects obtain finance from a wide range of EU-based banks in addition to Polish banks. Large long term bond markets in EUR and Sterling (GBP) enable active long term interest rate swap markets in these currencies, so that Project Special Purpose Vehicles (Project SPVs) can hedge their interest rate risk. Mexican PPPs have benefitted...
from the strengthening of its domestic debt markets since its financial crisis in the early 1990s. South Africa can also raise funds domestically for all but its largest projects. However, during the recent financial crisis, the comparator countries encountered major difficulties in financing infrastructure due to unavailability of finance: bank liquidity dried up when the securitisation markets (into which they packaged and sold loan portfolios) collapsed, forcing banks to reduce the size of their balance sheets through reduced lending (see Box 5 below).

To ensure that financing is available for a project, the comparator countries often require bidders to provide strong evidence of funders' support when submitting bids. Such support can be in the form of a conditional commitment letter from the banks, indicating that if the bidder is selected they will provide funding on the terms indicated, subject to satisfactory conclusion of due diligence on the project. Whilst such letters also have other "escape clauses", such as no material changes in market conditions, they provide reassurance to procuring authorities that the project is financeable. This process requires that there are sufficient banks to support different bids exclusively and to avoid conflicts of interest arising.

The depth of their financial markets allows most of the comparator countries to provide long term funding in their local currency. France and the UK respectively have readily attracted EUR and GBP denominated debt and equity for their multi-billion EUR PPP programmes. Mexico, with a BBB credit rating and a member of OECD, increasingly funds its PPP projects in Mexican Pesos (MXN) rather than in United States Dollars (USD), and has required less IFI funding, ECA guarantees or commercial international banks requiring political risk insurance. The Mexican financial markets have also allowed for Mexican PPPs to be financed in MXN and USD denominated bonds. South Africa (rated BBB+) has seen most of its PPP programme to date (other than large power projects) financed by domestic private commercial banks in South African Rand (ZAR). Despite its high rating (A), Poland's PPP programme has been predominantly funded in Euro, through a mix of commercial banks, IFIs and ECAs, due to relatively limited liquidity in the Polish Zloty's (PLN) long term credit markets.

The long maturities of PPP project loans in most comparator countries have made projects more readily affordable. Debt service and investor returns are modelled to be spread over as much of the project's economic life as possible, reducing the annual capital charge to be recovered from the authority through the project payments. In the UK and France, PPP loan maturities for projects are regularly in the region of 25 years, albeit shorter for power projects. Mexican toll roads currently are often financed through short term mini perm loans – seven to ten year bank loans with limited repayment, so that full debt pay-out assumes refinancing and repayment over a longer term. Mexican IPPs are typically financed through loans with tenors of around 15 years. Polish and domestically funded South African PPPs have typically obtained long commercial bank loan repayment periods of around 20 years (over 80% of the concession period). For large-scale power projects, South Africa has relied on ECA guaranteed funding with slightly shorter repayment periods, reflecting difficult market conditions. Some large-scale IFI and ECA-backed loans to Polish road projects have obtained up to 30 year repayment periods.

Even when projects in the comparator countries can be funded entirely from commercial sources, IFI lending has been used to complement commercial bank financing. For example, EU PPP projects that meet the European Investment Bank's (EIB's) lending criteria can apply for an EIB loan for up to 50% of construction costs. In such cases, the EIB "co-lends" alongside commercial financiers, normally on the same risk basis and documentary terms, other than loan pricing and repayment profile. For EU PPP projects, the risk appetite of the EIB is often well understood by the commercial debt arrangers, so that the common funding package can be readily agreed.

**Mediterranean partner countries**

Despite being financially solvent and liquid, the domestic financial markets in most Mediterranean partner countries are constrained in the amount of PPP lending they can provide. The banking sectors tend to be small relative to the size of the economy. The exceptions are Algeria (with its large State-owned banking sector), Israel (with a well-developed local financial system) and Lebanon (with a large banking sector due to its position as a regional financial centre, but whose appetite for PPP lending is still largely untested domestically). Morocco and Israel each have two or three dominant banks that can provide relatively large loans to individual PPPs. Egypt's and Tunisia's relatively fragmented financial sectors likewise have some banks with ability to provide limited lending to PPPs, as do (but to a lesser extent) the Jordanian banks that are rated by international credit ratings agencies. Syria's small and fragmented private commercial banking sector is more constrained. Nevertheless, despite their relatively small size, banking sectors in the Mediterranean partner countries are generally financially solvent and liquid (with low loan/deposit ratios by international standards), so that banks have lending capacity up to the constraints imposed by their individual balance sheet sizes and by their national banking regulations.

As a result of the relatively small financial markets, long term funding in local currency is not prevalent in the Mediterranean partner countries. Algeria is somewhat exceptional, since its State-owned banks can fund the Algerian PPP programme as long as they remain recipients of large deposit inflows from the government and State-owned entities, generated by the country's large hydrocarbon export earnings. Countries such as Israel, Tunisia and Morocco (with investment grade ratings) and Egypt, have shown domestic currency lending capacity for relatively large PPP projects. For example, the debt financing of Israeli road PPPs to date (over EUR 1 billion) has been provided exclusively in local currency by Israeli banks. Similarly, Egypt closed its first PPP in the water sector in April 2010 raising EUR 86 million of local currency financing. Finally, Morocco has recently obtained approximately EUR 300 million of local currency commitments for a wind power project. However, capacity even in these markets may not be sufficient to fund very large individual projects or PPP programmes in local currencies.
Mediterranean partner countries will benefit from the availability of IFI or ECA guaranteed funding to supplement domestic and foreign commercial bank funding of PPPs. IFI or ECA guaranteed funding is commonly used in some countries to fill absolute gaps in funding availability, especially in countries with no investment grade credit rating. This is likely to be the case particularly in Syria, Jordan and Lebanon. Other Mediterranean partner countries such as Tunisia, Morocco, Egypt and Israel, which historically have had access to a wide range of financiers, could also benefit from IFI and/or ECA guaranteed funding for their larger projects, in particular to take advantage of the long maturities that are available from IFIs or ECA guaranteed sources.

Box 5: Effects of the financial crisis

All comparator countries were adversely affected by the financial crisis that started in 2008, although to different degrees. Mexico suffered a 6.5% fall in real GDP in 2009 due to falling oil revenues. The UK’s real GDP declined by 4.9%, reflecting the large share of the financial sector in its economy. France and South Africa both underwent more moderate decreases in GDP, and Poland’s real GDP, alone amongst large EU countries, grew in 2009. The drying up of credit caused sharp increases in loan pricing during the crisis, which has only partly abated and is unlikely to reduce to pre-crisis levels, as a result also of higher bank capital requirements. During late 2008 and early 2009, a number of projects were either deferred, cancelled or reduced in scope due to lack of availability of funding. At the height of the crisis, and faced with imminent large PPP deals being unable to attract funders, the UK established a Treasury Infrastructure Finance Unit (TIFU) to co-lend to projects which has in practice served to support only one project to date (the Greater Manchester Waste PFI). France introduced increased capital spending to offset the downturn, including on major infrastructure projects such as extensions to its high speed rail system. Across Europe, the European Investment Bank (EIB) stepped up the volume of its PPP lending by around 30% (EUR 15 billion) in order to offset reduced credit. Anti-crisis measures adopted by the EIB included additional support for small and medium-sized companies, comprehensive packages on energy and climate change, the automotive industry, additional support for Central and Eastern Europe and a capital increase to cope with larger lending volumes. Market conditions improved during 2010 and funding is today generally available for viable projects, albeit at higher pricing and stricter conditions compared to prior to the crisis. The overall effect has been that projects undergo far more scrutiny by authorities, bidders and lenders.

Mediterranean partner countries have fared better in the international financial crisis. Most Mediterranean partner countries experienced positive real GDP growth in 2009 (see figures below) due largely to less highly leveraged banking sectors than many more established markets, which therefore incurred lower loan losses. Also, most governments in Mediterranean partner countries had relatively controlled debt levels, so that their ability to withstand cyclical increases in fiscal deficits during the crisis has been sustainable. The crisis was transmitted to Mediterranean partner countries mostly in the form of reduced demand for exports and services, notably of gas from Algeria, tourism receipts, and reduced foreign grant support. However, one effect of the international crisis that directly affects PPP programmes has been a reduced appetite by international banks. In this situation, Mediterranean partner countries need to compete for scarce resources, thus increasing the importance of supportive regulatory, financial and legal frameworks. The situation is currently improving with international credit availability increasing, particularly as lenders and investors seek to diversify into higher growth markets.

Real GDP growth, 2009:*

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lebanon</td>
<td>7.6%</td>
</tr>
<tr>
<td>West Bank</td>
<td>3.7%</td>
</tr>
<tr>
<td>Egypt</td>
<td>2.7%</td>
</tr>
<tr>
<td>Morocco</td>
<td>2.7%</td>
</tr>
<tr>
<td>Syria</td>
<td>1.5%</td>
</tr>
<tr>
<td>Tunisia</td>
<td>2.0%</td>
</tr>
<tr>
<td>Algeria</td>
<td>0.5%</td>
</tr>
<tr>
<td>Jordan</td>
<td>0.4%</td>
</tr>
<tr>
<td>Israel</td>
<td>1.4%</td>
</tr>
</tbody>
</table>

* source: IMF
2. INSTITUTIONAL ISSUES

A number of features of the institutional framework contribute to the successful development of Public Private Partnership (PPP) programmes: explicit PPP policies, adequate institutional capacity, clear processes for project identification and budget allocation and sound feasibility studies of potential projects verified by unbiased and rigorous approval processes.

This section reviews the experience of both the comparator countries and the Mediterranean partner countries in establishing policies and institutions to support a PPP programme, by examining the following issues:

- Does the government have a clear policy which identifies PPP as an important tool for the procurement and development of infrastructure?
- Which bodies are involved in project identification and how is project identification linked to budgets? Is there a clear process for allocating budgets for PPP project development and ongoing operational payments?
- Has the government taken steps to support the PPP path by the creation of specialist institutions and advisory units with sufficient financial and human resource?
- Are different levels of government (local and municipal as well as national) involved in PPP procurement or is there potential for this?
- Are PPP candidate projects thoroughly researched and assessed for feasibility prior to their launch in the market?
- What are the key elements of a project assessment process?
- Which institutions are involved in the procurement process?
- How can projects be implemented and monitored effectively?

Comparator countries

In several comparator countries, targeted policies have clarified the role of PPP within national infrastructure plans and have guided the implementation of a PPP programme. In the United Kingdom (UK) and South Africa, several government bodies (particularly the ministry of finance and the PPP unit) have issued policies that identify PPPs as a means of infrastructure procurement; describe the reasons and goals for adopting PPP schemes; provide general guidance on how PPP projects should be developed and procured by the national and local governments; and define the sectors in which PPP programmes are encouraged. Whilst compliance by relevant actors with PPP policies is generally not mandatory (unlike legislative compliance), these policies have encouraged synergies through standardising practices across sectors and through co-ordination between interested stakeholders and institutions.

Line ministries are encouraged to develop PPP programmes as part of their wider sector infrastructure development plans. In Poland, South Africa and Mexico there is a high degree of autonomy at State and provincial level, and the degree to which PPP is taken up varies according to local interests. It is, nevertheless, common for the ministry of finance to play a key role in translating government policy into practice and guiding line ministries as to the appropriate means of identifying and procuring projects.

Comparator countries

Exchange of knowledge with the awarding authorities in different countries and replication of best practices acquired on well developed projects, creates a core of expertise within early entrants. Dialogue over standard PPP contract terms and risk allocation has produced a developing core of knowledge on the bankability of PPP deals. This is the result of strong institutional PPP policies and frameworks in the comparator countries. Lessons learned from the UK and French market helped inform the development of other PPP markets in Europe (including Poland) and elsewhere. Institutions like Partnerships UK (PUK) (now Infrastructure UK) have helped to disseminate knowledge by providing advice to different countries (including Mexico and South Africa). In South Africa, the leading domestic banks imported PPP expertise learned in other markets to their domestic market. In Mexico, the PPP programme is largely concentrated on internationally well-understood project models, such as energy projects and toll roads. As a result, its PPP programme has attracted a mix of Mexican and foreign funders, who understand both the project structure and often the country specific economic, legal, and political features.

Most Mediterranean partner countries would benefit from increased PPP expertise in domestic financial institutions. Israeli banks are the exception, due to the long standing nature of their PPP programme. Large domestic banks in Egypt, Morocco and Algeria do possess some PPP arranging experience in their home markets. In addition, some of the foreign-owned banks throughout the Mediterranean partner region can access PPP expertise from their foreign parent banks, provided the parent bank is willing to lend to that country’s PPP programme. A series of targeted seminars and briefings on the opportunities of the PPP market, sponsored by the country’s PPP unit or nearest equivalent agency or advisers recommended by it, could serve to increase appetite for PPP lending. The government can also seek to obtain views from international banks, both IFIs and private sector, to help determine key requirements for making a PPP programme successful. As the best way to acquire PPP expertise is generally “learning by doing”, co-financing by local and international lending institutions (including IFIs) could also serve to strengthen PPP expertise in the local banking sectors.

Funding capacity and availability – recommendations/success factors

- Increase attractiveness of a country’s PPP programme to a wide a range of lenders and investors by establishing a pipeline and timetable of viable projects to which the government is committed to procuring.
- Encourage local currency funding if market capacity for long term loans is available, alongside foreign currency funding.
- Promote PPP expertise in the local banking sector.
- Encourage IFI participation, which will also serve to attract other sources of funding.

Mediterranean partner countries

Most Mediterranean partner countries would benefit from increased PPP expertise in domestic financial institutions. Israeli banks are the exception, due to the long standing nature of their PPP programme. Large domestic banks in Egypt, Morocco and Algeria do possess some PPP arranging experience in their home markets. In addition, some of the foreign-owned banks throughout the Mediterranean partner region can access PPP expertise from their foreign parent banks, provided the parent bank is willing to lend to that country’s PPP programme. A series of targeted seminars and briefings on the opportunities of the PPP market, sponsored by the country’s PPP unit or nearest equivalent agency or advisers recommended by it, could serve to increase appetite for PPP lending. The government can also seek to obtain views from international banks, both IFIs and private sector, to help determine key requirements for making a PPP programme successful. As the best way to acquire PPP expertise is generally “learning by doing”, co-financing by local and international lending institutions (including IFIs) could also serve to strengthen PPP expertise in the local banking sectors.

Does the government have a clear policy which identifies PPP as an important tool for the procurement and development of infrastructure?

Comparator countries

In several comparator countries, targeted policies have clarified the role of PPP within national infrastructure plans and have guided the implementation of a PPP programme. In the United Kingdom (UK) and South Africa, several government bodies (particularly the ministry of finance and the PPP unit) have issued policies that identify PPPs as a means of infrastructure procurement; describe the reasons and goals for adopting PPP schemes; provide general guidance on how PPP projects should be developed and procured by the national and local governments; and define the sectors in which PPP programmes are encouraged. Whilst compliance by relevant actors with PPP policies is generally not mandatory (unlike legislative compliance), these policies have encouraged synergies through standardising practices across sectors and through co-ordination between interested stakeholders and institutions.

Line ministries are encouraged to develop PPP programmes as part of their wider sector infrastructure development plans. In Poland, South Africa and Mexico there is a high degree of autonomy at State and provincial level, and the degree to which PPP is taken up varies according to local interests. It is, nevertheless, common for the ministry of finance to play a key role in translating government policy into practice and guiding line ministries as to the appropriate means of identifying and procuring projects.
Institutional Issues

Mediterranean partner countries

Most Mediterranean partner countries have not consolidated PPP legislation by introducing clear guiding policies aimed at coordinating implementation of PPP programmes. In several countries, PPP laws exist or have been drafted (Egypt, Lebanon, Syria and Jordan). This indicates that PPP is recognised as an important mode of procuring projects that have been identified and prioritised for the development of national infrastructure. In other countries, PPP is practised as a regular means of delivering projects, but there are no supporting specific PPP laws (Algeria, Tunisia, Morocco and Israel, although in the case of Tunisia and Morocco concession legislation is fairly advanced). However, most countries would benefit from clearer policies describing when and in which sectors PPPs could be an efficient procurement option, as well as practitioner guidance describing how a PPP project should be implemented on a step-by-step basis (addressing, for example, project identification, appraisal and oversight). Syria, Egypt, Morocco and Israel have developed PPP as a clearly defined policy. Tunisia has established a particularly clear and advanced policy in relation to PPP in the digital economy sector and is developing PPPs in other sectors.

Box 6: The importance of a PPP policy

In many countries legislation is supplemented by policy to stimulate the growth and development of PPP projects. For example, whilst not having strictly ‘legal’ status, government bodies may issue policy in relation to the rules of tendering and the terms of contract. PPP policies serve to define PPPs in comparison to other infrastructure service procurement options; to describe the reasons and goals for adopting PPP schemes; and to provide general guidance on how PPP projects should be implemented by the national and local governments. Compliance by relevant actors with the letter of PPP policies is generally not mandatory (unlike legislative compliance). However, PPP policies can encourage good relationships by directing and co-ordinating co-operation between interested sectors and the institutions of government. PPP policies also help to define the sectors in which PPP programs are encouraged and which the government sees as a priority.

Project identification is normally linked to multi-annual budget programmes typically set by the ministry of finance. Often the budget lines take the form of credits (which are centrally funded and are not repayable), both for project development and for the operational phase of the project. This system is used in France. In the UK and Poland, the credits are generally only extended for the operational phase of projects. Apart from requesting central government funding, procuring authorities are generally free to pursue PPP projects at any time, using their own resources. This approach is particularly prevalent in Poland and France, where there is a considerable degree of local autonomy.

Mediterranean partner countries

To enhance credibility and investor appetite, some of the Mediterranean partner countries have identified projects by developing a multi-annual infrastructure PPP plan. This can also provide a solid basis for a PPP project pipeline. Morocco provides a good example of a thorough strategic approach to planning national development needs, through the drafting of its national five-year development plan, which outlines the infrastructure developments needed to deliver the plan.

In most Mediterranean partner countries the budgetary processes are regular and institutionalised, although such practice could be strengthened across the region. Generally, line ministries bid for their budgets, which are mediated by the ministry of finance, as in the comparator countries. There is a high degree of centralised decision-making around budgeting in the Mediterranean partner countries, which enables robust control of public finances. This takes two forms: (i) regular annual budgets for line ministries; and (ii) special budgets for large projects of strategic national importance. The pursuit of individual projects is particularly prevalent in Jordan, which until early 2011 had a government ministry specifically established for that purpose (the Ministry of Mega Projects). This has benefits in terms of focusing effort and resources on strategic projects, but can lead to overlap of responsibilities and possible duplication of work with other PPP stakeholders. In Lebanon, the annual budgeting process is difficult to determine, due to a backlog of parliamentary procedures and the practice of rolling forward the previous year’s budget until this can be resolved.

Line ministries normally identify and provide their own resources to fund PPP projects. In cases where the project proposal has been originated from another source, for example a municipality, the line ministry is usually required to co-sponsor the project. Projects that originate from a region or municipality may be supported by local initiatives to the extent that there is some fiscal autonomy at local level, as well as being funded from ministerial budgets.

Which bodies are involved in project identification and how is project identification linked to budgets? Is there a clear process for allocating budgets for PPP project development and ongoing operational payments?

Comparator countries

In the comparator countries, infrastructure planning and project prioritisation is co-ordinated centrally. Decisions relating to which projects should be prioritised and budget allocation are determined by central government on the basis of national priorities. Responsibility for actual identification and planning of projects lies with the line ministries and local authorities. Bodies such as the Project Review Group (PRG) in England convene regularly to scrutinise projects and to decide which can go ahead.

The regular planning and announcement of national budgets do not necessarily emphasise PPP or ring-fence funds for PPP projects, except where it is an explicit part of government infrastructure funding policy, for example in Morocco and Syria, where PPP is integral to the national infrastructure plan. In some cases, where there is a strong track-record of a particular ministry in PPP project procurement, a budgeted programme of PPP projects will be clearly identified, for example for water projects in Algeria and power projects in Egypt.
In all Mediterranean partner countries, the ministry of finance has a vital role to play in approving budgets for PPP projects. To the extent that PPP projects commit the country to long term payments, they may be considered as adding to the national debt. Therefore it is important that proposed project costs are accurately calculated in order to enable appropriate budget-setting and approval by government agencies.

The process of planning and budgeting for individual PPP projects needs to improve in most Mediterranean partner countries. This can be enabled through the careful preparation of detailed business cases based on accurate assessments of costs, benefits and risks. Equally there is a case for encouraging a specific PPP budget to support projects, allocated either as a central pool for all sectors in the ministry of finance, or delegated to individual line ministries, as in the case of the comparator countries. In order to bring greater certainty as to the availability of resource, management of budget and a uniform process to encourage bids by procuring authorities, the Mediterranean partner countries may wish to introduce a PPP credit system which would be funded centrally and be overseen by the ministry of finance.

Countries that have reached an advanced stage of development in PPP implementation have often established sectoral PPP units within procuring authorities. There is often a need to adopt central guidance to reflect particular technical, legal, institutional and social aspects of the sector. This gives a significant degree of comfort to project investors, funders and operators that their concerns will be reflected in the particular sector PPP documentation and procedures. Examples include the health and education sectors in England, and the university sector in France.

PPP units are not usually directly involved in project procurement, monitoring and management, which is the responsibility of line ministries or local authorities. This practice encourages participation by line ministries and local authorities producing greater local accountability and dissemination of knowledge and good practice. PPP units maintain a general overview and scrutiny function. For example, in Mexico, the Federal States must submit their projects to the investment unit for technical review before they can be approved by central government. In some exceptional and strategic sectors, PPP units may become involved in procurement (such as large defence projects in the UK advised by Partnerships UK (PUK), now Infrastructure UK (IUK)). Generally, monitoring and management of completed projects during the operational phase is left to the procuring authorities, although they may have access to PPP unit support on an ad-hoc advisory basis, for example through help-desks and interactive websites.

**Comparator countries**

Governments have often created central PPP units to drive forward their PPP policy and programme. All comparator countries except Poland have central PPP units (or PPP centres of expertise). These have proved valuable in standardising practice and in encouraging the development of PPP.

**Practice of the comparator countries in establishing specialist PPP advisory functions (such as central PPP units) ensures cross-sector coordination and efficiency in the procurement process.** Such technical advisory bodies can help to ensure that project preparation is well co-ordinated and that the government’s approach to contract design and risk allocation is consistent across sectors, save for in relation to sector specific and project specific issues. This will contribute to making the project procurement process more efficient.

**Has the government taken steps to support the PPP path by the creation of specialist institutions and advisory units with sufficient financial and human resource?**

**Mediterranean partner countries**

An institutional entity has been created to support the implementation of PPP programmes where government has supported the use of PPP as an alternative procurement option. Usually this is a PPP unit or its equivalent that advises line ministries and local authorities on the various technical aspects of PPP project identification, appraisal and procurement. There are examples of this in Egypt (the PPP Central Unit) and more recently, Syria (the Central PPP Unit which will become the PPP Bureau under the new PPP law). Tunisia has established a Concessions Unit which, however, has not yet participated actively in PPP development. Jordan has a PPP advisory unit combined in the Executive Privatization Commission and the Privatization Council. These bodies, considered to be an important repository of expertise, play a key role in project initiation and procurement. As such, they have in some cases led the tendering of projects instead of the relevant line ministry. This was the case, for example, in the Queen Alia International Airport project. Morocco is taking a positive step towards the creation of institutional expertise as it has recently announced that it will be establishing a PPP unit using advisory services of the World Bank and IUK.

**Box 7: The benefits and role of a PPP unit**

- PPP policy-making and dissemination of best practice.
- Project identification.
- PPP project/programme planning and prioritisation.
- Provision of guidance / support to procuring / contracting authorities.
- Central repository of knowledge.

Procuring authorities normally benefit from support and guidance from the PPP units or other centralised centres of expertise when embarking upon PPP procurements. Usually this will be in the form of manuals, training activities, electronic information on websites (such as in Mexico where a website has been established to disseminate project information) and help-desk support. Infrastructure UK in England is also active in providing guidance for projects.
ministries can then be fostered through coordination by the Central PPP Unit. In some countries, including Algeria, Egypt and Jordan, several line ministries have already developed significant procurement experience and are relatively self-sufficient. However, when capacity is scarce, care should be taken to avoid atomising expertise. In these cases, involving staff from line ministers in centres of expertise could be more appropriate to facilitate knowledge exchange.

Central PPP advisory bodies tend to have limited human and financial resources, and would benefit from increased capacity. There is clearly a role for investment by the government, in association with International Financial Institutions (IFIs), to build institutional capacity. In some cases, this is already underway with multilateral or bilateral financial support, for example in Morocco, as mentioned above. In Egypt, it is proposed that successful PPP projects should be charged a levy to enable funding of future capacity development.

In several countries, more than one advisory body has been given a significant role in the implementation of PPP programmes. There are bodies with overlapping roles in Jordan, Lebanon, Morocco and Israel. It is recommended that there is a clearly defined institutional landscape to enable projects to be managed effectively, and for one PPP advisory body to take a clear lead in the whole advisory process.

Some line ministries have a more independent approach toward PPP project implementation whereas in other cases the central government, as a whole plays a larger role. Some line ministries have experience in procuring PPP projects in their particular sectors, such as water supply (Algeria), transport (Jordan) and power generation (Algeria, Egypt and Tunisia). In such cases, there are often sector specific PPP laws or regulations to enable the respective line ministry to operate. In these cases, the line ministry will also have developed the organisational capacity to handle a pipeline of projects. In other cases, where PPP is being introduced into new sectors or is a new policy for the country, central government may encourage participation of line ministries by creating satellite PPP units in those ministries, for example in Egypt and Syria. In Egypt a satellite PPP unit has been set up in conjunction with a university to work on health projects; whilst in Syria, nodal PPP units are being established in several line ministries, including the ministries responsible for transport and energy.

Comparator countries

Local authorities or municipalities often have a high degree of autonomy to initiate PPP projects, while central government remains involved for strategic projects. This is particularly the case in countries such as Poland, Mexico and France that constitutionally have always encouraged localised decision-making. In all comparator countries, projects are frequently initiated by local authorities and municipalities. In some countries organisations exist to share local authority experience and to disseminate good practice – for example Local Partnerships in the UK. This is a joint venture between IUK and the local authorities themselves to provide guidance and technical assistance to authorities wishing to procure PPP projects in a wide range of sectors. Similar initiatives exist in Poland and France. As a result, PPP programmes in the comparator countries demonstrate a healthy mix of PPP projects originating partly from the local level and partly from central government. The central government projects are usually of a strategic nature, such as major transport links or defence projects. Local authority projects tend to be those of a more social character, such as health, education and waste management projects.

Mediterranean partner countries

In most Mediterranean partner countries, central government drives PPP programmes and project implementation. The political importance of PPP is recognised through the creation of high-level inter-ministerial committees to review projects that have been submitted for approval by the line ministries. The committees will typically consist of representatives of all the key ministries with an interest in project development, including finance, sector interests (such as transport, water and telecoms) and the interior ministry. The inter-ministerial committee is a political high level filter. In countries where PPP is already well-established (such as Morocco, Lebanon, Jordan, Egypt and Israel), the PPP committee will report directly to the Prime Minister’s office. In the case of Syria, which is developing a new programme, the PPP organisational body reports to the office of the Deputy Prime Minister (DPM). The Syrian Draft PPP Law states that the Economic Committee (comprised of the DPM and several other ministers) will have direct control over the PPP programme acting as the PPP Council in Syria. Generally, a key function of the PPP committees in Mediterranean partner countries is to approve projects. They also require progress reports on projects that are in construction or operation.

The involvement of local authorities at the early stage of project development has proven to be useful in facilitating project implementation. Although local authorities may lack fiscal autonomy and technical capacity and have limited delegated powers, they have an important role in representing the interests of local communities. There is scope to educate and involve local authorities about PPP opportunities, as has been done effectively in the comparator countries. There may also be scope to set up organisations amongst local authorities and municipalities to enable participation in PPP initiatives originating from central government, and to encourage the transmission of local views and priorities to central government decision-makers. In this way, a constructive dialogue will evolve that can inform both PPP policy and practice. Exceptions to this state of affairs apply only to the largest municipalities, for example the Greater Amman Authority in Jordan. For the most part, even where powers exist for local authorities to become involved, there appears to be little participation in most cases. Exceptions are Syria and Algeria, where there are some signs of significant local authority interest.

Are different levels of government (local and municipal as well as national) involved in PPP procurement or is there potential for this?

Are PPP candidate projects thoroughly researched and assessed for feasibility prior to their launch to the market?

Comparator countries

Before a project is presented to the market, procuring authorities prepare a business case which is refined during project development phase and reviewed at various stages. The business case is normally presented in an outline version and submitted for review to external bodies for appraisal (see
below for the appraisal process); it is then complemented with further detailed information and resubmitted for further assessments. A number of features are common across the comparator countries: (i) technical feasibility, including availability of land for development, with initial environmental and planning approvals; (ii) economic feasibility, often with a cost-benefit analysis indicating what economic and social benefits will be secured against the necessary costs; (iii) risk analysis, including risks to be transferred to the private sector, and outline contractual terms; (iv) financial appraisal, including affordability to the authority, calculation of any required operational subsidies and the preparation of a public sector comparator to justify the choice of PPP as against other means of procuring the project; and (v) legal analysis, ensuring that the necessary approvals are in place and that there are no legal impediments to the project. These features are summarised in Box 8 below. Detailed business cases may include a shadow bid model, evidence of bankability and expected accounting treatment of the resulting PPP.

**Box 8: Key elements of a sound feasibility study/business case**

- Technical feasibility – outline plans, site preparation and environmental approvals.
- Economic feasibility – cost/benefit analysis.
- Risk analysis – allocation of risks between public and private parties.
- Financial appraisal – affordability, bankability, tax and accounting issues.
- Legal analysis.

Detailed standardised procedures to develop business cases enable efficient project appraisal and provide comfort to potential bidders. If the project development phase is not undertaken in sufficient detail, there is a risk that the project will be delayed or may even have to be cancelled during the bidding process. In addition, private sector bidders derive comfort from well-prepared projects as it reduces their bidding costs and ensures that there is less time and lower costs needed to get to preferred bidder stage, for due diligence and then financial close.

Several comparator countries test and inform the market through the preparation of project information memoranda and the organisation of “bidders’ days”. The information memorandum sets out the scope of the project and its outline business case. Potential bidders for the project can then express their interest and raise any issues that the procuring authority might need to consider in advance of going to market through the formal procedures. A data room is established containing all of the support documentation for the procurement, such as title to land, environmental and technical studies. Also, documentation (such as standard contracts) are made readily available on the internet. This approach is used routinely in the comparator countries and is particularly valuable when the project is technically complex or contains unusual and innovative features that need to be explained to potential bidders.

**Mediterranean partner countries**

Often projects have not been well prepared and have required restructuring or cancellation at the bidding stage, generating delays and discomfort in the market. In several cases, large and politically high-profile projects have been cancelled during procurement, due to insufficient preparation. An example is the Egyptian schools project originally launched in 2007, which was withdrawn as being too large and ambitious for the current stage of market development and is now being redefined to a more manageable size.

**Institutional capacity for effective project preparation is often not sufficiently developed and needs to be strengthened in order to attract investors and avoid renegotiations at the operational stage.** Institutional capacity can be reinforced through advisory services and technical assistance, with the support of IFIs and donor funding. However, in order to ensure that capacity and expertise is maintained, it is necessary to mobilise sufficient recurrent funding over the long term. This can be done through an annual contribution from the central government or from ministerial budgets. An alternative mechanism being considered (for example in Egypt and Syria) is a levy on project transactions to offset the government’s costs of project preparation. In addition, knowledge exchange programmes in the region may also contribute to establish best practices and lessons learned.

**Lack of standard practices and documentation has often been the cause of time consuming project development processes and weak business cases.** In some cases, this may be partly due to the fact that PPP markets are at an embryonic stage, with a lack of capacity and resources in the procuring authorities and line ministries. For example, few countries seem to have established a standard discount rate for economic appraisal (and comparison among bidders). Some countries use public sector comparators (Egypt and Israel) which are helpful to benchmark and cost projects; while in others there is little evidence of this practice.

**Where there is a good level of experience of project development and procurement in certain sectors, best practice should be institutionalised and transferred to other sectors.** This is the case, for example, in Algerian desalination projects where the line ministry has developed almost a routine process and has a high degree of autonomy. Expertise has also been developed by line ministries responsible for the energy sector in Jordan and Egypt. It would be beneficial to the country’s PPP programme as a whole if a centre of expertise established itself as a repository of knowledge acquired, which it could then use to disseminate to other projects or sectors. Projects also need to be scheduled so that there are synergies within and between sectors, and to ensure that there is sufficient institutional capacity to handle the deal-flow and sufficient market capacity and interest to respond to tenders.
Experience has shown that where PPP is being introduced in a new country or sector, projects which are not overly complex are most successful. It is often productive to develop expertise and a good market reputation in a particular sector. Ambitious, excessively large projects can be difficult to achieve until institutional capacity and expertise has been developed. Some large projects have been withdrawn from the market in recent years in several countries (for example, Egypt, Jordan and Tunisia) due to size and complexity.

**What are the key elements of a project assessment process?**

**Comparator countries**

Project assessment is normally carried out through a hierarchy of institutions. This begins with the procuring authority and the responsible line ministry; followed by a gateway review by the PPP unit and the ministry of finance; and ending with formal approval by an inter-ministerial committee. In the UK, a central government committee generally relies upon the PPP unit for detailed assessment of the economic, financial, legal and technical aspects of the submission. The same function is carried out by the PPP unit in France.

Line ministries are required to follow central government guidance and procedures, and require authorisation from the ministry of finance before allowing the sponsored projects to proceed. An interesting example is Mexico, where line ministries must submit a detailed justification of the project to the Investment Unit (IU) in central government.

Line ministries and other procuring authorities must first satisfy themselves that the PPP project is robust, before submitting it for approval by central government. Normally they will do this with the assistance of their internal technical teams and ministerial PPP unit, if one exists. There is often some negotiation and redesigning of projects to accommodate ministerial views and guidance before the project is considered to be strong enough to be put forward to the central government committee for final approval.

Inter-ministerial bodies provide political support and assure coordination between agencies. Typically, a committee is established to review projects that have been submitted for approval by the line ministries. The committee will usually consist of representatives of all the key ministries with an interest in project development, including finance, sector interests (such as transport, water and telecoms) and the interior ministry. The committee will ensure that a fair and transparent review process is undertaken for each major project that it is required to scrutinise and debate. This helps to ensure that marginal projects of doubtful economic and social benefit are unlikely to be selected and that strict budgetary criteria are applied. The committee will rely on technical reports provided by the relevant line ministry and the PPP unit to help arrive at its decision in each case. Box 9 below lists the key actors involved in approval processes and common stages of the approvals process.

**Mediterranean partner countries**

Procuring authorities need to obtain technical approval from the PPP unit or its equivalent before obtaining central government approval. In most cases, there is a further stage of high level approval by governmental committees that report to the Prime Minister and have line ministry representation.

**Box 9: Approval processes**

Key actors involved in approval process:
- Line minister/local government;
- PPP unit;
- ministry of finance;
- Inter-ministerial body.

Key approval processes
- Approval of the procurement option/Public Sector Comparator.
- Approval of the feasibility study/business case (financial and economic appraisal).
- Affordability test/Approval of public contribution/Approval of the accounting treatment.
- Approval by procuring entity if negotiated by a different body.
- Approval of the contract/variations to the standard template.
- Political approval.

Approval processes need to be more rigorous. As a general observation, it seems that while the approval processes in the Mediterranean partner countries are appropriate and established, they could be more detailed and thorough in terms of the standard and comprehensiveness of documentation expected and required.

The ministry of finance has a crucial role in approving projects, and needs strong business cases to be submitted from procuring authorities. If the business case is comprehensive, detailed and well-argued, it will give the ministry of finance confidence in approving the project and will allow it to assess accurately the likely future effect on national finances.

Central PPP units are often represented in an advisory capacity on inter-ministerial approval committees. In countries such as Syria and Egypt, the PPP unit is seen as an integral part of the decision-making process. The PPP unit has a place on the inter-ministerial committee and is able to inform its deliberations. However, the role of the PPP unit as informant needs to be distinguished from the decision-making itself, which would normally not include a vote by the PPP unit.

**Which institutions are involved in the procurement process?**

**Comparator countries**

Procuring authorities lead the bidding process, normally without the support of a central PPP unit, particularly when expertise is sufficiently developed at the sector level. There is therefore a clear demarcation of responsibilities between the procurement authority and the PPP unit. The procuring authorities can be local authorities, municipalities or line ministries. The PPP unit will become involved, usually in a strategic advisory capacity, only in the largest and most strategic projects, normally in support of a line ministry.
In common with the comparator countries, the PPP unit does not usually get involved in project implementation, as this is the responsibility of the procuring authority. However, there is a case for the PPP unit to have a monitoring role and to collate experience and lessons learned for the benefit of other authorities procuring and implementing PPP projects.

Resources will be needed in the line ministries to support project implementation and management of PPP contracts. The cost of post-completion project management should be included in the project business case and will need to be budgeted for by the line ministry. It would also be efficient to establish training programmes which could be part of the remit of the central PPP unit.

### Institutional issues – recommendations/success factors

#### Policy

- Issue a policy explaining the benefits of PPPs and the circumstances in which they should be used. Publicise this widely to encourage projects to be identified and developed in priority sectors.

#### Project life cycle

- Invest in organisation capacity and strong technical advice to ensure that projects are feasible and are adequately prepared before procurement. Feasibility agreements should be undertaken and project preparation should involve detailed output specifications, risk analysis, economic appraisal, site preparation and securing outline planning and environmental permissions for the development.
- Provide information and guidance to authorities on effective procurement, including standard contract documentation, support in appointment of advisers and examples of good practice.
- Ensure that projects are accurately budgeted at the outset, and that any financial support from central government to the procuring authority is used only for the benefit of the project.

#### PPP decision-making

- Establish a central government body, with ministerial representation, to review and approve projects.
- Encourage line ministries that are planning extensive PPP programmes to develop in-house capacity to develop and procure projects.
- Ensure that there is a high standard of business case development and that accurate budgets are prepared.
- Encourage local authorities to identify and promote PPP projects and to co-operate with line ministries to enable efficient procurement.

#### PPP units

- Establish a central PPP unit to:
  - disseminate policy and best practice;
  - review projects and support procuring authorities;
  - plan and prioritise PPP projects across sectors within the budget cycle.

### Mediterranean partner countries

Central PPP units often take an active role in project procurement, as authorities frequently lack sufficient experience in launching a PPP project to the market. This is particularly the case where the PPP procurement method is relatively new. As the programme develops, capacity problems begin to emerge, necessitating the development of expertise in line ministries. It is interesting to note that in Syria the PPP support institutions are being designed from the outset to develop satellite PPP units in the line ministries. In this sense, Syria is benefiting from the experience of other countries and is starting its PPP programme mid-way up the learning curve. Care should be taken to ensure that both the central PPP unit and PPP units in the line ministries are adequately staffed.

However, in some sectors, the procurement ability of line ministries is much more developed and there is less involvement of the central PPP bodies. This is the case in Algeria, Egypt and to some extent in Jordan and Tunisia. In Egypt, the Ministry of Electricity and Energy has procured a number of projects without the involvement of the PPP Central Unit. The energy sector benefits from its own PPP procurement law and a body of experience and practice that enables the efficient procurement of new electricity generation projects.

Local authorities have a limited involvement in procurement, which could be increased to assure their support to the project and enhance the quality of stakeholder management during the operational phase. As mentioned above, there is clearly scope to develop local government capacity. While the central State authorities will still need to be involved, not least to provide sovereign payment guarantees, the involvement of local authorities will allow wide consultation and enable local political and economic support for PPP developments. This will be particularly important if local tariffs are to be used (wholly or partly) to fund projects.

How can projects be implemented and monitored effectively?

### Comparator countries

Once the PPP procurement has been completed, it is common practice for procuring authorities to take full responsibility for project implementation. This will include managing the contract, ensuring that the payment mechanism is enforced and negotiating any contract variations. However, central government may still take an interest in overseeing the performance of the national portfolio of PPP projects. Often it will do this either through a sector economic regulator or through the auditing arm of government. The central PPP unit will not usually be involved in monitoring project performance after implementation. For example, an economic regulator (Monitor) oversees many large hospitals in the UK and will review the financial performance of PPP contracts where they are in place.

Contract managers are provided by the procuring authorities. Often these will be managers with a general background in administration, estate management or procurement. They do not usually receive specialist training for their posts, but can make use of guidance issued by the PPP unit or the line ministry.
3. LEGAL AND REGULATORY FRAMEWORK

Clarity and certainty of a country’s legal and regulatory framework are necessary conditions for the success of a Public Private Partnership (PPP) programme. The existence of a PPP law can help to attract investors to a country by enhancing or clarifying the legal framework applicable to PPPs. This will also prevent reliance on general laws that are not specific and therefore not suited to PPPs. Investors and lenders will seek comfort that the governing law of their contracts affords them adequate protection and that disputes can be resolved impartially and efficiently.

This section sets out the legal aspects and legal basis of PPPs and examines the following questions:

- Why should a country build a sound and attractive PPP legal framework?
- Does the legal framework sufficiently define the roles and powers of awarding authorities?
- Would lenders and investors be comfortable with the country’s law governing project and finance documents?
- Would lenders and investors be comfortable with the judicial system and commercial dispute resolution system in the country?

Why should a country build a sound and attractive PPP legal framework?

Comparator countries

The existence of a PPP specific law overcomes the difficulties that may be encountered when there are several laws which apply to PPPs. For example, there may be a combination of sector specific laws or the requirement for project specific laws. Differing regimes for different types of PPP models are not necessarily problematic – it must be clear which law applies to which model and leave little room for interpretation (for example, if there is a separate law on concessions, it should be clear whether that law applies to a project with even a small element of user/demand risk). A law which addresses PPP specifically has the benefit of not having to rely on uncertain interpretation of laws which regulate infrastructure procurement in general or the procurement of goods and services by public authorities. The importance of this is demonstrated by the Polish example. A PPP Act was enacted in 2009 to replace the much criticised PPP Act of 2005. A Concession Act also is in place as is a general procurement law. There is not always a clear distinction as to which law should apply to a particular project and this may create difficulties as the PPP programme develops.

Enacting specific PPP laws has facilitated the PPP development process in some of the comparator countries. Specific PPP laws have, for example, been enacted in France (the 17 June 2004 Ordinance), South Africa (Treasury Regulation 16 (issued pursuant to the Public Finance Management Act 1999 (PFMA)) and Poland (the PPP Act). In Mexico, proposals for a federal specific PPP law were introduced to the legislature in late 2009 and early 2010 and are still under discussion. In civil code jurisdictions, certainty and clarity of intention of the contracting parties is achieved by the presence of clear and comprehensive PPP contracts written under a legal system which is permissive and not prescriptive. The different approaches to PPP legislation in civil and common law jurisdictions are outlined in Box 10 below.

The enactment of specific PPP laws demonstrates political commitment towards the promotion of PPP programmes or projects. A specific PPP law can be an indication of the political will to pursue PPP and a measure to support the wider policy framework. This is particularly the case in Poland where the new PPP Act has served as a trigger for the launch of a number of PPP projects. The South African Treasury Regulation 16, together with the supporting PPP guidance available (the Treasury Practice Notes and Standardised PPP Provisions), also indicates the importance to the government of PPP as a means of delivering public infrastructure.

PPP laws can advance PPPs if they include clear and comprehensive provisions and provide overarching legislative guidance on headline issues. PPP legislation in France, Poland and South Africa, for example, identifies the scope and models of PPPs (such as concession or design, build, finance and operate structures), public authorities’ obligations with regard to feasibility and consultation, procurement procedures, issues to be addressed in contractual provisions, payments, the institutional framework and the duration of projects. PPP primary legislation should be supported by necessary secondary legislation (for example regulations or implementing decrees to address detail). Secondary legislation should be implemented promptly to avoid uncertainty and a loss of momentum and reviewed regularly to ensure that changing market conditions are addressed.

Experience shows that a specific PPP law is not a pre-condition for PPP development, where clear practitioner guidelines and standard contracts are present. In the United Kingdom (UK), for example, the absence of a specific law has not resulted in the absence of a structured framework for PPPs as case law and manuals (notably Standardisation of PFI Contracts version 4 (SoPC4) contract provisions and commentary) set out comprehensive guidance for procuring authorities and provide a reference point for bidders and contractors.

Mediterranean partner countries

Recent initiatives to enact specific PPP laws in some of the Mediterranean partner countries show increasing interest in and commitment to PPPs in the region. PPP laws are in the drafting stage in Jordan, Lebanon and Syria. Jordan has the benefit of the Privatisation Legislation, but the intention is to improve the legal basis for PPPs in a PPP law and simplify the governing legislation since key aspects of PPP and privatisation are different. A PPP law would be a welcome introduction in Syria and Lebanon as these countries currently have limited legal basis for PPP procurement.

The new PPP Law in Egypt (enacted on 1 July 2010) demonstrates the commitment of the Egyptian government to pursue further PPPs and this should be followed up with secondary legislation as intended. Having successfully procured the New Cairo Wastewater (NCWW) project, the Egyptian government is intent on procuring further PPPs. Whilst the NCWW project was procured under the old legislative

---

7 Privatisation Law No. 25 of the year 2000 and Privatisation Regulation No. 80 of the year 2008
framework (i.e. without the benefit of a specific PPP law), the success of this pathfinder project has cemented the use of PPP as a viable option for infrastructure development. The effectiveness of the PPP law has not yet been tested, but its use is anticipated in the forthcoming projects. The Egyptian PPP law states that executive regulations, intended to add substance to the provisions of the law, will be introduced.8

The other Mediterranean partner countries (Morocco, Tunisia, Algeria and Israel) do not have PPP specific laws. Israel, which has foundations in the common law but with some civil law influences, does not have a PPP law and to date, this has not been a hindrance as the system of introducing project specific laws when required has provided the necessary legal authority and has worked well. In Morocco and Tunisia, concessions are specifically governed by Law 54-05 and the Tunisian Concession Law (Law no. 2008-23 of April 1 2008) respectively. Whilst these provide sufficient authority for the PPP models they govern, further specific legislation will be beneficial if availability type models are more widely procured. If the Algerian government wishes to pursue a formal PPP programme, then it would be desirable to codify all relevant legal provisions in a single PPP specific legislative text. The benefits of introducing a specific PPP law are outlined in Box 11 below.

Box 10: Civil and common law jurisdictions – two different approaches to PPP legislation

The legal tradition of a country has had an impact on the approach it takes to enacting a specific PPP law. There are two main approaches employed: (i) enactment of specific PPP legislation (favoured by civil law legal systems); and (ii) regulating PPPs on a project by project basis by contract (favoured by common law legal systems as is demonstrated by the experience of the United Kingdom).

Civil law jurisdictions rely on written laws and PPP projects rely on express legal authority. The contractual provisions entered into by the procuring authority and private sector and the interpretation of them will be derived from legislation (as opposed to, for example, the English common law principle where the intention of the contracting parties is given priority when interpreting contractual provisions).

Common law jurisdictions have a less prescriptive approach than civil law jurisdictions. The absence of a specific law does not necessarily mean an absence of a structured framework for PPPs. By regulating projects on a contractual basis there is scope and flexibility to foster contractual and financial innovation. This approach also enables the development and dissemination of good practice by developing standard contractual clauses common for similar PPP projects.

The civil law and common law distinction is apparent in the approach to PPP laws in the comparator and Mediterranean partner countries. Of the comparators, Poland and France are civil law jurisdictions that have enacted PPP legislation – the Polish PPP Act and the Concession Act and, in France, the December 11, 2001 Law and the June 17, 2004 Ordinance. Mexico, also a civil law jurisdiction, is in the process of enacting a specific PPP law. England is a common law jurisdiction and thus, the experience to date has been to place greater emphasis on and to derive certainty from the contractual provisions. With a hybrid legal system, South Africa has the benefit of Treasury Regulation 16 but has also closely followed the English example of comprehensive guidance and contracting.

The majority of the Mediterranean partner countries are civil law jurisdictions. The foundation of the legal system in Israel is built upon the principles of both common law and civil law and so, despite the absence of a specific PPP law, PPP procurement is relatively advanced reflecting strong contractual frameworks and specific regulations introduced when necessary. The other countries, where the legal tradition is to rely on written laws, would benefit from a specific PPP law if PPP procurement is a priority. The recent enactment of a PPP specific law in Egypt and initiatives to introduce PPP laws in Jordan, Lebanon and Syria reflect this approach.

In practice, the difference of the approaches is less strict notwithstanding a country adhering to a common or civil law legal system. For example, England follows the common law approach and it has not enacted an overarching, specific PPP law, however it has enacted general pieces of legislation that impact on PPP projects and/or institutions entering into PPP contracts. By the same token, in France the presence of specific PPP regulations has not stopped contracts being as precise as possible so as to reduce reliance on the courts to address any gaps, which could create uncertainty.

---

8 The executive regulations were issued in Arabic in early 2011.
Box 11: Benefits of a specific well designed PPP law

A well designed PPP law could improve the legal framework applicable to PPPs by addressing the following essential elements:

- clear and complete procurement procedures for the award of a PPP contract (including content of the contract notice, negotiation/competitive dialogue stages, remedies available to unsuccessful bidders on a successful challenge);
- clear guidelines on the contents of tender documents;
- State support and guarantees that may be available to investors;
- a clear division of responsibilities for such matters as project planning, identifying priority sectors and conducting feasibility exercises;
- definition and safeguard of rights and responsibilities of both public and private sector bodies;
- institutionalisation of and capacity building within the government to ensure knowledgeable reference point to all stakeholders;
- clear and complete guidelines in relation to the control and supervision of procurement procedures by public authorities and of project implementation post contract award;
- establishment of a PPP institutional framework, including for example the establishment of a PPP unit.

Does the legal framework sufficiently define the roles and powers of the awarding authorities?

Comparator countries

By granting procuring authorities clear powers to enter into long term PPPs, investors will be reassured of the legality of the contract. Such powers may be derived from laws specific to PPPs (for example the 17 June 2004 Ordinance (France), the Treasury Regulation 16 issued pursuant to the PFMA (which applies to national and provincial bodies in South Africa), Municipal Act 2000 and Municipal Finance Management Act 2003 (which applies to municipalities in South Africa)). Alternatively they may be derived from more general laws governing delegation of powers by public authority bodies (for example, Ley Orgánica de la Administración Pública Federal (Public Administration Organisation Federal Law) in Mexico, the Act of December 20 1996 on municipal management (Poland) or the Local Government (Contracts) Act 1997 (England)). The existence of clear authority for public bodies to enter into PPPs will simplify and ease the due diligence that investors and lenders and their respective advisers will undertake in this regard.

In some countries, there will be an approvals or certification process which must be completed prior to the public authority entering into the contract. This may be approvals from the ministry of finance charged with budget allocation (as in South Africa) or local assembly approvals (as in France). Parties entering into PPP contracts with public authorities will wish to ensure that these approval processes are satisfactorily complete and may, for example, seek a warranty or a letter confirming this prior to entering into the contract.

PPPs can be procured by public authorities in sectors related to the provision of public services. In the comparator countries, the ability of public authorities to procure PPPs is generally related only to services which are provided for public needs and not in relation to purely commercial projects (for example, shopping malls). This is an important limitation and one which should be respected. As PPP payments will derive from the public purse or from user payments directly, public authorities should not be perceived to be pursuing commercial projects. In addition, areas such as defence or matters relating to security are frequently excluded from the PPP model (as is the case in Poland, for example) as they may compromise matters of confidentiality and public safety.

Scope of services may be limited to non-core services. Laws may prevent a private sector partner from providing core public services, for example teaching and healthcare. However, ancillary services, for example the provision of cleaning or catering, can be the subject of a PPP project. Such limitations are important, in particular for public perception of PPPs, as the public is unlikely to support the outsourcing of key core services to the private sector as this is seen as "privatisation". In England, for example, hospital and schools PPP projects have, until recently, been widely procured but the core services of providing healthcare and teaching have in all cases remained a government obligation.

Mediterranean partner countries

The powers of public authorities in the Mediterranean partner countries to procure projects are varied, resulting in a complex legal framework, which would benefit from simplification. Whilst in some countries there appears to be clear authority to procure PPPs, this is not the norm. Rather, and perhaps a reflection of the relatively early stage of PPP procurement in the region, the authority to procure PPPs is not always general but achieved by ad hoc measures, such as the enactment of project specific laws. This is the case in Algeria where, for example, a motorway concession which is currently not regulated/authorised by a sector specific law would require new legislation specifically permitting such a concession. In Lebanon, the Construction Act 1989 requires the passing of a law to authorise a new concession. However, in practice, this is not always adhered to and some concessions (albeit not project financed) have been concluded through private and direct negotiation without formal tendering or authority to award. Such practices can deter potential bidders from pursuing the market if they believe that standard and transparent processes may not be followed. In Egypt there is a number of legal bases upon which to procure projects (public economic entities, public utilities legislation, sector specific laws, project specific laws and the PPP Law9). PPP procurement in Morocco is particularly complex. A number of laws and avenues exist (i.e. Law 54-05 (the Concessions Law) and the Procurement Decree10), but procurement by some types of public bodies is not clearly permitted in the law, notably procurement by central government departments. PPP projects which are structured in a way other than a true concession model (where the private sector takes the demand risk) is also not specifically regulated by the current laws. Similarly, in Tunisia, there is a specific legal

---

9 Law No. 67 of the year 2010
10 Enacted by Dahir No. 1-06-15 of 14 February 2010
11 Decree No. 2-06-388 of 5 February 2007 in respect of procurement contracts
regime granting authority to procure concessions. However, other models are not specifically regulated. There are also some overriding sector specific laws (for example, in the energy, telecommunications and sanitation services sectors).

The benefits of streamlining the legal basis for procuring PPP projects has been recognised in Jordan. It is expected that the Draft PPP Law12 would achieve this by specifically excluding application of the Privatization Law11 and the Privatization Regulation14 to PPPs, which currently empower public authorities to procure PPPs. It is intended that the PPP Law will apply to all sectors, save for national defence, police, award of justice, core areas of healthcare and education and other specific activities identified. A similar approach could have been adopted in Egypt by abolishing the application of the legislation relating to public economic utilities, public utilities and specific sectors when the PPP Law came into force.

General commercial and administrative laws govern PPPs in Israel, but the ability to introduce project specific legislation when required ensures there is sufficient legal authority to bind the public sector. In Israel, legal authority to procure a PPP is not set out in any specific legislation. Rather the general laws applicable to corporate, commercial and administrative matters apply and where sufficient legal power relating to the project is not enshrined in the existing laws, a new law will be enacted (as was the case on the cross-national toll highway project where two laws were enacted to address land acquisition and tolling). Similarly, in the West Bank there are no specific legal powers to authorise the entering into of PPPs. Any such activities would be governed by existing laws applicable to corporate, commercial and administrative matters (including the Law of Tenders for Public Works number 6 of 1999).

The lack of general cross sector PPP authorisation may not be problematic if sector specific laws, in respect of sectors where PPPs are prevalent, provide the required authorisation to outsource the relevant services. Sector specific laws feature in Algeria in the water, electricity and gas sectors; in Egypt in the electricity, ports, airports and roads sectors; and in Syria in the ports, electricity and petroleum sectors. Projects have been successfully procured in these countries on the basis of these sector specific laws.

Would lenders and investors be comfortable with the country’s law governing project and finance documents?

Comparator countries

A clear underlying legal framework in the comparator countries instills confidence amongst local and foreign investors. PPP contracts in all of the comparator countries tend to be governed by the law of that country. This is a reflection of the maturity of that legal system in general.

In the case of England and France the PPP legal framework is well established and French law and English law often govern PPP financing contracts in other jurisdictions. These markets have achieved sufficient levels of maturity and created a broad experience base such that lenders participating in PPP projects in some countries insist that their finance contracts (not the PPP contracts) are governed by these laws. Lenders insist on such choice of law as they require certainty that adequate security for their rights is available and can be enforced if required. This is particularly an issue in relation to project finance structures where lenders require a range of security to protect their rights against the Project Special Purpose Vehicle (Project SPV) (notably rights to receive payments against the loan and rights in the event of other default by the Project SPV such as insolvency or non-payment to subcontractors).

The other comparator countries also have the benefit of legal frameworks, which are well developed and are suitable to govern the PPP contract documentation. Financing contracts in Mexican and South African PPPs tend to be governed by the law of the country. In Poland, international lenders are still likely to insist on a more familiar law (such as English law) to govern their contracts. The key requirements of lenders and investors for a legal framework are set out in Box 12 below.

Mediterranean partner countries

PPP contracts in the Mediterranean partner countries will be governed by the law of the country and investors will carry out due diligence as to the suitability of the law. As PPP contracts are public contracts, this position is as one would expect. This means that equity investors will carry out thorough due diligence into the laws of the country and will work with local legal advisers in this regard. It will also mean that investors are likely to insist, in common with lenders, on the ultimate dispute resolution method being arbitration, as this may avoid recourse to the local court system, with which they are unfamiliar. Experience to date and indications in draft PPP laws demonstrate that public bodies in the region are amenable to this approach.

Financing contracts involving international funders are usually governed by the law of countries with an established body of law applicable to financing. These are more familiar to lenders and are perceived as providing stronger protection to lenders. International lenders are likely to prefer more familiar legal systems governing their contracts and frequently, English or French law is chosen. This has been reflected in practice to date in Algeria, Egypt, Israel, Jordan and Morocco. By contrast, in Tunisia, Tunisian law must govern the contract where the applicable goods are located in Tunisia. This has the effect of restricting security documentation to Tunisian law. This may be a concern for some international lenders investing in Tunisia due to the lack of familiarity with the Tunisian legal system. In jurisdictions where there has been little evidence of project financed PPPs to date, notably Syria, Lebanon and the West Bank, it would be beneficial for attracting foreign participants if the contract design and the applicable legislation permit financing contracts to be governed by a legal system which caters more thoroughly for these types of structures.

---

12 Dated 1 June 2010 (a new draft law has been issued since 1 October 2010)
13 No. 25 of the year 2000
14 No. 80 of the year 2008
Both investors and lenders will require the following elements in the legal framework:

- Clarity of laws;
- Comprehensive laws;
- Due process and certainty of outcome; and
- Freedom to contract.

Lenders will additionally require:

- Availability and enforceability of security; and
- Certainty of the powers of the authority to enter into the contract and certainty for payment of compensation on termination.

**Box 12: Key elements of a legal framework**

Would lenders and investors be comfortable with the judicial system and commercial dispute resolution system in a country?

**Comparator countries**

The dispute resolution procedure applicable to the PPP contract and other project contracts should provide a clear, efficient and practical/commercial means of resolving disputes. To this end, it is common for PPP contracts to provide for tiered dispute resolution processes, incorporating informal methods of dispute resolution in the first instance (for example, discussion between senior representatives of the parties) and more formal next stage methods of dispute resolution, typically adjudication, expert determination (in relation to technical, non legal matters), arbitration or court proceedings.

PPP contracts may include court proceedings as the final forum for dispute resolution where the local court process is efficient and has the benefit of judges experienced in complex commercial disputes. In France, PPP disputes are in the main resolved in the courts as recourse to arbitration is generally prohibited for public entities, except where permitted by a specific law which is the case in the Ordinance on contrats de partenariat. Public authorities are likely to prefer dispute resolution in the courts as the courts are part of the institutional framework to which they belong and provide consistency as their other contracts are likely to provide for dispute resolution by the courts. Making the court process apply to PPP contracts may be beneficial from the public sector’s view as a matter of policy – it will allow the courts to build up experience in such disputes. However, this may present difficulties from an investor’s point of view.

Related disputes should be heard together. Where litigation is the chosen method of dispute resolution, it would be beneficial to the project from the point of view of cost-efficiencies, time efficiencies and consistency if related disputes at different levels of the supply chain were heard together. Therefore, a dispute between the public authority and the private sector partner which also impacts a subcontractor should be heard together. The Private Finance Initiative (PFI) guidance in England permits this approach. However, in some legal systems, this is not possible as different courts have jurisdiction over public contracts (i.e. contracts to which a public authority is party) and commercial contracts (between two private entities).

In France, for example, there is a jurisdictional duality such that public law contracts, such as PPP contracts, are subject to the administrative courts, whereas litigation of commercial contracts, such as a construction contract between the Project Special Purpose Vehicle (Project SPV) and its construction subcontractor, will be held before the civil courts.

Arbitration is a more viable option for final and binding dispute resolution as it is attractive to foreign investors, having been used to resolve disputes in PPP and other major infrastructure projects worldwide. Agreeing to arbitration as the final forum for dispute resolution is attractive to investors as it is not reliant on local law insofar as the applicable arbitration rules are complete, it preserves confidentiality and the more established rules have the benefit of past experience. Parties also maintain control over the arbitrator and the seat of arbitration. Choosing a foreign seat of arbitration is another way of ensuring that any gaps in the arbitration rules will be filled in by the law applicable to the seat of arbitration.

International arbitration is likely to be more appropriate than local arbitration. International contractors and lenders will prefer familiar and established rules of arbitration, such as the International Chamber of Commerce (ICC), the United Nations Commission on International Trade Law (UNCITRAL), the International Centre for Settlement of Investment Disputes (ICSID) and the London Court of International Arbitration (LCIA). However, domestic arbitration rules may be suitable where they are robust and similar to established rules. For example, this is the case in English PFI contracts, which tend to permit arbitration pursuant to domestic arbitration rules and are governed by the English Arbitration Act[^15].

**Mediterranean partner countries**

Many of the PPP contracts concluded in the Mediterranean partner countries recognise the benefits, in terms of time and cost-efficiency and in relation to the on-going partnering relationships, of tiered dispute resolution clauses. Such clauses ensure disputes are first referred to more informal processes for the resolution of disputes between the parties before reference to more formal dispute resolution procedures. Sometimes an interim measure (such as mediation) is also included. Such approaches have been seen in Algeria, Egypt, Jordan, Morocco and Israel and other countries should seek to replicate these approaches.

Enforceability of foreign arbitral awards made abroad is supported by the New York Convention. All Mediterranean partner countries, (except for the West Bank) are signatories to the New York Convention which requires signatories to recognise and enforce arbitral awards made in other signatory States. Enforcement of arbitral awards in the West Bank is likely to be difficult but court judgements made abroad may be enforceable on the basis of the Execution Law No. 24 of 2005. The preference of international project participants and lenders for arbitration over court proceedings has been recognised by procuring authorities in the Mediterranean partner countries. The default position is that disputes will be ultimately resolved by court proceedings. However, an arbitration agreement (set out in the dispute resolution provisions in the PPP contract) can alter this position.

[^15]: Arbitration Act 1996
In Algeria, Morocco, Jordan and Tunisia, practice to date has seen the adoption of arbitration under internationally recognised rules, such as ICC, UNCITRAL or LCIA, particularly where foreign parties are involved. Continuing such practices will provide comfort to international sponsors and lenders.

In Israel and Egypt, PPP contract disputes are frequently subject to arbitration, but unlike the experience in the countries mentioned above, the arbitration is run under domestic rules. This will be a satisfactory approach to the extent that these domestic arbitration rules broadly follow the more internationally recognised procedures and this will entail some due diligence on the part of international project investors. If foreign investors and lenders increase their participation in these markets, it may be that the relevant authorities will need to review the rules of arbitration and be more open to disputes being subject to international arbitration.

In Syria and Lebanon, it is expected that PPP contracts will provide for international arbitration. This will alleviate any concerns arising due to the early stage of the programme and concerns relating to the ability of the local courts to manage complex commercial disputes. The Syrian and Lebanese draft PPP laws recognise the benefits of and promote the use of international arbitration.

---

**Legal and regulatory framework – recommendations/success factors**

**Power of public authorities to procure PPP**
- Establish clear rights under law that permit public authorities to procure PPPs.
- Public authorities should obtain clear authorisation for the procurement of PPPs prior to entering into a contract.

**PPP laws**
- Ensure that the law governing PPPs is clear and comprehensive.
- Support primary PPP legislation with secondary legislation and comprehensive guidance.

**Dispute resolution procedures**
- Provide efficient and clear dispute resolution procedures for project contracts.
- Permit the use of international arbitration as a final forum for dispute resolution instead of court proceedings as this is often the preferred option for foreign investors.
4. BIDDING PROCESS

Clear procurement processes which uphold the principles of fairness and equality to all bidders and which provide transparency in the public sector’s decision-making process are necessary to encourage effective competition for Public Private Partnership (PPP) projects. This not only benefits foreign investors and funders by providing comfort that their bids will be treated on merit, but also benefits the public authority by achieving better value for money, as increased competition will help drive down prices and encourage better technical solutions.

This section addresses the suitability of PPP procurement procedures and examines the following questions:

- Does the law set out clear procurement processes which are suitable for PPP structures?
- Is the procurement process structured to reflect the complexity of the project?
- Does the procurement procedure respect the key principles of fairness, transparency and equality?
- Are unsuccessful bidders duly notified and do they have rights of challenge?
- Is the public sector accountable for its decisions?

**Comparator countries**

In each of the comparator countries there are clear laws which govern the procurement of works or services to the public sector and which are suitable for PPPs. The aim of the relevant laws is to secure the best value for money for the public sector by mandating procedures that will attract a wide number of bidders and increase competition. The procurement procedures in the comparator countries apply international standards of transparency and non-bias and the procedures are clear and understood by the bidding community. In South Africa, Treasury Regulation 16 issued in 2004 requires that the PPP procurement procedure "(a) must be in accordance with a system that is fair, equitable, transparent, competitive and cost-effective; and (b) must include a preference for the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination in compliance with relevant legislation." Similarly, there are set procurement procedures prescribed in European Union (EU) legislation (as implemented in French, English and Polish law) applicable to different types of public contracts, including PPPs. The procedures have as their aim the promotion of competition by giving bidders an equal opportunity to tender for and win public contracts on their merits. In Mexico, article 134 of the Federal Constitution sets out that procurements of services and/or public works must be through a public bid in order to ensure the best conditions for the State under the principles of efficiency, honesty, transparency and any other convenient conditions. Whilst not specific to PPPs, the Mexican procedures are well suited and have been adapted positively for PPPs.

**Mediterranean partner countries**

Egypt and Israel have adopted tendering procedures that have been designed specifically for use on project financed PPP projects. The new PPP Law in Egypt16 allows for dialogue and negotiations with bidders; which is more aligned to international PPP procurement practice than the general Tender Law17. The bidding procedures under the Tender Law will continue to apply where the procuring authority chooses to procure its projects under the old regimes. Therefore when choosing whether to opt to use the PPP Law, the Egyptian authorities should consider the relative advantages of the new procurement procedures in increasing competition and therefore value for money. The more simplified procedures under the Tender Law may be preferable for authorities where the projects being procured are relatively simple and where the authorities would not benefit from more involved discussions/negotiations with bidders. In Israel, the Mandatory Tenders Law18 and its implementing regulations govern procurement of PPP projects. The tenders legislation sets out defined stages in relation to the tender procedure, which are consistent with international PPP practice and if applied correctly should ensure a fair, transparent and competitive bidding process.

The procurement processes in Algeria, Morocco and Tunisia have been serviceable for certain complex projects, but the development of procedures specific to PPPs may be beneficial. The system in current use in Algeria has been designed for the procurement of a large range of different products and services (though not PPPs specifically). In particular the procedure set out in the Algerian Procurement Code has formed the basis of internal procurement procedures for use in the energy sector (for example procurement by SONELGAZ and SONATRACH). In Morocco, there are different legal procedures which can apply to PPP procurements, but application of an incorrect procedure can render the procurement susceptible to challenge and that may create a level of uncertainty which will disadvantage bidders. In Tunisia, the Concession Procurement Decree19 (secondary legislation under the Concession Law20) is relatively recent and therefore its application in practice is yet to be fully tested and proven (although the project specific procedure announced for a concession involving the construction and operation of two water plants (along with the operation of three others) appears to be consistent with international practice). Given the apparent uncertainty as to the application or effectiveness of the current procedures to PPPs, it may be advantageous for changes to be considered to the procurement regime which would be specific to PPP projects and clarify the process to be applied.

The detailed procurement procedures to be followed under the new PPP laws being developed in Jordan, Syria and Lebanon are still to be defined. The respective draft PPP laws in these countries leave the detailed procurement processes to be defined subsequently by secondary legislation. It therefore remains to be seen what stance the authorities in these countries are taking to tendering PPP projects and how they will ensure fairness, transparency and competition. After the passing of the law, the next step would be to introduce

---

16 Law No. 67 of the year 2010
17 Law 89 of the year 1998
18 Law No. 5752-1992
19 Decree No. 2010-1753 of 19 July 2010
20 Law No. 2008-23 of April 1 2008
secondary legislation; implementing it within a short timeframe following the PPP law would enhance the law’s credibility. It may also be an opportune moment for these governments to investigate other tendering procedures which are being implemented in the Mediterranean partner countries. For example, they might want to consider those procedures set out in the new PPP Law in Egypt\(^\text{21}\) which permits discussion in the tendering phase and does not simply demand an offer against fixed terms and conditions (restricted procedures) with a view to adopting further detailed procedures as part of a wider reform initiated by the respective PPP laws.

**Is the procurement process structured to reflect the complexity of the project?**

**Comparator countries**

Based on the experience of the comparator countries, procurement procedures are designed to reflect the scale and complexity of the project. Although each of the comparator countries has developed precise procedures with defined stages (and their own terminology), the stages set out below represent an approach that is broadly based on these countries:

- pre-procurement preparation;
- advertisement;
- pre-qualification questionnaire;
- invitation to tender;
- clarifications including discussion/negotiation;
- bid submission;
- selection of a preferred bidder;
- appeals (if any); and
- contract award.

In the comparator countries the procurement procedures that are adopted for PPPs allow a varying degree of interaction with tenderers and control over the process, generally reflecting the complexity of the project. In South Africa, for example, the procurement process set out in Module 5 of the ‘National Treasury PPP Practice Notes’ allows for a two-way communication process between the bidders and the authority during the initial preparation of the request for proposals documentation. Allowing feedback from all bidders prior to the issue of the bidding documents has proved useful in adding value to the bidding process; especially on complex projects. In Mexico, the public bid process allows for public question and answer clarification meetings. Similarly, EU law as applied in the domestic legislation of the United Kingdom (UK), France and Poland prescribes different processes depending on the complexity of the project. The process to be used for particularly complex projects (i.e. most PPPs) must include discussions and dialogue or negotiation with shortlisted bidders.

**Pre-procurement preparation is key to successful and efficient procurements.** Each of the comparator countries recognises that the authority must ensure adequate preparation prior to advertising the tender and issuing the tender documents. In the UK for example, the planning stage for PPP projects is lengthy. Before the project is advertised, the authority is required to:

- assess the business need;
- appraise the procurement options;
- discuss with the relevant governmental department;
- develop an Outline Business Case; and
- obtain approval by the relevant government body/board of the procuring organisation.

In France, a task force responsible for supporting and regulating PPP projects has been set up. The Mission d’Appui à la Réalisation des Contrats de Partenariat (MAPPP) is principally involved in the first part of the contrat de partenariat procedure by validating the preliminary assessment and also providing support in the preparation and negotiation of procurement and contract documents.

**Mediterranean partner countries**

Some of the Mediterranean partner countries may benefit from procedures that permit dialogue between the authority and pre-qualified bidders before final bid submission. In Morocco and Algeria, for example, there is no procedure which permits the authority to hold structured dialogue simultaneously with rival bidders. In contrast, individual discussions with each bidder are permitted in Israel and Egypt and are envisaged to be permitted under the Draft PPP Laws in Syria and Jordan\(^\text{22}\). If managed well, procedures which foster discussion and cooperation with bidders can be beneficial, especially in the early stages of maturity of PPP. Where complex projects are being procured, the authority may not be able to objectively define the technical solution to satisfy its needs or may be unable to identify in advance the legal or financial make-up of the project. In such circumstances, dialogue with bidders (treated equally), who have prior experience and technical know-how from similar projects may allow for refinement of the specifications and therefore result in a more robust project, which better meets the needs of the procuring authority.

Further, the use of such procedures provides confidence to those financing projects that such proposals are viable and procuring authorities have made well-researched and informed decisions on the selection of contractors.

**Pre-procurement preparation could be enhanced in the Mediterranean partner countries.** A number of projects (both PPP and other major projects) in Jordan and Algeria, for example, have not succeeded. The projects were withdrawn from tender after selection of preferred or shortlisted bidders. This was mostly due to lack of preparation and project viability assessment in the early stages or failure to provide clear specifications or complete tender documentation (including the terms and conditions of the contract). This resulted in further bid costs, uncertainty for bidders and prolonged tender periods. Upfront investment will ensure that the process is efficiently managed and investor/bidder interest is maintained. This investment should comprise engaging expert advisers to develop appropriate tender documents and to conduct necessary technical and economic viability studies. One way of achieving this would be to establish dedicated infrastructure units to strengthen and shorten the project preparation, appraisal and implementation stages.

\(^{21}\) Law No. 67 of the year 2010

Comparator countries

The principles of fairness, transparency and equality are upheld in the comparator countries through procedures which are open and transparent and that apply equal criteria to all bidders. For example in the UK, France, Poland and South Africa, transparency is achieved through procurement procedures that require the authority to set out clearly the way that the procurement is administered and to strictly adhere to those rules. Bidders are typically provided with:

• a clearly defined and detailed scope, including requirements, pricing and technical specifications;
• the ability to raise clarifications during the process and a clear process for how the authority will respond;
• provision of the same information to every potential bidder;
• fully disclosed selection criteria; and
• fully documented selection proceedings.

In Mexico, transparency is achieved by making the steps in the procurement process open to the public, particularly through the use of Compranet, an official government website dedicated to public procurement, administered by the Ministry of Public Function (see Box 21 below).

Transparency and fair competition is also ensured through widely advertised tenders and awards of contract. For projects procured in France, Poland and the UK, the public authorities are obliged to publish a notice in the Official Journal of the European Union (OJEU) both at the beginning and at the end of a procurement. The notices respectively advertise the intention to begin the tender procedure and notify of contract award. For public bids in Mexico, there is an open invitation to bid and question and answer clarification meetings are also events open to the public. All relevant information in respect of a bid in Mexico must be published on Compranet. In South Africa, the advertisement is placed as per the procuring authority’s procurement plan. This can include notification of the project in the government tender bulletin; in prominent newspapers and journals; on the relevant authority’s website; and on the national treasury’s PPP website. The result of advertisement practices in the comparator countries is to increase competition between bidders, which in turn has encouraged competitive pricing, innovative solutions and improved technical proposals.

Objective and transparent award criteria are prevalent in the comparator countries and ensure high quality competition. Pre-qualification is generally used in the comparator countries to eliminate certain bidders on objective criteria such as past experience or financial and technical capacity. By reducing the number of bidders, pre-qualification may also stimulate qualified firms to prepare better quality proposals due to the imposition of shortlisted bidders which all meet the contracting authority’s selection criteria. In France, for example, it is common in PPP procedures to reduce the number of bidders to four following the pre-qualification process. The invitation to pre-qualified bidders to participate in the tender are issued with objective award criteria. Comparator countries widely use criteria such as the “most economically advantageous tender” (MEAT). This is a benchmark that considers not only the tender price of a bidder’s offer but also enables the procuring authority to put a value on any risks that the bidder tries to transfer back to the authority. In Mexico, the procurement laws specify that the contract award should go to the bidder that tenders “the most advantageous conditions”. Such conditions take into consideration factors such as financing terms, technical conditions and past performance on other contracts.

Mediterranean partner countries

The fundamental core principles of transparency, fairness and equality are specified in the procurement legislation of most of the Mediterranean partner countries. Each country’s procedures uphold the principles to differing degrees as explained below.

Regarding the award criteria, Mediterranean partner countries adopt a two-stage evaluation procedure where the technical and financial bids undergo separate evaluation. This process is good practice if appropriate weighting is allocated to the technical solution. In some cases, significant emphasis is placed on the price of the bid and this could have the undesired effect of reducing the technical evaluation to a mere filter for inadequate technical proposals. In Algeria, Jordan, Lebanon, Tunisia and Syria, for example, the bidder with the lowest price evaluation for the financial offer is selected if it has met the minimum technical threshold. If there is a pass/fail evaluation in relation to the technical offers followed by a lowest price evaluation for the financial offer, there is a danger that the procuring authority may not select the best technical solution to meet its needs and therefore not achieve best value for money. An alternative could be to use sophisticated award criteria which apply weightings to different components of the bid and do not rely overwhelmingly on price (see Box 13). It is essential that thought is given to specifying individual criteria, since if no criteria are specified, “lowest price” applies by default. In Morocco, for example, the most commonly used award criterion is that of “most economically advantageous tender”. The Moroccan definition of “most economically advantageous tender” is broadly in line with international practice which places emphasis on the overall solution cost and not just the short term lowest cost offering. In Israel

---

23 Mandatory Tenders Regulations 5753-1993
24 Law No. 67 of the year 2010
procurements which are not based on lowest price consider the overall benefit of the bids to the procuring authority. There is, however, varying emphasis on financial/technical offers and scores are still weighted as much as 80% on price.

Box 13: Award criteria – lowest price or most economically advantageous tender?

The criteria on which the contract will be awarded should measure value for money. However, “value for money” cannot be an award criterion in itself. Whether the bid represents value for money is determined by the constituent parts of the bid. The applicable criteria are therefore “lowest price” or the “most economically advantageous tender” (MEAT) – that is consideration of price plus other factors, which are appropriately weighted and converted into scores for each bidder.

**Lowest price**

The lowest price approach does not always take into consideration differences in qualitative aspects of a bid. As such, it is generally only suitable for simple procurements for short term, low-level services or contracts of a standard specification. For complex projects procured as PPPs it would generally be more appropriate to use the MEAT criteria, subject to an assessment of the weightings to be applied.

**MEAT – Balancing quality and cost**

The emphasis that an authority places on price and on quality should naturally vary, depending on the available budget and the nature of the project procured. Scoring models can be devised to allocate different “weightings” to different elements of a bid. For example, a higher price weighting may be more suitable for a project with a very restricted budget combined with a clear and detailed statement of requirements, whereas quality (see below) would have the higher weighting for projects where the level of service to be delivered is key to the public body.

Quality criteria must be linked to the subject matter of the contract so that they are directly related and proportionate to the contracting authority’s requirements. Some examples are:

- Aesthetic and functional characteristics;
- Capability;
- Capacity;
- Continuous improvement;
- Customer care policies;
- Delivery date or period and ability to deliver;
- Equal opportunities;
- Performance standards, quality control, self monitoring and complaints;
- Relative impact on the environment;
- Sustainability issues and environmental characteristics;
- Skills level of the workforce;
- Technical assistance;
- Technical merit.

The above has to be balanced against the need of ensuring objective comparability of different technical solutions.

In Jordan, Egypt and Israel, the publication of evaluation criteria ensures transparency. In Israel the evaluation and award criteria are, in practice, determined on a project by project basis. The evaluation criteria and methodology tend to be described in detail, for example by outlining the scoring system. The Technical Committee in Jordanian PPPs is free to decide its own evaluation criteria, although it must disclose the evaluation criteria it selects in both the announcement soliciting expressions of interest and the section on instructions to tenderers in the Request for Proposals (RFP). This is good practice that ensures fairness and transparency. The PPP Law tender procedure in Egypt provides that the bid documents prepared by the PPP Central Unit (PPPCU) in coordination with the relevant procuring public authority should include general information relating to the project, project specification and technical requirements (including evaluation criteria and methodology and instructions and timetable for bid submissions). In theory, the process is rigorous and should assure competition.

Fairness to all bidders could be enhanced in Algeria by removing the preferential treatment given to domestic bidders, as has been done in Egypt. In contrast to the Tender Law\(^{25}\), the new PPP Law in Egypt\(^{26}\) provides no preferential treatment to Egyptian bidders. This is presumably in recognition that under the Tender Law this was an issue for foreign investors. Foreign investors could be at a disadvantage where countries are biased towards local companies. This uncertainty may deter foreign participation in tender competitions. For instance, margins of preference applied in Algeria continue to place potential foreign investors at a disadvantage. This important issue of fairness to all bidders may need to be specifically addressed by the Algerian government if foreign investment is to be encouraged.

Are unsuccessful bidders duly notified and do they have rights of challenge?

Is the public sector accountable for its decisions?

**Comparator countries**

The possibility of legal challenge and accountability of the public sector to due legal process in the comparator countries ensures that the general principles of a fair and transparent procurement are upheld. In all comparator countries, non-compliance by the authority with the prescribed procurement procedure entitles the unsuccessful bidder to challenge the contract award to an independent and impartial body. Given the size of the risks, resource commitment and costs involved in participating in the bidding process, it is important that bidders are confident that the procurement procedure affords them an equal opportunity and that any rejection of the bid is based entirely on its merits. If there has been a flaw in the procurement process in the comparator countries, aggrieved bidders can raise their grievance with an independent body empowered to provide an effective recourse. This increases public sector accountability.

---

25 Law No. 89 of the year 1998
26 Law No. 67 of the year 2010
Unsuccessful candidates are informed and de-briefed on why their bids were rejected. In the UK, France and Poland for example, the procuring authority is obliged (as a result of domestic implementation of EU procurement law) to de-brief the unsuccessful bidders. This then triggers the “standstill period”, during which the contract, although technically awarded, may not actually be entered into pending a challenge from an aggrieved bidder. These periods are not very long (for example, in EU procurement it is ten days) and therefore will generally cause little difficulty for the successful bidder or the procuring authority. In Mexico, aggrieved bidders may file a bid protest of award challenge within six working days of award if it believes the procurement procedure applied does not comply with the law.

The remedies available for non-compliance are clear and effective. Recent EU legislation (implemented in England for example through the Public Contracts (Amendments) Regulations 2009) has stipulated a new remedies regime which applies greater sanctions on public authorities that have breached the procurement procedures. The legislation allows the automatic suspension of any contract award when legal proceedings are issued against the contracting authority (no separate court application is required) but an authority can apply to have the suspension set aside. Contracts that have been awarded can also be ruled ineffective (or void). The authority would therefore be required to re-procure the project. Financial penalties are also payable by procuring authorities for operating flawed procurement processes although, in practice, uncertainty continues to surround the amount of such penalty. An effective remedies regime will act as an incentive for authorities to comply with the procurement procedure and will provide investors with comfort that they will have suitable recourse if the procurement is not managed in a fair and transparent manner.

Mediterranean partner countries

There are procedures in place in all Mediterranean partner countries to deal with aggrieved bidders and to resolve complaints regarding the integrity of the bidding process. These procedures are set out in specific PPP laws (enacted or in draft where relevant), or the general law may provide for the review of public sector decisions when procurement procedures have not been followed. This is the position in Tunisia where the general law allows public sector decisions to be reviewed in cases of alleged non-compliance by the procuring authority. The PPP Law in Egypt provides for a complaints procedure for aggrieved bidders, but is silent (and may therefore benefit from some clarity) on the issue of the remedies and relief available for non-compliance with the procurement rules. In Israel, case law has established a set of additional general principles applicable to all public procurements, which require the procuring authority to avoid even the appearance of impropriety. A breach of the principles of equal treatment of bidders, fairness of competition, reasonableness, good faith, non-discrimination, and the avoidance of arbitrariness and conflicts of interest runs the risk of challenge in the courts but, in practice, PPP cases are rarely challenged in court. Whilst there are options for challenging procurement decisions in Syria, the effectiveness of the process is not clear and will benefit from development in the PPP context. In Morocco, one of the benefits of a new PPP law is that it could improve the PPP procurement process by addressing the remedies available to unsuccessful bidders on a successful challenge.

Bidding process – recommendations/success factors

- Set out in the law clear procurement processes which are suitable for PPP structures.
- Ensure that procurement procedures uphold the key principles of fairness, transparency and competition.
- Ensure that the procurement framework makes the public sector accountable for its decision, which must identify a winning bidder who has the ability to implement the project successfully.
- Establish a procurement process which is structured and includes procurement stages that reflect the scale and complexity of the project.
- Design a procurement procedure which includes conditions that encourage competition between bidders so as to allow public authorities to achieve better value for money.
- Advertise projects appropriately, using accessible forms of media.
- Use award criteria that are objective and transparent.
- Authorities should strictly comply with procurement procedures as this ensures certainty by removing the risk of challenge.
- Publicly advertise contract award.
- Notify unsuccessful bidders of decisions and provide an opportunity to give a debrief of their bid, setting out the reasons for elimination.
- Give unsuccessful bidders access to clear rights of challenge and effective remedies.

27 Law No. 67 of the year 2010
5. Contract Design and Risk Allocation

A fundamental principle in project finance structures is that the economic benefit to all parties is optimised if risks are contractually allocated to the party best placed to manage the particular risk. Contract design is therefore crucial to achieving the optimal outcome for all parties.

This section first sets out the key principles of risk allocation and contract structure in Public Private Partnerships (PPPs) in the comparator countries. It then deals with each significant risk issue in turn, examines key questions relating to that risk and how they are addressed in PPP contracts in the context of the comparator countries and the Mediterranean partner countries: Payment mechanism issues and financial risks are discussed in the next section.

Key general principles of risk allocation and contract structure

Comparator countries

A typical project finance structure will recognise the participation and interests of all key project parties, including the authority, Project Special Purpose Vehicle (Project SPV), sponsors, subcontractors and lenders. In the experience of the comparator countries and Mediterranean partner countries the project structure usually includes direct agreements between the public sector contracting authority and the lenders, step-in rights for lenders (for example, to replace the operator if necessary), security by assignment of project receivables as well as the key project and financing documents. Principles of risk allocation between the public sector and private sector parties depend on the country and the specific project, although certain standard principles can be observed, as described below. A typical project finance PPP structure is set out in figure 2 below.

Figure 2: A typical project finance PPP structure

A unique feature of project financed PPP projects is that the budgeting, financial structuring and risk allocation between the Project SPV and its contractual counterparties – the authority, the subcontractors, the shareholders, or otherwise allowed for in the Project SPV financial plan. This risk allocation is achieved by specific provisions in the project contracts or, in certain cases, by application of general law. In the United Kingdom (UK), in the public sector business case approval of PPPs, risk allocation is specifically analysed by means of a risk matrix identifying, for the particular project, the nature of the risk and which party is to bear it. The same risk allocation principles are then included in procurement documents, so that the private sector is clear as to the expected risk allocation.

By striking the right risk balance in the PPP contract, coupled with a competitive bidding procedure, the public sector will ensure that the private sector offers the best price thereby maximising its cost-efficiency or value for money. A cost-efficient project is one that reduces the cost of capital; facilitates the bankability of projects; limits public sector risks to the necessary; and reduces the risk premium that the public sector has to pay and therefore the cost of the infrastructure service delivery. Best value for money, on the other hand, represents the optimum combination of whole-of-life costs and quality (or fitness for purpose) of the goods or services to meet the user’s requirement (definition of HM Treasury (UK)). It creates stable project cashflows that attract long term domestic and foreign lenders and investors to invest in PPPs. In effect, such investors would take a combination of project risk (supported by subcontractor guarantees as normal in project finance) and public sector credit risk – a combination which has been readily financed in a wide range of PPP markets.

A typical outcome in PPP in the comparator countries has been for the private sector to take all risks associated with delivering performance to the specification required. Fundamentally, the private sector takes the risks on its own performance. Macroeconomic risks such as exchange rates and inflation are generally allocated to the authority, unless these can be separately hedged or managed by the private sector. Changes in law and regulation require compensation by the authority or adjustment to the PPP contract terms, to keep the Project SPV
whole. Insurable events such as damage are a private sector risk for which insurance covers the costs (including lost revenues). Events outside the control of the parties – “force majeure” – are generally shared, but whether an event constitutes force majeure can vary between countries. In the comparator countries, the expected outcome is often set out in specific guidance published for the specific sector (as in the UK) or by the use of standardised documentation (as in Mexican road and power projects), with any deviations from standard or from precedent requiring central approval. Such guidance has needed only occasional updating to reflect changes in market conditions on specific issues, and has significantly assisted in shortening negotiation and procurement times for PPPs.

As a result of this risk allocation, the project parties have to keep to a clear discipline in their relationships and management of the project. The main benefit to authorities of the PPP approach is project discipline as, provided it is well structured, the private sector will have strong incentives to deliver on time and according to specifications. Consequently, the authority must carry out extensive evaluation that it is satisfied with the project design, timing and specification in advance of contract signature. After contract signature, it can request material changes only under exceptional circumstances through the contract variation procedure, to agree the price and specification of a variation. Thereafter the authority does not usually interfere in how the Project SPV delivers the project (providing it is doing so within the contract specification), but instead manages the project as a client, to ensure that the services are delivered in accordance with the contractual terms. This principle applies also where the authority or other government entity also participates in the Project SPV: such co-investment helps to foster partnership and share economic returns in the project, but does not permit the authority to seek to have the project contracts overridden. The public sector must ensure that it can properly manage the contract during the operational phase to ensure that the private sector is performing to the required standard. This is easier in projects such as power plants or toll roads, and harder in social infrastructure projects such as schools or hospitals.

The project agreement (or PPP contract) is the main agreement between the public authority and the private sector partner. This agreement regulates the partnership and risk allocation between the public and private sectors over the duration of the contract, typically long term and in the region of 25-30 years and sets out the terms of their relationship, including (without limitation): the scope of works and services; output requirements; performance standards; payment structure (including the allocation of demand and performance risk); delay events; consequences of changes in law; default events; termination rights; and dispute resolution procedures. The project agreement acts as the foundation of the project and establishes the framework for all of the other project documents.

Lenders provide financing to the Project SPV for the construction of the facility in accordance with the terms of the loan agreement and related financing documentation. The loan agreement will, inter alia, regulate terms of drawdown and repayment, events of default and lenders’ monitoring rights. Other finance documents include the following: notices of assignment (an assignment of the Project SPV’s rights and interests under the principal contract documents and security over its assets); direct agreements (to create step-in rights for lenders into the various contracts to which the Project SPV has entered into and other issues that lenders may require comfort for); hedging agreements (to hedge interest rate or exchange rate movements); accounts agreements (to govern the operation of the Project SPV’s bank accounts over which the senior lenders have security).

As a guide, Appendix 1 sets out a typical risk analysis of a bankable PPP project. For each risk the table in Appendix 1 includes potential mitigants and the preferred position of the lenders, sponsors and authority. The specific risks identified and their suggested mitigants and allocation are representative, in broad outline, of a range of projects that have been successfully project financed. However, specific risk analysis of each project is essential and the list in Appendix 1 is not comprehensive.

Insurance as a means of managing risk and the obstacles to the availability of suitable insurance for PPPs

Comparator countries

Obtaining satisfactory insurances at the start of projects is straightforward in normal market conditions. The main concern has been the risk of insurance becoming unavailable or unaffordable during the project term. Typically at financial close of a project, the Project SPV is able to obtain insurance for the full construction period, even if it spans several years. Thereafter, insurances are placed annually during the operating period. Insurance markets are, however, cyclical. Variations in insurance premiums depend on sector claims’ histories and economic conditions (for example, UK project insurance premiums approximately trebled after 11 September 2001). At times, insurances for certain risks can become unavailable or unavailable on commercially realistic terms. These risks are beyond the control of the Project SPV. Typically, availability based projects have high levels of debt and low cashflow surplus after operating costs. This means that significant increases in insurance premiums significantly reduce shareholder returns. To address these issues in the UK PPP market, PPP contracts include insurance benchmarking, with an adjustment to PPP payments if market insurance premiums vary beyond a threshold. Uninsurability – which typically constitutes an event of default under the project loan – is a termination event unless the authority agrees to act as insurer of last resort during the period of uninsurability.

Box 14 – Insurance packages for PPPs

Insurance standards for project financing tend to follow common key principles –

- A common insurance package is procured for the project, with all stakeholders as named insured – the Project SPV, the authority, lenders, and key sub-contractors. These parties are named insured (i.e. entitled to claim, subject to no double claiming) and the policy would typically have a “non-vitiation” clause, namely that the right of one insured party to claim will not be invalidated if one of the other insured parties invalidates the policy.
- The insurance package is comprehensive for all risks, including physical damage, theft, and third party liability, and compulsory insurances such as motor insurance and employer’s insurances. Risks covered will typically include...
Civil unrest and terrorism, and pre-delivery marine loss cover is required in respect of delivery of critical components of the construction. In certain countries (such as for the early Mexican PPP projects), political risk insurance is needed to cover risks including but not limited to expropriation, civil unrest and exchange transfer and convertibility.

- Advance loss of profits (in respect of construction period risks) or business interruption insurance during operations is necessary to cover lost revenues following an insured event. These policy extensions are crucial for funders, to cover debt service during the period when the project facilities are being rebuilt.
- Lenders insist on taking an assignment of the insurances as security, so as to control usage of the insurance proceeds following a claim. However, this is often controlled in the project agreements, so that the banks cannot prevent insurance proceeds from being used for reinstating the project.
- Lenders typically also require that the insurances are placed with creditworthy insurers, often by specifying a minimum credit rating for insurers. Lenders and borrowers typically contract insurance advisors to agree an insurance package that is acceptable to both. This process can be lengthy, particularly in untested markets.

**Mediterranean partner countries**

The comprehensive suite of insurance cover required for PPPs is typically available in the Mediterranean partner countries. Project agreements should therefore follow the example of the comparator countries and specify the required insurances and provide for the possibility of insurance becoming unavailable or unaffordable during the project term.

There are variations in insurance premiums between the Mediterranean partner countries. Insurance premiums in certain zones are affected by natural catastrophe risk including Algeria, northern Israel, the West Bank, Lebanon and the Syrian coast (earthquake risk), and Nile delta and Israeli coastal areas (tsunami). Terrorism cover is available in all Mediterranean partner countries (since the global premium pool for terrorism cover is very large), but at differing premium levels. Insurance premium taxes are high by international standards in Morocco (14% for construction all risks and property insurances), Tunisia (10%), Lebanon (11% including municipal taxes) and Syria (8%), which adds to the cost of projects, but is fiscally neutral for government as a whole.

Most countries require that insurances be placed in the local market, affecting insurance costs, risk of unavailability of insurance and lenders’ security over project insurances. All Mediterranean partner countries, except Israel, require that insurances of local entities (which include Project SPVs incorporated and resident in the country) are purchased from locally authorised insurers. Restricting the pool of primary insurers may cause premiums to be higher than otherwise could be the case. Local markets may be more susceptible to disruption than the global market and so the significance of specific protection for Project SPVs in project agreements against insurances becoming unavailable or unaffordable during the project term is greater than might otherwise be the case. In certain cases (notably in non-investment grade countries) the local insurer requirement could conflict with project lenders’ typical requirement that insurers have a certain minimum credit rating. However, lenders may not apply this requirement if the insurer is a subsidiary or affiliate of a major international insurance group, many of whom are represented in the majority of Mediterranean partner countries. Additionally, lenders will seek acknowledgement of security granted over the insurances from the Project SPV’s primary insurers (irrespective of whether the insurers re-insure the risk domestically or abroad).

**Contractual allocation of key project risks**

**Design and construction and technical specification risk**

- Are PPP contracts designed to be output based such that the private sector assumes design and construction risk? Do payments begin on satisfactory completion of construction (i.e. no service, no fee)?
- Is the standard of works clearly defined in the PPP contract?
- Does the construction subcontractor receive appropriate incentives to deliver on time and on budget?
- Is the construction subcontractor liable for defects in the works for a defined period of time?

**Comparator countries**

Established practice in the comparator countries is for the Project SPV to take construction and design risk and for it to pass all the risk down to a construction subcontractor (with appropriate warranties to the authority). By not taking construction or design risk, the public sector ensures that their concern is only that the project asset is capable of satisfying the authority’s service or output requirements. PPP contracts are typically output based which means that the Project SPV is responsible for designing and constructing the facility to meet the authority’s requirements. The Project SPV is not paid until completion of the facility and service commencement (i.e. ‘no service, no fee’). Therefore, lenders will want to see the Project SPV passing all design and construction risk down to a construction subcontractor with sufficient financial strength and expertise in design and relevant knowledge of any technology to accept the risk under a design-build contract.

In the comparator countries, the public authority has the ability to comment on designs and require small design changes that do not significantly affect costs. However, the public sector is not expected to approve or sign off on design as this will transfer the risk back to the authority. It is standard practice for the PPP contract to include a design review procedure setting out a mechanism for submission of the design by the Project SPV, authority comment and the extent to which minor design changes are permitted before they would impact on cost.

---

28 Information on Mediterranean partner countries collated by Willis Limited from country data sourced from AXCO Insurance Information Services and Crystal – Lloyd’s Global Trading Information
By transferring both design and construction risk to the Project SPV, authorities in the comparator countries ensure that the private sector is incentivised to design and build the asset to produce best "whole life" cost. The objective of such approach is to create better quality assets because the Project SPV will need to optimise the balance between keeping capital costs low and minimising future maintenance costs which may arise over the life of contract.

**Mediterranean partner countries**

In the Mediterranean partner countries with some experience of PPPs, design and construction risk allocation is consistent with the approach of the comparator countries. The private sector partner will therefore be responsible for designing and constructing the project. The Project SPV will manage this risk by subcontracting it to a construction subcontractor and designer. Further, permitting formal discussions on design during the tender process will allow for a more iterative approach to the development of the authority’s output requirements and will therefore encourage better design proposals for particularly complex projects. Such processes are envisaged under the Egyptian PPP Law\(^{29}\) and are contemplated in the draft PPP laws in Jordan and Syria.

### Is the standard of works clearly defined in the PPP contract?

**Comparator countries**

It is usual practice for the public sector to define the standard of performance of the works and include them in the bidding and contract documents. Whilst some legal systems may specify the standard of works that an employer will require from its construction contractor, the comparator countries' experience shows that standards for constructing PPP project assets should be explicitly set out in the contracts (by including detailed technical conditions that have to be met before reaching the operational phase). For example, the Polish Civil Code, PPP Act and Concession Act imply a standard of reasonable skill and care into PPP contracts, but PPP agreements in Poland additionally specify contractual provisions that create obligations for the Project SPV to comply with the authority’s specifications regarding technical or functional requirements. Similarly, French law includes the notion of "fitness for purpose", but PPP contracts will include their own standards specific to the project. In Mexico, where the law is silent on standards of works, practice has developed for the most suitable standard to be defined in the bidding and contract documents. In this way the most appropriate standards of performance can be defined according to the specific needs of the project. This provides the parties with greater certainty.

**Mediterranean partner countries**

Practice to date in the Mediterranean partner countries follows the approach of the comparator countries by specifying in the contract the standards of works specific to each project. Norms such as "reasonable skill and care", "rules of the art" and "international standards" are frequently used.

In Tunisia, Morocco and Lebanon, although the minimum standard of works is regulated by legislation, authorities would be well advised to specify additional standards in the PPP contracts. In Tunisia, the parties are required to perform their obligations with “reasonable skill and care” and to ensure that the output of their work is “fit for purpose”. The Concessions Law in Morocco\(^{30}\) provides that public services must be delivered to minimum standards that apply even if not expressly incorporated in the contract. In practice, however, detailed standards of application will be specified in Moroccan PPP contracts. Lebanese law requires contractors to perform works with reasonable diligence and care. However, Lebanese authorities specify additional standards of performance in their construction contracts, including international specifications and benchmarking measures (such as British Standards Institution (BSI) or European Union (EU) standards when defining contractual performance standards).

In Egypt and Syria, the absence of strict legislative regulation of the standard of works means that authorities must specify their required standards in the PPP contract. This is recognised in the Syrian Draft PPP Law\(^{31}\), which provides that each PPP contract should include provisions about the conditions of delivering the service, the applicable norms and standards and the performance criteria guarantees and related penalties. The Egyptian PPP Law\(^{32}\) does not specify standards of performance and these should be drafted into the PPP contracts.

### Does the construction subcontractor receive appropriate incentives to deliver on time and on budget?

**Comparator countries**

Generally, liquidated damages are payable by the construction subcontractor to the Project SPV for late completion and this acts as an incentive to complete work on time (with the exception of delays due to relief events and compensation events). The Project SPV is incentivised to complete on time because it will only start to receive the service payments upon completion of the construction (i.e. no service, no fee). The Project SPV backs off this potential loss in revenue by imposing liquidated damages on the construction subcontractor for late completion.

Both the civil and common law approaches to setting the level of liquidated damages are seen as acceptable by investors in the comparator countries. In particular, in Poland the PPP Act specifies that the PPP agreement must define the consequences of deficient performance (including liquidated damages). Although there is a broad scope to freely determine the circumstances in which liquidated damages will apply and their level, the Project SPV should carefully calibrate its losses (including in terms of increased financing charges and loss of revenue) in order to pass them down to the construction subcontractor. English case law has determined that the level of liquidated damages specified must be a genuine pre-estimate of the loss. If the level specified is excessive, they will be deemed to be a penalty and will be unenforceable. The Polish Civil Code stipulates that the level of liquidated damages may be adjusted if, in reality, the actual losses are much lower than the amount of liquidated damages, or if there has been substantial performance.

---

29. Law No. 67 of the year 2010  
30. Law 54-05 enacted by Dahri No. 1-06-15 of 14 February 2006  
31. Draft PPP Law dated 20 April 2010  
32. Law No. 67 of the year 2010
**Mediterranean partner countries**

All Mediterranean partner countries recognise the use of liquidated damages as an incentive to complete construction on time and on budget. Consistent with international best practice, the level of liquidated damages is specified in the construction contract and is designed to compensate the Project SPV’s losses (for example, increased financing costs and loss of revenue). In those Mediterranean partner countries that adopt a civil code, an emphasis is placed on the fairness of the agreed damages. The court can intervene on the application of a party and adjust the contractual level of liquidated damages if the actual loss exceeds or is lower than the contractual level. This is beneficial if such intervention is to correct manifest unfairness, but it can also introduce uncertainty. The contractual level of damages should therefore from the outset be a fair and reasonable estimate in order to prevent frequent adjustments. Certain types of liquidated damages in Lebanon may allow for what in other jurisdictions would be regarded as double-recovery. Specifically, if the liquidated damages can be characterised as a “delay penalty”, the court may still make a separate award of damages resulting from the actual breach of contract. Such an approach is unusual in international PPP markets. In Israel, the law on liquidated damages follows the English common law approach and places an emphasis on the parties’ estimates of foreseeable damage. Penalties (i.e. punitive sums) are not permitted.

**Comparator countries**

The construction contract may provide for a set defects liability period during which the construction contractor will be liable for defects in the building or design. The length of such period varies depending on the nature of the works, but is typically between one and five years. The Project SPV and its lenders will want the construction contractor to be responsible for defects for as long as possible (whilst recognising that unreasonably long defects liability periods may add substantially to the price).

Defects liability periods may also be mandated under the applicable law of a country, even where the construction contract may have made alternative provision for defects. Article 1792 of the French Civil Code, for example, sets a decennial liability for defects (i.e. a ten year limitation period) in completed civil works. This will apply to the works carried out by the construction contractor. The authority will have alternative recourse for defects, through the availability and performance provisions under the PPP contract.

**Mediterranean partner countries**

Liability for defects is prescribed by law in the majority of the Mediterranean partner countries. Legislative provisions impose decennial liability for the private sector for defects in the design or construction of the works in Algeria, Egypt, Jordan, Morocco, Syria and Tunisia. In Israel, liability for defects due to design failure is allocated under the contract and usually falls on the Project SPV. The defects liability period under the construction contract is negotiated with the subcontractor and will vary depending on the nature of the project. Under Article 668 of the Code of Obligations and Contracts in Lebanon, the party carrying out the construction works will be liable for any defects in the works for a period of five years from when the work is handed over.

**Planning and approvals**

- Will the public sector provide the land required for the project?
- Which party is responsible for obtaining consents and approvals including planning?

**Comparator countries**

The public sector will usually make land available for the PPP projects. This is because procuring authorities will generally either own the land in question and grant appropriate rights of use, or have the means to negotiate the purchase of the land. For PPPs in South Africa for instance, the procuring authority will grant the land and provide a number of the approvals (specifically zoning of the land and town planning approval). Additionally, many governments with established PPP programmes have the power to acquire land compulsorily if necessary, subject to the payment of appropriate compensation. However, there are usually carefully controlled circumstances permitting the use of such power of expropriation, due to the associated potentially negative political and social effects. Compulsory acquisition powers can be advantageous for PPP development but it is important that the process is managed carefully and that due regard is made to the rights to compensation of the affected persons.

**Mediterranean partner countries**

In the Mediterranean partner countries, PPP projects are usually established on land owned or acquired by the government. Therefore, land acquisition or ownership does not pose any practical difficulties for the Project SPV, other than the time it takes for the land to be acquired by the public authority (if not previously owned). This will be attractive to investors as the relevant governmental body will be responsible for obtaining any licences and consents directly related to obtaining the site. However, allocation of responsibility for obtaining other planning and permitting approvals for the development on the site varies between the countries.

**Comparator countries**

Planning risks for development on the site are either allocated to the private sector or, at least, shared between the parties. Planning processes are not tailored specifically to PPP projects. Generally, the normal provisions of property/planning law in the comparator countries allow the public to object and to be heard at planning tribunals (including rights of appeal), making the process slow, with the outcome uncertain. Some projects accordingly incorporate planning controls designed to reduce such third party objection and appeal rights. Projects in certain sectors (such as transport) can take advantage of certain statutory authorisations to avoid the application of general planning law. The Crossrail transport project in England is a good example of this practice. The Crossrail Act 2008 states...
that planning permission for carrying out developments in relation to the project are deemed to be granted by that act and the normal requirements for planning applications will not apply. The private sector will typically seek protection for delayed or refused planning consents and approvals particularly when it is in substantial compliance with the permit requirements. Other accepted methods of sharing planning risk include public authorities obtaining outline planning consent, with the private sector retaining the risk in obtaining detailed planning permission; and the public authority undertaking to facilitate the granting of permits.

Usually for PPPs in the comparator countries, all other final approvals will be the responsibility of the private sector (for example relevant environmental permits, building permits, water permits and other consents and approvals regarding compliance with health and safety, sanitary and fire protection requirements). The extent of the public authority’s obligation is normally only to provide reasonable assistance to the Project SPV in its effort to obtain approvals. Inter-ministerial co-operation and co-operation between the public bodies involved in issuing permits is encouraged.

Mediterranean partner countries

Planning and permit risk allocation in Egypt, Jordan and Morocco most closely follows the best practice of the comparator countries of sharing the risk in such a way that sponsors and funders will not have great concern that they are allocated risks which they cannot manage. The Project SPV is responsible for obtaining any planning permission and permits required, which will vary depending on the location of the project and type of activity to be undertaken. The private sector may be contractually protected where delay in issuing permits constitutes an event of default. The New PPP Model in Egypt protects the Project SPV against unreasonable delays or abusive rejection by government departments in issuing licenses and permits by considering this as an event of default by the contracting entity. This is a favourable position as the public authority retains some of the risks associated with unreasonable delays. In Jordan, the Project SPV usually obtains any planning permissions with the assistance of the procuring authority. The Concessions Law in Morocco requires the contracting authority to assist the private operator with obtaining the necessary authorisations. Here, the Project SPV is required to use its best efforts to obtain such authorisations but the private party will typically not be liable, under the project agreement, for a failure to obtain any relevant consents if it has taken all possible actions to do so. As planning powers are held at various levels of the government, the relevant planning authorities for a particular project must be made clear from the outset and lines of communication with these authorities should be open. This will mitigate the risk of delay. Often, however, outline planning permission is granted prior to financial close and therefore this issue is of less concern.

Contractually, the private sector takes the risk of obtaining the necessary permits and licences to enable construction and operation of the project in PPP projects in Algeria, Israel and Tunisia. The relevant public bodies will not guarantee that consents will be granted and so the private sector takes the risk of delays in obtaining necessary consents and the risk of failure in obtaining them. This may serve to deter foreign investors, who may not be prepared to risk the often substantial sums incurred in preparing designs, undertaking surveys and other due diligence to take forward planning applications when there is a significant risk of delay. In practice in these countries, the risk of obtaining planning and environmental approvals is shared between the public and private sector partners to a certain extent. For example, the relevant public bodies are willing to ensure sufficient preliminary work is undertaken before bringing projects to market. Assistance is also provided in obtaining planning and other consents and, in particular, there is a willingness on the part of the administration responsible for construction permits to be flexible where the project is of public interest.

Planning risk lies with the public sector in Lebanon and Syria. In Lebanon failure by the public sector to obtain any necessary consents that results in the project being delayed or redesigned may result in the private party being compensated. General planning laws in Syria suggest that planning permission must be obtained by the public sector who would therefore bear the risk of a failure or delay in doing so. This has been addressed in the Syrian Draft PPP Law which recognises that this approach to risk allocation is not workable for PPP projects. The Draft PPP Law makes the Project SPV responsible for planning applications or other required permits. The public entity is required merely to assist the Project SPV in securing the process of granting the necessary permits.

Extensions of time and compensation events

Do PPP contracts make provision for the payment of compensation and/or extensions of time on the occurrence of certain events which are beyond the control of the Project SPV?

Comparator countries

It is usual practice in the comparator countries for a Project SPV to obtain relief where an event occurs that is beyond its control and it causes loss of revenue, additional capital expenditure or delay to the construction programme. From the authority’s perspective, it is important that in such circumstances the continuity of public service is preserved. Granting extensions of time in such circumstances prevents the Project SPV from defaulting by failing to meet the construction longstop date. Due to the financial implications of delays to the construction programme, sponsors and funders require that PPP contracts provide for adequate relief to the Project SPV (which will be passed down to the construction subcontractor) where such delays are beyond its control. In the UK and South African PPPs, for example, the concept of “Compensation Events”, “Relief Events” and “Force Majeure” are established contractual mechanisms used in PPP contracts for dealing with such circumstances.

For PPPs in the comparator countries, authorities accept that it is appropriate to pay compensation to the Project SPV where the event which causes loss or delay is within the authority’s control. Taking the approach in the UK and South Africa as examples, there are three main categories of events where the authority is expected to pay compensation to the Project SPV:

---

33 Law 54-05 enacted by Dahir No. 1-06-15 of 14 February 2006
34 Draft PPP Law dated 20 April 2010
• breach of the authority’s obligations under the contract;
• variation to the specification, initiated by the authority;
• change in law (discussed in more detail below).

Such relief is drafted into PPP contracts in the form of a Compensation Event. The general principle for Compensation Events should be to restore the economic balance of the contract. The Project SPV is therefore put in no better or worse position than had the event not occurred. As well as economic compensation, a Compensation Event will allow for an extension of time to the construction longstop date equal to any delay caused.

The concept of *Imprévision* in French law entitles the private party to contractual changes in order to restore the economic balance of the contract. Under French law (and in other civil code legal systems where this is applied), the *Imprévision* theory will apply to administrative contracts (i.e. contracts including the State). The aim of this is to preserve the continuity of public services by preventing the contractor from being in default of its obligations when unforeseeable and external events occur which change the economic balance of the contract. *Imprévision* would be likely to apply to dramatic increase in raw materials; natural disasters (earthquake, tsunami or volcanic eruption); or certain measures taken by the relevant authorities (such as price freezing). The Project SPV is then entitled to partial compensation. The parties to French PPPs ensure that PPP contracts expressly define the relevant events where *Imprévision* will apply and their consequences.

PPP contracts in the comparator countries also provide for relief to the private sector for events that are beyond the control of either party. Relief Events and Force Majeure events are explicitly defined in the PPP contract. Force Majeure events are narrowly defined in the comparator countries and are confined to events which neither party is best placed to manage and which are likely to have a long term or permanent effect on the parties’ ability to perform their contractual obligations. Examples of Force Majeure events in the comparator countries’ definitions are war, acts of terrorism and nuclear, chemical and biological contamination. These are usually incapable of being insured against on commercially reasonable terms. Force Majeure events are distinguished from *Imprévision* in French PPPs due to the permanent nature of the economic changes resulting from such events. Relief Events are those events beyond the parties’ control which prevent performance by the Project SPV, but which can be better managed by the private sector.

Financial risk is borne by the private sector in respect of Relief Events, but is shared on the occurrence of a prolonged Force Majeure. Due to the more long term or permanent nature of Force Majeure events, typical provisions in PPP contracts in the comparator countries provide that the parties should consult to resolve the issues or amend the obligations appropriately. There is therefore some built-in flexibility in Force Majeure regimes. PPP contracts in the comparator countries provide that, ultimately, the parties can agree to terminate the contract due to a prolonged Force Majeure event. Financial risk is shared because consequential compensation on termination for Force Majeure is payable by the authority (see below). The private sector is deemed best placed to mitigate and manage against the occurrence of Relief Events and therefore to accept the financial consequences of such events occurring. Mitigation may be through insurance or by other means such as ensuring appropriate project management or operational risk management procedures. The Project SPV is given relief from termination due to deficient performance, but will suffer any increased costs or loss in revenue, as performance deductions will continue to be applied. This incentivises the Project SPV to ensure full services are restored as quickly as possible.

**Mediterranean partner countries**

The regime for compensation and extensions of time is treated in a similar manner in Egypt, Morocco and Israel and broadly follows established international practice. In these countries, there are no specific legislative provisions relating to compensation payable (or extensions of time in cases of delay in the construction of the project) caused by unforeseeable events except for general concepts falling under the civil law concept of *imprévision*. In practice parties are free to contract on such issues. PPP contracts concluded in Egypt and Israel make provision for the relief available to the private sector partner for delays in performance by the contracting authority that affects performance of the contract by the Project SPV; unexpected expenses; variations initiated by the contracting authority; and other events that are outside the Project SPV’s control. This treatment should satisfy lenders and investors.

In some civil code jurisdictions (including Algeria and Tunisia), the theory of *Imprévision* is applied when unforeseeable events threaten the economic viability of the Project SPV. However, even where the law provides relief it is best practice to include explicit contractual provisions relating to such events. For example, the Tunisian Concession Law allows an extension to the overall concession period in certain circumstances, including for delay as a result of unforeseeable events or force majeure events (subject to maximum periods for extension, depending on the circumstances, before the private sector could (whilst the project is still under construction) terminate). In this regard, a court may impose a limit on the parties’ rights to consider partial extensions to the construction period for PPPs based upon an availability model (so as to incentivise the Project SPV to complete the works). If extension of time provisions are addressed through commercial negotiations and captured in the PPP contract, a market position would be permitted to develop. Contractual drafting also tends to be more protective than case law and provides the parties with greater certainty as it provides a direct remedy for which court proceedings are not required. In Algeria and Tunisia there is no established standardised approach to the negotiation of extension of time and compensation event provisions and so it is recommended that express provisions are included in the PPP contracts to create greater certainty for all parties.

Relief due to unforeseen circumstances beyond the reasonable control of either party is provided for under the Draft PPP Law in Syria and the Jordanian Civil Code. Article 205 of the Jordanian Civil Code makes provision for “relief events” in certain circumstances. The court is able to provide relief from contractual obligations. However, in practice the parties are free to agree contractual provisions on this issue which is preferable.

35 Law No. 2008-23 dated 1 April 2008
36 Draft PPP Law dated 20 April 2010
as it creates more certainty. The Draft PPP Law in Syria allows for an extension of time for delays in project completion due to unforeseen circumstances beyond the reasonable control of either party. The Draft PPP Law limits the extension period of any delayed project to two years. This is presumably to account for circumstances which may cause indefinite disruption or delay; typical of Force Majeure. Of itself, two years would normally be reasonable for a construction period of three to five years. Whilst regulating the extension period through the Syrian Draft PPP Law ensures a uniform approach between authorities during the initial introduction of PPPs, it is unusual to legislate for a maximum period of extension and such matters are typically dealt with contractually, for example by having a construction longstop date relevant to the particular issues affecting a particular project.

Operational performance

Are there adequate contractual provisions to enforce performance standards during the operating phase?

Comparator countries

The contractual mechanism adopted by the comparator countries for enforcing performance standards during the operating phase is affected by whether demand risk is transferred to the private sector. Under mechanisms based on performance and availability (i.e. the public sector retains demand risk), performance is maintained and assessed on the basis of the Project SPV’s compliance with output specifications, which specify the level of service required in respect of each element of the project’s scope. A service payment is payable by the authority to the Project SPV on, for example, a monthly or quarterly basis and the public sector will usually enforce the standards specified in the PPP contract by making financial deductions from the contractor’s payment for non-availability and poor performance. The PPP contracts aim to set a level of deductions which is relative to the seriousness of the fault and the time taken to remedy the issue. In this way, the contractor is encouraged to rectify faults quickly and efficiently. Generally, the Project SPV will be required to self monitor its performance, with the public sector having the general right to access the facility to audit performance and impose additional deductions for performance reporting failures. In Poland, for example, the PPP Act stipulates that the PPP contract must set down a detailed description of the consequences of inappropriate performance or non-performance of commitments, in particular contractual penalties or decreases in the remuneration of the private partner.

Deductions are generally the authority’s sole remedy for poor operational performance, with the authority’s ultimate sanction being termination of the PPP contract. Sponsors and lenders will require certainty as to the financial exposure for poor performance and so will be concerned if the authority would be able to request separate damages in addition to the stipulated contractual performance regime. For less serious faults, financial deductions may not be appropriate. Instead, the authority may impose a “performance points” system, whereby a fixed number of points will be allocated for each failure and a deduction will only be made once a certain level of aggregate points has been reached. This approach is favourable to lenders, who will want to ensure that the Project SPV’s revenue stream is not disproportionately affected by minor faults.

Concession agreements will usually provide for the concessionaire to pay a fixed sum to the relevant authority for performance falling below the specified standards. Essentially, the authority will pre-estimate the “cost” of a particular event (in a road project, the road being unavailable for use for a period of time, for example) and demand that the contractor pay this money to the authority in compensation. This is also consistent with the principles adopted in civil law jurisdictions. The French Civil Code for example entitles parties to contract on a so-called “penalty clause”, which has the aim of specifying a pre-estimated amount of damages to be paid on a contractual default. Such mechanisms act as an incentive on the contractor to perform its contractual obligations. In practice, the penalties will be passed down to the subcontractors who bear the relevant risks.

Mediterranean partner countries

It is generally recognised in each of the Mediterranean partner countries, as in the comparator countries, that it is important to clearly define performance requirements in the contract documents. The level of deductions tends to be proportionate to the severity and frequency of the breach. In addition, deductions may be subject to grace periods or rectification periods, to enable the Project SPV to mobilise and respond to failures effectively. This is good practice. If broader types of payment mechanisms were to be adopted in the Mediterranean partner countries, contracting authorities will need to develop alternative regimes for enforcing operational standards such as payment of damages by the Project SPV to the authority.

Change in law

How will changes in law be handled during the term of the contract – is there a mechanism for sharing change in law risk?

Comparator countries

Change in law risk is the risk that the laws effective at the time of entering into the PPP contract are changed by a governmental body during the PPP contract term and which affects operating costs. Whilst it may be possible for the private sector to price for the costs of changes in law which can be foreseen prior to contract signature, the private sector will be concerned that the effect of unforeseen changes in law (over which they have no control) may increase the project construction or operating cost, affecting profitability or the ability to service debt.

For some concession projects in the comparator countries it is possible to treat all changes in law as the private sector’s risk. For example, in concessions where the costs of implementing changes in law can be passed on to the end users through price rises (such as toll roads), the private sector would be expected to bear the change in law risk. However, political difficulty can be caused by the involvement of the private sector in setting tariffs. Therefore, the private sector cannot and does not always set tariffs, and in these circumstances, will not be able to pass on the financial consequences of changes in law to the end users. In South African PPPs, for example, where tariffs may be set by the contracting authority or a third party, a risk sharing approach to change in law has resulted.
Where the main user or payer of the project is the authority, the comparator countries’ approach recognises that there is a balance to be struck in the allocation of the risk. The private sector is not expected to absorb all of the costs of unforeseen changes in law which directly affect and specifically target the particular project or sector. Conversely, it is expected that project companies recognise that, in some instances of change in law, all organisations or businesses will be subject to the same changes in law and the private sector is usually best able to manage the effects of changes in law to minimise the costs to their business.

Comparator countries have developed a risk sharing approach to changes in law. In England for example, PPP contracts differentiate between (i) "General Changes in Law" that affect a wider group than the particular project or sector to which the project relates and (ii) "Specific" or "Discriminatory" Changes in Law which specifically apply to the project or sector in question. The public sector retains all risk of Specific or Discriminatory Changes in Law (whilst receiving the full benefit of any cost savings which may arise) and the increased costs of general changes in law are shared between the parties on a progressive scale. For example, if we consider a project for the construction of a hospital in England, a change in law concerning specifications regarding surgical units equipment should be considered as a Specific Change in Law which the authority pays for, whereas a change in law concerning the number of elevators that should be provided in a public building should be considered as a General Change in Law. Risk is shared by the private sector agreeing to bear the full costs of such General Change in Law up to a certain threshold, and the authority taking increasingly more of the risk with increased expenditure required to comply with the change. In South Africa, there is also a general acceptance by authorities that unforeseeable changes in law that discriminate against the private party (either specifically or in respect of the relevant sector) should normally be at the authority’s risk.

Mediterranean partner countries

In Israel, Egypt, Morocco and Tunisia a similar risk sharing approach to the comparator countries in relation to change in law has been adopted. This may be a reflection of the maturity of the PPP markets in these countries. In Israel, the public sector has gone one step further in retaining discriminatory change in law risk by permitting termination of the PPP contract by the Project SPV if, within a permitted grace period, the authority does not insulate the Project SPV from the effects of a discriminatory change in law or compensate it and grant it any necessary extension of time for performance of the agreement.

In those Mediterranean partner countries which do not currently adopt a risk sharing approach to changes in law, developing such an approach could achieve better value for money. In Algeria, for example, a change in law during the term of the contract does not entitle the Project SPV to an automatic increase to its payments. Change in law is therefore currently viewed as essentially a private sector risk for which bidders should price. The risk premium allocated to change in law may decrease if the authority accepted that the private sector should be entitled to some compensation. Given the long term nature of PPP contracts, some sponsors and lenders may have some difficulty in accepting change of law risk without some risk sharing mechanism. A possible approach would be to include change in law as a limb of political force majeure. In the case of Syria, although early in its PPP maturity, a risk sharing approach is indicated in the Draft PPP Law\(^37\), such that a PPP contract can be revised at the request of the Project SPV in the case of any changes in the financial equilibrium deriving from major changes in mandatory laws which are detrimental to the Project SPV. This detrimental test is more beneficial to the private sector than the discriminatory/specific tests used in the comparator countries. Lebanon and the West Bank should adopt a risk sharing approach to change in law if their authorities enter into long term PPPs. In Jordan, change in law is a risk borne by the public sector. Whilst there may be specific cases where it would be too onerous for the private sector to accept full consequences of the change in law, Jordanian authorities should consider pursuing an approach where change in law risk is shared. Indeed, this could ease the burden on the authority in the event of a change in law with significant financial consequences.

Termination and compensation on termination

Are the termination rights clearly set out in the PPP contract?
Does each party have the right to terminate for the other’s default in certain circumstances or for Force Majeure?
Does the PPP contract make clear provision for the consequences of termination, in particular compensation on termination?
Does the compensation adequately reflect the nature of the termination?

Comparator countries

As with other contractual provisions, termination rights (of both parties) are clearly defined in the PPP contract. This ensures that each party is aware of the circumstances that will give rise to termination, the process to termination (including notice provisions and remedy periods) and the consequences of termination. Even if termination is addressed in legislation (as is the case in the Polish PPP Act, which gives the public authority termination rights) the long term PPP contract should comprehensively define termination events.

Provision should be made in the PPP contract for all key modes of termination. As a minimum these should include:

- termination by the authority for a contractor default;
- termination by the contractor for authority default; and
- termination on the occurrence of a force majeure event.

PPP contracts in the comparator countries typically provide for termination in these circumstances.

Termination as a result of default of one of the parties should relate to specific significant or substantial breaches. It is good practice to define what these are (rather than simply referring to significant/substantial breaches). For example, an authority default typically comprises non-payment, and examples of contractor default are contractor insolvency, abandonment of the works and subcontracting without consent.

Parties may agree in the contract to further termination rights. For example termination for convenience by the authority, break-point termination (at specified times during the contract term (or break points)), termination on a change in law (where

\(^37\) Draft PPP Law dated 20 April 2010
the contractual obligations can no longer be performed) or
termination where a risk which is usually insurable becomes
uninsurable (i.e. where insurance is no longer available at all
or not available on commercially acceptable terms).

Both the termination triggers and the consequences of
termination should be clearly formulated in the contract.
Whilst the general law may permit the innocent party to
claim damages through a court process, a more straightforward
and certain approach of setting out the compensation in the
contract, albeit by reference to a formula, is preferable and
is standard practice in England, France and South Africa.

The measure of compensation reflects the nature of the
termination event and the of risk allocation. Thus, where the
PPP contract is terminated due to an authority default or at the
authority’s convenience, the compensation payable to the
Project SPV will comprise subcontractor and financing breakage
costs, redundancy payments, loss of profits, outstanding debt
service and equity returns. These elements exist in the English
PFI (Private Finance Initiative) guidance and this level of
compensation meets the objective that the Project SPV and
its financiers are fully compensated and no worse off than if
the contract had run its full course. If termination occurs due
to a force majeure event (neither party’s fault), financial
consequences should be shared and so, the Project SPV will
not normally be compensated for equity injected or returns
on that equity.

Compensation on termination is offered, even where
termination is for contractor default. Whilst this may at first
be seen as permitting the contractor to benefit from its own
default the rational is to ensure in circumstances where one
of the consequences of termination is that the project asset is
handed back to the authority and the authority should not
make a windfall gain (no unjust enrichment). A market value
approach should be taken, so that the level of compensation
is based on what a third party would pay for the contract.
A market value approach does not necessarily guarantee that
the lenders will be compensated in full and as such, it
incentivises the lenders to step-in and rescue the project.
An alternative approach in France, for example, would be for
the Project SPV to be compensated in these circumstances for
the level of investment made/works undertaken, subject to a
ceiling in some cases, but not for loss of profit.

Authorities are only expected to pay a fair compensation sum.
Deductions in the calculation for compensation are made in
respect of the following elements: insurance proceeds; revenue
received; credit balances; costs and expenses to be incurred by
the authority in rectifying defects and performing the operations.

**Mediterranean partner countries**

In the more developed PPP markets within the Mediterranean
partner region, PPP contracts tend to clearly set out the trigger
for termination and the rights of each party. This is the case,
based on practice to date, in Algeria, Egypt, Israel, Jordan,
Morocco and Tunisia. In these countries, the PPP contract
typically provides for termination in the following circumstances
(i) authority default; (ii) contractor default; (iii) force majeure;
and (iv) convenience (not typically provided for in Jordanian
PPP contracts). The PPP contracts are relatively comprehensive
in this regard and tend to incorporate express termination
provisions which exist in law and which, for example, would be
implied by the civil code.

Due to the limited experience of PPPs in Lebanon and Syria, it
is unclear whether termination provisions will reflect best
practice (as described above). However, some confidence can
be gained from the contracts agreed in Lebanon to date which
cater for termination and in the case of Syria, the Draft PPP
Law18, which expressly states that contracts should include the
ability to be terminated in defined circumstances (being: (i) by
Sovereign decision (i.e. voluntary termination), (ii) an authority
default, (iii) on contractor default and (iv) for force majeure).
PPP contracts in the Mediterranean partner countries provide for
compensation on termination, but there are varying approaches
(as set out below). This is perhaps reflective of the limited
experience of project financed structures involving international
banks who are key players in more developed PPP markets.

Of the Mediterranean partner countries, Egypt, Jordan and
Israel appear to have the most developed contract mechanisms
for compensation on termination. The PPP contracts agreed to
date specify clear formulae for the calculation of compensation.
Importantly, there is precedent for protecting senior debt and
equity investment under certain circumstances. The favoured
approach is for the level of compensation to vary according to
the reason for termination. A contractor will therefore receive
less compensation if the contract is terminated due to its own
default. The availability of compensation for contractor default
in these countries recognises the principle established in the
comparator countries that the authority should not
unaccountably benefit from the project.

In Algeria, Tunisia and Morocco, contractual provisions
provide for compensation on termination, although specific
acknowledgement of senior debt and equity compensation is
not prevalent. The normal approach to compensation would
take account of the value of the works and loss of profit but
the relevant contractual mechanism might not explicitly provide
for senior debt and equity protection. To encourage lender
confidence, this is a key area for development in the overall
contract design.

Should a PPP programme be pursued in Lebanon, Syria and
the West Bank, these countries should address compensation
on termination as a key issue in the overall contract design.
This is important to new entrants in an infrastructure market
who are embarking on long term contracts.

---

18 Draft PPP Law dated 20 April 2010
Contractual allocation of project risks – recommendations/success factors

Design and construction

- Transfer the design and construction risk to the private sector.
- The public sector should be encouraged to make payments on a "no service no fee" basis, i.e. where payments to the private sector begin only on satisfactory completion of construction or demonstration of achievement of the specified performance criteria.
- Clearly define the standard of work required in the PPP contract.
- Apply incentives (penalties/bonuses) for the private sector to perform.
- Make the construction contractor liable (either by contract or in law) for defects in the works for a defined period of time.

Planning and approvals

- The public sector would normally provide the land required for the project.
- Allocate planning risks to the private sector, but encourage the public sector to provide assistance.
- Allocate responsibility for obtaining all other approvals (for example, construction permits) to the private sector, but the public sector should provide reasonable assistance.

Change in Law

- This is best treated as a shared risk, whereby the general change in law risk is shared and change in law specific to the project is retained by the public sector.

Extensions of time and compensation

- In the PPP contract, provide for the payment of compensation to the private sector on the occurrence of certain events within the authority's control, so as to restore the economic balance of the contract.
- Clearly establish in the PPP contract the provisions for extensions of time and relief from obligations upon the occurrence of specific events that are beyond the control of either party.

Operational Performance

- Use payment mechanisms and performance/quality requirements to enforce standards during the operating phase.
- Specify the consequences of not meeting such requirements clearly in the PPP contract

Termination and Compensation on Termination

- Clearly set out termination rights in the PPP contract, including rights for each party to terminate for Force Majeure and for the other’s default in certain circumstances.
- Make clear provision in the PPP contract for compensation payable by the authority on termination which adequately reflects the nature of the termination.
6. Payment Mechanism & Financial Risks

The payment mechanism is the key mechanism for allocating economic risks between the authority or users and the Public Private Partnership (PPP) provider. It seeks to ensure that authorities pay only for services or output delivered and to ensure that providers do not have to make costly provisions in their pricing for risks which are beyond their control.

This section examines the PPP payment mechanism and in particular how the key macroeconomic financial risks of inflation and foreign exchange rates can be dealt with in the PPP contract design, by examining the following:

- How do authorities create the right incentives for the private sector to deliver a service or output at the least cost to the authority whilst ensuring the project is bankable?
- Are macroeconomic risks of inflation, exchange rate and interest rate allocated efficiently?

### Box 15: Role of payment mechanisms in PPP

In PPP contracts, the payment mechanism is the principal tool for allocating economic risks between the authority and/or users and the Project Special Purpose Vehicle (Project SPV). In PPP, the public authority does not reimburse the Project SPV for the capital costs of the project when those costs are incurred. Instead, the Project SPV recovers the capital cost, together with financial returns and operating costs, over the operational life of the project from either regular payments from the authority, from user charges or a combination of both. The formula for determining the payments and/or user charges and any payment adjustments are specified in the PPP contract payment mechanism. Also, the public authority typically has the right to withhold elements of the payment if the performance is sub-standard and not remediated in time (see operational performance section above).

In general, the aggregate PPP payments in a given project must comprise an “operating element” and a “financial element”. These cover, respectively, (i) the operating costs and periodic expenditures such as life cycle maintenance, and (ii) the debt service and equity remuneration to the lenders and shareholders who funded the project’s capital costs. The split between the operating and financial elements may be explicit, for example by defining them expressly as financial and operating elements. Alternatively, the split may be implicit, with formulae in the payment or tariff mechanism reflecting the underlying split between operating and financial elements.

PPP payments may take several forms:

- If using availability payments or capacity payments, the public sector pays for the facility as long as it is available and operated in accordance with agreed performance standards, irrespective of whether it is actually using the output of that facility.

- In certain sectors, such as transport, toll or other user charges (whether paid by government or by the user or both) may be demand or volume related, if the project has required the Project SPV or concessionaire to forecast demand and take risk on the demand for the projects.

Government grants may be combined with the payment mechanism to cover some (but not all) of the capital cost. In a PPP, providing a capital grant may allow the required user charge to be kept to a level that is affordable for users. Alternatively, if the budgetary process allocates funds to authorities on a discrete capital and revenue basis, authorities may find it more efficient to use some of their capital allocation to provide a grant which reduces potential pressure on future revenue budgets from having to fund the annual PPP payment obligations. Finally, a capital grant is appropriate if the total project funding requirement is larger than the market appetite for funding projects of that nature, sector or country, (for example a number of light rail projects in the UK, the Gautrain project in South Africa). This practice has been adopted in road projects in Israel which have all included capital grants, with the aim of reducing the cost passed on to users through fares or tolls.

As an alternative to a capital grant, an annual operating subsidy can serve to reduce the cost passed onto the end user. Such payments can be performance linked like an availability payment. However, using operating subsidies rather than capital grants can increase overall project costs since the Project SPV has to fund the entire project cost.
Some projects have the potential to generate third party or ancillary revenues, the profits from which can be shared so as to reduce the annual cost of the project. These include, among others, letting of service stations on motorways, cafeteria and other ancillary services in hospitals or private residential or commercial units developed as part of the PPP development. However, experience in the largest PPP markets (such as the UK or France) indicates that few projects have the potential for a substantial cross-subsidy, and that often the sponsor selected to deliver the PPP does not necessarily have strong expertise in managing the third party income business. Exceptions arise where the project can release surplus land for redevelopment or if the project (for example, an airport) can include retail outlets. Nevertheless, if a project does have potential third party sources of income, it may be more advantageous for authorities to split the PPP from the third party opportunity, and procure them separately. This would enable the authority to use the revenue from the third party activity partly to fund its project payments.

**Mediterranean partner countries**

Mediterranean partner countries have adopted different PPP payment mechanisms depending on the country and sector involved. Due to relatively few PPPs having been procured to date, clear principles have not been set out for payment mechanism design, other than to follow the evolving precedent of any similar previous projects in that country, such as the desalination projects in Algeria. In the absence of available international precedent, countries have followed international practice. Countries with concession traditions such as Morocco, Jordan and Tunisia have generally procured projects in which the concessionaire earns regulated user-paid fees, in some cases sharing the fee revenues with the authority. On the other hand, availability payments have been the norm in a number of sectors across the Mediterranean partner countries, notably in water treatment and desalination projects in Algeria, Egypt and Israel. Power projects, such as the AES Amman East IPP in Jordan and the proposed Dairut IPP in Egypt, typically rely upon take-or-pay power purchase agreements with the tariff per unit of electricity output adjustable for any movement in underlying fuel costs.

When launching user fee based projects, the procuring authority needs to ensure that demand forecasts are robust and have been independently validated. Where investors bid for a toll charge or bid the amount of subsidy required (whether a capital or revenue subsidy), there is an inherent tension between project affordability and its bankability. This is because bidders are often selected on the basis of minimum subsidy, which requires the most aggressive traffic forecast. In turn, this would be the most difficult to obtain finance for, especially during the current credit conditions. Market studies have shown that in a majority of transport projects worldwide, actual demand fails to reach the level originally forecast. In some Mediterranean partner countries, like Syria and Jordan, which are contemplating road and light rail PPPs but which have a limited track record of comparator projects for forecasting demand, international funders will be cautious when assessing such projects. In these cases, it would be desirable to seek early feedback from the investor, market and lending community in order to design the most appropriate payment mechanism. Measures such as a minimum revenue guarantee (proposed for the Amman-Zarqa light rail project in Jordan), and a surplus profit sharing arrangement could be considered. Israel has applied minimum revenue guarantees in its road projects, as well as providing capital grants.

Increased sharing of information among Mediterranean partner countries would enable replicating payment mechanisms successfully applied elsewhere, thereby speeding up procurements. This could be in addition to learning from good practice in the international market generally. This would be particularly beneficial for instance in projects where technological measurement of performance tends to be complex but similar across countries, such as energy generation (including renewables), water and other social infrastructure projects. Greater regional knowledge sharing on how specific risks are dealt with in the payment mechanism would also attract bidding sponsors who could begin to apply resources to PPP on a whole region basis.

**Macroeconomic risks**

**Comparator countries**

Inflation risk in the comparator countries is dealt with by a combination of adjustments for general price indexation and specific cost benchmarking. PPP payments in comparator countries typically deal with operating cost inflation with one or both of (i) annual indexation of the operating element and (ii) periodic (for example every three or five years) benchmarking or market testing of the cost elements against similar services provided in the country. These mechanisms are necessary because the Project SPV is not in a position to absorb general price inflation, or real wage increases. Some concessions which rely on third party revenues provide for the operating element of unit tolls or tariffs to be increased in line with inflation and/or benchmarked cost changes. This has been the case for instance in toll roads and bridge projects in France and Mexico.

Capital markets in the comparator countries are sufficiently deep that the private sector can generally raise long term fixed rate funding in their domestic currency or hedge exchange rate risks. Other than in Poland and in some Mexican projects, the public sector in comparator countries does not usually assume exchange rate risk in the payment mechanism. In the UK, France and South Africa (other than the latter’s large power projects), debt and equity markets have been able to provide sufficient funding for PPP projects. In Mexico, the bulk of recent funding of the toll road PPP programme has been in Mexican Peso (MXN). Earlier projects were typically funded in United States Dollars (USD), with payments by the public sector periodically adjusted for exchange rate movements. In the case of toll roads, Project SPVs have certain flexibility to adjust user charges but this can have an impact on demand and traffic volumes. Much of the funding for Polish PPP’s is denominated in Euro (EUR) rather than in the Polish Zloty, which reflects the government’s policy of adopting the Euro in the near future. As a result, Poland’s position is similar to a number of the Mediterranean partner countries as regards the public sector having to bear exchange rate risk in its PPP programme.

Project affordability for the authority is adversely affected if the Project SPV has to bear risks which it cannot control or mitigate, in pricing risks such as inflation, private sector sponsors (and their lenders) are likely to assume a wider range of possible inflation scenarios than the government would and this results in increased costs for the public sector. As a result, the position taken in the comparator countries is that the public sector assumes inflation risk. Regarding the other financial risks, exchange rate and interest rate, most comparator countries have well developed financial markets in
which it is possible for the private sector to assume exchange rate risk at a reasonable cost and the depth of capital markets means that private sponsors are normally able to obtain long term fixed interest rates (or swap arrangements) on their lending. Box 15 above describes some common principles regarding financial risk allocation that have been developed in the comparator countries.

**Mediterranean partner countries**

Similarly to the comparator countries, inflation risk is normally assumed by the public sector in order to maximise project cost-efficiency. This risk can be covered through general indexation, benchmarking or market testing. In most Mediterranean partner countries, either price inflation has been relatively volatile (as in Egypt, Syria, and Jordan) or the published price indices are not always comprehensive or regulation and price controls (such as in Syria) are in place. In these cases, regular benchmarking or market testing would be desirable. In other cases (such as Israel and Morocco) inflation has been sufficiently low and stable to allow general indexation to apply to a substantial component of the project payments, other than in relation to specific cost elements such as specialist commodity or technical inputs. Israel has adopted highly specific indexation formulae that closely match the Project SPV's cost base, incorporating adjustments for general consumer price and sector cost indices and currency movements.

The allocation of exchange rate risks in payment mechanisms is largely determined by the depth of local capital markets. The source of the Project SPV's funding determines the optimal allocation of these financial risks, as outlined in Box 16. Countries with local currency savings bases – Algeria, Israel, Egypt, Tunisia and Morocco – can to varying degrees obtain sufficient domestic funding for a significant portion of their PPP programmes, but for larger projects are likely to require funding from international lenders in foreign currency. In any event, even if a project is funded in domestic currency, payment mechanisms may need to include an adjustment to cover any exchange rate movements affecting the foreign currency component of construction costs, if these cannot be hedged over the full construction period. In Algeria's case, the government allocates fixed rate debt funding to the project on terms common to all bidders, which is disbursed as loans from State-owned banks, and projects therefore only require exchange rate adjustment in respect of the foreign currency element of construction costs. In Egypt, Morocco and Tunisia, there is availability of local currency funding for PPP, but not at fixed rates for the full loan period due to the absence of long term interest rate swap markets. Mediterranean partner countries with formal exchange rate pegs (such as Jordan, Lebanon and the West Bank (which does not issue its own currency)) and/or small private commercial banking sectors such as Syria, are likely to find foreign currency funding of PPPs to be more cost-efficient since the public sector is better placed to assume this risk. Requiring the private sector to assume exchange rate risk could result in the procuring authority being faced with higher payments to be made during the operational period.

**Box 16: Managing exchange rate risks in PPP – general principles**

To the extent that the project is funded with local currency denominated debt and equity, the authority need not bear any significant exchange rate risk. For example, if the project is funded with local currency denominated debt from local banks and local infrastructure fund equity, exchange rate risks in the project will be very limited, and project payments can be denominated in local currency without the need for significant foreign currency adjustments. Limited adjustments may be necessary for specific items, such as imported capital equipment but only for scheduled replacement, or if the construction period is longer than the tenors of the local currency forward exchange rate or currency swap markets.

To the extent that the project has foreign currency denominated debt and equity, the authority is likely to have to bear exchange rate risk in order to maximise cost-efficiency of the project. In such cases, project payments need to be adjusted for exchange rate variations, either by denominating foreign costs (including debt service) directly in foreign currency or through indexation of payments in local currency. There is no market in which the Project SPV can hedge local currency exchange rate risk for the duration of the project. Bidders and their funders will see this risk as outside their control, being a largely macroeconomic or policy determined variable, particularly when exchange rates are controlled as is the case in many of the Mediterranean partner countries. As a result, to keep the Project SPV net cashflow stable, the financial element of project payments would need to be adjusted to reflect changes in the underlying exchange rate. Where a government remains committed to the exchange rate peg, funding in foreign currency will be more cost-efficient since longer term fixed rate funding is more widely available in currencies such as the EUR or USD, than in local currency. If a country has a policy to peg or partially peg its currency, then it is better placed than the private sector to cover the risk (e.g. by currency indexation in the payment mechanism) since it is a risk controlled by the public sector.

**Financial risks and payment terms – recommendations/success factors**

- Design payment mechanisms in accordance with the principle that risks are allocated to the party best able to manage, control and mitigate them - typically, to ensure that the private sector takes the risks on its own performance and the authority takes macroeconomic risks unless these can be separately hedged or managed by the private sector.
- If specific elements of the Project SPV’s cost base are exposed to domestic price, cost or wage inflation, allow the Project SPV to pass through cost changes to the authority via payment mechanism adjustments.
- Allow payment mechanism adjustments for exchange rate movements if the Project SPV has been funded in foreign currency, or (if funded in domestic currency) incurs capital costs in foreign currency and cannot hedge the exchange rate risk.
7. PPP / Project Finance Investment Readiness For Lenders And Investors

The success of a country’s Public Private Partnership (PPP) programme depends on the quality of investors it is able to attract and the availability of finance. Development of a transparent investment regime coupled with the removal of barriers to investment (such as currency exchange controls or restrictions on repatriation of dividends) will assist in attracting potential foreign investors, which will in turn have the effect of increasing competition. A robust security package is essential for lenders (including creditworthy public sector covenants (or some form of guarantee or support of the public sector’s obligations), the ability to pledge project receivables, charges/mortgages, direct agreements and step-in rights).

This section provides an analysis of the key issues that are likely to influence foreign investors in making their investment decisions, by addressing the following:

- What are the key incentives and restrictions to foreign investment?
- Are appropriate guarantees provided when necessary?
- Is a robust security package available?
- How do tax and accounting issues affect the affordability of PPPs?
- Are there any general business regulations or practices which might affect the smooth implementation of a PPP?

What are the key incentives and restrictions to foreign investment?

Comparator countries

All comparator countries have succeeded in attracting foreign investors to their PPP programme, although certain very specific restrictions to investment still exist in some countries. South Africa for instance still has certain controls prohibiting payments in foreign currency by local entities without the prior approval of the Exchange Control Department of the South African Reserve Bank in addition to controls regulating the receipt of foreign currency payments by local entities. These restrictions are gradually being lifted, although the global financial crisis may have recently slowed this process, as no significant progress has been made in 2010. In Mexico, the Foreign Investment Law\(^\text{19}\) establishes that foreign ownership in sensitive sectors such as port services, oil, gas and electricity would be restricted to 49% (i.e. shareholding by foreign companies in the Project Special Purpose Vehicle (Project SPV) would be limited to 49%). However, in practice this restriction has not applied and no PPP activities in Mexico to date have been subject to any foreign investment restrictions.

Comparisons of foreign direct investment (FDI) volumes clearly show the benefit of improving the business climate and incentivising investments. Figure 3 shows the stock of foreign direct investment inflows for the comparator countries in 2007-2009. The United Kingdom (UK) and France have huge FDI inflows each year, reflecting the relative openness of their economies and general investment attractiveness of their markets and full integration into the European Union (EU).

The effects of the economic crisis in 2008 can be clearly seen by the decline in FDI in 2008 and 2009. Even though the FDI inflows to Mexico, Poland and South Africa are considerably lower than those to the UK or France, they each still receive considerable FDI each year.

**Figure 3: Inward FDI in comparator countries**

![Inward FDI in comparator countries graph](image)

**Source:** UNCTAD

**Mediterranean partner countries**

Foreign investment regulation in Egypt, Israel, Lebanon and Morocco is relatively light. There are no unique or uncommon restrictions affecting FDI that cannot be overcome in practice. In Egypt, there are no legal restrictions on the distribution of profits by joint stock companies to foreign shareholders and no consents are required or restrictions applicable on the remittance of profits outside Egypt. In Israel, current investment laws and policies facilitate PPP funding and the level of current regulatory control is conducive to the creation of healthy secondary markets in PPP projects. In Lebanon, there are no special provisions or constraints on foreign investment but restrictions do exist on the ownership of companies involved in certain sensitive sectors such as the media and land ownership. In Morocco, protection is afforded by the law to foreign investments and rights to repatriate capital and proceeds are well entrenched in both law and practice.

Recent reform of the Tunisian regulatory framework, focusing on easing the level of regulation and red tape applicable to foreign investors, has improved the country’s attractiveness for investors. This has been achieved through a series of legislative enactments (such as the Code d’incitation aux investissements), which have established the principle of freedom of foreign investment in specific sectors such as communication, transport and tourism. These provisions guarantee foreign investors (whether resident or non-resident) the ability to invest in Tunisia without discrimination.
The regulation of foreign investment in Syria has improved in recent years, although further reforms of certain regulation could ensure increased attractiveness of foreign investors. Syria maintains a currency control system, which could affect the ability of Project SPVs to repatriate certain project revenues outside Syria; money can be transferred abroad only if it was originally transferred from outside Syria to a Syrian bank account and kept in that bank in foreign currency. This could potentially cause an issue for PPPs in respect of the repatriation of payments received by the Project SPV under the project in Syria or repaying the interest of foreign loans. Further steps to improve investment appetite for PPPs are likely to be taken into account in the new PPP law, currently in draft form. It is likely that Project SPVs and financiers will be exempted from such foreign currency requirements.

In Jordan, the West Bank and Algeria, share ownership by foreign entities is restricted in certain sectors but exemptions may be granted. In Jordan, the Regulation for the Promotion of Non-Jordanian Investments no. 54 of 2000 (Investment Regulation) sets out the restrictions on foreign ownership of Jordanian companies for certain sectors and activities. In some sectors, such as construction and services related to operating subways, bridges and highways (among others), foreign ownership is restricted to 50% or 49%. Limited waivers of such restrictions may be granted to foreign PPP investors in Jordan by the Council of Ministers, allowing them to hold a bigger share of equity than ordinarily permitted. In respect of projects in the West Bank, the Minister of National Economy can waive the restriction that a foreign entity may not own more than 49% of shares in a local company and up to 99% foreign ownership may be permitted. In Algeria, strict regulations on foreign ownership, borrowing and repatriation of earnings were introduced in 2009. Whilst it may in theory be possible for exemptions to be granted, there is no explicit guidance on when such exemptions might be permitted. Foreign investors have been active in Algerian PPPs in recent years, and in order to sustain this inflow of foreign investment, it would be beneficial if some guidance on whether and under which circumstances projects may benefit from exemptions from this legislation.

Comparisons of foreign direct investment (FDI) volumes in the Mediterranean partner region are shown in Figure 4 below. FDI has reduced in several of the Mediterranean partner countries due to the impact of the international financial crisis, which has curtailed investment in export-oriented sectors such as ports and tourism. Egypt and Israel experience the largest inflows of FDI in the region, reflecting their fairly liberalised investment regimes. Lebanon’s growth reflects sustained recovery following the 2006 conflict and a booming construction and real estate sector.

Figure 4: Inward FDI in Mediterranean partner countries
Are appropriate guarantees provided when necessary?

Comparator countries

In the comparator countries, payment guarantees from the public sector (including sovereign guarantees) are available when necessary and depend on the specific circumstances of a project and the contracting authority’s creditworthiness.

For PPP projects where the public sector pays availability payments and where bidders and lenders are concerned with the creditworthiness of the contracting authority, they may seek to obtain a payment guarantee from a third party, such as the sponsoring ministry. It should be noted that the guarantees being considered here are guarantees of the obligations of an authority under a payment mechanism, not direct sovereign guarantees of debt. State-backed guarantees are not permitted in Mexico, for example, but PPPs are relatively established and public entities acting as contracting authorities are generally investment grade rated and there is a sustained track record of meeting payment obligations. The sponsoring ministry or government departments in South Africa and England have provided a form of guarantee of the contracting authority’s payment and performance obligations in some exceptional cases, but it is not standard policy. For instance, it is recognised by the South African authorities that some form of support may need to be provided in respect of Eskom as the off-taker of the Independent Power Plant (IPP) projects, despite its investment grade rating, as a result of concerns raised by the rating agencies on Eskom’s balance sheet ability to finance the huge infrastructure investment without a cost-reflective tariff. In England, the PPP obligation of NHS trusts (which are statutory corporations which manage public hospitals) are effectively guaranteed by the State.

Mediterranean partner countries

For some projects in the Mediterranean partner countries, the provision of sovereign guarantees in respect of the contracting authority’s payment obligations will improve the projects’ bankability. As is common practice amongst PPP investors, bidders and lenders will, as part of their diligence relating to the project, assess the overall creditworthiness of the procuring authority and their confidence in it. Where there are residual concerns with the ability of the authority to make payments, bidders and lenders will seek additional support. The extent to which sovereign guarantees or other State support are available (and the conditions of their availability) to assist with obtaining investment by foreign lenders in PPPs varies between the Mediterranean partner countries, depending largely on their credit rating or creditworthiness of the public entity.

The Israeli State does not tend to issue guarantees/securities in respect of the fulfillment by authorities of their obligations under the underlying contract. Whilst this may be acceptable to international investors in some cases, the provision of sovereign guarantees on a project specific basis could have a positive effect on financing terms and better value for money may be achieved.

In Egypt, a pragmatic approach to sovereign payment guarantees has been adopted. The availability of guarantees is largely determined on a project specific or sector specific basis by such factors as prevailing market conditions and specific project features. This approach will be attractive to foreign sponsors and lenders, which may seek State-backed guarantees to help off-set some risks (e.g. those risks arising from poor user up-take of a facility under demand based payment mechanisms). Such guarantees can reduce capital costs of a project through improved lending terms.

In Morocco, the terms of such guarantees are negotiated on a commercial and project specific basis and come at a cost for the private sector lenders. There is some concern within the lending community regarding the cost of such securities (currently 3.5% of the loan amount). In order to evaluate whether such guarantees are beneficial to the public sector in net terms, it would be important to consider how the costs of the guarantees will be priced in by the bidders.

In Algeria sovereign guarantees are not generally provided and the attractiveness of payment guarantees has been overcome in practice by introducing a strong public sector company as off-taker. Relatively recently, procuring authorities have established State-owned entities in the sectors in which PPPs have been prevalent (water and renewable energy). The relative infancy of these entities has raised reasonable concerns amongst investors as to the creditworthiness of the procuring authority as off-taker. In one particular example, the water off-taker in the first desalination plant initially proposed was an entity established only five years previously and it was considered that the balance sheet was insufficiently robust to support the off-taker payments. This was overcome in practice by setting up a joint venture with SONATRACH. This satisfied funders but came at the cost of a prolonged negotiation process and significant revision of contractual documentation which was then applied to all subsequent desalination PPPs.

PPP investment by foreign sponsors and lenders in Jordan, Lebanon, Syria and Tunisia will be made more attractive if a clear policy on sovereign guarantees (to guarantee the procuring entity’s payment obligations) were introduced. It is not usual for these governments to provide a guarantee to support the obligation of the procuring authorities to make payments. Given the early stage at which PPP currently is in Lebanon for example, the offer of such guarantees is likely to be essential to engender confidence in the private sector and mitigate some of the perceptions of country and payment related risks that are likely to influence investment decisions. In Jordan, the Draft PPP Law40 leaves the option of providing sovereign guarantees open. The Draft PPP Law in Syria41 does not currently include any provision concerning State guarantee of payments due to the Project SPV.

The absence of sovereign guarantees in Tunisian projects is consistent with the fact that to date PPPs have principally taken the form of concessions, where the concessionaire takes demand risk and revenues are dependent on end-users (and not payments from the authority). The State does not generally offer any form of support such as minimum payment guarantees. However, in instances where there is concern about poor user uptake of a facility under a demand based scheme, the state could consider offering a guarantee as this would serve to off-set some demand risks and may have positive effects on affordability and value for money for the public sector.

40 Draft PPP Law dated 1 June 2010
41 Draft PPP Law dated 20 April 2010
When considering whether or not to provide State guarantees, countries are also constrained by their current indebtedness. For countries with high debt/GDP levels (for example, Lebanon and Jordan), providing state guarantees for a number of large infrastructure projects may not be feasible in the near term as this would impose an unsustainable burden on their finances. In these cases, prioritisation and phasing of projects becomes crucial. In addition, a combination of availability payments and user fees in certain sectors (and if forecasting demonstrates that this is feasible) could also help reduce the public sector payment commitments.

**Is a robust security package available?**

**Comparator countries**

The legal frameworks of the comparator countries permit the standard securities usually required in international PPPs. Lenders will expect a robust security package to protect their investments in the case of default by the borrower (the Project SPV). For PPP projects in the comparator countries, lenders require security over all the assets (including contractual rights) of the Project SPV (including assignment by way of security, charges over bank accounts and security over the shares in the Project SPV). The broad range of project finance securities available to lenders in the comparator countries include the following:

- Mortgages over any land and property held by the Project SPV;
- Fixed and floating charges over shares of the Project SPV and any plant and machinery, credit balances, book debts, intellectual property and other beneficial interests;
- Assignment of insurance policies by way of security;
- Assignment by way of security with respect to all receivables against the public authority, the subcontractors, the hedging counterparties, the insurance companies and the tax authorities and all rights in respect of any agreement to which the Project SPV is a party. In France, the Cession Dailly arrangement is a feature of lender protection, as it creates a direct relationship between the lenders and the authority, whereby lenders may request direct payments from the authority;
- Arrangements relating to the proceeds account to channel the proceeds generated by the project through a blocked account usually kept with the leading bank; these usually provide for a payment order in accordance with a cash cascade (or waterfall) clause;
- Project support agreements: completion guarantee and/or cost-overrun guarantee from the project sponsors;
- Subordination of sponsor’s capital and loans to the lender’s facilities;
- Interest hedge/currency hedge arrangements;
- Collateral warranties such as direct duty of care agreements from subcontractors; and
- Direct agreements, which provide step-in rights for the lenders to step-in to the project in circumstances where the Project SPV has defaulted and is in danger of its contract being terminated (for example, by replacing the constructor or operator if they are not performing during a specified period of time or by transferring the contract to a suitable substitute). Direct agreements also usually provide for the subordination of the authority’s rights to those of the lenders.

**Mediterranean partner countries**

Israel adopts sophisticated lender security structures compliant with international practice. This includes all forms of security considered as best practice above in the comparator countries. The recognition of such security under Israeli law for the purposes of enforcement represents a crucial attraction for investors in PPP projects in Israel.

Robust security packages, generally compatible with international market practice for project financed PPPs, are also available in Egypt, Algeria, Jordan, Morocco and Tunisia, but with some exceptions that are overcome in practice. For example, even though Egyptian law does not recognise assignment by way of security, an assignment agreement is concluded simultaneously with the facility agreement and its exercise is subject to declaration of an event of default. In Morocco, the level of protection available to funders is a matter of negotiation and generally a robust security package can be expected, including securities over assets, shares and bank accounts of the Project SPV and also direct agreements in favour of lenders. Moroccan law restricts the ability of the private sector to obtain mortgages over public sector assets in certain circumstances. While this is overcome in practice for public enterprises, who can benefit from an exception to this rule under the Concessions Law, (provided the assets revert to the public authority on the repayment of the loan)42, it does not apply to private sector owned SPVs. In Jordan both the lenders and the authority can be protected through a robust security package, although Jordanian law does not recognise a floating charge on assets. All secured assets therefore need to be specified with sufficient certainty and security documentation will need to be updated regularly to capture any additional assets acquired from time to time by the Project SPV. The terms of the security instruments in Tunisian concessions are in line with the international market.

Standard security instruments are available to lenders to Algerian PPPs, which are publicly owned banks. The case of Algeria is atypical in the sense that lenders to PPPs have been public sector banks. It is unclear whether lenders would be granted step-in rights, although the connection between public sector lenders and the off-taker (i.e. the public sector entity purchasing the service and/or output) may somewhat mitigate this risk.

Typical project lending securities are new concepts in Lebanon and Syria given the initial stage of their PPP programme. Lebanon and Syria are both currently developing their PPP policies and programmes (including PPP Laws) and it is expected that standard security will be available. Until recently, both countries have generally practiced traditional, construction-based procurement. PPP project specific securities such as lender step-in and charges over all project assets will therefore need to be developed. In Syria, whilst it is common for agreements with Syrian public authorities to include the right of step-in by the authority, it is not usual for lenders to be granted rights of step-in. It may be an opportunity for appropriate precedent in respect of lender step-in rights to be set out in early project agreements procured under the new PPP law (when enacted).

---

42 Law 54-05 enacted by Dahir No. 1-06-15 of 14 February 2006 (Article 8)
How do tax and accounting issues affect the affordability of PPPs?

Comparator countries

PPP is generally “tax-neutral”, and has not required any specific tax incentives in the comparator countries. For instance in the UK, where the procurement decision rests with a “spending department” of government, that authority evaluates bids on a pre-tax basis. This is useful because in PPPs bidders price their offers so as to achieve a certain after-tax rate of return on equity. Whilst they endeavour to make the financial structure as tax-efficient as possible, in essence they include whatever taxes are payable in the project financial model, and price these into their bid. Correspondingly, in order to establish the net cost to the public sector, tax payments have to be netted out of the analysis.

Mediterranean partner countries

Likewise, Mediterranean partner countries have not introduced specific tax or accounting incentives or treatment for PPPs. Project SPVs will follow national rules. Corporation tax rates range from 30% down to 15% – a typical range internationally – and most countries levy withholding taxes (commonly at 10%, subject to tax treaties) on interest or dividends paid to foreign entities.

Offering tax incentives for PPP investment needs to be carefully studied, since bidders include the forecast tax liabilities (however high or low) when pricing their bids. As a result, the net cost to the government or to end users (gross project payments less tax receipts from the Project SPV) will be broadly the same irrespective of tax rate or incentives offered. However, foreign currency earning and internationally competing projects, such as ports or airports, may merit specific investment incentives or tax treatment.

Consistency of tax treatment is more important for investors in PPP than absolute levels of taxation or incentives. When calculating the project payments to be paid over the entire project period, sponsors have to assume that domestic tax treatment will remain substantially unchanged during the project life, and to achieve this they will seek a degree of protection from adverse changes in tax rules through the change in law provisions in the project agreement.

Striking the right balance in tax and accounting regulation can enable authorities to maximise project cost-efficiency. When evaluating bids, in addition to the gross project payments proposed by the bidder, the procuring authority should also consider the tax forecast to be paid (including withholding taxes) by the Project SPV over the project life. There are a number of possible tax treatments depending on the capital structure of the bidder, and so it is possible that the bid with the lowest proposed project payments is not necessarily the bid with the lowest cost after tax payments are taken into account.

A number of tax rules in some Mediterranean partner countries could potentially distort project procurement decisions, or could lead to inefficient capital structures for projects. Use of contract debtor accounting helps to reduce the cost of capital for Project SPVs, as described below. Thin capitalisation restrictions (in Egypt, Morocco, and Tunisia), intended to prevent parent companies from overloading subsidiaries with excessive inter-company debt to minimise tax liability, may restrict the amount of project debt that Project SPVs can cost-effectively raise. Since Project SPVs can generally sustain higher levels of debt than general corporate entities due to their long term contracted revenue stream, the effect of thin capitalisation restrictions can be that a higher proportion of project cost is funded by more expensive equity than is necessary, increasing the cost to the procuring authority. Also, procurement decisions may be affected if one bidder can obtain domestic debt finance which does not attract withholding tax, whilst other bidders with foreign debt funding have to assume withholding tax on interest. In such cases (ignoring any separate policy preferences for domestic funding) the authority may wish to consider netting out the withholding tax component from the project payments bid to ensure comparability of bids.

For availability-based projects, the adoption of “finance debtor” accounting will make projects more affordable, by enabling accounting profit to match project cashflows after debt service much more closely. Finance debtor accounting for subsidiary entities such as Project SPVs is permissible under the accounting standards of all Mediterranean partnership countries except Algeria, Morocco, and Tunisia. However, finance debtor treatment for tax purposes is permitted only in Israel, Jordan, Syria, and (whilst not formally applied to date) in the West Bank. Use of finance debtor accounting is recommended by international accounting standards as it avoids many of the inefficiencies caused by fixed asset accounting in PPP projects. Without it, bidders are forced to delay dividends and pay higher taxes, which would encourage them to fund projects with more equity and less debt (to avoid holding distributable cash in the Project SPV for an extensive period), making their bids more expensive.

---

43 Finance or contract debtor accounting treats the PPP concession as being an investment not in a fixed asset to be depreciated, but as a debt entitlement arising from the concession rights. The capital cost is amortised in a profile equating to the principal component of an annuity, i.e. amounts rising over time. The effect is that net revenues less amortisation and interest is much more evenly spread over the project life, and much more closely matches actual cashflows, so that the problem of accounting losses (which restricts dividend payments) does not arise. For PPP contracts where the main benefits of asset usage accrue to the public sector, finance debtor accounting is recommended by IFRIC 12 – Service Concession Arrangements (International Financial Reporting Interpretation Committee note no. 12, issued by the International Accounting Standards Board) and has been practiced in the UK under Financial Reporting Standard No. 5 – Application Note F: Reporting the Substance of Transactions – PFI and Similar Contracts, September 1998. It is also permitted in Poland and South Africa, but not in French PPPs where French accounting standards are applied to Project SPVs, and international accounting standards are applied to group consolidated accounts.

Finance or contract debtor treatment compares to the more common fixed asset treatment, where the asset is depreciated, often on a straight line basis. The combination of straight line depreciation and high interest charges in the early years of the project can give rise to accounting losses, even though the project is generating cash surpluses before finance costs.

44 Higher aggregate income tax over the project life arises if the tax losses caused by fixed asset accounting cannot be carried forward indefinitely to be utilised to offset taxable income in later years of the project. The majority of Mediterranean partner countries have time limitations (typically 3-5 years) on the carrying forward of tax losses, which can cause carried forward tax losses to expire before they can be utilised.
Concluding remarks on the general business regulations or practices which might affect PPPs

PPPs function most efficiently when the project parties can carry out their project responsibilities without excessive regulatory restrictions. Whilst PPP laws and contracts govern how a project is to be carried out, no project can be operated in isolation from general business regulations and practice. All PPPs must adhere to local laws and regulations on matters such as employment, health and safety, tax compliance, environment, consumer protection, data protection, corporate registrations and filings. However, if such regulations are considered excessive by potential bidders and investors (especially foreign parties), they may be deterred from investing in one country in favour of a country in which it is easier to do business. Moreover, even when bidders are familiar with a country’s business environment, the cost of the project will be affected by having to factor in higher administrative costs for complying with heavy regulations.

Most fundamentally, the key to success of PPPs is partnership. A well designed, comprehensive project scope, transparent and competitive procurement and bid evaluation, and balanced contract risk allocation, are all crucial for successfully financing and signing PPPs. Thereafter, the ultimate success of the project is determined by the parties, both public and private sector (including lenders), recognising that they have a shared interest in the success of the project.

PPP/project finance investment readiness for lenders and investors – recommendations/success factors

- Minimise restrictions on investment and create incentives for foreign investment in order to increase competition.
- Sovereign guarantees should be considered in specific circumstances where there are concerns as to the creditworthiness of the procuring authority or off-taker.
- Ensure that a robust security package which meets the requirements of lenders can be created in PPP contracts. Include security over the assets of the Project SPV (including its revenue flows) and lender step-in rights as available security options.
- Throughout the life of the PPP contract, an open dialogue between the authority and private sector provider, recognising their shared interests, is key to a successful project.
### Risk

<table>
<thead>
<tr>
<th>Risk</th>
<th>Typical Solutions or Mitigants</th>
<th>Lender (including IFIs and ECAs) preferred position</th>
<th>Sponsor preferred position</th>
<th>Authority preferred position</th>
<th>Typical risk allocation</th>
</tr>
</thead>
</table>
| **Equity Sponsor - management / technical quality**  
Insufficient level of expertise and experience in managing similar projects, and resourcing for this project | Evidence of expertise and experience is a core pre-qualification criterion. Strong subcontractors or specific project resourcing can partly offset a weak sponsor | Key requirement, usually determined by sponsor having an established client relationship with the bank | Key requirement, established with prior knowledge of sponsor reputation and information gained in the procurement process | Satisfactory sponsor selected |
| **Equity Sponsor - capital strength for unforeseen requirements**  
Available resources to inject to avoid loss of equity if sponsor chooses not to "walk away" (Non-recourse nature of project finance means contingent equity is not usually committed) | General, but not legally contracted, comfort from size and reputation of sponsor, and strategic importance of project to the sponsor (for example if sponsor cannot have reputational damage of a failed project) | Project considered as strategically important so that sponsor would be reluctant to "walk away" | No formal commitment to inject equity in excess of amounts committed at financial close (otherwise it is a corporate financing rather than project financing) | Reputable sponsor with strong track record, including possible evidence of having successfully turned around projects which experienced problems |
| **Construction - delay risk and/or cost over-run**  
Project not completed on time and/or budget | Separate construction Project SPV or Engineering Procurement and Construction (EPC) subcontractor (who may also be an equity sponsor) contracts on a fixed price, date certain basis with liquidated damages for delay. Terminate and replace contractor if delay exceeds longstop | Fixed price contract makes capital costs certain, and liquidated damages to cover finance costs of delay | Same as lender | Cost certainty since payments to Project SPV do not start until construction complete: strong incentive to complete on time |
| **Construction - contractor default risk**  
Construction or EPC contractor becomes insolvent and cannot continue project | Prior assessment of contractor strength is a core pre-qualification criterion. Performance bonding. Payment retentions. Step-in: ability to replace contractor and continue project | Ability to step-in and replace contractor without a project termination is core security for banks. Satisfactory levels of performance bonds and retentions to cover cost of disruption | Same as lender | The strong financial incentives on the Project SPV, its sponsors and lenders to save the project following contractor default generally makes giving step-in rights less costly for the authority than terminating and taking back the project |
| **Project permits and consents (planning, environmental, and other regulatory requirements)**  
Project does not obtain permits to carry out project | Obtain permits in advance of financial close or start of construction. Ensure construction and operations comply with conditions of permits | Pre-condition of committing funds. Once obtained, Project SPV obliged to comply with conditions as a loan covenant | Pre-condition of committing funds. Project SPV or sponsor is responsible for submitting applications in correct format, and cannot progress until approvals obtained | The authority or other public bodies should not obstruct or frustrate the permitting process |
| **Technical risk - design and technology selection**  
Project design or technology specification does not conform to legal standards or does not meet required specifications | Design is agreed in sufficient detail prior to contract award and financial close  
Technical due diligence for banks confirms if design is appropriate  
Design accepted by construction or EPC contractor | Due diligence to confirm if design is appropriate  
Risk passed to construction or EPC contractor | Due diligence to confirm if design is appropriate  
Risk passed to construction or EPC contractor | Design is fixed at financial close: avoids risk of "gold plating" by officials, i.e. costly further amendments to design without a formal variations approval process |

---

**Appendix 1 PPP PROJECT RISK ANALYSIS**

---

**European Investment Bank**  
Volume 1 – May 2011
<table>
<thead>
<tr>
<th>Risk</th>
<th>Typical Solutions or Mitigants</th>
<th>Lender (including IFIs and ECAs) preferred position</th>
<th>Sponsor preferred position</th>
<th>Authority preferred position</th>
<th>Typical risk allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technical risk - defects or commissioning risk</td>
<td>Constructed project does not meet standards on completion</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Turnkey contract – non-acceptance or handover</td>
<td>Due diligence to confirm if achievable</td>
<td>Risk passed to construction or EPC contractor</td>
<td>Risk passed to Project SPV since payments do not start until completion</td>
<td>Construction or EPC subcontractor bears risk</td>
</tr>
<tr>
<td></td>
<td>Performance damages payable to Project SPV</td>
<td>Risk passed to construction or EPC contractor</td>
<td></td>
<td></td>
<td>Liquidated damages not payable to authority unless a clear economic loss from late delivery</td>
</tr>
<tr>
<td></td>
<td>Contractor liability, up to a cap</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Terminate and replace contractor to rectify</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technical risk - operational performance</td>
<td>Project does not perform technically to specifications required</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Once commissioned, an operator risk with claim on construction or EPC contractor for defects</td>
<td>Due diligence to confirm if realistic</td>
<td>Risk passed to operator</td>
<td>Risk passed to Project SPV since project payment mechanism includes deductions to reflect reduced output, availability, or performance</td>
<td>Operator risk</td>
</tr>
<tr>
<td></td>
<td>Project SPV’s lost revenues (including authority payment deductions) are deducted from its payments to the operating subcontractor, up to a cap</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Terminate and replace operator if cap exceeded</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operations - performance standards not achieved</td>
<td>Project is not operated to standards required</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operations - cost over-run risk</td>
<td>Operating costs exceed budget</td>
<td>Operating subcontractor’s fee is fixed, subject to indexation and bench-marking or market-testing of some or all cost components</td>
<td>Due diligence to confirm if cost assumptions are reasonable</td>
<td>Risk passed to operator</td>
<td>Risk passed to operator; authority’s costs are known in advance (from operation of payment mechanism) unless the scope of services is changed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk passed to operator</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operations – supply of inputs for example fuel source</td>
<td>Project SPV enters into a long term fuel supply agreement sufficient to achieve full output</td>
<td>Fuel supplier to be reliable and creditworthy</td>
<td>Risk passed to fuel supplier</td>
<td>Project payments are likely to be lower if the fuel supply price basis matches the project revenue payment mechanism, than if financial reserves or contingencies are priced into the contract</td>
<td>Fuel supplier bears risk, and fuel price basis matches the project revenue payment mechanism (i.e. project payments adjust on a 1-for-1 basis with fuel costs)</td>
</tr>
<tr>
<td></td>
<td>Fuel price is either fixed or the project payment mechanism (see “Revenues – price risk” below) has adjustments which match movements in fuel price</td>
<td>Matching fuel supply price basis to project revenue payment mechanism is crucial</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Financial reserves or contingencies established for any residual risk</td>
<td>Highly conservative assumptions for any residual fuel price risk</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operations - contractor default risk</td>
<td>Operations and maintenance contractor or service contractor becomes insolvent and cannot continue project</td>
<td>Prior assessment of contractor strength is a core pre-qualification criterion</td>
<td>Same as for “Construction - contractor default risk”</td>
<td>Same as for “Construction - contractor default risk”</td>
<td>Same as for “Construction - contractor default risk”</td>
</tr>
<tr>
<td></td>
<td>Step-in: ability to replace contractor and continue project</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenues - demand risk</td>
<td>End-user demand for project output is lower than base case original forecast</td>
<td>Sector specific: in many sectors the Project SPV cannot control or reliably predict end-user demand. In such cases, the PPP project payment mechanism is designed to eliminate demand risk: the authority accepts the great majority of the project’s full capacity output</td>
<td>Generally only acceptable if end-user demand can be reliably predicted and cannot be influenced by public sector action without compensating adjustment to project payments. If accepted (for example toll roads), loan amount and cover ratios assume conservative volume of demand</td>
<td>Same as lender, but inclined to be more optimistic than banks when forecasting</td>
<td>Authority should be aware of over-optimistic bidding, where a bidder achieves lowest toll or tariff by assuming unrealistically high demand. If not achieved, project can rapidly become insolvent through inadequate revenues</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Same as lender, but inclined to be more optimistic than banks when forecasting</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**European Investment Bank**

**Volume 1 – May 2011**

**Appendix 1 PPP PROJECT RISK ANALYSIS**
<table>
<thead>
<tr>
<th>Risk</th>
<th>Typical Solutions or Mitigants</th>
<th>Lender (including IFIs and ECAs) preferred position</th>
<th>Sponsor preferred position</th>
<th>Authority preferred position</th>
<th>Typical risk allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues - output risk</strong>&lt;br&gt;Project output is lower than base case original forecast for reasons other than underperformance or demand: for example due to damage or insufficient resources (for example in renewable energy projects)</td>
<td>For resources: detailed prior analysis of available resource, and financial protections such as reserve accounts. Project SPV risk, Damage: comprehensive insurance package.</td>
<td>Due diligence to confirm adequacy of insurances. Base case forecasts to assume conservative wind or solar resource.</td>
<td>Same as lender.</td>
<td>Authority does not have to pay, or can make deductions, for supply or services which are not delivered.</td>
<td>Project risks to be managed by Project SPV.</td>
</tr>
<tr>
<td><strong>Revenues - price or tariff risk</strong>&lt;br&gt;Unit price or tariff is lower than base case original forecast</td>
<td>PPP project payment mechanism typically sets the price to cover project operating, capital, and financing costs. The mechanism typically includes indexation, cost benchmarking, and interest rate or exchange rate adjustments if the Project SPV cannot separately contractually fix or hedge these variables.</td>
<td>Since the project cashflow is the sole source of loan repayment, the lenders require the cashflow to be as certain as possible. This is achieved by the Project SPV largely fixing its revenues and costs through the project contracts, so that cashflows are predictable as long as the project parties continue to perform and not default.</td>
<td>Same as lenders.</td>
<td>Authority seeks to transfer to the Project SPV those risks which it believes can be controlled or mitigated by the Project SPV and/or its subcontractors.</td>
<td>An equitable payment mechanism, in which the Project SPV assumes only those risks which it can manage, generally achieves the optimal and most affordable outcome for the authority. The Project SPV obtains the lowest cost of capital for the particular project, and the authority transfers the majority of project risk.</td>
</tr>
<tr>
<td><strong>Revenues - authority/off-taker payment default risk</strong>&lt;br&gt;The authority or off-taker cannot pay contracted unitary charge or tariff</td>
<td>Lender and sponsor assessment of authority and sovereign credit risk. State guarantee of contract obligations (whether in law or in the project contract).</td>
<td>Lender and investor confidence in the ability of State entities to meet their liabilities is essential for funding to be available.</td>
<td>Same as lenders.</td>
<td>A State guarantee of the contract obligations can be justifiably made if the project appraisal, procurement and approval procedures determine that the project is viable and affordable, and that a budget allocation can be made.</td>
<td>State guarantee of the contract obligations (whether in law or in the project contract) generally provided for significant projects.</td>
</tr>
<tr>
<td><strong>Financial - interest rate exposure</strong>&lt;br&gt;The Project SPV’s interest costs exceed base case original forecast</td>
<td>Fixed rate funding or interest rate hedging if available. Payment mechanism adjustment if Project SPV is funded in currency with limited term interest rate swap or bond market.</td>
<td>Either of the two mitigants (hedging or payment mechanism to be used) can be used.</td>
<td>Same as lender.</td>
<td>Separate hedging by the Project SPV is the preferred position, but payment mechanism adjustment may be necessary as a trade-off, for example to utilise local currency funding.</td>
<td>Separate hedging by the Project SPV is applied, if available in the market.</td>
</tr>
<tr>
<td><strong>Financial - exchange rate exposure</strong>&lt;br&gt;Exchange rate movements cause project costs in currency of financing to be higher than base case original forecast</td>
<td>Payment mechanism adjustment is required if Project SPV is funded in currency different from the currency of the project payments.</td>
<td>Payment mechanism adjustment is required.</td>
<td>Same as lender.</td>
<td>If project is funded in foreign currency, the currency risk is largely unavoidable for the authority – otherwise no project.</td>
<td>Can be authority risk if project is not funded in domestic currency, particularly if currency peg applies.</td>
</tr>
<tr>
<td><strong>Financial - liquidity</strong>&lt;br&gt;Project runs out of cash due to short term problem whilst otherwise solvent</td>
<td>Project SPV’s finance plan includes creation of cash reserve accounts, for example a debt service reserve account.</td>
<td>To be included in project financial plan.</td>
<td>Sponsors generally accept lenders’ requirements.</td>
<td>A Project SPV matter, though in procurement authorities should ensure the financial plan is robust.</td>
<td>Project SPV risk.</td>
</tr>
<tr>
<td><strong>Financial - tax</strong>&lt;br&gt;Project SPV’s tax bill (as a proportion of profit and cashflow) higher than forecast</td>
<td>Depending on stability and suitability of tax regime, either acceptance of tax law as at start of project, or pre-agreed specific project treatment. Payment mechanism adjustments to preserve post-tax returns on investment if change in tax law or treatment.</td>
<td>Some exposure to general corporate tax rate changes may be acceptable, but all specific changes to taxes on project or sector must be fully adjusted for in the payment mechanism or other contract adjustment.</td>
<td>Same as lenders. Necessary because, unlike general commercial entities, the Project SPV cannot arbitrarily raise its prices to cover increased costs.</td>
<td>Not agreeing this would send an adverse signal as to creditworthiness and authority payment risk.</td>
<td>As per Lender position.</td>
</tr>
<tr>
<td><strong>Insurance</strong>&lt;br&gt;Project insurances not adequate to cover risks outside control of Project SPV</td>
<td>Comprehensive scope of insurances to be agreed between parties at start of project.</td>
<td>Key requirement.</td>
<td>Key requirement.</td>
<td>Key requirement.</td>
<td>Comprehensive insurance package obtained.</td>
</tr>
</tbody>
</table>
## Risk

<table>
<thead>
<tr>
<th>Risk</th>
<th>Typical Solutions or Mitigants</th>
<th>Lender (including IFIs and ECAs) preferred position</th>
<th>Sponsor preferred position</th>
<th>Authority preferred position</th>
<th>Typical risk allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political and Legal</td>
<td>Includes expropriation, non-convertibility or non repatriation, change in law, enforceability, civil strife, war</td>
<td>Prior assessment by lenders, International Financial Institutions (IFIs) and Export Credit Agencies (ECAs) and sponsors of their country and sovereign risk appetite</td>
<td>Lender credit appetite for country is a pre-requisite. Political risk insurance, if available, may assist in certain cases</td>
<td>Similar to lender position although sponsors with previous dealings with government may have greater confidence</td>
<td>Project contracts specify expropriation and non-convertibility as an event of default. Change in law to be dealt with through contract adjustment, and war and civil strife typically as force majeure (although in some countries government may have to retain this risk)</td>
</tr>
</tbody>
</table>
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.

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. This study is financed under the FEMIP Trust Fund.

Operational contacts

**Claudio Cortese**  
Deputy Director General,  
Directorate for Operations outside the European Union and Candidate Countries  
(+352) 43 79 - 86836  
cortese@eib.org

**Alain Nadeau**  
Head of Maghreb Division  
(+352) 43 79 - 86816  
a.nadeau@eib.org

**Javier Gutiérrez Degenèве**  
Head of Near East Division  
(+352) 43 79 - 84820  
j.gutierrez@eib.org

**Angus Macrae**  
Head of Special Operations Division  
(private equity operations)  
(+352) 43 79 - 86406  
amacrae@eib.org

**Ioannis Kaltzas**  
Head of the Policy and Trust Funds Division  
Directorate for Operations outside the European Union and Candidate Countries  
(+352) 43 79 - 86425  
kaltzas@eib.org

External Offices in Mediterranean partner countries

**Egypt**: Jane Macpherson  
Head of Regional Office  
6, Boulos Hanna Street - Dokki, 12311 Giza  
(+20-2) 3 336 65 83  
j.macpherson@eib.org

**Morocco**: Guido Prud’homme  
Head of Office  
Riad Business Center, Aile Sud Immeuble S3, 4e étage Boulevard Er-Riad, Rabat  
(+212) 537 56 54 60  
g.prudhomme@eib.org

**Tunisia**: Robert Feige  
Head of Office  
70, avenue Mohammed V  
TN-1002 Tunis  
(+216) 71 28 02 22  
r.feige@eib.org

Press contacts and general information

**Anne-Cécile Auguin**  
(+352) 43 79 - 83330  
(+352) 43 79 - 61000  
a.auguin@eib.org

**European Investment Bank**  
98 -100, boulevard Konrad Adenauer  
L-2950 Luxembourg  
(+352) 43 79 – 1  
(+352) 43 77 04  
www.eib.org/femip – info@eib.org
FEMIP

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

Volume 2 – Country Analysis
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.

The contents of this Volume have been prepared by external consultants. The opinions expressed are those of the consultants and do not necessarily reflect the view of the European Investment Bank.

This Volume is not designed to be professional advice in respect of any particular matter and should not be relied upon in the making of any legal, commercial or financial decision.
## CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>GLOSSARY</td>
<td>1</td>
</tr>
<tr>
<td>INTRODUCTION</td>
<td>2</td>
</tr>
<tr>
<td>1. ALGERIA</td>
<td>4</td>
</tr>
<tr>
<td>2. EGYPT</td>
<td>8</td>
</tr>
<tr>
<td>3. ISRAEL</td>
<td>13</td>
</tr>
<tr>
<td>4. JORDAN</td>
<td>17</td>
</tr>
<tr>
<td>5. LEBANON</td>
<td>21</td>
</tr>
<tr>
<td>6. MOROCCO</td>
<td>25</td>
</tr>
<tr>
<td>7. SYRIA</td>
<td>29</td>
</tr>
<tr>
<td>8. TUNISIA</td>
<td>34</td>
</tr>
<tr>
<td>9. WEST BANK</td>
<td>38</td>
</tr>
</tbody>
</table>

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.
ACKNOWLEDGEMENTS

In preparing the Report, the Consortium has been assisted by Paloma Perez de Vega, Francesco Totaro and Nicholas Jennett from the European Investment Bank, Willis Limited (in relation to insurance matters) and the following in-country experts:

Mediterranean partner countries:

**Algeria**
- Ghellal & Mekerba Law Firm
- Mazars Hadj Ali

**Egypt**
- Sharkawy & Sarhan Law Firm
- Mazars Mostafa Shawki

**Israel**
- Glusman Shem-Tov Chowers Broid & Co – Law Offices
- MBT Consultants

**Jordan**
- J.C. Law Firm
- Mazars (UAE)

**Lebanon**
- Takla, Trad, Daouk Law Firm
- Mazars (Lebanon)

**Morocco**
- UGGC & Associés Law Firm
- Mazars Masnaoui

**Syria**
- Syrian Legal Bureau
- Mazars (UAE)

**Tunisia**
- Ferchiou and Associés
- Mazars (Tunisia)

**West Bank**
- A, F & R Shehadeh Law Office
- El Wafa Company

Comparator countries:

**France**
- Salans
- Mazars France

**Mexico**
- COMAD, S.C.
- Mazars Mexico

**Poland**
- Salans
- Mazars Poland

**South Africa**
- Webber Wentzel
- Mazars South Africa

The Consortium is grateful for the support that has been given.
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)
Report: A report comprising three volumes titled "Volume 1 – A Regional Approach", "Volume 2 – Country Analysis" and "Volume 3 – Best Practices and Lessons Learned – Selected Experiences from Other Countries"; this being Volume 2
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.

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 (the present Volume)**

This Volume 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**

Volume 3 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. 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 this Volume 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.

**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.

---

Further information about the FEMIP Trust Fund is available at [www.eib.org/ftf](http://www.eib.org/ftf)
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;
- 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.
1. ALGERIA

Overview

Algeria’s infrastructure sector is heavily reliant on public sector investment, which has discouraged the development of PPP initiatives. Government agencies and state-owned corporations have sufficient funding to procure projects directly, without the need for private sector financing. Significant amounts of public investment originate in the country’s significant mineral reserves, which account for a substantial percentage of the country’s GDP. For instance, hydrocarbon resources (especially natural gas), represented 43% of GDP during the period 2005-2008. They have also accounted for 98% of the country’s total exports during the period 2004-2010. Algeria is also the world’s fourth largest producer of liquefied natural gas (LNG), supplying approximately 10% of the EU natural gas consumption.

Regulatory restrictions imposed on private sector investments have also discouraged the development of PPP in the country. PPP procurement and financing cannot be easily pursued in Algeria due to strict regulations introduced in 2009 on foreign ownership, foreign borrowing, and repatriation of earnings. The Complementary Financial Law of 2009 (particularly through the Ordinance no. 09-01 of 22 July 2009) introduced a number of restrictions to foreign investment, including elimination of free transfer of imports, mandating that Algerian partners must hold a majority stake (at least 51%) in any foreign investment and allowing the State the right to buy back the assets of private companies. Private investment restrictions have had a discouraging effect on the appetite of international companies to invest in Algeria thereby reducing the chances of furthering a PPP programme involving foreign investors.3

An exception to fully public-funded infrastructure is the case of desalination plants and independent power projects, where Algeria has developed successful PPP initiatives. The procurement and financing expertise gained from these PPP programmes is helpful in at least some sectors, should Algeria decide to further a comprehensive PPP programme in the future. The PPPs developed in the water and energy sector were successful in attracting a considerable number of international investors. Financing of these projects was provided by the public state owned banks. The Government’s stated objective in developing PPPs in these sectors was to reduce the foreign currency exposure during the period 2004-2010. Algeria is also the world’s fourth largest producer of liquefied natural gas (LNG), supplying approximately 10% of the EU natural gas consumption.

In order to meet some of the country’s future investment needs, Algeria may find it beneficial to maintain a selective PPP programme that allows international sponsors and investors to participate effectively. Such an initiative would help preserve diversity in potential funding sources for future infrastructure development in the chosen sectors. Developing and maintaining a consistent track record in infrastructure financing could be a prudent measure that Algeria could rely on if it were to seek foreign funding for its infrastructure procurement commitments (especially during any sustained period of adverse oil and gas market conditions).

Funding capacity and availability

Large foreign currency reserves and minimal debt levels allow Algeria to maintain substantial investment in infrastructure, either through PPP or other means, although at the cost of sustained capital inflows from the state or state owned entities. The main state-owned banks have approximately a 93% share of the domestic lending market. Since, under the present law, any borrowing for domestic expenditure or investment insofar as public entities are involved must be raised from local banks, PPP or other infrastructure project borrowing will continue to be provided exclusively by the five main state-owned banks. In effect, to date public banks have provided all long term PPP debt at preferential fixed interest rates equivalent to the Banque d’Algérie (Central Bank’s) discount rate. The ability of these banks to fund even a small portion of Algeria’s future infrastructure investment programme (whether or not procured by PPP) will require continued large net deposit flows from state-owned entities and/or the government directly.

Public banks have provided PPP projects with preferential long-term debt with fixed interest rates, thereby the public sector has assumed the financing risk of projects. Since the availability of preferential fixed rate funding has a major effect on the project economics, invitations to tender for PPP projects specify that such funding will be made available to the winning bid. This approach enables bidders to submit their bids on equal funding terms, so that debt terms and availability will not be competitive items between bidders. In addition, as the debt is provided by the public banks and is an element of the bid, the private sector is compensated for any changes in the financing conditions during the life of the project.

Legal and regulatory framework

Improved approaches to publishing case law would benefit domestic and international investors. In Algeria, case law, or the application of law to contractual matters, is not widely published. Moreover, circulars issued at all levels of the government and which either give interpretation of laws (interpretative circulars) or issue new regulations (regulatory circulars), lack consistency in the manner of their official publication.

A general legal framework on concessions and PPP procurement would bring certainty and predictability to potential investors. The country’s general public procurement law and the Civil Code currently take the place of a PPP law in Algeria. In the absence of a general legal framework, concessions in Algeria are regulated on a sector by sector basis or through project-specific laws. A general PPP law could bring a more uniformed implementation of procurement policies, benefiting both the government and the investors.

---

1 We understand that, as at April 2011, legal texts regarding the new regulation are currently in the process of being drafted. These should hopefully provide greater clarity on the procedures regarding partnership.
Arbitration is a viable alternative to court proceedings and is often available to commercial parties in Algeria. The adoption of arbitration as the preferred dispute resolution procedure to resolve PPP project disputes could encourage PPP investment. For a valid arbitration agreement, the parties will need to agree on a seat and rules of arbitration. Algerian arbitration practices include those from the International Court of Arbitration (ICC) and the United Nations Commission on International Trade Law (UNCITRAL). Both arbitration rules are widely respected amongst the international bidding and lending community.

Disputes resulting from a PPP contract may be subject, depending on whether a public entity is involved, to commercial or administrative law. Cases in which a public authority is involved or where the provision of the “public service” is affected, will be heard in the administrative courts. By contrast, commercial disputes not involving the procuring authority or the provision of the public service will be subject to the jurisdiction of the civil courts.

**Institutional issues**

A sector specific PPP law would enhance Algeria’s prospects in PPP. PPPs have been successfully tendered and delivered in Algeria, although the contract conditions have been negotiated in the context of each project. A clear policy framework, such as the passing of a PPP law, would encourage best practice and contribute to investor and lender confidence. Such a law would be particularly important considering the recent announcement of a new five year plan heralding USD 286 billion of investment, which demonstrates a clear commitment to large-scale infrastructure expenditure by the Algerian authorities.

In the absence of a ‘PPP unit’, several key actors participate in potential PPP projects in Algeria. The Ministry of Finance grants the budgets and therefore has a crucial role in the PPP decision making process. In addition, the Commission Nationale des Marchés (National Committee of Transactions, CNM) plays an important role in the management of PPPs. The Caisse Nationale d’Équipement et de Développement (National Fund for Capital and Development) (CNED) is responsible for: increasing the efficiency of public spending; for improving the evaluation, implementation and follow up of large projects; and for diversifying the sources of financing of large projects. Whilst local entities and sector based “by services” entities (such as universities and hospitals) do have the ability to procure major projects, in practice significant projects are usually centrally procured.

The CNDE holds a powerful position in the lifecycle of major infrastructure projects and could be a useful platform on which to establish a ‘PPP unit’. The CNED has extensive experience in developing projects in a wide range of infrastructure sectors, and has credibility with the international project finance industry. This experience could be used to create a PPP Unit which could act as a centre of expertise for the structuring of project financed PPPs and, if necessary, help in steering ‘pathfinder’ projects to completion. Such a PPP unit could harness the existing strengths of the CNED based on the major role it plays throughout the lifecycle of traditionally financed projects. A PPP unit could also facilitate standardisation of project planning, contractual conditions and financing. For CNED successfully to expand its already prolific role into project financed PPP, its mandate, position in the governmental hierarchy, staffing and strategy could be reviewed to examine its suitability as a cost-efficient base for a PPP unit.4

The role of local administrative units, Wilayates and Baladiyates, is important in promoting local projects and could be further developed to benefit an Algerian PPP programme. Although the Wilayates and Baladiyates already have statutory powers to promote and execute PPP projects, their role to date has been somewhat limited. However, this role in planning and facilitating projects will become increasingly important in the context of the very ambitious five year infrastructure programme currently planned, which includes social infrastructure such as housing developments and health facilities as well as transport and utilities projects.

Infrastructure projects are currently required to be analysed through various preparatory studies, covering both financial and technical aspects. In the event that PPP projects are procured more frequently and across a range of sectors, a standard approach to assessing project feasibility and business case could be developed at central and local level in order to facilitate efficient administration by the responsible authorities.

**Bidding process**

There are various bidding processes used in Algeria for the procurement of public projects. The central bidding process is enshrined in the Algerian Procurement Code (APC) but other sector specific bidding processes (which are largely modelled on the APC) are used by state-owned corporations such as SONELGAZ and SONATRACH. Whilst a two-stage tender process (i.e. an initial qualification stage followed by a bid submission stage with bid submission often being in two, technical and financial, stages) is available, it is not consistently used.

The current bidding processes could be developed to include a structured phase that involves discussion and interrogation of bidders’ proposals, which would be of particular benefit to complex PPP projects. Any future reform of the APC could include amendments to the procurement procedures to ensure that a more suitable two-stage bidding be institutionalised, allowing for some measure of negotiation. Pro-active engagement of bidders has proven to be, in other markets such as the European Union, a means of fine-tuning and optimisation of solutions for the delivery of the project.

International participants in the Algerian infrastructure sector have observed that the bidding processes could be improved by enhancing the quality of the bidding documentation available. Due to unclear specifications and contract documentation issued in the tender phase, bidders have experienced difficulties in accurately pricing their bids. Lack of appropriate information before the initiation of procurement procedure could lead to protracted bidding processes, potentially increasing the bid costs and even deterring future participants. In order to avoid these shortcomings, procuring participants would need to have a greater understanding of the project and its bidding documentation. A PPP unit could also facilitate standardisation of project planning, contractual conditions and financing. For CNED successfully to expand its already prolific role into project financed PPP, its mandate, position in the governmental hierarchy, staffing and strategy could be reviewed to examine its suitability as a cost-efficient base for a PPP unit.4

---

4 As at April 2011, we have been informed that the creation of a centre of expertise on PPP within CNED is currently being contemplated by the Algerian government. The role of CNED vis-à-vis line ministries would be to evaluate and follow up PPP projects in which public money is mobilised to finance such projects, or to support the preparation and implementation of a PPP project if the financing is ensured by other resources different from the State budget.
The sometimes excessive emphasis on lowest price criteria to the detriment of technical quality and the legal regulations generally favouring local participants (in the event that the bids’ quality is comparable) can be factors which challenge foreign investment in Algeria. A more balanced approach addressing technical experience and expertise could be instrumental in attracting foreign contractors to Algerian tenders and ensuring full competition, which will be beneficial for the country. One way of softening domestic preference criteria would be to allow foreign investors to incorporate a domestic entity, so that the margin preference will lose much of its significance. A good example in this direction is Egypt where, although the same margin has existed, its effect can be neutralised by incorporating a local entity.

**Contract design, risk allocation and financial terms**

In Algeria, the approach to risk allocation has not yet been codified in a standard PPP contract. However, some contracts are influenced by standard forms such as the International Federation of Consulting Engineers Contract (FIDIC) or the Cahier des Clauses Administratives Générales (General Conditions of Contracts) (‘CCAG’), which is often part of the tender documents sent to bidders. The CCAG was introduced in 1964 and has been specifically applicable to contracts entered into by the Ministry of Works. In particular, the CCAG is not recommendable for PPP as it does not take account of PPP specific issues and risk allocation and partnership concepts inherent in PPP models.

PPP contract terms could be standardised on a sector by sector basis. An element of standardisation, at least for projects in the same sector, would serve to increase confidence amongst bidders and to incentivise investors to take a long term view of their investment in Algeria.

Risk allocation in the Algerian PPP market follows international practices. Design, construction, planning and delays in project delivery risks are normally absorbed by the private sector partner. Under Algerian law, the private sector is also responsible for changes in the contract that derive from a change in law and financing costs. Unforeseeable events and financial risks, such as inflation and exchange risks, are normally under the responsibility of the public sector partner.

Some specific areas of risk allocation require further development. In particular, the authority’s position on the level of compensation paid out on early termination of contracts could be standardised and reviewed as currently most contracts do not tend to offer adequate protection of the investment made by lenders and sponsors in a termination scenario.

In Algeria, macroeconomic risks have been reasonably well addressed, although improvements would be beneficial in order to increase the projects’ value for money. For instance, the cost of inflation could be better adjusted through regular benchmarking or market testing than a general price inflation adjustment. Two main factors explain the convenience of benchmarking. Firstly, statistical indices available in Algeria are not sufficiently comprehensive of economy-wide measures of inflation. Secondly, price inflation is relatively volatile year-on-year in Algeria, partly due to regulation and price controls.

By striking the right risk balance in the PPP contract, coupled with a competitive bidding procedure, the public sector will ensure that the private sector offers the best price thereby maximising its value for money. Best value for money represents a balance of costs, benefits and risks which is most favourable to the public sector. It creates stable project cash flows that attract long-term lenders and investors to invest in Algerian PPPs. In effect, such investors would take a combination of project risk (supported by sub-contractor or sponsor guarantees as normal in project finance) and Algerian sovereign risk – a combination which has been successfully banked in Algerian desalination projects.

**PPP / project finance investment readiness for lenders and investors**

Long term PPP initiatives would benefit from a more investor-friendly legislation. Foreign investment regulation in Algeria, particularly as enacted in the Complementary Finance Law for 2009, has institutionalised the resident national shareholding requirement, minimum levels of participation by Algerian residents and, more importantly, the requirement that debt must be sought from local banks. In order to ameliorate some of these measures, Algerian authorities could consider publishing some guidance on the circumstances in which foreign potential investors may benefit from exemptions, if any, from the effects of this legislation. If no adjustment and/or interpretation of investment rules are made by Algerian authorities, potential foreign investors will be faced with the prospect of entering into long-term partnering contracts without adequate guarantees over key decisions affecting their investments.

The extension of state guarantees to PPP projects could attract long term investment. Under current Algerian legislation, the state is permitted to guarantee loans taken by strategic public companies from banks and financial institutions. If the government wishes to pursue PPP initiatives, especially those of a long term nature, it should consider extending the same authorisation to private sector investors. Long-term PPP initiatives financed by private investors necessarily require significant financing from international banks, in which case state guarantees could play an important supportive role to access banking resources.

It would also be convenient for Algerian authorities to pay careful attention to the need of a right balance between tax and accounting regulation, in order to obtain the most favourable conditions for the private sector. Specifically, tax rules should be expressly considered when evaluating PPP tenders in order to compare bidders on the basis of their after-tax offer as well as their pre-tax offer. Similarly, the adoption of “finance debtor” accounting could help eliminate the negative impact of some tax rules and make project more affordable. Finance debtor accounting enables accounting profit to match project cash flows after debt service much more closely, avoiding many of the inefficiencies caused by fixed asset accounting in PPP projects. Finance debtor accounting is not yet allowed under Algerian accounting standards, requiring a change in tax law to be used for tax purposes.
Conclusion – Key Recommendations

- Increased clarity of the legal framework applicable to PPP procurement could be achieved through the enactment of PPP specific legislation, which would cover such matters as the authority to award projects, bidding processes and required contractual provisions.

- A clearer and explicit policy framework for PPPs would facilitate financing the ambitious infrastructure development plan for 2010-2014.

- Affordability exercises and selection criteria should be improved and international best practice should be adopted when developing criteria specific to PPP procurements.

- The role of the CNED could be expanded and developed to establish a centre of expertise for the supervision of project financed PPPs. This knowledge would then be disseminated to ministries and local government.

- The Algerian Procurement Code (APC) could be supplemented to recognise and facilitate the competitive investigation and evaluation of bids for international PPP projects. New procedures should provide for improved transparent evaluation criteria that does not disadvantage foreign bidders. Procuring authorities could be strengthened so as to ensure that the standard of tender documents is improved in terms of clarity and comprehensiveness.

- The approach to risk allocation should be clarified through policy, in guidance commentary and the development of draft contractual provisions.

- Regulations on foreign direct investment could be reformed to facilitate the in-flow of foreign funds. In particular, greater clarity could be provided (for example through the issuance of official guidance) on the circumstances in which the exemptions to the Investment Legislation will apply.
2. EGYPT

Overview

Despite recent political turmoil in Egypt, relatively solid macroeconomic conditions place the country in a favourable position to continue developing its PPP (Public Private Partnership) programme. Sustained economic growth, a controlled fiscal position and low aggregate and foreign debt outstanding (relative to Gross Domestic Product (GDP)) will give sponsors and investors confidence in the capacity of the Egyptian government to commit to PPP concession payments for projects with a good business case. The political developments of early 2011 are likely to cause investors to be cautious due to increased uncertainty. This can be overcome by a strong commitment to developing PPPs (for those projects where it is appropriate to do so) by the new government.

Successful experiences with PPP projects can be replicated by developing a sustainable pipeline of well-designed projects focusing on particular sectors. Whilst government has not implemented an official policy on project prioritisation, the successful financial close of the New Cairo Wastewater (NCWW) Project demonstrates the feasibility of wastewater projects, which are expected to continue to see procurement activity. In addition, a small number of hospital and highway projects are currently in the pipeline for procurement as PPPs, as well as both conventional and renewable power projects. Building a credible pipeline of projects in particular sectors will serve to attract both local and international investors and lenders to the Egypt PPP market.

Building on the successful implementation of the NCWW project, authorities should focus in the first instance on medium size projects or those of lesser complexity. Particularly, wastewater projects, potable water facilities or standard power and transport projects, seem to be ideal projects to crystallize and test the capacity acquired through the implementation of successful pilot projects.

Difficulties in developing large-scale PPP projects should be overcome by strengthening institutional capacity. For example, particularly complex projects in the education sector, involving the procurement of 345 school buildings in various locations of the country, have been postponed or delayed. This has been partly due to the limited resources and means of the PPP Central Unit (PPPCU) to manage mega-projects, as well as lack of market appetite for projects of this sort. However, it is worth noting that the schools project has not been cancelled and that the government is likely to re-tender the project on the basis of fewer schools spread over 18 governorates. Through the effective use of advisers to successfully deliver ‘pathfinder’ projects, Egypt can improve the prospects of developing a good market reputation for their successful delivery. Such a reputation is important for long term investor participation in Egyptian PPPs.

Funding capacity and availability

Limited financial capacity of the domestic banking sector to fund small to medium sized PPP projects can be surmounted by foreign credit. The Government’s policy intention is to fund investment spending in Egyptian Pounds (EGP) where possible, to avoid exchange rate risk on foreign currency borrowing. However, if the PPP programme grows rapidly, or if large projects are undertaken, projects may have to be funded in foreign currency, with the Government underwriting the exchange rate risk in the payment mechanism. This requires the fragmented domestic banking sector to pool with International Financial Institutions (IFIs) alongside Egyptian banks (including subsidiaries of foreign banks), to boost available debt funding for Egyptian PPPs.

Upgrading resources within the domestic banking sector could be achieved by enhancing the skills and insight of specialist PPP lending teams. This could be brought about for instance through a series of targeted seminars and briefings on the opportunities in the PPP market. Such seminars could be sponsored by the PPPCU or advisers recommended by it.

Restricted availability of long term fixed-rate bank funding in EGP can be mitigated through contractual provisions enhancing the financial sustainability of PPP projects. Particularly, payment mechanisms need to be adapted in the absence of financial instruments able to hedge certain macroeconomic risks such as inflation and exchange rate risks (as long term currency or inflation swaps are not available in EGP). Since these risks are macroeconomic in nature and cannot be mitigated by bidders, the procuring authority is likely to achieve the best cost effectiveness if it bears these risks in the payment mechanism.

Relative short loan maturities available to Egyptian projects may be overcome by accessing long term commercial-bank and IFIs lending. Short loan maturities affect project affordability because annual debt service is higher with shorter repayment periods and so project payments have to be correspondingly higher. The potential availability to PPPs of IFIs lending jointly with commercial banks for longer maturities, could encourage competition amongst commercial banks to increase the repayment periods which they offer. To date, loan repayment periods for Egyptian projects (PPP and non-PPP) have been around 15 years, compared to 25-30 year repayment periods for equivalent projects in more established PPP markets of the European Union (EU).

Although domestic sources of infrastructure equity have been limited, international investors have substantially contributed project equity to Egyptian PPPs. Equity for PPP projects has and will have to come from trade sponsors (i.e. the PPP subcontractors bidding for the project) and international investors such as sovereign wealth funds with appetite and knowledge of investing in Egypt. A number of sovereign wealth funds have previously invested in Egyptian projects and infrastructure.

---

5 This section on Egypt is accurate as at 1 October 2010 and does not cover recent events in the country. The general recommendations of the report remain valid. Following recent events in early 2011, the four current PPPs in the pipeline (Rod el-Farag and 6th of October roads, the Abu Rawash wastewater scheme and the Alexandria hospital) will likely be postponed but not cancelled. In March 2011, the executive regulations governing the public-private partnership (PPP) tendering have been published in English on the PPP Central Unit’s website (www.pppcentralunit.mof.gov.eg).
Legal and regulatory framework

Egypt’s legal system is one of the most highly developed in the Mediterranean partner region. The legal system has foundations in the civil law tradition and distinguishes primarily between civil disputes (between exclusively commercial parties) and administrative disputes where for example, one party is a commercial party and another is an emanation or institution of the state.

Egypt has enacted a fairly advanced PPP law, however its general legal framework for procuring infrastructure is fragmented and needs to be simplified to attract investments. Potentially, PPP projects can be procured through the system of public economic entities, public utilities legislation and any number of sector specific or project specific laws currently in existence. The new PPP Law provides an additional channel for procurement, which was expected to replace the others. This has not happened and it seems unlikely that the government will impose the PPP law as the single framework for PPP procurement. This may have the undesired effect of hindering ministry and sector-wide support for the PPP Central Unit (PPPCU) and the New PPP Model. With the possible exception of the Ministry of Electricity and Energy which has successfully procured projects through sector specific legislation, ministries should be encouraged to procure projects under the regulations of the new PPP Law. In this regard, the PPCU has a key role to play in raising its profile and encouraging support for and uptake of the New PPP Model. Should the government consider amending the PPP Law so that it becomes the exclusive regime for procuring PPPs, this would enhance the process of procuring projects as PPPs.

Although Egypt boasts a modern judicial system, its complexity regarding dispute resolution may deter investors considering international arbitration a more comfortable option. In particular, the possibility of similar disputes being heard in either the Administrative Courts (disputes between the contracting authority and the project company) or the Economic Courts (disputes between the project company and its supply chain) means that there may be a disparity in court judgments. This is not ideal where the project is inherently dependent on a number of key project parties. It is important to note, however, that the successful development of PPPs is not dependent on an extensive change to the Egyptian judicial system, as commonly PPPs do not avail themselves of the court process as they incorporate PPP specific dispute resolution mechanisms.

The use of national arbitration by the Egyptian legal system has been positively received by local investors, although foreign investors will consider international arbitration a more viable option. Egypt is already a signatory of the New York Convention (and therefore willing to recognise and enforce foreign arbitral awards) and, recognising that there are domestic arbitral institutions in Egypt, there remain concerns that the government’s willingness to arbitrate only on the basis of local arbitral rules institutions may add to ‘country risk’ concerns for some potential investors. Contracting authorities should consider agreeing to international arbitration procedures, such as those under the International Chamber of Commerce (ICC) or London Court of International Arbitration (LCIA) rules, which will provide comfort to international lenders, in particular, as they are commonly adopted for PPPs in markets globally. This would also help reduce the risk margin applied by investors in their required remuneration and should lead to lower payments by the public sector.

Institutional issues

The national PPP unit (PPPCU) has demonstrated leadership in the development of PPP programmes and projects. Investor confidence in Egyptian public sector projects has been boosted by the creation of the PPPCU as the centre of expertise, and by giving the High Committee for Partnership Affairs (HCPA) steering and supervisory powers.

The PPCU should be further strengthened in order to allow it fully to capitalise on its gained experience. The unit’s reputation as the “power-engine of PPPs” in Egypt has been cemented by its institutionalisation in the PPP Law which will increase its powerful position, lend it further prestige and attract the best professionals. The PPCU has shown its capability in its successful involvement in the NCWW project. If it follows this example and builds successfully on its existing track-record, it will contribute greatly to long term investor confidence and the success of PPPs in Egypt. Currently, the PPCU faces a number of challenges in its development, especially if a more ambitious PPP programme were to be adopted. In particular, it is essential that funding of the PPCCU is secured for future years, for instance through a combination of donor funding and the levy of a fee on successful bidders (as provided for in the PPP Law), in order to enable the PPCCU to survive and develop its capability to select, negotiate and monitor projects.

While keeping the PPCU’s central role, strengthening PPP expertise in line ministries will enhance project selection and preparation. The PPCU is integrated in the Ministry of Finance and as such is of critical importance in order to assure investors and lenders of a viable long term programme of PPP projects in Egypt. Potential PPP projects are identified by the line ministries and submitted to the PPCU for approval. However, the lack of PPP units in individual ministries means that some projects have not been satisfactorily scoped prior to launching of procurement and as a result have been withdrawn or delayed.

Increasing the involvement of local administrative bodies (governorates) in the procurement of local projects will contribute to public support for the projects. Currently such bodies are involved at best in identifying infrastructure needs and lobbying central authorities for particular infrastructure requirements. By raising the profile of governorates within the matrix and thereby increasing local involvement in the PPP process, the government will not only be ensuring that projects are better suited to local requirements and therefore also be viable commercial concerns, they will also be ensuring the long term buy-in of the local end-users into the concept of PPP as a delivery model for local services.

Expertise should be shared across the institutions involved in PPP development to enhance their synergies and accelerate PPP program implementation. Government could foster capacity building and knowledge transfer between government bodies to ensure efficient interactions between major public-sector actors involved in the development and supervision of PPPs. The establishment of satellite PPP units may be an option to ensure line ministries develop technical expertise to procure sector specific projects successfully, when the PPP market will reach sufficient maturity.
Processes for development of PPPs and feasibility studies should be standardised in specific guidelines to enhance expertise and consistency of procedures across sectors. The methodology currently in use for assessing feasibility studies is not documented or crystallised in precise regulation. Government, in coordination with the PPPCU, could better define project feasibility guidelines and make them universally applicable. These guidelines would be based on international best practices and incorporate standard templates and financial model guidelines for bidding.

The establishment of an infrastructure facility dedicated exclusively to PPPs would also bring further resources and expertise, aiding and complementing the PPPCU. To overcome problems in project identification and scoring, the government could create an infrastructure facility, such as the Infrastructure Project Preparation Facility (IPPF) recommended by IFC. Several international financial institutions (IFIs) have fostered infrastructure facilities aiming to strengthen and shorten the project preparation stage and to facilitate appraisal and execution. The role of the facility would be to assist Egyptian public authorities in the identification, development and preparation of sustainable and bankable PPP projects. The facility, funded through donor contributions, could also cover part of the costs for necessary international advisers to be provided to the PPPCU and other government bodies.

The success of a PPP program can be further enhanced by the implementation of an efficient gateway process. The key role of the PPPCU both in the definition and approval of feasibility, as influential constituent member of the HCPA (which has the ultimate role under the PPP Law of approving PPP projects) could lead to assessments on individual projects lacking the level of objectivity that could be achieved where these roles were split between institutions. The effectiveness of PPPCU’s analysis could be enhanced by an independent review, or gateway process, carried out by experts not involved in the preparation of the feasibility studies.

In the interim, the existing limited resources available for PPP planning and procurement should be focused on smaller, well-defined social projects and basic infrastructure. Care should be taken to avoid embarking on excessively large or hugely complex projects, and focus should be on medium sized projects in relatively straightforward sectors such as waste water treatment plants, conventional power plants or road projects. Once strategic PPP programmes have been successfully developed for each sector and a positive market reputation established a more ambitious deal-flow can be assured. This approach would consolidate the progress made to date in PPP.

**Bidding process**

The existence of multiple ways of procuring PPP projects leads to the undesired effect that other procurement procedures are often used rather than the PPP Law. As mentioned above, the PPP Law is not the only channel for procurement, as the tender procedures under the PPP Law will co-exist with those under the Tender Law. Authorities’ chosen method of procuring PPP projects will determine which bidding procedure will apply. Where the choice is to use the old framework (e.g. Public Economic Entities, Public Utilities Legislation, sector or project specific laws), the bidding procedures of the Tender Law will apply. These procedures, which have been the most commonly utilised process of tendering for infrastructure projects to date, are “tried and tested” with a successful track record. The Tender Law, although relatively simple to apply, is not specifically tailored to major infrastructure projects. The Tender Law allows a number of tendering routes including the ‘public tender’ (a tender that is open to all participants) and the ‘limited tender’ (which is used where the nature of the work being procured requires restricting participation to certain contractors). However, these are not designed specifically to meet the requirements of tendering major infrastructure projects, as much of its provisions relate to the procurement of goods and services. Furthermore, the general nature of the provisions leaves significant scope for interpretation by those operating the tender processes, thereby reducing clarity and transparency in their application.

A key draw-back of the Tender Law procedure from the perspective of PPPs is the absence of a structured dialogue with bidders during tendering. Most PPPs are complex and require a solution-focus that can be reached through a process of negotiations or dialogue between bidders and the procuring authority, in addition to standard question and answer sessions. The ability of the private sector to contribute its expertise to develop, jointly with the procuring authority, a viable solution in order to technically, legally and financially define a complex project, is rather restricted under the Tender Law. The PPP Law allows negotiation with the private sector during bidding and introduces the possibility of using competitive dialogue. If it is to be used, the procedure for using simultaneous dialogue with competing bidders is expected to be fleshed out in executive regulations (secondary legislation) of the PPP Law. If the procedure is implemented as anticipated, it is important that it leaves little scope for subjective interpretation by those managing the bidding process and ensures transparency and fairness in the selection of the best offer. The manner of implementing this competitive dialogue can vary immensely such that it can provide real benefits, for example allowing a procuring authority to fully explore solutions being offered prior to a bidder being selected, leading potentially to a more competitive bidding resulting in better value to the authority. However it can add unreasonably to costs and also requires a high level of management input and planning in order for the process to achieve its full potential. The regulations should be introduced with the assistance of the PPPCU, who could be involved in disseminating appropriate training and guidance to procuring authorities in managing such a procedure as efficiently and fairly as possible.

**Contract design, risk allocation and financial terms**

The general principles of risk allocation are set out in the new PPP Law and further defined by the PPPCU, although the use of standard contracts would enhance the PPP process. The approach to risk allocation in the new PPP Law is based on the well known principle that risks should be borne by the party best able to manage them, in accordance with international best practice. The PPPCU has identified a broad allocation of risks to be applied to all projects known as the “New PPP Model”, which is based on standard PPP practice in other countries, notably the United Kingdom. However, there is no standard contract (or standard contracts by sector) for Egyptian PPP projects. Introducing these contracts and making them readily available to potential investors, for example through internet, would add considerably to transparency and can
Contribute to quicker and more efficient selection procedures. The contracts would serve as a basis on which to start negotiations for a specific project.

To date, in common with many other countries, PPP projects in Egypt have relied upon availability payments. In this structure, the public sector pays for the use of the facility as long as it is available and operated in accordance with agreed performance or quality standards. The public sector partner has the right to withhold elements of the payment if the performance is sub-standard and not remediated in time. Following standard practice, the terms and conditions of payment and the risk distribution between public and private sectors, are included in a long term agreement between these two parties (the PPP Contract, “off-take” or “take or pay” agreement), which is the key contract in a PPP. Due to budget constraints, however, the government, in common with other countries, may eventually need to consider more innovative PPP payment mechanisms in addition to availability payments, such as introducing toll charges in road transport projects or other user fees where practicable.

The contractual approach of the New PPP Model generally follows international practice, although certain specific financial issues would benefit from a different treatment. Generally the risk distribution can be considered adequate. However, key issues such as certain financial and economic risks (see below) need to be addressed. Until they are adequately covered, Special Purpose Vehicles (SPVs) – created to carry the project forward- will be required to bear risks that they cannot adequately manage, and thus participants will either not tender for projects or will require a higher price, adversely affecting project affordability.

When issuing invitations to tender, the authority should clarify its position on allocation of financial and economic risks (inflation, interest rate, and exchange rate movements). In the absence of a hedging market and where exchange rates are partially or totally centrally managed, the public sector is best placed to compensate the private sector for the exchange rate risk in the foreign cost components. High and volatile price inflation leads to planning, pricing, and costing problems for potential sponsors and investors. This can be solved through adequate payment indexation in the long term off-take agreement. Further, specific cost inflation may need to be addressed through payment adjustments which more closely match the Project SPV’s cost base (as assessed by regular benchmarking or market testing) rather than a general price inflation adjustment. Finally, the public sector could assume interest rate risk when the only option for the bidder is local currency funding, as this is imposed by the public sector, and when the hedging market is not sufficiently well developed.

Another issue that authorities should pay careful attention to is the need to strike the right balance in tax and accounting regulation, to obtain the most favourable conditions from the private sector. When evaluating bids, in addition to the gross project payments proposed by the bidder, the procuring authority should also consider the tax forecast to be paid (including withholding taxes) by the Project SPV over the project life. Similarly, the adoption of “finance debtor” accounting will make projects more affordable, by enabling accounting profit to match project cashflows after debt service much more closely. Finance debtor accounting is permissible under Egyptian accounting standards, but may require a change in tax law to be used for tax purposes. Use of finance debtor accounting is typical in more established PPP markets and is recommended by international accounting standards as it avoids many of the inefficiencies caused by fixed asset accounting in PPP projects. Without it, bidders are forced to delay dividends and pay higher taxes, which would encourage them to fund projects with more equity and less debt, making their bids more expensive.

By striking the right risk balance in the PPP Contract, coupled with a competitive bidding procedure, the public sector will ensure that the private sector offers the best price thereby maximizing its cost effectiveness or value for money. The right structure will enable a stable equity cashflow that may help to attract IFIs, sovereign wealth funds, and international infrastructure funds to invest in Egyptian project equity. In effect, investors would take a combination of project risk (supported by subcontractor or sponsor guarantees as normal in project finance) and Egyptian sovereign risk – a combination which has been successfully banked in previous Egyptian PPPs.

**PPP/project finance investment readiness for lenders and investors**

There is potentially a very comprehensive security package available to investors. This is one of the key comforts to investors in PPP projects in the Egyptian PPP market. The availability of a security package is a key attraction for foreign investors considering Egypt as an investment prospect. The range of securities includes the typical pledges over shares, mortgages and the assignment of insurance proceeds. In addition, the government has a policy of co-signing direct agreements where appropriate with project companies and lenders whereby the Ministry of Finance will undertake to pay the Project SPV directly if the relevant contracting authority fails to do so.

The PPP Law maintains certain restrictions that are not optimal, but that could be ultimately overcome or accepted. The PPP Law restricts the Project SPV from assigning its rights and obligations arising from the PPP contract to third parties, except for the purposes of financing the project (and then only after the approval of the contracting authority). This is acceptable, as it does allow lenders to step-in and replace the operator and/or constructor, should there be serious project difficulties. In addition, the restriction on assignments of shares in the Project SPV is, although not ideal from an investor’s point of view, a market-accepted norm designed effectively to enable the authority to retain control at all times of the identity of the key shareholders in the Project SPV. This restriction follows the practice existing under the Old Model PPP.

A key attraction for foreign investment in Egypt is the absence of financial and legal restrictions on foreign direct investment, including on contracts with the public sector. However, under the Tender Law, one theoretical disadvantage to foreign companies is that the bids of domestic firms will be deemed to be of a lower price even where they in fact exceed the lowest foreign tender up to 15%. This disadvantage is easily overcome in practice by the incorporation of an Egyptian joint stock company prior to the bidding process. No such restrictions exist under the PPP Law and therefore foreign companies investing in Egypt will be treated on an equal basis as local companies under this law. This is important as giving preference to local companies is in direct conflict with procurement guidelines of most IFIs.
Conclusion – Key Recommendations

- Increased resourcing of PPP lending teams in Egyptian Banks should be encouraged.

- Where large projects are undertaken they may have to be funded in foreign currency and in that event the government would receive better cost efficiency by underwriting exchange rate risk, given the absence of a well developed exchange rate risk hedging market.

- The use of international arbitration procedure would provide comfort to lenders, in particular, as they are commonly adopted for PPPs in markets globally.

- The PPP Law could become the exclusive regime for procuring PPPs, thereby reducing uncertainty in procuring PPPs. All ministries (with the possible exception of the Ministry of Electricity and Energy which has a proven track record) should be encouraged to procure projects in all sectors under the regulations of the PPP Law.

- The PPPCU has a key role to play in raising its profile and encouraging support for and uptake of the New PPP Model.

- The government could adopt an IFC recommendation to establish an IPPF with donor support to provide for project planning, including advisers costs.

- There is a requirement for increased training and knowledge transfer between government bodies so that the supervision of PPPs is split among the major actors. The establishment of satellite PPP units is necessary to ensure line ministries develop the technical expertise to procure their projects successfully.

- Another key area for future reform would be to better define and make universally applicable a standardised project feasibility and development process that is rigorous and, for example, uses internationally recognised procedures and modelling.

- By raising the profile of governorates within the matrix and thereby increasing local involvement in the PPP process, the government will not only be ensuring that projects are better suited to local requirements and therefore also viable commercial concerns, they will also be ensuring the long term buy-in of the local end-using public into the concept of PPP as a delivery model for local services.

- Existing limited resources available for PPP planning and procurement should be focused on smaller, well-defined social projects (such as hospital projects or more waste water treatment projects) until strategic PPP programmes have been developed for each sector and a more ambitious deal-flow can be assured.
3. ISRAEL

Overview

Stable macro-economic conditions place Israel in a favourable position to continue expanding its use of Public Private Partnership (PPP) as a procurement tool. Israel’s fiscal and debt position, sovereign credit rating6 and balance of payments position give it ample capacity to maintain investment in infrastructure, whether through PPP or other means. The banking sector is healthy and sophisticated and avoided much of the solvency and liquidity pressures that occurred elsewhere during the international financial crisis. Investors have confidence in the capacity of the Israeli government to commit to PPP concession payments, or to set viable toll fee levels and in developing PPP projects with a good business case.

A successful track-record of PPP projects is being developed across a number of sectors by various procuring authorities. There are now signed projects in the roads, light rail and desalination sectors. As well as more transport and water projects, there are conventional and renewable power projects currently in procurement. The independent power project (IPP) procurement model offers considerable scope for application in Israel.

Difficulties have arisen in projects where preferred bidders have been selected and contracts awarded prior to key issues being resolved. Failed procurements such as the Tel Aviv Light Rail Project would have benefited from having more contract terms and authorisations agreed or confirmed in advance of contract award. Premature contract award typically results in terms and authorisations agreed or confirmed in advance of contract award. This allows the procuring authority to require that funders provide indicative terms at final bid stage. The benefit of early bank involvement is to allow them to understand and to contribute to the project financing.

Funding capacity and availability

The leading Israeli banks have shown their capability in PPP by underwriting large New Israeli Shekel (NIS)-denominated loans in individual transactions on keen terms. Credit margins achieved on Israeli PPPs such as Hadera desalination plant (see Box 1) have been similar to those achieved in equivalent European PPP markets at similar times, reflecting the banks’ liquidity and Israel’s sovereign credit rating.

Nevertheless, for large PPP schemes (and any substantial aggregate PPP investment programme) foreign currency funding by international banks will still be required. Larger projects are likely to attract international bank lenders, especially where international contractors are project sponsors. However, international commercial bank appetite for Israeli PPPs has not been significantly tested since the international financial crisis. Current tenders for projects in new sectors such as Independent Power Projects (IPPs, including renewable power projects) may indicate the extent of potential international commercial bank appetite for Israeli PPPs.

Bank capacity for Israeli PPP loans may become constrained by their maximum group credit exposure limits to key sponsors and contractors active in Israeli PPPs. If a Project SPV is a subsidiary of a sponsor company, the project debt counts towards the bank’s total group exposure to that sponsor group. If the bank has an extensive lending relationship with other parts of that sponsor group (e.g. through real estate or corporate loans), its ability to lend to that sponsor’s Project Special Purpose Vehicles (Project SPVs, the project companies) will be constrained. To overcome this, Israeli corporate PPP sponsors will need to progressively form strategic alliances with financial investors, to form investment joint ventures such that project debt is not counted as group debt, and to provide a way of recycling equity capital through project equity disposals.

Bank capacity for NIS-denominated PPP loans may also become constrained if more projects are structured without a significant proportion of government capital grants. Some of the PPPs to date have benefited from government capital grants paid in during or at the end of construction. If fewer projects receive capital grants such that the entire project cost is to be recovered from the project operating period, the debt requirement for each project will increase. Therefore, the public sector may consider increasing the availability of capital grants.

The domestic bond markets are sufficiently developed potentially to allow bond issuance by Project SPVs at a lower cost of funds than on bank debt. However, careful preparation is needed if the bond finance route is to be actively considered for PPP funding.

Expansion of PPP expertise amongst Israeli banks remains necessary, especially to ensure that banks carry out sufficient commercial due diligence when supporting bids. This could help avoid repeat situations where projects reach preferred bidder or contract award stage and do not subsequently satisfy prior lending conditions specified by the banks. Whilst this is primarily an issue for procurers to resolve, best practice in PPP tendering requires bid-supporting banks to participate actively in the bid process. The benefit of early bank involvement is to allow them to understand and to contribute to the project negotiations. This allows banks to issue indicative lending terms and a support letter for the bid, which, although not binding, indicates that there is no undisclosed matter that would prevent them lending on the terms indicated, if subsequent due diligence was confirmatory.

Overall, debt funding of the Israeli PPP programme is likely to continue to be provided by domestic banks, supplemented in larger projects by international financial institutions (IFIs) and foreign commercial banks. However, availability of foreign commercial bank funding is uncertain, despite Israel’s investment grade credit rating. Therefore, continuing to develop domestic bank expertise and managed PPPs programme offering a regular flow of projects will itself develop domestic capability, as well as attract foreign sponsors and banks to invest larger volumes in Israeli projects and assist in meeting Israel’s infrastructure investment needs.

---

6 Israel’s sovereign long term credit ratings as of 1 October 2010 were (S&P) AA-/Stable (local currency) and A/Stable (foreign currency), and (Moody’s) A1/stable.
Legal and regulatory framework

Israel's legal system is one of the most highly developed in the Mediterranean partner region and is capable of meeting the needs of complex PPP transactions. The legal system has foundations in the common law but with some civil law influences. The law comprises written legislative text and caselaw. Decisions of the higher courts are binding on lower courts. The court system is divided into three general law courts (consisting of the Supreme Court, district courts and magistrates' courts) and quasi-judicial tribunals. PPP contract disputes will generally be heard in the district courts. Disputes affecting the project company or its supply chain can be heard in the same court, which will contribute to consistency and efficiency in time and cost.

Despite the absence of a legal framework specific to PPPs in Israel, the general legal framework accommodates PPP procurements through a number of channels. Public authorities enter into PPP contracts on the basis of Israeli administrative law, project-specific legislation, resolutions of the procuring authority and the legal framework impacting on specific issues. Since the modes of procurement accommodate the needs of PPPs, the lack of a general PPP-specific framework has not disadvantaged the procurement of PPPs in Israel.

Project-specific laws are enacted where required to provide the legal powers for entering into contracts between the public authority and the private sector partner for the procurement of projects in a particular sector. The general law, project specific laws and the contractual agreements will govern the relationships between the project parties.

The enactment of a PPP-specific law, whilst not essential, could enhance PPP procurement and the government may wish to consider its benefits. These would include, amongst other things, giving specific authority to public bodies to enter into PPP arrangements, regulating tender processes specifically for PPP and setting out key principles for the allocation of certain PPP contractual risks.

Although Israel boasts a modern court system, as with any national court process generally, its complexity may deter investors who may see arbitration (because of its relative confidentiality and its specialist responsiveness to commercial disputes) as a more comfortable option. PPP contracts therefore generally avoid the court system by including provisions for arbitration. Arbitrations tend to be governed by Israeli substantive and procedural law. International arbitrations are permitted and international investors who will more readily submit to international arbitration may seek assurances that the applicable law and rules are consistent with international arbitration procedures with which they are more familiar. Certainly in terms of substantive law, particularly where the lending institution is non-Israeli, there will be a preference for the substantive law governing the financing documents to be that of a country familiar to lenders (for example English law).

Institutional issues

Israel has a sophisticated approach to planning and procuring PPP projects and has developed a significant PPP programme in a variety of sectors. There are clear and well-defined procedures for project identification and execution. These procedures (which include developing a project’s business case and examining whether PPP is in fact the most suitable mode of procurement) are based on international best-practice and include a public-sector comparator as the basis for judging the merits of projects and deciding whether they should proceed as PPPs.

Making institutional roles and responsibilities clearer by defining the roles of particular institutions better will prevent duplication of effort and improve pre-procurement preparation. The Ministry of Finance has the overall responsibility for PPP project identification and approval through the Infrastructure and Projects Division of the Office of the Accountant General. Part of the work of project execution is devolved to a government-owned company – Inbal, which co-ordinates the work of the relevant government office that is immediately responsible for the project. In the past, the roles of these institutions have overlapped. In complex PPP procurements such as those involving both line ministries and municipalities, clear demarcation of roles can bring efficiencies in procurement which can enhance investor confidence.

Bidding process

A general set of legal provisions is applicable to public procurement in general and these can be (and in the past have been) suitably adopted for PPP procurement. PPPs are procured under the Mandatory Tenders Law 5752-1992 (the “Tenders Law”), using the procedures specified in the Mandatory Tenders Regulations 5753-1993 (“Tenders Regulations”).

The current procurement legislation allows procuring authorities to negotiate elements of the PPP contract with the bidders. This is an appropriate framework for projects which are technically complex and which involve complex technical and legal risk allocation. The tender procedure allows for discussions to clarify elements of the procuring authority’s tender requirements and to negotiate technical and legal aspects. The provision for negotiations between the procuring authority and one or more bidders, which is regularly exercised in Israeli PPPs, fosters discussion and cooperation, encouraging a solution for implementation of the project which meets the procuring authority’s needs. The procurement procedure allows for competitive and transparent bidding processes with an appropriate level of objectivity when assessing bids.

The limited number of Israeli banks active in PPP makes it impractical for bidders to seek exclusive bank support at bid stage. In such circumstances, such bidders should seek from banks: (i) confirmation that they (the bidder) are acceptable as credit counterparties in their capacity as sponsors or contractors to the Project SPV; (ii) acceptance of key draft concession terms and risk matrix; and (iii) stipulation of core requirements, for example minimum cover ratios, maximum loan periods, or security and bonding requirements or retention of certain risks by the authority. In any event, such support letters will not be binding, since banks will not have completed due diligence on multiple bidders’ proposals and will reserve the right to collaborate with various bidders, so they have greater chances of eventually financing the successful bidder. Likewise, bidders will be reluctant to divulge commercially sensitive bid details with non-exclusive banks.
**Contract design, risk allocation and financial terms**

Risk allocation between the public and private sector tends to follow international practice. The PPP programme has developed sufficiently to incorporate standardised allocations of risks and market-based contractual clauses. Both the government entities and their private sector partners have become increasingly adept at managing the risks and the process of PPP procurement, meaning that standard documentation has emerged, along with market-driven contractual drafting.

Contractual terms in Israeli PPPs have begun to standardise as procuring authorities and the market have become more adept at managing the risks common to PPP projects. Project specific risks are subject to the negotiations permitted under the procurement legislation. In practice, risks are allocated to the parties best placed to manage them, consistent with international best practice. International contractors and their lenders will be reassured by this approach, which includes the allocation of risks such as termination being addressed appropriately (with the agreed compensation regimes) in the contract documents.

This matching or hedging of the financial risks in the payment mechanism appears to offer the best value for money to the Israeli government. It creates predictable cashflows, allowing banks to offer relatively low annual debt service cover ratios. It creates a stable equity cashflow that helps to attract sponsors and investors to invest in Israeli project equity. In effect, investors take a combination of project risk (supported by subcontractor or sponsor guarantees as normal in project finance) and Israeli sovereign risk. Not to offer such mechanisms would be likely to result either in funding not being available, or if available at all, the required debt service cover ratios and equity investment returns being so high as to make the project unaffordable.

Israeli PPP payment mechanisms tend to follow best international practice. This is beneficial as familiarity in risk allocation is likely to make it easier to foster international participation where investors are able to participate on the basis of familiar international practice. They have been flexible in relation to the indexation mechanisms applicable to offset the Project SPV’s cost inflation. In general the public sector has retained such risks by including comprehensive indexation mechanisms in the payment mechanism. Interest rate risk has generally been transferred to the Project SPVs, since they can manage this risk by interest rate hedging. To the extent that projects have been funded in foreign currency, the authority has absorbed this risk through providing currency adjustments in the payment mechanism.

By striking the right risk balance in the PPP Contract, coupled with a competitive bidding procedure, the public sector will ensure that the private sector offers the best price thereby maximizing its value for money. Best value for money represents a balance of costs, benefits and risks which is most favourable to the public sector. It creates stable project cashflows that attract long term domestic and foreign lenders and investors to invest in Israeli PPPs. In effect, such investors would take a combination of project risk (supported by subcontractor or sponsor guarantees as normal in project finance) and Israeli sovereign risk – a combination which has been successfully banked in previous Israeli PPPs.

**PPP/Project finance investment readiness for lenders and investors**

Israel’s tax and accounting regulations enable Project SPVs to have effective capital structures, so that project payments can be made as efficient as possible. Nevertheless, when evaluating bids, the procuring authority evaluates not only the gross project payments proposed by the bidder, but also net out tax forecasts to be paid by the Project SPV over the lifetime of a project. This particularly applies to the evaluation of withholding tax levied on dividends and interest.

Project finance practices in Israel recognise the full range of securities familiar in the financing sector internationally. For example lender securities include direct agreements with procuring authorities providing for step in rights for the authority in the underlying contract. In addition there are extensive rights to project company assets. However, in order to improve the overall security package on offer the public sector could consider the provision of state guarantees on a project-specific basis where this can be shown to improve value for money.

A key attraction for foreign investment in Israel is the absence of financial and legal restrictions on foreign direct investment, including on contracts with the public sector.

**Conclusion – key recommendations**

- Expansion of PPP expertise amongst Israeli banks remains necessary, both within existing PPP lenders and across more banks, to enable banks to carry out sufficient commercial due diligence when supporting bids. This could help avoid repeat situations where projects reach preferred bidder or contract award stage and do not subsequently satisfy prior lending conditions specified by the banks.

- A series of targeted seminars and briefings on the opportunities of the PPP market, sponsored by the Ministry of Finance or advisers recommended by it, would serve to increase bank appetite for PPP lending. It could also be targeted at non-bank financial institutions to examine the potential for the domestic bond market to fund PPPs.

- Whilst the current legal framework is supportive of PPPs, Israel may wish to consider whether the enactment of a specific law regulating PPPs would be beneficial. For example, a PPP-specific legal enactment could simplify the legal authority for granting PPPs, clearly setting out those sectors in which private investment is permissible and those in which it is not. This will increase investor confidence as to the legal basis for PPPs and avoid costly legal challenges as to the legitimacy of private sector participation in certain sectors.

- A clearer division of labour between those key sections of the Ministry of Finance and other government bodies involved in the procurement of PPPs is desirable. Better defined roles would improve efficiency by reducing the duplication of effort caused by overlap in roles and would also be of assistance to investors.
• A clearer and more comprehensive approach from the government though for example a comprehensive PPP strategy which demonstrates the future strategic direction of PPPs, the priority sectors and the level of financial support that sectors will attract would help to define the PPP opportunities for the market.

• Whilst procurement under the Mandatory Tenders Law (5752-1992) provides a procedure conducive to the procurement of PPPs, the enactment of a specific PPP law could also provide an opportunity to fashion a tender process specifically designed for procuring complex long term infrastructure projects.

• By reviewing the current policy of not providing state guarantees, Israel could identify circumstances in which the provision of state guarantees may have a positive effect on public sector value for money.
4. JORDAN

Overview

The World Bank classifies Jordan as a lower middle income country with an estimated GDP of €20.6 billion (€3,448 per capita in 2009). Exports only account for 39% of foreign currency earnings. Jordan is heavily reliant on foreign transfers, specifically from Jordanians working abroad (59%), tourism & transit fees for Iraq bound goods (23%) and government grants (6%). Natural resources include potash, phosphate and relatively unexploited oil shale deposits. The population is 78% urbanised (2008), and has been increasing rapidly (6.5 million in 2010 compared to 3.2 million in 1990).

A number of large PPPs were successfully signed over the past five years. Examples include the AES Amman Jordan IPP (signed in March 2007), the Al Qatrana IPP (signed in October 2009), the new terminal for Amman Airport (November 2007) and the Disi Water PPP (June 2009). Total project funding for these four projects amounted to €2.4 billion, with 30% made available by sponsors in the form of project equity plus significant support from Islamic Development Bank, KEXIM, KfW, OPIC, JBIC, and EIB in the case of Disi Water.

Jordan has attempted a number of PPPs which were later withdrawn mainly due to limited project preparation. For instance, the Amman-Zarqa Light Railway System project, a transport demand-based BOT, was tendered three times without success. This project was first approved in 2004 but the preferred bidder failed to raise finance and procurement was suspended in March 2009. In September 2009 IFC was appointed as consultant to this project with the purpose to review, assess and update the economic, technical, legal and environmental studies that were conducted previously for the project. Following IFC’s conclusion of this preparation stage, the project has been recently put on hold for financing-specific reasons. The Aqaba New Port Development, a $540 million project, was terminated in November 2009 and procured conventionally after the consortium selected failed to agree terms with its public sector counterpart, reflecting limited project preparation. New projects are now subject to greater pre-procurement due diligence.

There is scope in Jordan for authorities and ministries to propose PPP projects that are smaller in scale, and simpler to implement, than its current large projects. A suitable PPP programme with certainty of deal flow will also serve to boost foreign interest in the Jordanian PPP market. This approach would have a greater likelihood of demonstrating successful PPP procurement earlier than otherwise, as well as stimulate domestic funding markets with projects of a scale that can be absorbed by the local bank market without significant dependence on IFI and ECA funding. The experience of the projects withdrawn highlights the need for more complete pre-procurement project scoping, and for appropriate project scaling to match investor appetite for projects in an economy the size of Jordan’s.

Funding capacity and availability

Jordan has found it difficult to attract private sector debt funding without either IFI or export credit guarantees. A future PPP programme will need to be funded by a combination of IFI or ECA-guaranteed debt as the domestic banking sector is small and very constrained regarding the level of support it can provide. Jordan’s government debt is rated BB, and therefore does not have a long-term investment grade rating and Debt/GDP is relatively high.

The Jordanian dinar (JOD) is pegged to the US dollar (USD) which has facilitated project funding in USD in PPPs. The Central Bank of Jordan (CBI) has maintained the peg since 1995 with the result that PPP projects are being funded in US dollars. Funding capability in local currency is minimal, generally available only on a floating or prime rate basis and all domestic government debt has maturity of less than 5 years. As there is no long-term interest rate swap market in JOD, PPPs generally obtain project payments denominated in foreign currency, or guarantees from the authority of the exchange rate risk in the payment mechanism, following a formal application for this risk to be covered by the Government of Jordan (GO).

Legal and regulatory framework

Jordan’s legal system is based on civil law. Although a legal structure supporting current Privatization has been in existence in Jordan for several years, it is not specifically tailored for PPPs. The provisions of the Privatization Regulation, implementing parts of the Privatization Law, have provided a legal basis for tendering and concluding PPPs since 2008. However, the current laws have not been designed specifically for PPPs but for a broader programme of private sector participation in public services. The Privatization Regulation defines PPP as “a relatively long-term written agreement between the public and private sectors, which aims to introduce a service of a public nature, execute a project or undertake a specific business. Such project shall be financed and the risk arising from there shall be allocated pursuant to the said agreement.” The Privatization Law (Article 4) empowers government to conclude PPPs by any method as determined by the Council of Ministers. The current legislation does allow for PPPs in principle, but relevant legislation specific to PPPs is missing.

New legislation is under consideration which will be more specifically directed to providing a stable legal framework. The new PPP Law when enacted will become the exclusive legal regime for the procurement of PPPs in Jordan. The Draft PPP Law is expected to make the following key provisions: (a) unify the tender procedures applicable to PPPs to ensure a consistent approach is adopted across sectors and ministries; (b) develop an institutional framework through the creation of a PPP Commission to support line ministries during the procurement stage; (c) set out objectives for PPP development – including improvement of public infrastructure; mobilisation of private finance and recognition of risk allocation between state and private sector; and (d) make provision for terms that are required in PPP contracts, including duration of the contract (to not exceed more than 35 years except for specific sectors such as nuclear energy), the extent and conditions for the transfer of employees at contract commencement and finalisation, termination provisions and security arrangements. The PPP Law will thus become the exclusive legal regime for the procurement of PPPs in Jordan. The law will apply to all sectors except national defence, police, award of justice, core areas of health care (medical and diagnostic) and other activities identified by the Partnership Council.7

7 Comments in the Report in respect of Jordan’s draft PPP law relate to the draft current at 30 October 2010. A revised draft was published in February 2011 and is not taken into account in the Report.
Jordan’s court process offers a framework for commercial agreements although specific dispute resolution systems are typically embedded in the PPP contract. The legal system distinguishes between civil disputes (i.e. between commercial parties or between commercial parties on the one part and the government, when dealing on a non-sovereign basis, on the other part) and administrative disputes brought before the Higher Court of Justice, which relate to challenges of decisions issued by the government or any of its agencies in their sovereign capacity. The court system has not been designed to cater for the particular needs and requirements of PPP contracts. However, the successful development of PPPs is not dependent on an extensive change to the Jordanian judicial system, as typically PPPs by-pass the legal system by the incorporation within contracts of PPP of specific dispute resolution mechanisms.

International dispute resolution has the support of the Jordanian courts. Jordan has in the past agreed to arbitration (domestic or international) as the contractual conflict resolution mechanism, including the adoption of recognised international arbitration under rules such as International Court of Arbitration (ICC) or International Centre for Settlement of Investment Disputes (ICSID). PPP contracts in Jordan typically provide for ‘informal’ methods of dispute resolution. These can take the form of tiered dispute resolution clauses where the emphasis is on resolving disputes at an early stage through director level meetings or similar measures before resorting to formal dispute resolution mechanisms.

Jordanian law generally applies to all PPP contracts but financing contracts will be governed by English law. Currently public and private sector organisations are free to choose the law that will govern their contracts, provided the chosen system of law does not violate mandatory rules of Jordanian law. The foreign law as the governing law of the other project documents is a valid choice of law and will be recognised by Jordanian courts. However, the new proposed PPP legislation will require that the governing law of future PPP contracts to be Jordanian law.

**Institutional framework**

A number of specialist bodies exist in Jordan with a strong role in the PPP process. The Privatisation Council is a high level body chaired by the Prime Minister, set up initially as part of the general privatization drive. It has an advisory role and also approves proposals for PPP projects. Its membership comprises the Minister of Finance, the Minister of Planning, the Minister of Justice, the Governor of the Central Bank and the Chairman of the EPC. The PPP Committee was established in September 2008 pursuant to a Council of Ministers decision. Its stated role is to identify projects suitable for PPPs and to supervise feasibility studies. However, in practice it has had limited involvement in PPP projects to date. The Executive Privatisation Commission (EPC) is a public body with financial and administrative independence but reporting directly to the Prime Minister. It does not sit within any particular ministry and has an independent budget approved by the Privatization Council and by the Council of Ministers. The EPC has played a major role in projects that have been procured through PPPs, either led by the EPC or by the relevant ministries. In some cases, the EPC has taken a more minor role, for example on the Queen Alia International Airport (QAIA) project, where the Ministry of Transport took the lead (with its advisers). There are no criteria which specify how the projects are to be allocated to the EPC or the line ministry. The EPC is a procurement vehicle, while the Projects Administration (formerly, the Mega Projects Administration) was introduced under the organizational structure of the Prime Ministry as a support to the line ministries in terms of coordination, follow-up, provision of technical and financial advice, and the packaging of mega projects. In 2010, a GOJ decision was passed requiring EPC and PA to merge; however, the decision has not yet been implemented.

The institutional framework for delivering PPP projects in Jordan is in transition. The Draft PPP Law prepared by EPC creates new organisations: PPP Commission and the PPP Council – to replace those currently responsible for PPP. However, the GOJ has not yet endorsed any particular institutional framework.

Capacity needs to be enhanced to avoid over-dependence upon external advisers in project preparation and procurement. The Jordanian PPP programme would benefit from developing a core group of financial, legal and technical experts who could assist line ministries and the EPC/PPP Commission in delivering PPP projects.

**Bidding process**

The bidding process under the Privatization Law and the Privatization Regulation is broadly consistent with practices in many other PPP markets. The process involves an expression of interest, pre-qualification, bid submission, evaluation and limited negotiation phase. A limited amount of negotiation is currently permitted after the appointment of the preferred bidder, but this is restricted to amendments which do not distort the tender documents made available to all bidders. This approach serves to uphold principles of fairness and transparency.

The PPP Law will introduce the concept of competitive dialogue, which can provide a robust mechanism for interrogating project scope and probing value for money solutions only in some cases and only if best practice is followed. The procedure for the operation of such dialogue is expected to be detailed in regulations (secondary legislation) of the PPP Law. Competitive dialogue should be adopted only where it is appropriate (i.e. it should not be a option for the relatively simpler projects) and should leave little scope for interpretation. It would be desirable to introduce dialogue regulations with the assistance of advisers, who could be involved in disseminating appropriate training and guidance to procuring authorities in managing such a procedure as efficiently and fairly as possible. This will serve to ensure that best practice is pursued and that the dangers inherent in such a procedure, such as increased costs for all parties, are avoided.

**Contract design, risk allocation and financial terms**

Contractual design broadly follows international PPP practice with some aspects specific to Jordanian PPPs. Whilst PPP contracts generally incorporate practice familiar in PPPs in other jurisdictions, in allocating risks such as design, standard of work and services and delay events, there are peculiarities in the Jordanian experiences. These may be project-specific such as the imposition of a public sector design and may cause
difficulties in the acceptability of risk. As far as possible contractual authorities should seek to achieve fair risk allocation which supports a PPP model and assures value for money. There is at present no standard contract, but increased procurement by PPPs in specific sectors will serve to standardise certain elements of the contract design and by-laws to the new PPP law were expected to address that.

Payment mechanisms vary depending upon the type of PPP project being undertaken in Jordan, allowing many different types of PPP projects to be procured. A wide variety of payment terms can be used on a project specific basis, including lump-sum payments by the procuring authority as a contribution to capital development costs, minimum revenue guarantees by the procuring authority (availability payments), regular payments of operating fees made to the government by the private sector partner and profit-sharing arrangements.

The public sector is best placed to assume macroeconomic risks if it controls and for which there are limited hedging possibilities. When projects are funded in foreign currency, the procuring authority is likely to have to assume the exchange rate risk. This is achieved either by having the project payments denominated in foreign currency, or by having JOD-denominated payments adjustable for any exchange rate movement. Volatile price inflation presents some risks for sponsors and investors in long term PPP projects. Planning, pricing and costing risks also need be addressed in the PPP contract payment mechanisms, for example through regular benchmarking of project costs rather than a general price inflation adjustment.

In projects with inherent demand risk, the government should be conservative in its demand forecasts. Transport PPP projects often use toll charges or fares to generate revenue. There is an insufficient track record and lack of comparator projects in Jordan for forecasting such demand, so international funders will be very cautious when assessing such projects for investment. Procuring such projects on an availability (or mixed availability/user fee) basis may have a greater likelihood of success and be more cost-effective.

**PPP / project finance investment readiness for lenders and investors**

Jordan’s limited restrictions on foreign investment are a positive factor for foreign investors. There are no restrictions on foreign companies contracting with government organisations and foreign investors are able to freely repatriate capital, profits and dividends. In addition, foreign investors are protected by law from arbitrary interference when managing and controlling their investments.

Jordan restricts foreign ownership in key sectors but special exemptions may be given for specific PPPs. The Council of Ministers can pass a resolution to increase the level of permitted foreign investment, but no blanket exemption will be granted to PPPs. Practice to date suggests that if there are any restrictions on foreign ownership in any sector related to the project, the EPC will liaise with the Council of Ministers at the pre-procurement stage and seek that the restrictions be waived.

Lenders are able to obtain the necessary level of security over project assets. Lenders are able to obtain standard lender protection, including direct agreements. However, floating charges are not legally recognised in Jordan which can be an issue for lenders. Jordan does not automatically provide state guarantees for public sector payments to be made during the operational phase of PPP projects. The Draft PPP Law provides future flexibility but at present this is not automatically the case.

**Conclusion – key recommendations**

- The EPC or relevant procurement agency in Jordan should seek early feedback from bidders as to their funding strategies and sources of finance. If projects require IFI debt or ECA guarantees, then bidders’ credentials need to be assessed as to whether they satisfy IFI or ECA criteria and whether they have previous successful experience in arranging funding for similar projects. Bidders’ track record should be assessed.

- The new PPP Law should be enacted as soon as possible in order to provide clarity regarding the legal basis for procuring PPP projects.

- The roles and responsibilities of both the new organisations to be introduced by the proposed PPP Law are expected to be clarified shortly and should be clearly defined. Any required transfer of organisational capacity and staff from one organisation to another should be planned well in advance.

- New projects should be carefully scoped by the responsible public bodies and business cases should be developed that clearly set out the justification for each proposed PPP project, including realistic estimates of cost and affordability. The GOJ should prioritize among projects, and probably be guided through a “master plan” or clear sectoral guidelines that would adequately scope and prepare the projects, defining their financial costs and revenues and determining their expected horizon.

- Projects under procurement must be fully supported with information on site availability and conditions, including outline planning permission and detailed output specifications. Interfaces with other utilities and service providers must be clearly identified and defined.

- When the new PPP Law is enacted, it should ensure that the bidding process is suitable for PPP procurement and follows international practice specifically with respect to publication of tenders, tender documents, tender evaluation and contract award.

- The EPC and any successor agency should develop its expertise in running procurements and disseminate appropriate training and guidance to procuring authorities in managing bidding processes.

- Jordan’s procuring authorities are likely to obtain best cost efficiency and value for money in the long term if they avoid passing risks to the private sector that the latter cannot adequately control or mitigate.

- Finance debtor accounting should be used by bidders (as permitted by Jordanian accounting standards). Tax rules could be amended to permit the use of finance debtor accounting when calculating PPP asset depreciation for tax purposes.
• To encourage interest from foreign investors each potential PPP project should be assessed for the applicability of the restrictions on foreign ownership. If necessary, a resolution of the Council of Ministers to increase the level of permitted foreign ownership should be obtained prior to the project being put up for tender.

• State-backed guarantee for payment on individual PPP projects is desirable in certain instances (for example, in the case of a weak offtaker) since it will make projects more financeable and indirectly benefit the public sector by leading to a lower overall price for the service. However, the provision of state guarantees could be determined on a case by case basis and judged against overall level of government indebtedness.
5. LEBANON

Overview

In Lebanon national political stability is an absolute pre-condition for the development of public-private partnerships (PPPs). In particular, large and long-term PPP projects require political stability to ensure that the rule of law will be upheld and contracts will be enforced.

A sizeable PPP programme in Lebanon would be affordable for the public sector, provided that strong economic recovery continues and the government maintains its efforts to reduce its net public debt. Since the war of 2006, the Lebanese economy has recovered strongly, enabling the government to run primary fiscal surpluses. Moreover, a stable monetary policy (driven by a USD fixed exchange rate) has encouraged international investment in the country’s banking sector, as well as the financial and real estate markets. Nevertheless, despite significant efforts, Lebanon’s public debt remains high in absolute terms. At the end of 2009, gross public debt and interest debt repayments accounted for 148 % and 11.7 % of GDP respectively.

The government of Lebanon has taken significant steps to raise awareness about the importance of PPP for its infrastructure development, including the drafting of a new PPP law. Recent initiatives include an awareness program that helps local banks to identify PPP opportunities, as well as a workshop designed to explain private sector engagement in water infrastructure. Complementary institutional reforms include the establishment of the Higher Council of Privatisation (HCP) and the Council for Development and Reconstruction (CDR), both created to promote efficient long-term development of infrastructure in Lebanon. The HCP is responsible for developing the PPP laws sent to the Council of Ministers in November 2010.

The government has identified PPP as a potential tool for procuring essential infrastructure investment although a pipeline of future PPP projects has not yet been identified. Further analysis is necessary to determine for which sectors PPP is a viable method for financing at least part of the significant reconstruction of Lebanese infrastructure currently being planned. Public sector capital expenditure is very low by international standards. With the right political and institutional conditions, Lebanon could focus its attention on key selected sectors in which to develop projects of lesser complexity, particularly those that can meet pressing socio-economic demands. Such projects if delivered successfully could play an essential role in cementing Lebanon’s reputation as a destination for PPP investment.

Funding capacity and availability

Lebanon’s economy depends on the continuing capacity of its banks to attract international deposit and investment inflows, with which the banks buy government debt. The very high level of the debt of the public and private sectors exposes the country to any external shock which curtails deposit or portfolio investment inflows, or to any domestic event (such as a real estate price collapse) or policy which reduces confidence in the Lebanese financial system. However, the banking system appears robust financially in aggregate terms, with high reserve levels and a prudent loan/deposit ratio.

A lighter public debt burden will free up financial liquidity for PPP investments. If the government continues its efforts to maintain the public debt at sustainable levels, newly unrestricted public funds could be channelled to fund PPP projects. Nevertheless, due to the liability mismatch between long-term loans and shorter-term deposits, Lebanese banks might be hesitant to undertake PPP lending. Participation by International Financial Institutions (IFIs) or Export Credit Agencies (ECAs) could support the efforts of Lebanese banks to stimulate the PPP market and serve as a source of long-term funding and credit guarantees.

Due to their limited experience with PPPs, the appetite of Lebanese banks for long-term PPP lending is presently untested. Procuring authorities should request letters of support from funders of successful bidders in order to receive sufficient information on funding strategies and sources of finance. Although it may be impractical to require bidders to obtain exclusive commitment letters from banks prior to preferred bidder stage, a preliminary indicative feedback could assist authorities in identifying the possible funding sources.

The Lebanese Pound (LBP) is pegged to the United States Dollar (USD). High dollarisation of bank deposits is likely to result, at least initially, in PPPs to be funded in USD. Dollar funded PPPs will enable Project Special Purpose Vehicles (SPVs) to more easily hedge interest rate risks, allowing banks an interest rate basis for syndicated project loans. Nevertheless, procuring authorities will have to absorb exchange rate risk.

An annual public budget should be submitted to Parliament in order to ensure the reliability of information on government expenditure. The annual public budget has not been approved by the Parliament since 2005 due to the unfavourable political context. Private investors and lenders need credible information on government spending to boost their confidence in the ability of the government to meet its financial commitments.

Legal and regulatory framework

Although it is a Lebanese Constitutional requirement that concessions be granted by law, few contracts have been signed with such authorisation. Projects involving a measure of public participation have primarily resulted from private negotiation between the State and the private investor. Other projects have been framed as alternate types of contracts and have not been subject to the stipulations of concessions. For example, the Tripoli Water project was described as a “management contract”, rather than a concession. These closed-door proceedings could be challenged before the courts, increasing the amount of risk incurred by private investors.

A Draft PPP Law, submitted for Parliamentary approval, establishes a clearer legal and institutional framework for PPP, which could be further improved through secondary regulation. This draft law is an amended version of a previous PPP draft law which was prepared by the HCP and approved by the Council of Ministers in 2007. The Draft PPP Law grants legal powers to the HCP to develop and procure PPPs. The law applies to public authorities at the national, district, county and municipal levels. In accordance with international best practices, it also requires public authorities to treat bidders equally. The Draft PPP Law defines the roles of essential PPP institutions and the intended process for PPP project development. The implementation of detailed requirements
through decrees (at the same time or soon after the primary legislation) would create the certainty necessary for a successful PPP programme.

Possible conflicting decisions of commercial and administrative courts make of arbitration the dispute-resolution method favoured by investors. Disputes resulting from a PPP contract may be subject, depending on whether a public entity is involved, to commercial or administrative law. Cases in which a public authority is involved or where the provision of the “public service” is affected, will be heard in the administrative courts. By contrast, commercial disputes not involving the procuring authority or the provision of the public service will be subject to the jurisdiction of the civil courts. Considering the implications of multiple legal interpretations, investors to a PPP contract typically favour arbitration as the dispute resolution method, to avoid difficulties in the enforcement of court decisions.

A clearer policy outlining the authorization criteria for the approval process of arbitration procedures by the Council of Ministers would increase PPP investment attractiveness and is contemplated in the current Draft PPP Law. Lebanon’s Civil Code allows procuring authorities to enter into contractual arbitration, provided that the procedure has been approved by the Council of Ministers on the recommendation of the Minister responsible. Contractual arbitration approvals do not follow particular criteria; rather, approvals are decided at the sole discretion of the Council of Ministers. The inclusion of this method of dispute resolution in the Draft PPP Law introduces the likelihood of greater certainty and, consequently, investors’ confidence in Lebanon’s institutional framework. International arbitration is a widely embraced alternative method of dispute resolution for international investors.

**Institutional issues**

The institutional framework for infrastructure is geared primarily towards traditional construction procurement supported by multilateral development funding. This flow of funds has taken a variety of forms including direct grants and low-interest sovereign loans and has enabled a large reconstruction programme to benefit the country’s public and commercial infrastructure. The CDR has been responsible for delivering the infrastructure redevelopment programme and has become a powerful institution in Lebanon.

In Lebanon, decision-making on infrastructure policy rests with the Parliament and line ministers. At the top of the institutional pyramid is the Parliament, which has the power to enact specific legislation to authorise the provision of public services, either by the public or the private sectors. According to the Lebanese Constitution, the grant of rights to exploit any natural resources or public interest service needs to be provided by law. Formal decisions on the procurement of infrastructure rest within individual line ministries. The CDR (main government body for advice, expertise, and advocacy in the field of infrastructure) and the Minister of Finance have considerable influence over infrastructure procurement decisions.

The recent openness of Lebanon to private sector participation has put the HCP at the centre of current and future PPP policies. Established in 2000, the remit of the HCP extends to the privatisation of different sectors. The HCP is responsible for increasing the efficiency and productivity of those entities previously under state control, as well as encouraging foreign investment in the country. If the PPP law is enacted, the HCP will become a key agency in PPP projects. Donor agencies and IFIs may wish to consider contributing to the technical resource required to upgrade the capacities of the HCP to meet the demands of the new PPP law, increase activity and become a centre for PPP expertise. A concrete application of technical assistance could come in the form of a new framework for building PPP budgets, including the respective roles and responsibilities (as applicable) of the CDR, the HCP and line ministries.

Under the Draft PPP Law, municipalities can propose PPP projects for the consideration of the HCP. Municipalities have not been particularly active in the promotion of infrastructure projects. Nevertheless, the Draft PPP Law presents them with significant challenges in terms of local PPP projects. In order to guarantee the technical quality and design of PPP projects, municipalities will have to be provided with capacity building opportunities and training.

In Lebanon, the implementation of the PPP law would be facilitated by the presentation of guiding policies outlining the scope and objectives of government engagement in PPPs. PPP policies could serve different purposes. First, they could help clarify the role of PPPs in comparison with other infrastructure procurement options. Secondly, they could serve to promote awareness about the advantages of PPP schemes. Finally, they could provide general guidance on how PPP projects should be implemented by the national and local governments across sectors.

**Bidding process**

Lebanon’s current procurement legislation, the Public Finance Law 14969, does not provide an appropriate framework for PPP contracts. Procedures under this framework have not been designed to procure complex project-financed partnership contracts. Therefore, its application to PPP projects has been generally avoided. In order to address these shortcomings, the government has enacted project-specific legislation to facilitate tenders. The procurement procedure selected by the government to award the provision of mobile services through concession (BOT) provides a number of lessons learned for future procurements regarding the way in which prequalification, initial offer, “best and final” offer and preferred bidder stages can be used.

Robust feasibility study and increase transparency in the bidding process could enhance PPP investment attractiveness and competition. Lack of sufficient competition is partly due to the limited preparation of projects. In addition, lack of transparency may also reduce competition, as in the case of two historic tourism projects based on private investor participation, where contracts were negotiated directly with Lebanese companies that did not previously enter into a formal competition. It will be beneficial for the future success of PPP projects in Lebanon to ensure that procurement procedures develop fair and transparent processes.

Although the Draft PPP Law attempts to fill procurement gaps in Lebanon, its provisions could be completed, ultimately through secondary regulation. Potential investors in PPP projects would be more certain about their investment prospects in Lebanon if the law could define in more detail the procurement process and procedure. In order to fill this
vacuum, Lebanese authorities could issue secondary legislation (including decrees) describing the stages of the procurement process, legal recourse and guarantees.

**Contract design, risk allocation and financial terms**

The introduction of private sector participation in public service delivery has provided valuable expertise regarding risk management in PPP contracts. Until recently, the discussion on risk allocation in Lebanon was mainly based on trends and practices from government funded procurements. In the last few years, international practices are the main criteria to determine and assess risks in infrastructure contracts. The limited enforceability of land rights in Lebanon should be factored into any consideration of land permitting risk. Ownership uncertainty regarding land rights and constructors effective access to the land upon expropriation (enforcement of expropriation) may affect investment projections in PPP contracts. In order to avoid potential conflicts, government authorities could develop land management strategies (i.e. engaging communities in the provision of land permits and securing access to land).

In order to maximize project cost efficiency, invitations to tender should clarify early in the process the allocation of risks (exchange rate and inflation). The optimal risk allocation generates the best cost effectiveness for the authority in a PPP Project affordability and value for money for the authority are adversely affected if the Project SPV has to bear macroeconomic which it cannot control or mitigate. In a context of macroeconomic uncertainty, a Project SPV is naturally forced to include in its pricing of the project a buffer against such risks. Moreover, if such risks are misallocated, either the necessary funding will not be available or the required debt service cover ratios and equity investment returns will be significantly high. In this scenario, the project would become unaffordable.

The optimal allocation of exchange rate risk will depend on whether the Project SPV has obtained local or foreign currency funding, the availability of foreign currency hedging and the country’s exchange rate policy. In Lebanon, as in most Mediterranean partner countries, the ability to hedge against local currency exchange rate movements is limited by the relatively fragmented financial sector. Contractually, exchange rate risk when borne by the public sector is covered through the payment mechanism of the long term PPP contract, either by indexing local currency payments to exchange rate variations or by directly paying the foreign portion of the costs directly in foreign currency.

Regular benchmarking, or market testing, is more suitable to address inflation costs in Lebanon than a general price inflation adjustment mechanism. Two main factors explain this preference: (i) real wages in specific sectors can rise rapidly, usually at a higher rate than general inflation, and (ii) price inflation is volatile year-on-year.

**PPP / project finance investment readiness for lenders and investors**

Lebanon has a ‘light-touch’ regime for foreign investment and exchange controls. There are no legal restrictions stipulating minimum use of local labour or on currency conversions and transfers. The country has also signed over 40 bilateral investment treaties with countries of the European Union and Middle East. In addition, the government has established special bodies, such as the Investment Development Authority of Lebanon (IDAL), to promote foreign direct investment (for example, income tax exceptions, fee reductions for work permits, etc).

The selection of the most convenient bid should consider both gross project payments and tax obligations attached to the project. Depending on the capital structure of the bidder, different tax treatments will apply. In this context, it is possible that the bid with the lowest proposed project payments is not necessarily the bid with the lowest cost after tax payments are taken into account. This recommendation is especially relevant for the evaluation of the withholding tax position of bidders with foreign shareholders or lenders.

The adoption of “finance debtor” accounting and tax treatment for PPP projects could help eliminate the negative impact of some tax rules and make projects more affordable. Finance debtor accounting enables accounting profit to match project cash flows after debt service much more closely, avoiding many of the inefficiencies caused by fixed asset accounting in PPP projects. The use of finance debtor accounting by subsidiaries (such as Project SPVs) is allowed under Lebanese accounting standards, although it would require a change in tax law to be used for tax purposes. The use of finance debtor accounting is typical of more established PPP markets and is recommended by international accounting standards.

Lender friendly securities such as step-in rights and rights over assets are yet to achieve an optimal level of familiarity in the Lebanese market. Due to the lack of historic PPP exposure, security arrangements available to parties to infrastructure contracts are largely those found on traditional procurement projects. Their absence is of crucial importance in any PPP procurement and particular emphasis should be placed on developing such securities to an international standard in some of the early PPP projects. This should ensure that appropriate preference is given to project participants, so they have the comfort of knowing that investments can be secured and where necessary can be enforced.

**Conclusion – key recommendations**

- Continued national political stability and institutional development are essential pre-requisites to attracting international participation in Lebanese PPP projects.
- The successful delivery of a series of simple projects with the assistance of experienced international advisers, such as IFIs, could help establish a positive market reputation for Lebanon.
- Enacting a PPP law and the supporting regulations promptly should ensure continued momentum in interest from potential participants and investors. Constitutional requirements relating to the procurement of concessions should be observed so projects cannot be legally challenged.
- A move away from informal project awards to a regularised tender procedure based on regulations issued under an enacted PPP law will instil confidence in potential international investors. It will also assist Lebanon in obtaining the best solutions to its infrastructure needs.
• The respective roles of the different public entities involved should be defined more clearly than in the past to ensure that their roles do not overlap in the PPP procurement process.

• A significant amount of technical resource will be required to upgrade the capacities of the HCP to meet the demands of a new PPP law and increase PPP activity generally. Where possible, maximum political consensus should be achieved so that there is a high level of ‘buy-in’ from across the Lebanese political spectrum for institutional reforms. The HCP should be encouraged to develop a set of procedures and model documentation for efficient PPP procurements.

• Donor agencies and IFIs may wish to consider supporting the HCP to develop its role as a centre of PPP expertise.

• Budgetary procedures for PPP projects need to be clarified.

• The lack of established precedent in project securities is an essential area for further development and is crucial to investor and lender participation. Early projects can be used to set the appropriate precedent by allowing security for lenders over project assets and step-in rights and ensuring such rights are enforceable.
6. MOROCCO

Overview

Morocco’s sustained economic growth and progressive structural reforms have created favourable macroeconomic conditions for PPP investment. Morocco’s fiscal deficit (4.4% of GDP) and foreign debt levels (24.5% of GDP) are moderate and sustainable despite a deterioration following the slowdown in the Euro area, which is Morocco’s primary export market and main source of foreign direct investment. Nevertheless, the government has the capacity to maintain current spending levels and has a diversified range of funding sources offering long-term maturities. Morocco’s investment-grade rating also implies reliable access to international capital markets at favourable rates.

There is a growing recognition in Morocco that PPPs provide an optimal procurement method for meeting infrastructure needs in a number of sectors. The National Development Plan has stated that the government can significantly benefit from a well-designed PPP initiative to help close Morocco’s substantial infrastructure gap. Primary sectors include water, wastewater, irrigation, energy and transport. The government is pursuing policies that prioritise alternative sources of energy (e.g. wind and waste to energy) and PPP structures could be appropriate methods for realising these initiatives. Other sectors could also benefit from further PPP investment including non-commercial sectors, such as health, education and justice.

Although a legal framework exists to support concessions, broader PPP procurement in Morocco, such as projects where payments are directly related to performance, requires the implementation of comprehensive legal and regulatory reforms coupled with institutional capacity building. PPPs to date have been ad hoc in nature due to the absence of a single policy or procurement channel. Public bodies such as the National Office of Electricity and some state-owned entities have been active in entering into partnership contracts with the private sector in a number of sectors, including energy, water supply, and ports. These projects demonstrate that Morocco can attract high quality domestic and international bidders.

Funding capacity and availability

The government of Morocco has several potential sources of domestic financing for its PPP programmes, including national infrastructure funds, local banks and international investors. A number of infrastructure funds have been established in Morocco with the specific objective of investing equity in Moroccan infrastructure projects. These funds make Moroccan PPP more attractive for bidding sponsors since co-investment by such funds enables sponsors to reduce their own equity commitments and to have potential buyers for their shareholdings at a later date. As the PPP pipeline grows, foreign banks may be attracted to lend in larger volumes to Moroccan projects, especially if international financial market conditions continue to improve.

The domestic banking sector has capacity to fund relatively large, individual PPP projects, but could benefit from increased PPP experience. The financial sector is solvent and liquid. Some local banks have participated in a number of PPPs/concessions signed to date in Morocco as co-financiers. Nevertheless, the banking sector as a whole would benefit from increased specialised PPP lending expertise and resourcing, thereby enabling local banks to handle larger deal flows. Developing domestic bank expertise in PPP financing will also enable smaller PPP projects (such as social infrastructure projects in the health and education sector) to be denominated and funded in local currency thereby reducing foreign exchange risk.

A floating rate inter-bank loan market in Moroccan dirhams enables commercial bank interest rate setting for PPP loans denominated in the local currency. However, the long-term interest rate swap market in dirhams is not fully developed. As a result, Project Special Purpose Vehicles have difficulties at hedging local interest rate risk in the market and to the extent projects are funded by dirham-denominated debt, project payments will be required to be adjustable for interest rate movements. Although a long-term (25 years) fixed rate bond market exists in Morocco, its total size, limited issuance in longer maturities, and the small size of banks, prevents the establishment of a long-term interest rate swap market in dirhams.

Large PPP schemes (and any substantial aggregate PPP investment programme) will likely require foreign sources of financing. Procurers should seek early feedback from bidders as to their funding strategies and the sources of finance, to identify if there is potentially a funding gap. Larger projects are likely to attract international bank lenders, especially where international contractors are project sponsors. As a result, debt funding of the country’s PPP programme will come from a combination of domestic and international bank debt, including International Financial Institution (IFI) and Export Credit Agency (ECA) funding.

Legal and regulatory framework

Legislation regarding the procurement of concessions is relatively well developed but further clarity on the legal framework applicable to PPPs would be beneficial. While a legal framework exists to support concessions, there is no comprehensive legal and institutional framework applicable specifically to PPPs. The existing legal framework is relatively developed in relation to concessions procured by the municipalities or public bodies; it is governed, on the one hand, by Law 54-05 (the ‘Concessions Law’) for general matters of principle and, on the other hand, by sector-specific laws to regulate each sector (for example, specific laws relating to ports, water and electricity). However, specific regulations to Law 54-05 in relation to key areas such as the bidding process have not yet been implemented. Other aspects of PPP procurement and implementation are less developed. Notably, PPP procurement by central government departments is not addressed in the legal framework and the regulation of procurement of projects other than concessions does not have a clear legal basis. Furthermore, there is no clear legal basis for the procurement of broader categories of PPPs, such as direct availability based payment flows from the contracting authority to the project company (as opposed to user fees). Whilst developing these categories of PPPs using existing legislation might still be feasible, by enacting a PPP-specific law, the government could more clearly expand the type of PPP models it implements, group all PPPs under one unique “umbrella” framework and strengthen the legal basis for procurement (whether at a local, regional or national level). This would also reassure investors of the legal basis for their projects.8

8 It is to be noted that the International Finance Corporation (IFC) and Infrastructure UK (IUK) are currently analysing Morocco’s legal framework in relation to PPPs.
Morocco’s civil law tradition distinguishes between public and private (commercial) matters, which could result in disputes of one PPP project being heard in different courts. Public contracts, including PPP contracts concluded between a public authority and a private sector company, are subject to the jurisdiction of the Administrative Courts. Disputes within the project company’s/concessionaire’s supply chain will be heard in the Commercial Courts but can be joined to proceedings in the Administrative Courts if they are related to a dispute at the public authority – project company level and this should be encouraged where possible. The possibility however of disputes at different levels within a PPP structure being heard in different courts still exists (this is the same as the French system). Where this happens, the effects could be inconsistent findings of facts by different courts on the same dispute and a duplication of efforts. The resulting disparities between outcomes can prolong and complicate disputes and increase the risk perceived in investing in PPPs in Morocco.

PPP contract disputes in Morocco will be subject to the jurisdiction of the Moroccan courts unless a valid arbitration agreement has been reached between the parties. The court system is adapting to deal specifically with PPP-related disputes, but costly court procedures means that commercial parties are more likely to prefer arbitration as a means of resolving differences. The use of arbitration as a means of dispute resolution in PPP projects is specifically mentioned in Law 54-05 and should be encouraged. Where disputes between parties to PPP contracts occur at different levels of the PPP supply chain, the courts could facilitate their efficient and speedy resolution by permitting, where possible, the joining of such disputes into one set of proceedings in order to foster efficiency and consistency of outcome. International arbitration (such as pursuant to the International Chamber of Commerce (ICC) or International Centre for Settlement of Investment Disputes (ICSID)) is available to international commercial parties and is foreseen in Law 54-05 for foreign direct investments.

Institutional issues

In Morocco, the decision-making process for major infrastructure projects involves many parts of central government and can also be initiated at the municipal level. Projects are likely to involve a wide range of stakeholders, including decision-making committees across ministries for centrally procured projects. Although there is desire and an impetus at the local level to develop PPP projects, there are some concerns as to whether municipalities have sufficient legal powers to award contracts. Legal reforms to remove ambiguities in the powers of municipalities to procure projects will enhance investor confidence and the scope of local authorities to develop projects in line with local needs.

Capacity building and policy coordination within the Moroccan government needs to be further prioritized. In order to address capacity constraints and ensure coherence across the government, the Ministry of Economy and Finance is creating a new PPP unit with the assistance of the International Finance Corporation (IFC) and Infrastructure UK (IUK). The role of this unit will be to develop policy, to support the identification, structuring and implementation of projects (particularly in key service sectors such as health or education) as well as to provide guidance, oversee procurement processes, and monitor projects in the implementation and operational phases, contribute to knowledge sharing, draw up operational manuals, etc. This new unit will need to build on the experience of the DEPP (“Direction des Etablissements et Enterprises Publiques et de la Privatisation”) and the DRSC (“Direction des Regies et des Services Concedes”) to ensure that existing PPP knowledge is mobilised and enhanced. At the same time, the new PPP unit will contribute to enhancing the capacity of both the DEPP and the DRSC in PPPs. Close partnership between the DEPP and the European Union-sponsored capacity building programme has provided a platform for the creation of a central PPP unit. Morocco’s challenge will be to develop sufficient number and quality of PPP projects and to provide the PPP unit with sufficient expertise and financial means to be able to carry out its functions.

Bidding process

A clearer legal framework, grouping procurement of all PPPs under a single, specific PPP law, would bring benefits in the overall framework for PPP procurement. The Concessions Law is intended to regulate the choice of the most appropriate procedure but, to date, the relevant implementing regulations have not been enacted for centrally procured PPP projects. The government should consider their early implementation since, in the absence of specific legal regulation, bidding procedures are designed on a project by project basis and are set out in the tender document. This provides bidders with information as to how the procurement will be run but does not provide certainty that similar procedures will apply to all major project procurements. PPPs that require availability payments from the public sector and that do not fall under the ambit of the Concessions Law will, it is expected, be procured under the Procurement Decree (2-06-388). However, this governs general public procurement and not PPPs specifically. The tender processes outlined in the Procurement Decree are not appropriate for complex procurements of long term PPP contracts.

Regulations which are introduced to govern bidding procedures would benefit from drawing on practices in PPP markets internationally. The key to efficient procurement is to achieve competition, fairness and transparency. Provision should be made for specified stages of procurement, negotiation and (where the complexity of the project warrants it) dialogue. There should in addition be provision for evaluation criteria and the separation of technical and financial evaluation. By following recognised international practices, investors will be comforted that procuring authorities intend to run fair and transparent processes.

The inclusion of a dialogue provides a suitable method of PPP procurement in some particularly complex projects. Typically, a process of dialogue can be undertaken prior to the selection of a preferred bidder when the procuring authority enters into in-depth discussion simultaneously with each bidder until it has

9 Concerning local authorities, for the application of Law 54-05, the Government published Decree 2-06-362 on the 9th of August 2006 relating to articles 5 and 12 of the Law.
volume 2 – May 2011

Comparative Countries: Morocco

‘settled’ on a solution. The benefit of this method to the procuring authority would be the ability to probe value for money solutions and the use of such a method would give comfort to investors that tender processes are solution orientated and are therefore designed to identify and develop long term and viable solutions. In considering the appropriateness of such a process, however, the public authority should consider whether it has the management in place to conduct such exercises robustly but efficiently and fairly. In Morocco, public/private consultations have taken place and are more frequent following the entry into force of Law 54-05, which does not foresee any exclusion to dialogue. Whether to use this procedure of simultaneous consultations is decided on a case-by-case basis and is common for international competitive bidding procedures.

Morocco is adopting a gradual approach to changes in its legal and institutional changes, trying to draw lessons from experience. Morocco’s legal and financial framework allows carrying out PPPs but would benefit from a number of improvements. Particularly, creating a central PPP unit as soon as possible and developing a number of pilot PPP projects would contribute to increased PPP expertise. Morocco could also draw from experiences of PPPs in other countries and swiftly introduce certain key reforms mentioned above.

**Contract design, risk allocation and financial terms**

Risk allocation between the public and private sector in PPP projects is negotiated contractually and is not currently standardised. Generally the allocation of risk follows recognised international practice whereby the outcome of commercial negotiations results in risks being allocated to the party best able to manage them. Under the Moroccan concession model, demand risk is usually allocated to the private sector. If the government expands the use of PPP and structures projects with alternative payment models, such as an availability-based model, certain aspects of risk allocation will need to be revisited, including payment guarantees, performance standards and relief events, to ensure that the projects remain attractive to project investors and operators.

As international lending to Moroccan projects increases, international lenders will play an increasing role in shaping risk distribution and will seek to ensure that their interest in the projects is secure. Key provisions such as protection against unforeseeable events, dispute resolution procedures, change in law and compensation on termination will undergo close scrutiny. Lenders will negotiate provisions to ensure that the Project Special Purpose Vehicle’s (SPV’s) exposure is kept to a minimum, by insuring against or sub-contracting obligations and risks, so as to ensure that debt service is secured.

When issuing invitations to tender, the authority should clarify early in the process its position on allocation of financial and economic risks. For instance, the procuring authority is likely to achieve the cost effectiveness in the payment mechanism if it bears macroeconomic risks under its control, such as inflation and exchange rate risks. This applies particularly to availability based payment mechanisms or a combination of availability/user fee payment structures. Investors would then take a combination of project risk (supported by subcontractor or sponsor guarantees) and Moroccan sovereign risk. The optimal allocation of interest rate risk will depend on whether the Project SPV has obtained dirham or foreign currency funding. To the extent that the project is funded with dirham, the authority is likely to have to include interest rate adjustments in the payment mechanism in order to match movements in the Project SPV’s cost of senior debt. This is due to the absence of a significant long-term interest rate swap market in dirham to allow Project SPV to fix its interest rate exposure. In the case of Project SPV funded in a foreign currency and when hedging is possible, the authority does not need to bear the interest rate risk.

**PPP / project finance investment readiness for lenders and investors**

The lack of specific restrictions on foreign direct investment is a significant attraction to foreign investors. Light touch regulation for foreign investment and foreign exchange control has been implemented over the past two decades. The Investment Charter enacted by Law 18-95 (1995) provides a series of tax incentives to qualifying foreign investors. The approval of the Foreign Exchange Office (FEO) (the main regulator of foreign exchange transactions) is now only required in limited circumstances. Investments can be repatriated without major bureaucratic obstacles. The current framework in this context is encouraging however further structural reforms will be needed to enhance the ability to implement PPPs successfully in Morocco.

Lenders can receive a full range of securities in line with those which are commonly seen on the international market. The exception is that assets in the public domain that are owned by the public authority cannot be pledged as collateral. Article 8 of the Concessions Law allows pledges in relation to assets held by public enterprises. In order to enhance the ability of public authorities to pledge project assets without the use of public enterprises, the government could consider permitting by legislation the pledge of assets in the public domain as security. Project SPVs and other incorporations can generally operate without any special restrictions on ownership although generally when contracting with the government, an entity should be incorporated in Morocco.

Tax and accounting may require different treatment in Moroccan PPP contracting and tender evaluation. Some Moroccan accounting and tax rules encourage inefficient capital structures in long-term PPP projects. The treatment of tax will need to be considered in bids to ensure that the full impact on project costs is evaluated. In addition, permitting “finance debtor” accounting and tax treatment for PPP projects will help eliminate these inefficiencies. These technical changes are consistent with international project finance practice and produce a better match of project returns against tax liabilities.

**Conclusion – key recommendations**

- For projects in procurement (and especially larger projects), the procuring authorities should seek early feedback from bidders as to their funding strategies and the sources of finance, evidenced for example by letters of support from funders. This can assist in identifying if there is a funding gap and in confirming that the project scope and risk allocation is acceptable to the market.
• The legal framework for PPPs that are not concessions should be clarified. A specific PPP law could be introduced to govern broader types of PPP. Such a law could grant authority to all types of public bodies who will be involved in PPP procurement and could give legal power to structure PPPs with different payment models, depending on the most economically feasible approach.

• The use of arbitration as a means of dispute resolution in PPP projects should be further supported.

• The new PPP unit should harness and strengthen the existing expertise of the DEPP and the DRSC and its remit should specifically include co-ordination of the PPP project pipeline, provision of advice to municipalities, development of standard contracts, guidance and standard criteria for evaluating PPP project bids.

• Municipalities would benefit from the removal of ambiguities and legal difficulties in their powers to approve the award of PPP contracts.

• In the absence of a comprehensive specific PPP law, bidding processes should continue to be under the Concessions Law and other PPP procurement routes could be strengthened by continued development so that they continue to benefit from best international practice in terms of advertisement, tender documents, evaluation and contract award.

• The current practice of structuring risks so that each party is assuming risks which it is best placed to manage should continue.

• Moroccan law does not allow lenders to secure against publicly owned property (that is owned directly by the public authority). The government should consider ways in which the pledge over public assets could be extended. This has happened with the creation of two exceptions to this rule (i) applicable to certain public bodies and (ii) under Law 15-02 to harbour projects. Further exceptions to the general rule could be considered.
7. SYRIA

The Report is accurate as at 1 October 2010 and does not take into account the recent political events taking place in the country since March 2011. These events are likely to cause investors to be cautious regarding PPP opportunities in the country, pending clarification of their outcome. These political aspects and their consequences are outside the scope of the Report.

Overview

Syria’s economy is gradually improving as a result of some structural reforms; public finances remain under control. During the last five years, Syria has undertaken a transition from a centrally planned economy to a relatively open social market economy. Structural reforms that are being introduced include replacing inefficient and costly price subsidies with targeted cash transfers, notably on energy, oil products and agricultural input subsidies, unifying the exchange rate and easing access to convertibility and transferability of domestic currencies in order to promote foreign investments. The reforms have helped to increase Syria’s non-oil economy activity and to offset the effects of a decline in domestic oil reserves. The country’s real GDP per capita has grown consistently in recent years (4.7% p.a. average over the last five years) and its fiscal position is under control despite high fiscal deficits (7.7% in 2008 and 5.5% in 2009). The Syrian government follows a policy of limiting public debt to a maximum of 30% of GDP. In 2009, total Debt/GDP was 21% (including Foreign Debt which represented 10% of GDP).

Consistent economic growth and progressive market reforms have created a reasonably favourable platform for PPP investments in Syria, although a lot still needs to be done. Continued reforms will enable the country to attract high quality investments and to upgrade its public infrastructure. A PPP law is currently being drafted and is under review by key stakeholders in the government and the public administration. In addition, a Central PPP Unit (CPPPU) was established in 2009 in the Office of the Deputy Prime Minister for Economic Affairs as a first step to promote and develop a pipeline of viable PPP projects.

Syria has limited track record to date with “project financed” PPPs but is moving up the learning curve quickly by appointing transaction advisors and learning from other countries’ experience. Two foreign currency earning privately operated port developments (Latakia and Tartous), although not strictly PPPs (as defined in the Report), possess some features of a PPP, such as a revenue-sharing payment mechanism. The true first PPP project in Syria (as defined in the Report) is currently being tendered by the Ministry of Electricity (MoE) with International Finance Corporation (IFC) as transaction advisor. The project, an Independent Power Producer (“IPP”), consists of the design, financing, construction, operation and maintenance of a 250MW thermal power plant at Al Nasserieh. The experience of the projects mentioned above demonstrates the importance of comprehensive pre-procurement preparation. For instance, the prequalification for the Al Nasserieh IPP was launched twice with only two companies pre-qualified in the first round, compared to 16 strong and reputable consortia and companies pre-qualified in the second round, after the project had undergone thorough preparation by the MoE with the assistance of IFC. Full professional and project management advice to guide the procuring authorities has proved to be highly beneficial and this should be encouraged, especially for the initial PPP projects.

Capacity building within institutions and personnel across government will make future delivery of PPPs more effective and efficient. Key decision-making and executive bodies need to develop a set of skills that understand PPP requirements as distinct from those of traditional public procurement. In this sense, it will be beneficial if the knowledge of PPPs that exists in the apex institutions such as the Prime Ministry will continue to filter through to line ministries and public entities, as is currently occurring at the Ministry of Electricity. First steps in this direction have already been taken, as shown for instance by United Nations Development Programme (UNDP) sponsored training programs that are currently underway. In addition, the University of Damascus, in coordination with the Prime Ministry, companies from the private sector, as well as the UNDP, is establishing a Training Centre within the University specifically to tackle this issue.

Project selection and preparation should reflect the early stages of PPP development in Syria. Projects identified as potential PPPs include an airport, a metro, highways, power, and waste water treatment projects. Some of the projects being prioritised are ambitious in size, complexity and risks, and will take many years to fully implement. In a first stage, the CPPPU may wish to encourage line ministries to prioritise the smaller and relatively simple “candidate” PPP projects. Such projects would build up expertise required for the procurement of larger and more complex projects. A viable PPP programme with certainty of deal flow will attract investor interest in the Syrian PPP market.

Funding capacity and availability

Until further banking sector reforms are implemented, it is unlikely that there will be a significant market in Syrian Pound (SYP) denominated lending to PPPs. The financial sector remains highly state-controlled and regulated relative to most other countries in the Facility for Euro-Mediterranean Investment and Partnership (FEMIP) region. There has been only limited and recent public debt issuance and state-owned banks control approximately 76% of the market share. The majority of the private commercial banks are subsidiaries or affiliates of Middle Eastern banks. The Government could direct state-owned banks to lend to PPPs, but at the expense of credit availability for other sectors. The private commercial banking sector is characterised by strong balance sheets and highly liquid, and could therefore become active in lending to PPP projects. However, privately owned banks struggle to compete with state-owned banks in long-term lending in SYP as, with no public debt markets, interest rates in SYP remain regulated rather than market determined.

Due to the absence of a PPP law as of yet, the two ports were structured within the current legal framework of Syria, but aspects of a PPP transaction are public and private sector sharing in the revenue as well as the risks of the project, with the port authority as a partner in the terminal operations.

Bank loans outstanding totalled approximately 62% of GDP as of December 2009, and the aggregate loan/deposit ratio was 68%, relatively low ratios compared to typical European commercial banking sector ratios. (Data Source: Central Bank of Syria website: Monetary Statistics 2010, Tables 1 and 7)
Consequently, in the initial stages, private sector commercial bank lending to Syrian PPP projects is likely to remain relatively small and denominated in foreign currency. Private commercial banks located in Syria have access to foreign currency deposits, directly or via their foreign parent company. Individually they are relatively small banks, so that their ability to provide significant amounts of long-term lending for a large PPP programme is likely to be severely constrained. In addition, international private commercial bank appetite for lending to Syrian PPP projects will be reduced in the short term as a result of Syria’s limited track record in international bank or bond debt markets and the absence of a widely recognised international credit rating for Syria. Possible exceptions to this position may arise in foreign currency earning projects, or where a strong international sponsor is able to attract relationship banks. The Syrian government has recently launched two rounds of bond issuances and both have been met with significant interest from both public and private banking institutions, marking the potential appetite for such instruments in the country. In this respect, further developing domestic banks’ lending capacity as well as expertise in PPP is a pre-condition for a successful long term PPP programme involving the local banking sector.

The initial phase of Syria’s PPP programme is likely to be debt-funded in foreign currency, primarily by a combination of International Financial Institutions (IFIs) and Export Credit Agencies (ECA)-guaranteed lending. IFI and ECA activity in Syria is currently relatively low though increasing. The European Investment Bank (EIB) is the largest IFI lender to Syria. In addition to lending and capacity building by the European Union Delegation to Syria, other institutions include the French AFD (Agence Française de Développement) and the German KfW (Kreditanstalt für Wiederaufbau) – KfW mostly in the water and microfinance sectors.

Continued banking sector reforms by the Central Bank of Syria would contribute to increased funding capacity for the PPP programme. In the past few years, the Central Bank of Syria started to reduce restrictions on foreign-currency transactions in order to facilitate foreign direct investment. In July 2008, the Central Bank issued Treasury bills on a trial basis in an attempt to gradually open the financial market. The Ministry of Finance has begun issuing Treasury bills to help to establish a local bond market, which would increase lending capacity. These measures should also help to develop and modernise the banking sector.

Syrian Holding Companies can equally be expected to play an active role in the development of PPP in Syria. The five existing Holding Companies all plan to be active in bidding and developing infrastructure projects, and are likely to be major providers of project equity for Syrian PPP projects. As a result, in some procurements, the key selection of contractors and operators will be made by Holding Companies when they select partners, rather than by the procuring authority at the preferred bidder selection stage. In this way, the Holding Companies may have a quasi-authority role and the government may wish to test this approach prior to procuring some PPPs. Also, in cases where a Holding Company has already signed an early stage Memorandum of Understanding (MoU) in respect of a project or sector, de facto control of procurement is transferred to the Holding Company. Care should be taken to ensure that the role of the Holding Company does not deter other participants and that procurements are run on a level playing field.

Legal and regulatory framework

Whilst relatively developed, certain aspects of the Syrian legal system would benefit from targeted reforms in order to increase clarity and time efficiency in legal processes. Syria has foundations in a civil law tradition. Whilst written legislative text is available, the law is relatively untested, court processes tend to be lengthy and judges do not have specific expertise in PPP or complex procurement issues. Regarding dispute resolution procedures, as is common in most PPPs, arbitration is likely to be a more viable method of resolving PPP disputes. In Syria, parties are free to refer a matter to international arbitration under their own contractual arrangements and this is likely to be the case at least in the medium term.

Developing the legal framework to cater more specifically for PPPs will enhance chances of success. The current legislative framework is not well suited to PPP procurement. Whilst partnerships between the public and the private sectors have been achieved within the existing legal environment, notably in the ports sector, they have required a number of exceptions and specific ratification processes that cannot form the base for a wide and prolonged programme of infrastructure investments. Therefore, considerable development is needed (and is underway) to provide adequate comfort to private developers and lenders that their projects are supported by a sound legal framework.

The enactment of a new PPP law, currently in draft form, is expected to considerably strengthen the PPP legal framework in Syria. This new PPP law will address key issues, such as tendering procedures, institutional framework, dispute resolution mechanisms (including allowing international arbitration) and availability of state support. However, the right balance should be struck in the final version of the law in order to provide a degree of flexibility while at the same time spelling out key aspects of the law so as to ensure clarity and enforceability on the part of the judiciary. The new PPP law will have greater chances of success if it allows sufficient flexibility to resolve concrete issues depending upon the project and the sector, while setting a clear framework regarding general legal, procurement, contractual and institutional issues.

Institutional issues

The Draft PPP Law sets out comprehensive institutional arrangements for project identification, approval, procurement and monitoring. A PPP Council would be established within the Prime Ministry, with representation from other ministries. Specifically, the Economic Committee comprised of the Deputy Prime Minister and several other key Ministers, will carry out the role of the PPP Council in Syria. The draft law envisages the creation of a PPP Bureau to provide technical support to the PPP Council and to the line ministries. This PPP Bureau would replace the Central PPP Unit (CPPPU) already in existence. Nodal PPP Units would also be established in the line ministries. This could be an effective approach to creating the

---

32 The Syrian Holding Companies are: Syrian Qatari Holding (SQH); Cham Holding (currently sponsoring the training centre in coordination with the University of Damascus); Construction Products Holding Co; Kuwait Syria Holding Company; and Souria Holding.
necessary institutional infrastructure but care should be taken
to avoid overlapping of responsibilities among key institutions
involved in PPPs.

A key institutional challenge for Syria will be to make this well-
structured organisational system work in practice, as it is yet
untested. It is particularly important that funding should be
secured to enable the technical support system to be recruited
and developed to increase capacity and know-how within the
key institutions. In particular, know-how must be developed
across those institutions interested in pursuing PPP.

Experience in other countries suggests that careful attention
will need to be given to project selection and design. Before
going to market, projects must be supported by strong
business cases and detailed documentation. Comprehensive
project scoping and design will make the procurement process
smoother and provide greater clarity to bidders. Transaction
advisers and technical consultants appointed by the procuring
authority have an important role to play and authorities should
work with their advisers from an early stage in the project
lifecycle. Current limited availability of funding, of both equity
and debt, has to be carefully considered in the planning
exercise as the size of each project and the cumulated volumes
can significantly increase the risk of not reaching financial
close. Furthermore, as sovereign credit support to procuring
public entities is likely to be required, co-ordination at central
level, with direct involvement of the Ministry of Finance, is to
be encouraged.

Bidding process

The new PPP Law is expected to introduce bidding procedures
specific to PPPs, overriding existing procurement legislation that
is not well suited. The various procedures under the Public
Procurement Code were initially designed for the procurement of
goods and are therefore not appropriate for the procurement of
complex works and services contracts. The current draft PPP
Law on the contrary, refers to restricted, negotiated and
competitive dialogue procedures, which are commonly used in
countries with developed PPP practices. The detail of these
procedures will be set out in separate executive orders which
will need to be carefully considered in order to ensure the core
principles of competition, fairness and transparency. By issuing
the executive orders at the same time or within quick succession
of the new PPP Law, Syrian authorities will ensure that projects
can be rapidly procured in the spirit of the new Law.

Contract design, risk allocation and financial terms

Syria has a limited track record in PPPs to date and is hiring
international consultants to carry pilot project forward as well
as learning from other countries’ experiences. Procuring
authorities should continue to work closely with the newly
established PPP units and internationally experienced advisers
to formulate a basis of risk allocation. Authorities would
normally aim to ensure the output or service is delivered
according to specifications and the PPP contract should
therefore create sufficient incentives for the private sector to
deliver in a cost efficient manner. An internationally proven
contractual structure that has already delivered positive results
to contracting authorities in the region will encourage top
private sector companies to participate in the project tendering.
By striking the right risk balance in the PPP contract, coupled
with a competitive bidding procedure, the public sector will
ensure that the private sector offers the best price thereby
maximizing cost efficiency and value for money.

When issuing invitations to tender, the authority and
Government should clarify early in the process its position
towards allocation macroeconomic risks such as foreign
exchange rate and inflation. The optimal risk allocation
generates the best value for money for the authority in a PPP.
Project affordability and cost efficiency for the authority are
adversely affected if the Project Special Purpose Vehicle (SPV)
has to bear macroeconomic or policy risks which it cannot
appropriately control or mitigate. The private sector will not be
able to cover risks of adverse movements in financial variables
which it cannot hedge or pass through to contractors and will
therefore include a premium against such risks in its pricing.
Moreover, if such risks are misallocated, either funding will not
be available, or the required debt service cover ratios and
equity investment returns will be so high as to make the
project unaffordable.

The optimal allocation of the exchange rate risk depends
largely on availability of foreign currency hedging and the
country’s exchange rate policy. In Syria, as in most FEMIP
countries, the ability to hedge against exchange rate
movements is limited by the relatively small and fragmented
financial sector. Furthermore, as the public sector controls the
exchange rate movements to some extent, with the Syrian
pound managed by the Central Bank and loosely pegged to the
IMF’s special drawing rights since October 2007, then from an
optimal risk allocation perspective, it will be necessary and
more cost efficient for the public sector to assume this risk.
Contractually, exchange rate risk can be covered by the public
sector in the payment mechanism (by indexing local currency
payments to exchange rate variations or by directly paying the
foreign portion of the costs directly in foreign currency).

Inflation is a macroeconomic risk that is generally best covered
by the public sector in the PPP contract’s payment mechanism.
Consumer price inflation tends to be volatile in Syria. As it is a
macroeconomic risk influenced by economic policy, inflation is
more easily controlled by the public sector than private
companies. Among the different strategies to address this risk,
there is regular benchmarking of project costs (particularly
useful when inflation is volatile) as well as general price
inflation adjustments.

In projects with demand risk authorities should be realistic in
their forecasts and consider complementing user revenues with
availability payments. Transport PPP projects often use toll
charges or fares to generate revenue. There is insufficient track
record or comparator projects in Syria for forecasting such
demand, so international funders will be very cautious when
assessing such projects for investment. As it is likely that
investors will not be willing in the medium term to assume
traffic risks, procuring such projects on an availability basis may
have a greater likelihood of success and be more cost-efficient.
When demand risk is assumed by the public sector through availability payments, it is likely that the payment obligations of the procuring authority will need to be backed by a sovereign guarantee. A government guarantee will be needed as there is no track record of independent borrowing by public sector bodies in Syria other than the state. The guarantee is necessary not only as a promise of ultimate payment, but also of timely payment: project SPVs, which have no autonomous resources other than the project assets, require timely payment to provide the services and to ensure a regular cash flow to meet their debt service obligation and to satisfy expectations of equity return.

**PPP / project finance investment readiness for lenders and investors**

The regulation of foreign investment in Syria has moved in recent years towards a more liberalised regime, although further reforms in key areas are still needed. Even though regulation of foreign investments is now less stringent than in the past, current regulations do continue to pose some difficulties. Syria maintains a form of currency control system, which could affect the ability of Project SPVs to repatriate project revenues outside of Syria; money can be transferred abroad only if it was originally transferred from outside Syria to a Syrian bank account and kept in that bank in foreign currency. This may cause an issue in respect of honouring debt service obligations (interest and principal) and the return on equity, both dividends and capital. In addition, the current restrictions relating to repatriation of capital, interest and profits only at annual intervals are likely to deter foreign investment from contractors or lenders, which will be needed to support Syria’s ambitious PPP programme. This issue is expected to be adequately addressed in the draft PPP law in order to exempt SPVs from several of these restrictions. Particularly for repayment of loans and related interests, common practice is that transfers outside of money outside of Syria are allowed on the basis of what is stipulated in the loan agreements, so it can be quarterly or semi-annual or whatever is agreed in the respective finance contract and notified to Central Bank.

Tax and accounting regulations can have a substantial effect on the price paid by the public sector and/or user for the service or output. Tax incentives to investments, provided they are well targeted, can have a considerable impact on the price that investors will require the public sector to pay for the services or outputs deriving from PPP contracts; as a consequence, it is in the interests of the government to carefully compare the reduced revenue from tax incentives with the lower price they would have to pay during operational period. The Syrian draft PPP law recommends granting SPVs certain tax incentives or exemptions. Furthermore, there are a number of possible tax treatments depending on the capital structure of the bidder, and so it is possible that the bid with the lowest proposed project payments is not necessarily the bid with the lowest cost after tax payments are taken into account.

**Improving the range of protections available to lenders, notably lenders’ step-in rights, will improve the overall business environment for project financing in Syria.** It is not common in Syria for lenders to be granted a direct agreement providing step-in rights. The new PPP law is expected to specifically create the principle of step-in rights, such that banks can protect their investment by stepping into the project in the event that the Project SPV defaults. This will enable the lenders to rescue the project and, if necessary, transfer the project to a suitable substitute constructor or operator.

As more PPPs are procured in Syria, the security package will more closely mirror commonly used securities for PPPs. At present, the most common method of security for Syrian financial institutions is placing a lien on property. However, the new PPP Draft law is expected to allow PPP contracts to have the following security conditions: liens and securities on the income stream (ie. on project agreements) and shares of the Project Company as well as mortgages on assets. Although mortgages on assets have been explicitly granted in the draft PPP Law, the mortgaging of government owned land in particular has been excluded.

### Conclusion – key recommendations

- Syria has limited experience in PPPs to date (as they are defined in the Report) but has shown commitment to learn from other countries’ experience and to engage experienced transaction advisors to assist developing individual projects. In this sense, Syria has started quite high in the learning curve.

- The new PPP Law is expected to comprehensively addressing key legal, regulatory and institutional issues relating to PPPs. The Draft PPP Law sets out comprehensive institutional arrangements for project identification, approval, procurement and monitoring. It is important however that the level of detail does not work to the detriment of a flexible project by project approach when this might be necessary.

- The scoping, economic feasibility analysis and procurement of projects needs to be carried out to the standard required by the best practice guidelines approved by IFIs and ECAs to ensure that Syrian PPPs have maximum opportunity to access these essential funding sources.

- Funding should be secured to enable the PPP Bureau and the line ministry’s Nodal PPP Units to recruit experienced staff and to function effectively. Funding must also be made available to support capacity building across the institutions involved in PPP more generally.

- Careful attention should be given to (i) developing sound business cases during project preparation and (ii) detailed tenders and supporting documentation at the request for proposals stage, in order to build confidence in the developing PPP market.

- The CPPPU may wish to encourage authorities and ministries to propose PPP “candidate” projects that are relatively small in scale and simple to implement, rather than excessively large or complex projects. This would help develop a track record of successfully procured projects early in the process. One example of a project with reasonable size and complexity is the Al Nasserieh IPP currently being tendered.

- Contract structure and risk allocation should be designed so that each party is assuming risks which it can best manage. When issuing invitations to tender, the authority should clarify the risks it is prepared to assume.
The new PPP law should specifically create the principle of step-in rights, so that banks can protect their investment by stepping into the project operations in the event that the Project SPV defaults. This will enable the lenders to rescue the project and, if necessary, transfer the project to a suitable substitute.

Sovereign guarantees of PPP payment obligations should be considered, particularly at the beginning.

The country is undergoing gradual liberalisation from a centrally planned economy to a social market economy. Further liberalisation of the banking sector and elimination of some remaining barriers to foreign investment will attract strong private sector companies to invest in the Syrian PPP programme. An external credit rating of the country by a well reputed rating agency would also help to attract investors and lenders to Syria’s upcoming PPP projects.
8. TUNISIA

Overview

Despite recent political turmoil, relatively stable macroeconomic conditions provide a solid platform for PPP investment in Tunisia. The country presents a reasonable fiscal deficit (3% of gross domestic product (GDP) in 2009), a controlled external debt (17% of GDP), and consistent economic growth (4% real GDP). Moreover, Tunisia’s investment grade status provides the government with access to a diversified range of domestic and foreign funding sources. All together, these conditions give the government capacity to maintain spending and to commit plausibly to PPP payments.

In addition, Tunisia’s experience with concession contracts offers a valuable foundation to develop PPP initiatives. The concessions in Tunisia that are procured under the Concession Law can be considered as PPPs for the purposes of the Report, as they involve a partnership between the public and private sector pursuant to a long-term contractual agreement and are backed by project financing. The country has successfully implemented PPP concessions in different sectors such as water (desalination plants), electricity generation and airports.

By leveraging current experience, the development of a formal PPP policy and the establishment of a PPP centre of expertise could assure a coordinated and effective implementation of PPP programmes. A PPP framework including institutions has been established to manage digital economy-related PPP projects tasked with upgrading Tunisia’s ICT and telecommunications infrastructure (the “Digital Economy Initiative” or DEI). Following the success of many concession projects and of the DEI, Tunisia could bring consistency and efficiency in the implementation of PPP schemes by setting policy goals and priorities regarding the desired impact of PPP at the sector and local government level. In addition, identification of priority sectors and announcing a pipeline of projects would enhance the credibility of the PPP policy. The establishment of a centre of expertise could then assure the sharing of best practices and lessons learned, as well as monitoring and support for the implementation of the set PPP policies.

Funding capacity and availability

The implementation of PPP programmes is constrained by the banking sector’s long-term lending capacity and could therefore benefit from being complemented through IFI and ECA-backed financing. Despite sufficient liquidity and solvency, domestic banks lack the capital base to provide long term financing for large infrastructure projects. In this context, international financing in foreign currency, especially from IFIs and/or financing or guarantees by ECAs, emerge as critical contributors to the expansion of PPP initiatives in Tunisia, by providing long term foreign currency lending.

PPP programmes implementation is also affected by limited expertise in PPP lending by the domestic banking sector, which could be enhanced by targeted training and co-financements with international lenders. The Tunisian banking sector is small and fragmented relative to the size of the economy and has limited PPP experience. With the exception of local branches of international banks, the banking sector in Tunisia has not been actively engaged in PPP lending, and is therefore lacking the expertise other financial institutions have developed in promoting PPP projects. A series of targeted seminars and briefings organized, among others, by international banks or IFIs on opportunities in the PPP market, could serve to increase local understanding and appetite for PPP lending. In addition, Tunisian local banks could provide some finance for PPPs together with international financial institutions, thus gaining valuable “on the job” training.

Legal and regulatory framework

Tunisia follows a civil code legal system albeit one that places emphasis on court precedent as well, which serves as a general framework for concession laws. Tunisian law comprises formal sources such as legislation, regulations and customs, and interpretive sources such as case law. Both legislative text and case law are published, widely available and in written form. A hierarchy of courts, the availability of written law and published decisions, the right to appeal and the persuasive nature of superior court judgments, are preconditions for an impartial and consistent application of the law. Within this framework, and in the absence of a specific PPP Law, the Concession Law governs procurement of all PPP concession projects in Tunisia, except where there is a sector-specific law, as in the case of energy, sanitation, telecommunications and the digital economy.

Although the existing Concession Law is in practice applied to PPP projects, it would be beneficial to adapt the legal and institutional framework to the specificity of PPPs. The Concession Law, despite being a successful framework for private sector engagement, does not provide a formal platform for project financed PPP where the public sector takes demand risk through the use of availability payment funding. The “unique user” interpretation of the Concession Law, through which the conceding authority pays the concessionaire directly, has allowed the adaptation of the concession model to project financed PPP. Nevertheless, investors, especially those willing to commit to long term PPP, would be reassured were such an interpretation to be formalised so that the power of public authorities to sanction and operate such projects is robust. Preferably this would be done by being enshrined in a legal instrument with preeminent status in Tunisian law (such as a legislative act or decree).

The Tunisian government prefers disputes to be resolved in the Tunisian courts but the parties may agree to international arbitration. The ability of the court system to deal with complex PPP disputes could be strengthened but is a suitable mechanism for resolving disputes. Common practice in PPP projects is to agree the mechanism for dispute resolution in the...
long term contract between the public and private sector. Foreign arbitral awards are enforceable in Tunisia under the New York Convention on the Recognition and Enforcement of Arbitral Awards. Where arbitration or other forms of dispute resolution have not been agreed, disputes between a public authority and a project company/concessionaire will be subject to the jurisdiction of the administrative courts. This creates a potential complexity because disputes between the concessionaire and a member of its supply chain will normally be subject to the jurisdiction of the commercial courts, but if a commercial dispute has arisen in the contract of a public service by the concessionaire the commercial dispute can be also be subject to the administrative courts.

**Institutional issues**

The central government is highly involved in the development of PPP projects which ensures consistency but could also create capacity bottlenecks if a large PPP programme is developed. Actors at the centre of government include the Office of the Prime Minister (key decision-making body), the Ministry of Finance (responsible for PPP procurement issues), and the Concessions Unit (regulation and supervision of concessions). Project selection is driven mostly by line ministries, although local authorities can also propose PPP projects and concessions. The assessment of projects’ affordability and feasibility are normally undertaken by procuring authorities and their advisers, in particular project sponsors from the line ministries. The threshold on investment affordability by sector is set annually by the government for each line ministry, taking into consideration a five year plan. The budget is mainly allocated by the Ministry of Finance. At the local level, regional governors and local authorities can conclude concession contracts subject to the final approval of the Minister of the Interior.

The development of budget-linked, multi-annual infrastructure plans has improved Tunisia’s PPP market although the robustness of its project pipelines could be enhanced. Both strategic and annual development plans have contributed to better policy formulation, and to information access by investors. Nevertheless, these initiatives have often been too broad, lacking sufficient details on funding sources and anticipated methods of procurement. Improving the quality of information provided in those instruments will have significant impact in the formulation of PPP policies and PPP market attractiveness. Investors are more likely to make a long term strategic commitment to the Tunisian PPP programme if the scale and shape of the investment programme is published.

The development of a PPP centre of expertise would serve to provide know-how and leadership in the design and implementation of PPP programmes. In order to maximise existing resources and increase PPP expertise, the Concession Unit could be developed into a PPP agency. By playing an active role in the procurement of projects, the Concessions Unit could develop valuable expertise in PPP procurement and implementation. However, it would be advisable that its expertise be strengthened through the recruitment of a core team of experts. Such expertise could then support the line ministries, local authorities and other state organisations involved in procurement of PPP projects. The role of any PPP centre in relation to other interested parties of government would need to be clarified.

**Bidding process**

The recently issued Concession Procurement Decree has provided Tunisia with a modern procurement regime, which if applied correctly should ensure a fair, transparent, and competitive bidding process. Among the most important provisions of Decree 2010-1753 are the establishment of a dialogue between the public authorities and bidders, the separation of technical and financial bids, and the creation of special committees responsible for different aspects of the tender process.

A certain degree of dialogue with bidders, as is allowed in Tunisia’s procurement law, can be beneficial for large PPP projects provided it is handled transparently. The Concession Procurement Decree allows bidders to express their concerns on the contractual documents and to propose amendments. Whilst there is not an explicit reference to dialogue or negotiation during the tender phase, authorities may use this framework to promote the exchange of views and opinions among competitors and authorities that can be beneficial in helping to better define the project. As long as the dialogue does not materially increase the costs of bidding and is handled transparently (for example, by spreading information to all bidders equally), it can be a powerful tool to drive cost-efficiency, value for money and attain optimal solutions for complex projects. In other markets, such as the European Union, pro-active engagement of this type has proven to be a means of fine-tuning and optimising solutions for the delivery of the project.

The separation of technical and financial bids by the Concession Procurement Decree could undermine technical aspects of an offer and adversely affect overall value for money. The process of separating the evaluation of the technical from the financial offers could serve to provide a technically sound bid, which is also financially attractive. Nevertheless, there is a risk that there will be a pass/fail evaluation in relation to the technical offers, followed by a lowest price evaluation of the financial offer. Where the "lowest price" is the over-riding evaluation criteria, there is a risk that the technical evaluation becomes a mere filter with the overall result that once the technical solution has achieved the requisite score to enable the financial proposal to be considered, the financial proposal is the effective determinant. In order to prevent those unbalances, authorities should seek to ensure that appropriate objective criteria and weightings are given to different components of the technical evaluation.

**Contract design, risk allocation and financial terms**

Although under the concession law “substantial” risk has to be allocated to the private sector, in current PPP transactions risk allocation has been gradually tailored to the project and risks are allocated to the parties best placed to deal with them. Under the concession model, demand risk has been generally allocated to the private sector as Article 4 of the Concession Law provides that the concessionaire shall bear a “substantial part of the risks” associated with performing the contract. In this context, a project-based risk allocation becomes crucial to securing investors’ interest in the project.

35
In the projects financed to date, allocation of the main risks has in practice followed international norms, albeit without a standard template. Tunisian law permits extensions of time available to the construction period as well as extensions to the overall concession period although aspects of the law are very prescriptive. Termination and compensation on termination also generally follows standard practice and is regulated in each individual contract. The Concession Law does not provide for compensation, although sector specific laws in the sanitation and civil aviation sectors provide that compensation should reflect the direct and material loss suffered by the concessionaire. Liquidated damages (the standard protection against delays in construction) are permitted and as occurs in civil law jurisdictions elsewhere, the courts place an emphasis on the fairness of the agreed damages, so that the damages stipulated in the construction contract may be increased or reduced in court. The public sector has wide powers unilaterally to modify the contract in the protection of the public service and user interests. However, where this power is exercised, the concessionaire will be entitled to compensation to restore the financial balance of the contract. There is at present no standard template for Tunisian PPPs; a template with general principles would provide greater clarity on key risks which the public sector is prepared to assume at an early stage and this would lower both costs and negotiation timing.

When issuing invitations to tender, the authority should clarify early in the process its position on allocation of macroeconomic risks (exchange rate and inflation), in order to maximise project cost-efficiency. Project affordability and value for money for the authority are adversely affected if the Project SPV has to bear macroeconomic or policy risks which it cannot control or mitigate. In a context of macroeconomic or policy uncertainty, a Project SPV is forced to buffer against such risks in its pricing. By striking the right risk balance in the PPP contract, coupled with a competitive bidding procedure, the public sector will ensure that the private sector offers the best price thereby maximising its cost-efficiency. In order to maximise the value of PPPs for Tunisia, procuring authorities need to adapt risk allocation to the characteristics of each project.

The optimal allocation of exchange rate risk will depend on whether the Project SPV has obtained Tunisian Dinars (TND) or foreign currency funding, the availability of foreign currency hedging and the country’s exchange rate policy. Rather than peg or track the TND exchange rate to foreign currencies as in some other Mediterranean partner countries, the Central Bank of Tunisia (CBT) conducts a flexible exchange policy. In Tunisia, as in most Mediterranean partner countries, the ability to hedge against TND exchange rate movements is limited, although the CBT makes a range of currency risk hedging instruments - such as futures, options and swaps - available to economic entities. This makes it difficult for foreign investors to hedge against exchange rate risk. In this event, the private sector partner (and its lenders and sponsors) generally assumes a wider range of possible risk scenarios which it prices into its offer, if it is able to provide an offer at all. It also makes sense (from an optimum risk allocation perspective) for the public sector to assume exchange rate risk where funding is obtained in foreign currency as this is not a risk that can be managed by the private sector. Contractually, exchange rate risk when borne by the public sector is covered through the payment mechanism of the long term PPP contract by indexing local currency payments to exchange rate variations or by directly paying the foreign portion of the costs directly in foreign currency.

Relatively volatile price inflation in Tunisia presents risks for sponsors and investors, especially in long-term PPP projects and needs to be addressed through contract provisions. Planning, pricing and costing risks need to be addressed in the PPP contract payment mechanisms. In Tunisia, when inflation risk is assumed by the public sector, this is normally covered contractually through indexation (over consumer or producer price indices, for instance). Regular benchmarking of project costs presents advantages vis-à-vis a general price inflation adjustment particularly because of the volatility of inflation rates.

**PPP / project finance investment readiness for lenders and investors**

The level of regulation of foreign investment has eased considerably in recent years, providing investors with a wide range of protective measures. The Concession Law allows foreigners to participate in concessions without restrictions, including the guarantee of repatriation of their investment (including capital, capital gains and dividends). Moreover, under the freedom of investment regime, no prior authorisation is required for foreign investors to carry out business in Tunisia. The security package available to lenders follows standard international practice and includes measures such as charges, mortgages, step-in rights, direct agreements (between the lenders and the authority), and pledges over shares and receivables.

Although Tunisia’s corporate tax regime is generally favourable for business, several tax and accounting rules discourage SPVs from having an efficient capital structure. As a result, both the after-tax cost of capital for SPVs and the PPP concession payments become more expensive. Unless the impact of taxation is expressly considered when evaluating project bids, distorting tax rules will encourage bidders to use less debt, i.e. by using more expensive equity relative to debt, further increasing the cost of capital. Furthermore, the adoption of “finance debtor” accounting and tax treatment for PPP projects could help eliminate the negative impact of some tax rules and make project more affordable. Finance debtor accounting enables accounting profit to match project cashflows after debt service much more closely, avoiding many of the inefficiencies caused by fixed asset accounting in PPP projects. Finance debtor accounting is currently not permissible under Tunisian accounting standards, requiring a change in tax law in order to be used for PPP purposes.

**Conclusion – key recommendations**

- Tunisia’s macroeconomic stability provides an adequate platform from which to launch medium and large infrastructure projects such as PPPs.
- Tunisia’s experience with concession contracts which are project financed offers valuable experience in PPP, though it would be desirable for the country to create a comprehensive PPP policy and framework.
- A central PPP unit stemming from the Concession Unit could enhance expertise in the public sector and line ministries to maximise the effectiveness of a PPP policy. A credible pipeline of PPP projects would further enhance credibility and investor appetite for these projects.
• Local financing is constrained by the fragmented financial sector and limited experience in large PPP projects. Co-financing with IFIs and targeted training sessions could contribute to increasing awareness and expertise on PPPs.

• The legal framework based on concessions has proven adequate for PPP, although a PPP Law and setting out general principles of risk allocation could contribute to lower negotiation times and greater cost effectiveness (or value for money) and create an environment more attractive to foreign investors.

• Inflation and exchange rate risks are generally better covered by the public sector, as these are not risks that can be properly managed by the private sector. If the private sector were asked to cover this risk, it would be priced into the tariff to be paid by the public sector for the service/output (making the project more expensive) and it could also potentially prevent financing.
9. WEST BANK

Overview

An unstable political and fiscal framework puts the West Bank in a difficult position to develop Public-Private Partnership projects (PPP). Despite investment-friendly policies implemented by the Palestinian Authority, the lack of full control by the government over some parts of the territory and the absence of fully fledged statehood coupled with restrictions on parts of its territory, make political risk the key investor concern for developing PPPs in the West Bank. In addition, its weak economy, which remains vulnerable to political developments and dependent on grants from the international community, does not provide sufficient long-term fiscal sustainability for PPP projects.

However, in the medium to long-term, Palestinian Authority’s policies, and donors’ support is expected to increase and expand private participation in infrastructure (PPI). There is potential for further private sector participation beyond the current small-scale PPI in the telecom sector. Much of this is expected to be facilitated through the Palestinian Investment Fund (PIF), particularly in key sectors, such as waste and water management and the energy sector. In the medium to long-term, the need to bridge a huge infrastructure gap and enhance infrastructure, could also lead to the development of small-scale PPP pilot projects, particularly through blending of grants and loans.

The development of a coherent infrastructure plan could foster a clear sequencing of PPI projects. Developing a pipeline of well-designed projects could leverage PIF and international financial institutions’ funding and catalyze private investment in the medium-term, mainly through regional investment funds. The partnership of the PIF with International Financial Institutions (IFIs) in the design and implementation of such program may also strengthen the PIF’s capacity and contribute to the prioritization of viable and realistically achievable projects. These could provide the basis for future PPP project development when investment conditions are met.

PPP pilot projects could be developed if stability and investment climate improve. Given the current political and macroeconomic context, the private sector is unable to finance, build and operate projects without IFIs and donors assuming most of (if not all) the risks (through concessional financing, for instance). Therefore projects currently undertaken in the Palestinian Territories do not fall within the definition of PPPs used in the Report. A viable sequencing of PPP investments from telecoms to energy as well as water and waste management sectors, may simultaneously allow less reliability on IFI/concessional funding and lead to a gradual transfer of risks to the private sector. In addition to improving political and macroeconomic stability, institutional strengthening, increased funding capacity and simplification of the legal framework, could lead to the development of targeted PPP projects in the medium term.

Funding capacity and availability

The Palestinian Authority (PA) has little if any autonomous borrowing capacity due to its dependence on the international community to sustain its fiscal stance. Despite growth (real GDP growth of around 7% p.a. in 2009 and 2010), the economy remains weak, vulnerable to political developments and dependent on grants from the international community for its fiscal stability. The PA follows general economic policies outlined in the Palestinian Reform and Development Plan (PRDP) 2008-10 aiming, among others, at fiscal consolidation and improved infrastructure through private-sector investment. An extension of the PRDP, originally funded by pledges made at the 2008 Paris donor conference, is currently being prepared. PA’s ability to progress economically however, is constrained by the political situation. The PA will continue to depend heavily on donor support in the medium term, which could be further targeted specifically to development projects.

Commercial bank lending capacity for project financing is very limited, both from Palestinian banks and from foreign commercial banks. All the financing currently available on the market is short term. The experience of the Wataniya Telecom financing – the nearest equivalent to PPP financing to date in the West Bank – indicates that even locally active banks require credit insurance or export credit guarantees for lending to long term projects located in the West Bank.

Infrastructure funding in the West Bank is likely to continue to be predominantly based on grants. In the foreseeable future, IFIs, Export Credit Agency (ECAs) and political risk insurers are likely to be the only long-term funders or collateral providers for any PPP project that may be developed in the West Bank. Commercial bank appetite for long-term lending to West Bank projects would require both a significant easing in political tensions and on restrictions on the West Bank economy. For any potential PPP projects under which payments would be made by the PA (e.g. through availability payments), the PA’s fiscal sustainability would need to improve and move away from reliance on grant funding.

The Palestinian Investment Fund (PIF) could provide equity and act as catalyst for equity investment in infrastructure including PPPs in the medium-term. Wholly owned by the PA but independently managed, the PIF’s aim is to strengthen the local economy through key strategic investments. It is currently leading an ambitious five year investment program amounting to USD 4 billion. Target projects include construction of a 140MW-200MW power plant in the northern West Bank, under an IPP scheme, with construction and commissioning expected to take between 24 and 30 months, after the required clearances have been secured. If the PIF is to become a significant source of equity for PPPs, it would need to be kept independent from specific bidders until the procuring authority selects the preferred bidder, in order to ensure a competitive and transparent procurement process.

---

15 Note on the usage of terminology in the Report: Whilst the Report covers the West Bank (and the economic analysis throughout the Report concerns exclusively the West Bank unless otherwise stated), the terms Palestine/Palestinian refer to the territories covering Gaza and the West Bank in the context of the activities of, or the institutions operated by, the Palestinian Authorities.
Legal and regulatory framework

The lack of full territorial control by the PA affects the enforceability of its legal framework for infrastructure development. The legal framework applicable to infrastructure and more generally, the application of Palestinian law, varies in accordance to the level of control that the PA exercises over each area. This, in addition to the lack of full PA statehood, affects the enforcement of the legal framework for infrastructure.

Despite difficulties and the complexity of the PA’s current legal framework, authorities do have powers to enter into PPP projects. An example is the power project mentioned above that, although not a PPP in strictu sensu, it is a project led by the PA.

The Disputes can be settled by international arbitration in the PA, although the court system is not well equipped to deal with complex PPP contracts. Even though international arbitration is possible, arbitration awards are difficult to enforce in practice. The absence of bilateral treaties means that foreign investors have less protection against government actions.

Institutional capacity

The decision making process for infrastructure development in the PA is complex due to the political situation which inevitably leads to delays in implementation that may discourage investors. The Presidency has been involved in the procurement of infrastructure projects (such as telecommunications) and the Ministry of Public Works plays a key role in initiating and overseeing the procurement of projects including those falling within the responsibility of local authorities (such as utilities). Given the current political circumstances, project identification within the Palestinian Territories requires coordination with the Israeli authorities and prior authorization by Israel of certain import of materials and equipment. Key actors include the Israeli Civil Administration (ICA) and the State of Israel, which affect the development of infrastructure in the Palestinian Territories.

Weaknesses in institutional capacity for infrastructure development have been successfully tackled through technical-assistance, the level of which it would be desirable to increase. Most infrastructure and technical assistance projects are initiated, funded and normally executed by bilateral agencies and/or multilateral financial institutions in close cooperation from the PA. Notable progress has been made under the “European Neighbourhood Policy” in public finance management and in other fields (for example with the introduction of computerised tax procedures and decentralised internal auditing); such success could be replicated in through similar initiatives to increase capacity in infrastructure development.

The PA could benefit from closer cooperation with institutions or agencies in neighbouring FEMIP countries with experience in infrastructure and PPP development. Knowledge exchange programmes with such institutions could have a positive effect on the PA’s ability to carry out successful PPP pilot projects in the future. Lessons learned by peer countries could foster technical expertise, which could then be centralized in a specialized unit dealing with large infrastructure projects.

Bidding Process

The Tender Law permits the procurement of major infrastructure through open, restricted or negotiated procedures. Whilst existing tender procedures are generally suitable for processing major infrastructure, because much infrastructure procurement is undertaken by foreign donors (in partnership with the PA), often the applicable procurement procedures of the donor countries are followed. In the case of bilateral aid, this means that procurement is at times subject to country of origin specifications, thus reducing international competition.

Bidding processes and evaluation criteria broadly follow international norms. Bids are assessed by a standing Central Tenders Committee and whilst there is no standard procedure for contesting decisions, they are susceptible to judicial review.

Contract design risk allocation and financial terms

Due largely to the political situation, the PA does not currently have experience in the field of PPP. Except for the privatisation of the telecom sector, which may be considered similar to PPPs since it involves the financing of public infrastructure by the private sector, the PA has not engaged in a PPP that is project financed. If, after detailed analysis, PPP is viewed as the best mechanism to partially finance public infrastructure in the Palestinian Territories, a whole framework for PPPs would need to be developed. Such framework includes, among others, risk allocation mechanisms through contract design and the development of typical financial terms. This could only be achieved through strong technical assistance funded by donors.

The general law and policy within the PA would allow for a correct allocation of risks, with the support of the donor community. Whilst PPP have not been tested in practice, there is no reason to believe that appropriate structures and terms could not be developed in the future, after the political situation improves. The underlying issue of political risk would need to be mitigated in any event, with the support of governmental and multilateral organisations prepared to absorb substantial elements of the political risk.

Opportunities and expectation

The economic outlook of the PA will depend on easing of the political situation and continued donor support. The ability of the PA to eventually fund some of its needed infrastructure projects using PPPs is constrained in the medium term by political instability. Economic growth will depend on improvement in the political situation and a reduction in the currently imposed trade barriers. It is likely that the PA will continue to rely heavily on donor support, which could be strengthened and targeted more directly to infrastructure development projects. In the future, increased private sector participation through PPPs or other contractual structures, will be a key element for economic growth.
CONCLUSION – KEY RECOMMENDATIONS

• The political situation is a key constraint to infrastructure development in the PA. Continued efforts to improve political stability, regional peace and further progress towards statehood which lead to improvements in the socio economic conditions of PA’s population, would foster a more favourable climate for investments.

• Private sector involvement through PPPs for example, has the potential to improve infrastructure in the Palestinian Territories. The PA should consider the optimal institutional collaborations to achieve this.

• Continued partnerships and knowledge/skills transfer through technical assistance from neighbouring FEMIP countries and the agencies currently active in the Palestinian Territories, is likely to be of long term benefit.

• Some sources of funding for a future PPP programme have been identified. The PIF could become a major equity provider for future PPP projects. However, the PIF is to become a significant source of equity for PPPs, it would need to be kept independent from specific bidders until the procuring authority selects the preferred bidder, in order to ensure a competitive and transparent procurement process. Other sources of equity and debt are likely to be donors, IFIs and ECAs, capable of covering the political risk as well as providing funding.

• The PA’s huge infrastructure needs will be continued to be covered through international support. Donor support, which is currently sustaining the PA’s economy, could be further targeted to development projects. The ability of the West Bank and the PA to embark on PPPs in the medium/long term will however remain subject to substantial improvements in the political situation.
FEMIP for the Mediterranean

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.

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. This study is financed under the FEMIP Trust Fund.

Operational contacts

Claudio Cortese
Deputy Director General, Directorate for Operations outside the European Union and Candidate Countries
(+352) 43 79 - 86836
c.cortese@eib.org

Alain Nadeau
Head of Maghreb Division
(+352) 43 79 - 86816
a.nadeau@eib.org

Javier Gutiérrez Degenèvé
Head of Near East Division
(+352) 43 79 - 84820
j.gutierrez@eib.org

Angus Macrae
Head of Special Operations Division (private equity operations)
(+352) 43 79 - 86406
a.macrae@eib.org

Ioannis Kaltzas
Head of the Policy and Trust Funds Division Directorate for Operations outside the European Union and Candidate Countries
(+352) 43 79 - 86425
i.kaltzas@eib.org

External Offices in Mediterranean partner countries

Egypt: Jane Macpherson
Head of Regional Office
6, Boulos Hanna Street - Dokki, 12311 Giza
(+20-2) 3 336 65 83
j.macpherson@eib.org

Morocco: Guido Prud’homme
Head of Office
Riad Business Center, Aile Sud Immeuble S3, 4e étage Boulevard Er-Riad, Rabat
(+212) 537 56 54 60
g.prudhomme@eib.org

Tunisia: Robert Feige
Head of Office
70, avenue Mohammed V
TN-1002 Tunis
(+216) 71 28 02 22
r.feige@eib.org

Press contacts and general information

Anne-Cécile Auguin
(+352) 43 79 - 83330
(+352) 43 79 - 61000
a.auguin@eib.org

European Investment Bank
98 -100, boulevard Konrad Adenauer
L-2950 Luxembourg
(+352) 43 79 – 1
(+352) 43 77 04
www.eib.org/femip – info@eib.org
FEMIP

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

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

The contents of this Volume have been prepared by external consultants. The opinions expressed are those of the consultants and do not necessarily reflect the view of the European Investment Bank.

This Volume is not designed to be professional advice in respect of any particular matter and should not be relied upon in the making of any legal, commercial or financial decision.
## CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>GLOSSARY</td>
<td>1</td>
</tr>
<tr>
<td>INTRODUCTION</td>
<td>2</td>
</tr>
<tr>
<td>1. ENGLAND</td>
<td>4</td>
</tr>
<tr>
<td>2. FRANCE</td>
<td>14</td>
</tr>
<tr>
<td>3. MEXICO</td>
<td>20</td>
</tr>
<tr>
<td>4. POLAND</td>
<td>25</td>
</tr>
<tr>
<td>5. SOUTH AFRICA</td>
<td>31</td>
</tr>
</tbody>
</table>

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.
ACKNOWLEDGEMENTS

In preparing the Report, the Consortium has been assisted by Paloma Perez de Vega, Francesco Totaro and Nicholas Jennett from the European Investment Bank, Willis Limited (in relation to insurance matters) and the following in-country experts:

Mediterranean partner countries:

**Algeria**
- Ghellal & Mekerba Law Firm
- Mazars Hadj Ali

**Egypt**
- Sharkawy & Sarhan Law Firm
- Mazars Mostafa Shawki

**Israel**
- Glusman Shem-Tov Chowers Broid & Co – Law Offices
- MBT Consultants

**Jordan**
- J.C. Law Firm
- Mazars (UAE)

**Lebanon**
- Takla, Trad, Daouk Law Firm
- Mazars (Lebanon)

**Morocco**
- UGGC & Associés Law Firm
- Mazars Masnaoui

**Syria**
- Syrian Legal Bureau
- Mazars (UAE)

**Tunisia**
- Ferchiou and Associés
- Mazars (Tunisia)

**West Bank**
- A, F & R Shehadeh Law Office
- El Wafa Company

Comparator countries:

**France**
- Salans
- Mazars France

**Mexico**
- COMAD, S.C.
- Mazars Mexico

**Poland**
- Salans
- Mazars Poland

**South Africa**
- Webber Wentzel
- Mazars South Africa

The Consortium is grateful for the support that has been given.
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)
OEJEU: 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.

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
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).

<table>
<thead>
<tr>
<th>Country</th>
<th>Currency</th>
<th>Exchange Rate (EUR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>USD/EUR</td>
<td>1.3213</td>
</tr>
<tr>
<td>UK</td>
<td>GBP/EUR</td>
<td>0.8483</td>
</tr>
<tr>
<td>Poland</td>
<td>PLN/EUR</td>
<td>3.8973</td>
</tr>
<tr>
<td>Mexico</td>
<td>MXN/EUR</td>
<td>16.1978</td>
</tr>
<tr>
<td>South Africa</td>
<td>ZAR/EUR</td>
<td>8.9071</td>
</tr>
</tbody>
</table>
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. GDP fell by 4.9% in 2009. 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.

---

1 Data sources: IMF Government Finance Statistics Yearbook and data files, and World Bank and OECD national accounts data files
2 Source: World Bank national accounts data, and OECD National Accounts data files
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.

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

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

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.
English

**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 financial 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. 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.

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.

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 to 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 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 has criticised the use of the procedure as a default procedure. Used correctly, competitive dialogue should foster discussion and cooperation 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
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

<table>
<thead>
<tr>
<th>Procedure</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Open</strong></td>
<td>1. All interested parties submit a bid to the contracting authority (without a need to express an interest beforehand). uri: 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.</td>
</tr>
<tr>
<td><strong>Restricted</strong></td>
<td>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.</td>
</tr>
<tr>
<td><strong>Competitive Dialogue</strong></td>
<td>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.</td>
</tr>
</tbody>
</table>
| **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.  
While 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

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:
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 subcontract (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 subcontractors 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 1.8 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 20109 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.

---

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 future 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. 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. This definition is in line with the definition of concessions according to European Union Case Law.

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.

---

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

<table>
<thead>
<tr>
<th>France</th>
<th>Loan amounts (EUR millions)</th>
<th>Number of Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power (incl renewables)</td>
<td>not included</td>
<td></td>
</tr>
<tr>
<td>Social Infrastructure</td>
<td>4,548</td>
<td>45</td>
</tr>
<tr>
<td>Transport</td>
<td>3,778</td>
<td>11</td>
</tr>
<tr>
<td>Water &amp; Sewage</td>
<td>13</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>8,338</td>
<td>59</td>
</tr>
</tbody>
</table>

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 Daily 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 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) 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 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 (rétéré 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 juridiction) 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 Daily 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 public 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.

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. 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

<table>
<thead>
<tr>
<th>Mexico</th>
<th>Loan amounts (EUR millions)</th>
<th>Number of Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power excl</td>
<td>1,608</td>
<td>5</td>
</tr>
<tr>
<td>Renewables</td>
<td>218</td>
<td>2</td>
</tr>
<tr>
<td>Social Infrastructure</td>
<td>210</td>
<td>6</td>
</tr>
<tr>
<td>Transport</td>
<td>5,328</td>
<td>17</td>
</tr>
<tr>
<td>Water &amp; Sewage</td>
<td>186</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>7,550</td>
<td>32</td>
</tr>
</tbody>
</table>

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 instill 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.

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 online 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. 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

<table>
<thead>
<tr>
<th>Poland</th>
<th>Loan amounts (EUR millions)</th>
<th>Number of Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power excl renewables</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Renewables</td>
<td>641</td>
<td>10</td>
</tr>
<tr>
<td>Social Infrastructure</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Transport</td>
<td>2,671</td>
<td>3</td>
</tr>
<tr>
<td>Water &amp; Sewage</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>3,312</td>
<td>13</td>
</tr>
</tbody>
</table>

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 arenas15.

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.

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 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 determinate 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

<table>
<thead>
<tr>
<th></th>
<th>Concession Act</th>
<th>PPP Act</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Project structure</strong></td>
<td>Private partner implements the project (unlikely to involve a Project SPV)</td>
<td>Project implemented jointly under either a contractual joint venture (JV) or through a Project SPV</td>
</tr>
<tr>
<td><strong>Purpose of contract with private sector</strong></td>
<td>Mandate the provision (delegation) of services, deliveries, public works</td>
<td>A partnership between the public and private sector to deliver a service based on a clear allocation of risks</td>
</tr>
<tr>
<td><strong>Ownership of project assets</strong></td>
<td>Public entity retains ultimate ownership of the asset but grants the private partner the right to exploit it</td>
<td>Assets may be transferred to the private partner or the Project SPV</td>
</tr>
<tr>
<td><strong>Risk allocation</strong></td>
<td>Private partner assumes operational risk (operation of a service may be the only purpose of the concession)</td>
<td>Risk division between parties. Operating of services must include operation of assets</td>
</tr>
<tr>
<td><strong>Payment</strong></td>
<td>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)</td>
<td>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</td>
</tr>
<tr>
<td><strong>Contract period</strong></td>
<td>Concessions are limited to 15 years (services) or 30 years (construction) unless extended to allow cost recovery</td>
<td>No time limit</td>
</tr>
<tr>
<td><strong>Applicable procurement procedures</strong></td>
<td>Has its own procurement procedure</td>
<td>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.</td>
</tr>
</tbody>
</table>

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.

---

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.

**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.

---

12 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.

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; 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.

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.

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. 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%. 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 36 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 Trichard 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 6 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. 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. 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.

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

---

20 Data sources: IMF Government Finance Statistics Yearbook and data files, and World Bank and OECD national accounts data files
21 IMF World Economic Outlook Database – Inflation, average consumer prices for the year
22 South African PPPs’ Road to Success (Dunning M, Issue 258 Project Finance International, 5 February 2003)
24 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

<table>
<thead>
<tr>
<th>South Africa</th>
<th>Loan amounts (EUR millions)</th>
<th>Number of Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power excluding renewable</td>
<td>829</td>
<td>3</td>
</tr>
<tr>
<td>Renewables</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Social Infrastructure</td>
<td>44</td>
<td>2</td>
</tr>
<tr>
<td>Transport</td>
<td>553</td>
<td>3</td>
</tr>
<tr>
<td>Water &amp; Sewage</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1,426</td>
<td>8</td>
</tr>
</tbody>
</table>

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 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.

---

\(^{24}\) An analysis of the preferential procurement legislation in South Africa (Bolton P, 2006 PPLR 36)
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.

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. This study is financed under the FEMIP Trust Fund.

Operational contacts

Claudio Cortese  
Deputy Director General,  
Directorate for Operations outside the European Union and Candidate Countries  
(+352) 43 79 - 86836  
c.cortese@eib.org

Alain Nadeau  
Head of Maghreb Division  
(+352) 43 79 - 86816  
a.nadeau@eib.org

Javier Gutiérrez Degenève  
Head of Near East Division  
(+352) 43 79 - 84820  
j.gutierrez@eib.org

Angus Macrae  
Head of Special Operations Division  
(private equity operations)  
(+352) 43 79 - 86406  
a.macrae@eib.org

Ioannis Kaltsas  
Head of the Policy and Trust Funds Division  
Directorate for Operations outside the European Union and Candidate Countries  
(+352) 43 79 - 86425  
l.kaltsas@eib.org

External Offices in Mediterranean partner countries

Egypt: Jane Macpherson  
Head of Regional Office  
6, Boulos Hanna Street - Dokki, 12311 Giza  
(+20-2) 3 336 65 83  
j.macpherson@eib.org

Morocco: Guido Prud’homme  
Head of Office  
Riad Business Center, Aile Sud  
Immeuble S3, 4e étage  
Boulevard Er-Riad, Rabat  
(+212) 537 56 54 60  
g.prudhomme@eib.org

Tunisia: Robert Feige  
Head of Office  
70, avenue Mohammed V  
TN-1002 Tunis  
(+216) 71 28 02 22  
r.feige@eib.org

Press contacts and general information

Anne-Cécile Auguin  
(+352) 43 79 - 83330  
(+352) 43 79 - 61000  
a.auguin@eib.org

European Investment Bank  
98 -100, boulevard Konrad Adenauer  
L-2950 Luxembourg  
(+352) 43 79 – 1  
(+352) 43 77 04  
www.eib.org/femip – info@eib.org