UNCITRAL UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

UNCITRAL
Legislative Guide on
Public-Private Partnerships

UNITED NATIONS

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Vienna, 2020

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UNITED NATIONS PUBLICATION
Sales No.: E.20.V.2
ISBN 978-92-1-130399-5
e-ISBN 978-92-1-004805-7

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Publishing production: English, Publishing and Library Section, United Nations Office at Vienna.

Preface

The *Model Legislative Provisions* and the *Legislative Guide on Public-Private Partnerships* were prepared by the United Nations Commission on International Trade Law (UNCITRAL) and adopted at its fifty-second session (Vienna, 8–19 July 2019).[1] In addition to representatives of member States of the Commission, representatives of many other States and of several international organizations, both intergovernmental and non-governmental, participated actively in the preparatory work. The *Model Legislative Provisions* translate into legislative language the advice given in the recommendations contained in the *Legislative Guide.*

The *Model Legislative Provisions* are intended to assist in the establishment of a legislative framework favourable to public-private partnerships (PPPs). The *Model Legislative Provisions* follow the corresponding notes in the *Legislative Guide*, which offer an analytical introduction with references to financial, regulatory, legal, policy and other issues raised in the subject area. The user is advised to read the *Model Legislative Provisions* together with the *Legislative Guide*, which provides background information to enhance understanding of the legislative recommendations.

The *Model Legislative Provisions* deal with matters that it is important to address in legislation specifically concerned with PPPs. They do not deal with other areas of law that, as discussed in the *Legislative Guide*, also have an impact on PPPs. Moreover, the successful implementation of PPPs typically requires various measures beyond the establishment of an appropriate legislative framework, such as adequate administrative structures and practices, organizational capability, technical expertise, appropriate human and financial resources and economic stability.

The *Model Legislative Provisions* and the *Legislative Guide* update, expand and replace two earlier texts prepared by UNCITRAL, namely the *Legislative Guide on Privately Financed Infrastructure Projects*, which was adopted by UNCITRAL at its thirty-third session (New York, 12 June to 7 July 2000),[2] and the *Model Legislative Provisions on Privately Financed Infrastructure Projects,* which were adopted by UNCITRAL at its thirty-sixth session (Vienna, 30 June to 11 July 2003).[3]

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[1] *Official Records of the General Assembly, Seventy-fourth Session, Supplement No. 17* (A/74/17), chap. III and annex I.

[2] *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 372.

[3] *Official Records of the General Assembly, Fifty-eighth Session, Supplement No. 17* (A/58/17), para. 171.

Contents

Resolution adopted by the General Assembly on 18 December 2019

[on the report of the Sixth Committee (A/74/423)]

74/183. Model Legislative Provisions on Public-Private Partnerships of the United Nations Commission on International Trade Law

The General Assembly,

Recalling its resolution 2205 (XXI) of 17 December 1966, by which it established the United Nations Commission on International Trade Law with a mandate to further the progressive harmonization and unification of the law of international trade and in that respect to bear in mind the interests of all peoples, in particular those of developing countries, in the extensive development of international trade,

Recalling also its resolution 58/4 of 31 October 2003, by which it adopted the United Nations Convention against Corruption,[1]

Recalling further its resolution 70/1 of 25 September 2015, by which it adopted the 2030 Agenda for Sustainable Development, and its resolution 69/313 of 27 July 2015, by which it endorsed the Addis Ababa Action Agenda of the Third International Conference on Financing for Development,

Convinced that public-private partnerships can play an important role in improving the provision and sound management of infrastructure and public services and in supporting government efforts to achieve the Sustainable Development Goals,

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[1] See also United Nations, *Treaty Series*, vol. 2349, No. 42146.

Concerned that the inadequacy of the legal framework and a lack of transparency may discourage investment in infrastructure and public services and lead to a greater risk of corruption and mismanagement of public funds,

Emphasizing the importance of providing efficient and transparent procedures for the awarding of contracts for public-private partnerships and of facilitating project implementation through rules that enhance transparency, fairness and long-term sustainability and remove undesirable restrictions on private sector participation in the development and operation of infrastructure and public services,

Recalling the valuable guidance that the Commission has provided to Member States towards the establishment of a favourable legislative framework in that respect, through its *Legislative Guide on Privately Financed Infrastructure Projects*[2] and the accompanying *Model Legislative Provisions on Privately Financed Infrastructure Projects*,[3] and the recommendation by the General Assembly, in its resolution 58/76 of 9 December 2003, that States give due consideration to those texts when revising or adopting legislation related to private participation in the development and operation of public infrastructure,

Convinced that the advice provided by the Commission will be of further assistance to States, in particular developing countries, in promoting good governance and establishing appropriate legislative frameworks for public-private partnership projects,

1. *Expresses its appreciation* to the United Nations Commission on International Trade Law for the completion and adoption[4] of the *Model Legislative Provisions on Public-Private Partnerships*[5] and the *Legislative Guide on Public-Private Partnerships*;

2. *Requests* the Secretary-General to publish the *Model Legislative Provisions* and the *Legislative Guide*, including electronically, in the six official languages of the United Nations and to disseminate them broadly to Governments and relevant international intergovernmental and non-governmental organizations, private sector entities and academic institutions;

[2] United Nations publication, Sales No. E.01.V.4.

[3] *Official Records of the General Assembly, Fifty-eighth Session, Supplement No. 17* (A/58/17), annex I.

[4] Ibid., *Seventy-fourth Session, Supplement No. 17* (A/74/17), chap. III.

[5] Ibid., annex I.

3. *Recommends* that all States give due consideration to the *Model Legislative Provisions* and the *Legislative Guide* when revising or adopting legislation relevant to public-private partnerships, and invites States that have used the *Model Legislative Provisions* to advise the Commission accordingly.

51st plenary meeting,
18 December 2019

Introduction and background information on PPPs[1]

A. Introduction

1. The roles of the public and the private sectors in the development of infrastructure have evolved considerably over time. Public services such as gas street lighting, power distribution, telegraphy and telephony, steam railways and electrical tramways date back to the nineteenth century. The private sector funded many of the early road or canal projects, and there was a rapid development of international project financing, including international bond offerings to finance railways or other major infrastructure.

2. However, during most of the twentieth century, the worldwide trend turned towards public development of infrastructure and other services. Infrastructure operators were often nationalized, or they underwent mergers and acquisitions to reduce competition. In many countries, the provision of public services by private companies required a licence or concession from the Government. The degree of openness of the world economy also receded during this period. The infrastructure sector remained privately operated only in a relatively small number of countries, often with little or no competition. In many countries, the pre-eminence of the public sector in infrastructure service provision became enshrined in the constitution.

3. The reverse trend towards private sector participation and competition in infrastructure sectors started in the early 1980s. Factors driving this development include significant technological innovations; high indebtedness and stringent budget constraints limiting the public sector's ability to meet increasing infrastructure needs; the expansion of international and local capital markets, with a

[1] Section B offers general background information on matters that the *Guide* examines from a legislative perspective. For in-depth policy and technical information, the reader is particularly advised to consult publications by other international organizations, such as the *Guidelines for Infrastructure Development through Build-Operate-Transfer (BOT) Projects*, prepared by the United Nations Industrial Development Organization (UNIDO publication, Sales No. UNIDO.95.6.E) (hereafter "*UNIDO BOT Guidelines*"); the Public-Private Partnerships Reference Guide – Version 3, prepared by the World Bank and its partners (International Bank for Reconstruction and Development/The World Bank, 2017), the *Recommendations of the Council on Principles for Public Governance of Public-Private Partnerships*, OECD, May 2012.

consequent improvement in access to private funding; and an increasing number of successful international experiences with private participation and competition in infrastructure. Many countries adopted new laws, not only to regulate such transactions, but also to modify market structure and competition policies for the sectors in which they were taking place.

4. The purpose of the *Guide* is to assist in the establishment or adaptation of a legal framework to facilitate private participation in the development of public infrastructure, facilities or services through public private partnerships ("PPPs") with a view to improving the efficiency and quality of public infrastructure and services. The advice provided in the *Guide* aims to achieve a balance between facilitating PPPs and protecting the public interest. The *Guide* discusses fundamental concerns that are of public interest, which are recognized by most legal systems, despite the numerous differences in policy and legislative treatment.

5. Public interest concerns include, for example: continuity in the provision of public services; long-term sustainability and affordability of projects; environmental protection, health, safety and quality standards; fairness of prices charged to the public; non-discriminatory treatment of customers or users; full disclosure of information pertaining to the operation of infrastructure facilities; flexibility to meet changed conditions, including expansion of the service to meet additional demand and periodic review of the contractual terms and conditions; accountability of decision-makers and monitoring of project implementation. Fundamental concerns of the private sector, in turn, usually include issues such as stability of the legal and economic environment in the host country; transparency of laws and regulations, and predictability and impartiality in their application; enforceability of property rights, and assurances that private property is respected and not interfered with other than for reasons of public interest and only if compensation is paid; and freedom of the parties to agree on commercial terms that ensure a reasonable return on invested capital commensurate with the risks taken by private investors. The *Guide* does not provide a single set of model solutions to address these concerns, but it helps the reader to evaluate the different approaches available and to choose the one most suitable in the national or local context.

1. *Organization and scope of the* Guide

6. The *Guide* consists of legislative advice and recommendations in the form of notes offering an analysis of key financial, regulatory, legal, policy and other issues raised in the subject area. The notes are followed, as appropriate, by model legislative provisions, which exemplify how a legislator could translate the advice and recommendations of the *Guide* into legislative language. The user is advised to read the model legislative provisions together with the notes, which provide background information to enhance their understanding.

7. The model provisions deal with matters that should be addressed in laws specifically concerned with PPPs. They do not deal with other areas of law, which, as discussed in the *Guide*, also have an impact on PPPs. Moreover, the successful implementation of PPPs typically requires various measures beyond the establishment of an appropriate legislative framework, such as adequate administrative structures and practices, organizational capability, technical expertise, appropriate human and financial resources and economic stability. Although some of these matters are mentioned in the notes, they are not addressed in the model provisions.

8. The *Guide* is intended to be used as a reference by national authorities and legislative bodies when preparing new laws or reviewing the adequacy of existing ones. For that purpose, the *Guide* helps identify areas of law that are most relevant to PPPs and discusses the content of those laws, which would be conducive to attracting private capital, national and foreign. The *Guide* briefly mentions other areas of law including, for instance, promotion and protection of investments, property law, security interests, rules and procedures on compulsory acquisition of private property, general contract law, rules on public contracts, tax law and environmental protection and consumer protection laws (see chap. VII, "Other relevant areas of law") that could be enacted specifically with respect to PPPs or that should be kept in mind when establishing a legislative or regulatory framework for PPPs. The *Guide* is not intended to provide advice on drafting agreements for the implementation of PPPs. However, the *Guide* does discuss some contractual issues (for instance, in chap. IV, "PPP implementation: legal framework and PPP contract" and chap. V, "Duration, extension and termination of the PPP contract") to the extent that they relate to matters that might usefully be addressed in legislation.

9. The *Guide* covers a wide variety of PPP arrangements, in particular those that involve an obligation for the private partner to design, build, maintain and operate a new facility or system or to rehabilitate, modernize, expand, maintain and operate an existing facility or system. These facilities or systems may be operated by the private partner to provide services or goods to the public, may be open for use by the public under the control of the private partner, or may also be used by Government to meet its own needs or to support the provision of a public service. The *Guide* covers both PPPs where the private sector recovers its investment through the price charged to the public or to a public authority (or both) for the use of the infrastructure facility or system, or for the services or goods it generates, as well as PPPs in which only the contracting authority or other governmental agency pays for the facilities, goods or services provided under the PPP contract. Although PPPs are sometimes grouped with other transactions for the "privatization" of governmental functions or property, the *Guide* is not concerned with "privatization" transactions that do not relate to the development and operation of public

infrastructure, facilities and services. In addition, the *Guide* does not address projects for the exploitation of natural resources, such as mining, oil or gas exploitation projects under some "concession", "licence" or "permission" issued by the public authorities of the host country.

2. *Terminology used in the* Guide

10. The following paragraphs explain the meaning and use of certain expressions that appear frequently in the *Guide*. For terms not mentioned below, such as technical terms used in financial and business management writings, the reader is advised to consult other sources of information on the subject, such as the *Guidelines for Infrastructure Development through Build-Operate Transfer (BOT) Projects* prepared by the United Nations Industrial Development Organization (UNIDO).[2]

(a) "Public infrastructure" and "public services"

11. As used in the *Guide*, the expression "public infrastructure" refers to physical facilities that directly or indirectly provide or house services essential to the public. Examples of public infrastructure in this sense may be found in various sectors and include various types of facility, equipment or system: power generation plants and power distribution networks (electricity sector); systems for local and long-distance telephone communications and data transmission networks (telecommunications sector); desalination plants, waste water treatment plants, water distribution facilities (water sector); facilities and equipment for waste collection and disposal (sanitation sector); and physical installations and systems used for public transportation, such as urban and inter-urban railways, underground trains, bus lines, roads, bridges, tunnels, ports, airlines and airports (transportation sector). The term "infrastructure" also covers facilities or systems – whether or not open or accessible to the public – that the Government or other public authorities require for their own functions (court houses, office buildings) or facilities that house public services such as schools, health-care facilities or correctional institutions.

12. The line between publicly and privately owned infrastructures must be drawn by each country as a matter of public policy. In some countries, the Government, for instance, owns airports, in others they are privately owned but subject to regulation or to the terms of an agreement with the competent public authority. Hospital and medical facilities, as well as prison and correctional facilities, may be in public or private hands, depending on the country's preferences. Often, but not always, power and telecommunication facilities are operated by private entities, but distribution remains in the public sector. No view is expressed in the *Guide* as to where the line should be drawn in a particular country.

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[2] UNIDO publication, Sales No. UNIDO.95.6.E, hereafter referred to as the *UNIDO BOT Guidelines*.

13. The notions of public infrastructure and public services are well established in the legal tradition of some countries, being sometimes governed by a specific body of public law, known as "administrative law" (see chap. VII, "Other relevant areas of law", paras. 25–28). However, in a number of other countries, apart from being subject to special regulations, public services are not regarded as being intrinsically distinct from other types of business. As used in the *Guide*, the expressions public services and public service providers should not be understood in a technical sense that may be attached to them under any particular legal system.

(b) "Public Private Partnership", "(PPP)" and related expressions

14. The term "Public Private Partnership" (PPP) is used in practice to refer to a wide variety of contractual arrangements or joint ventures through which the public and private sector cooperate towards a common purpose, and there is no internationally acknowledged legal definition covering all possible variants. The *Guide* uses the term PPPs to specifically refer to long-term arrangements between public authorities and private entities contributing to the private financing of public infrastructure in the broad sense indicated in para. 11 above.

15. PPPs are not a special new category of Government contracts. In fact, PPPs may use various well-known contractual structures (leases, concessions, services contracts, turnkey contracts, design-build-finance-operate contracts). PPP arrangements covered by the *Guide* may be divided into two broad categories. Firstly, the *Guide* covers PPPs in which the private partner operates the infrastructure and charges a price to the public under a licence or "concession" (see para. 18) issued by the Government (also known as "concession-PPPs"). Secondly, the *Guide* covers PPPs in which the private partner undertakes some work in connection with an infrastructure or facility (ranging from design and construction, renovation, expansion, maintenance or management, any contribution thereof) or services system (information or telecommunication, customer services) but does not charge any fees directly to the public, receiving instead payments from the contracting authority or other governmental agency ("non-concession PPPs").

16. The latter situation resembles what in some legal systems is known as "partnership for infrastructure" or "partnership contract", an innovative arrangement that allows for work or services to be procured against payment over the life of the contract, without upfront commitment of public funds. Under these arrangements, the private partner typically undertakes the financing and the construction of an infrastructure facility and transfers it after completion to the contracting authority or its designee. This arrangement is most often used for construction of a facility to host a public service provided directly by the contracting authority, whereas the private partner remains responsible for the operation and maintenance of the facility for the entire duration of the PPP agreement. Regardless of the type of

arrangement, the *Guide* generally refers to the public authority that enters into a PPP as the "*contracting authority*", and to the private entity that carries out a PPP project as the "*private partner*". The agreement between contracting authority and private partner, which that sets forth the scope, terms and conditions of the PPP project is referred to in the *Guide* as the "*PPP contract*".

17. Where the context so requires, the *Guide* uses sometimes the term "project company" to refer specifically to an independent legal entity established for carrying out a particular PPP project.

(c) "Concession" and related expressions

18. In many countries, the provision of a "*public service*" by an entity other than a public authority typically requires an act of authorization by the appropriate governmental body. Different expressions are used to define such acts of authorization under national laws and in some legal systems; various expressions may be used to denote different types of authorization. Commonly used expressions include terms such as "concession", "franchise", "licence" or "lease" ("*affermage*"). In some legal systems, in particular those belonging to the civil law tradition, certain forms of infrastructure projects are classified in well-defined categories (such as "public works concession" or "public service concession"). Where the context so requires, the *Guide* uses the word "concession" to refer generally to this act of authorization, but not in the technical sense that may be attached to it under any particular legal system or domestic law.

19. When the context requires, the *Guide* uses the word "concessionaire" to refer specifically to an entity that carries out an infrastructure project under a concession issued by a public authority of the host country. Other expressions that may be used in some legal systems to refer to some forms of PPP agreements, such as "concession agreement" or "concession contract", are not used in the *Guide*.

(d) References to national authorities

20. As used in the *Guide*, the word "Government" encompasses the various public authorities of the host country entrusted with executive or policy-making functions, at the national, provincial or local level. The expression "public authorities" is used to refer, in particular, to entities of, or related to, the executive branch of the Government. The expressions "legislature" and "legislator" are used specifically with reference to the organs that exercise legislative functions in the host country.

21. The expression "contracting authority" is generally used in the *Guide* to refer to the public authority of the host country that has the overall responsibility for the project and on behalf of which the project is awarded. Such authority may be national, provincial or local (see below, paras. 71–72).

22. The expression "regulatory agency" is used in the *Guide* to refer to the public authority that is entrusted with the power to issue and enforce rules and regulations governing the development and the operation of the project. The regulatory agency may be established by statute with the specific purpose of regulating a particular public infrastructure sector.

(e) "Build-operate-transfer" and related expressions

23. The various types of projects referred to in this *Guide* as PPPs are sometimes divided into several categories, according to the type of private participation or the ownership of the relevant infrastructure, for example, as indicated below (see also the discussion of modalities of private sector participation in PPPs in paras. 48–55):

(a) Build-operate-transfer (BOT). A project is said to be a BOT project when the contracting authority selects a private partner to finance and construct an infrastructure facility or system and gives the private entity the right to maintain and/or operate it commercially for a certain period, at the end of which the ownership of the facility is transferred to the contracting authority;

(b) Build-transfer-operate (BTO). A project is said to be a BTO when the contracting authority selects a private partner to plan, finance, design and build an infrastructure facility or system that immediately becomes the property of the contracting authority upon its completion, but the private partner retains the right to maintain and operate the facility for a certain period;

(c) Build-rent-operate-transfer (BROT) or "build-lease-operate-transfer" (BLOT). These are variations of BOT or BTO projects where, in addition to the obligations and other terms usual to BOT projects, the private partner rents to the contracting authority the physical assets on which the facility is located for the duration of the agreement and undertakes to maintain and operate it;

(d) Build-own-operate-transfer (BOOT). These are projects in which a private partner is engaged for the planning, financing, design, construction, operation and maintenance of a given infrastructure facility in exchange for the right to collect fees and other charges from its users. Under this arrangement, the private entity owns the facility and its assets until it is transferred to the contracting authority;

(e) Build-own-operate (BOO). This expression refers to projects where the private partner owns the facility permanently and is not under an obligation to transfer it back to the contracting authority.

24. Besides acronyms used to highlight the particular ownership regime, other acronyms may be used to emphasize one or more of the obligations of the private partner. In some projects, existing infrastructure facilities are turned over to private

entities to be modernized or refurbished, operated and maintained, permanently or for a given period. Depending on whether the private partner will own such an infrastructure facility, those arrangements may be called either "refurbish-operate-transfer" (ROT) or "modernize-operate transfer" (MOT), in the first case, or "refurbish-own-operate" (ROO) or "modernize-own-operate" (MOO), in the latter. The expression "design-build-finance-operate" (DBFO) is sometimes used to emphasize the private partner's additional responsibility for designing the facility and financing its construction.

B. Background information on PPPs

25. In most of the countries that have built new infrastructure through private investment, PPPs are an important tool to meet national infrastructure needs. Essential elements of national policies include the level of competition sought for each infrastructure sector, the way in which the sector is structured and the mechanisms used to ensure adequate functioning of infrastructure or public services markets. National policies to promote private investment in infrastructure are often accompanied by measures destined to introduce competition between public service providers or to prevent abuse of monopolistic conditions where competition is not feasible.

26. In devising programmes to promote private sector investment in the development and operation of public infrastructure and services, a number of countries have found it useful to review the assumptions under which public sector monopolies were established, including the historical circumstances and political conditions that had led to their creation, with a view to:

(a) Identifying those activities that still maintain the characteristics of natural monopoly; and

(b) Assessing the feasibility and desirability of introducing competition in certain infrastructure sectors.

1. Private investment and infrastructure policy

27. The measures that may be required to implement a governmental policy to promote competition in various infrastructure sectors will depend essentially on the prevailing market structure. The main elements that characterize a particular market structure include barriers to the entry of competitors of an economic, legal, technical or other nature, the degree of vertical or horizontal integration, the number of companies operating in the market, as well as the availability of substitute products or services.

(a) Competition policy and monopolies

28. The term "monopoly" in the strict sense refers to a market with only one supplier. However, pure monopoly and perfect competition mark two ends of a spectrum. Most markets for commodities or services are characterized by a degree of competition that lies between those two extremes. Generally, monopolies can be classified as natural monopolies, legal monopolies and de facto monopolies; each of them may require different policy approaches:

(a) *Natural monopolies.* These economic activities allow a single provider to supply the whole market at a lower cost than two or more providers. This situation is typical for economic activities that entail large investment and high fixed costs, but decreasing costs of producing an additional unit of services (for example, an additional cubic metre of water) to attend an increase of demand. Natural monopolies tend to exhibit large upfront fixed investment requirements that make it difficult for a new company, lacking comparable economies of scale, to enter the market and undercut the incumbent;

(b) *Legal monopolies.* Legal monopolies are established by law and may cover sectors or activities that are or are not natural monopolies. In the latter category, monopolies exist solely because competition is prohibited. The developments that led many countries to the establishment of legal monopolies were often based on the consideration that national infrastructure needs, in terms of both quality and quantity, could not be adequately met by leaving infrastructure to the free market;

(c) *De facto monopolies.* These monopolies may not necessarily be the result of economic fundamentals or of legal provisions, but simply of the absence of competition, resulting, for example, from the integrated nature of the infrastructure company and its ability to control essential facilities to the exclusion of other suppliers.

29. Although monopolies are sometimes justified on legal, political or social grounds, they may produce negative economic effects. A service provider operating under monopolistic conditions is typically able to fix prices above those that would be charged in competitive conditions. The surplus profit that results from insufficient competition implies a transfer of wealth from consumers to producers. Monopolies have also been found to cause a net loss of welfare to the economy because of inflated prices generated by artificially low production, a reduced rate of innovation and insufficient efforts to reduce production costs. Furthermore, in particular in infrastructure sectors, there may be secondary effects on other markets. (For example, lack of competition and efficiency in telecommunications has negative repercussions through increases in cost for the economy at large.)

30. Despite their negative economic effects, monopolies and other regulatory barriers to competition have sometimes been maintained in the absence of natural monopoly conditions. One of the reasons cited for retaining monopolies is that

they may be used to foster certain policy objectives, such as ensuring the provision of services in certain regions or to certain categories of consumer at low prices or even below cost. Examples of services for which the price may not cover costs include lifeline telephone, water or power services, discounted transport for certain categories of traveller (for example, schoolchildren or senior citizens), as well as other services for low-income or rural users. A monopolistic service provider is able to finance the provision of such services through internal “cross-subsidies” from other profitable services provided in other regions or to other categories of consumer.

31. Another reason sometimes cited for retaining legal monopolies in the absence of natural monopoly conditions is to make the sector more attractive to private investors. Private operators may insist on being granted exclusivity rights to provide a certain service to reduce the commercial risk of their investment. However, that objective has to be balanced against the interests of consumers and the economy as a whole. For those countries where the granting of exclusivity rights is found to be needed as an incentive to private investment, it may be advisable to consider restricting competition, though on a temporary basis only (see chap. II, “Project planning and preparation”, paras. 21–22).

(b) Scope for competition in different sectors

32. Until recently, monopolistic conditions prevailed in most infrastructure sectors either because the sector was a natural monopoly or because of regulatory barriers or other barriers to entry or operation (for example, vertically integrated structure of public service providers) prevented effective competition. However, a number of factors, such as technological progress and innovation, the growing need for infrastructure funding and financing, limited government revenues and the need to develop and operate public infrastructure more efficiently, have broadened the potential scope for competition in infrastructure sectors, prompting legislators and regulators in most countries to promote competition in various infrastructure sectors by adopting legislation that abolishes monopolies and other barriers to entry, changes the way infrastructure sectors are organized and establishes a regulatory framework that fosters effective competition. The extent to which meaningful competition is possible depends on the sector, the size of the market and other factors.

2. Restructuring of infrastructure sectors

33. In many countries, private participation in infrastructure development has followed the introduction of measures to restructure infrastructure sectors. Legislative action typically begins with the abolition of rules that prohibit private participation in infrastructure and the removal of all other legal impediments to competition that cannot be justified by reasons of public interest. It should be noted, however,

that the extent to which a particular sector may be opened to competition is a decision that is taken in the light of the country's overall economic policy. Some countries, in particular developing countries, might have a legitimate interest in promoting the development of certain sectors of local industry and might thus choose not to open certain infrastructure sectors to competition.

34. For monopolistic situations resulting from legal prohibitions rather than economic and technological fundamentals, the main legislative action needed to introduce competition is the removal of the existing legal barriers. This may need to be reinforced by rules of competition (such as the prohibition of collusion, cartels, predatory pricing or other unfair trading practices) and regulatory oversight (see chap. I, "General legal and institutional framework", paras. 37–60). For a number of activities, however, effective competition may not be obtained through the mere removal of legislative barriers without legislative measures to restructure the sector concerned. In some countries, monopolies have been temporarily maintained only for the time needed to facilitate a gradual, more orderly and socially acceptable transition from a monopolistic to a competitive market structure.

(a) Unbundling of infrastructure sectors

35. Vertical or horizontal integration[3] of market players, including infrastructure companies, can significantly lessen competition in a market. Integrated companies might abuse their position in a market by weeding out competitors or excluding others from entering the market. The anticompetitive impact of this situation is compounded by the presence of monopolistic elements in some infrastructure services, such as the single rail or road infrastructure. At the same time, however, integration can also enhance efficiency, thereby promoting competition. As such, a case-by-case economic assessment is generally required to determine whether particular type or level of integration is on balance favourable or detrimental to competition. In any event, given the difficulty for some types of infrastructure to allow competition, some countries have found it necessary to separate the monopolistic element (for example, the electrical grid used to supply electricity) from competitive elements in given infrastructure sectors (for example, energy production).

36. However, the costs and benefits of such changes need to be considered carefully. Costs may include those associated with the change itself (for example, transaction and transition costs, including the loss incurred by companies that lose benefits or protected positions as a result of the new scheme) and those resulting from the operation of the new scheme, in particular higher coordination costs

[3] Vertical integration is the common control of two businesses that are at different stages of production – for example, a manufacturer of electrical equipment and a firm providing engineering and installation of electrical networks. Horizontal integration is the merging together of businesses that are at the same stage of production, such as two transportation companies.

resulting, for example, from more complicated network planning, technical standardization or regulation. Benefits, on the other hand, may include new investments, better or new services, more choice and lower economic costs.

(b) Recent experience in major infrastructure sectors

(i) Electricity

37. Electricity laws recently enacted in various countries call for the unbundling of the power sector by separating generation, transmission and distribution. In some cases, supply is further distinguished from distribution in order to leave only the monopolistic activity (that is, the transport of electricity for public use over wires) under a monopoly. In those countries, the transmission and distribution companies do not buy or sell electricity but only transport it against a regulated fee. Trade in electricity occurs between producers or brokers on the one hand and users on the other. In some of the countries concerned, competition is limited to large users only or is being phased in gradually.

38. Where countries have opted for the introduction of competition in the power and gas sectors, new legislation has organized the new market structure, stipulating to what extent the market had to be unbundled (sometimes including the number of public service providers to be created out of the incumbent monopoly), or removed barriers to new entry. The same energy laws have also established specific competition rules, whether structural (for example, prohibition of cross-ownership between companies in different segments of the market, such as production, transmission and distribution, or gas and electricity sale and distribution) or behavioural (for example, third-party access rules, prohibition of alliances or other collusive arrangements). New institutions and regulatory mechanisms, such as power pools, dispatch mechanisms or energy regulatory agencies, have been established to make the new energy markets work. Finally, other aspects of energy law and policy have had to be amended in conjunction with these changes, including the rules governing the markets for oil, gas, coal and other energy sources.

(ii) Water and sanitation

39. The most common market structure reform introduced in the water and sanitation sector is horizontal unbundling. Some countries have created several water utilities where a single one existed before. This is particularly common in, but is not limited to, countries with separate networks that are not or are only slightly interconnected. In practice, it has been found that horizontal unbundling facilitates comparison of the performance of service providers.

40. Some countries have invited private investors to provide bulk water to a utility or to build and operate water treatment or desalination plants, for example. In such

vertical unbundling, the private services (and the discrete investments they require) are usually rendered under contract to a utility and do not fundamentally modify the monopolistic nature of the market structure: the plants usually do not compete with each other and are usually not allowed to bypass the utility to supply customers. A number of countries have introduced competition in bulk water supply and transportation; in some cases, there are active water markets. Elsewhere, competition is limited to expensive bottled or trucked water and private wells.

(iii) Transport

41. In the restructuring measures taken in various countries, a distinction is made between transport infrastructure and transport services. The former may often have natural monopoly characteristics, whereas services are generally competitive. Competition in transport services should be considered not only within a single mode but also across modes, since trains, trucks, buses, airlines and ships tend to compete for passengers and freight.

42. With respect to railways, some countries have opted for a separation between the ownership and operation of infrastructure (for example, tracks, signalling systems and train stations) on the one hand and of rail transport services (for example, passenger and freight) on the other. In such schemes, the law does not allow the track operator also to operate transport services, which are operated by other companies often in competition with each other. Other countries have let integrated companies operate infrastructure as well as services, but have enforced third-party access rights to the infrastructure, sometimes called "trackage rights". In these cases, transport companies, whether another rail line or a transport service company, have right of access to the track on certain terms and the company controlling the track has the obligation to grant such access.

43. In many countries, ports were until recently managed as public sector monopolies. When opening the sector to private participation, legislators have considered different models. Under the landlord-port system, the port authority is responsible for the infrastructure as well as overall coordination of port activities; it does not, however, provide services to ships or merchandise. In service ports, the same entity is responsible for infrastructure and services. Competition between service providers (for example, tugboats, stevedoring and warehousing) may be easier to establish and maintain under the landlord system.

44. Legislation governing airports may also require changes, whether to allow private investment or competition between or within airports. Links between airport operation and air traffic control may also need to be considered carefully. Within airports, many countries have introduced competition in handling services, catering and other services to planes, as well as in passenger services such

as retail shops, restaurants, parking and the like. In some countries, the construction and operation of a new terminal at an existing airport has been entrusted to a new operator, thus creating competition between terminals. In others, new airports have been built on a BOT basis and existing ones transferred to private ownership.

(c) Transitional measures

45. The transition from monopoly to market requires careful management. Political, social or other factors have led some countries to pursue a gradual or phased approach to implementation. As technology and other outside forces are constantly changing, some countries have adopted sector reforms that could be accelerated or adjusted to take those changing circumstances into account.

46. Some countries have felt that competition should not be introduced at once. In such cases, legislation has provided for temporary exclusivity rights, limitation in the number of public service providers or other restrictions on competition. Those measures are designed to give the incumbent adequate time to prepare for competition and to adjust prices, while giving the public service provider adequate incentives for investment and service expansion. Other countries have included provisions calling for the periodic revision (at the time of price reviews, for example) of such restrictions with a view to ascertaining whether the conditions that justified them at the time when they were introduced still prevail.

47. Another transitional measure, at least in some countries with government owned public service providers, has been the restructuring or privatization of the incumbent service provider. In most countries where State-owned enterprise providing public services have been privatized, liberalization has mostly either accompanied or preceded privatization. Some countries have proceeded otherwise and have privatized companies with significant exclusivity rights, often to increase privatization proceeds. They have, however, found it difficult and sometimes very expensive to remove, restrict or shorten at a later stage the exclusive rights or monopolies protecting private or privatized public service providers.

3. Forms of private sector participation in PPP projects

48. PPPs may be devised in a variety of different forms, ranging from publicly owned and operated infrastructure to fully privatized projects. The appropriateness of a particular variant for a given type of infrastructure or service is a matter to be considered by the Government in view of the national needs for infrastructure and service development and an assessment of the most efficient ways in which particular types of infrastructure and services facilities may be developed and operated. In a particular sector, more than one option may be used.

(a) Public ownership and public operation

49. In cases where public ownership and control is desired, direct private financing as well as infrastructure and service operation under commercial principles may be achieved by establishing a separate legal entity controlled by the Government to own and operate the project. Such an entity may be managed as an independent private commercial enterprise that is subject to the same rules and business principles that apply to private companies. Some countries have a well-established tradition in operating infrastructure facilities through these types of companies. Opening the capital of such companies to private investment or making use of such a company's ability to issue bonds or other securities may create an opportunity for attracting private investment in infrastructure.

50. Another form of involving private participation in publicly owned and operated infrastructure may be the negotiation of "service contracts" whereby the public operator contracts out specific operation and maintenance activities to the private sector. The Government may also entrust a broad range of operation and maintenance activities to a private entity acting on behalf of the contracting authority. Under such an arrangement, which is sometimes referred to as a "management contract", the private operator's compensation may be linked to its performance, often through a profit-sharing mechanism, although compensation on the basis of a fixed fee may also be used, in particular where the parties find it difficult to establish mutually acceptable mechanisms to assess the operator's performance.

(b) Public ownership and private operation

51. Alternatively, the whole operation of public infrastructure and service facilities may be transferred to private entities. One possibility is to give the private entity, usually for a certain period, the right to use a given facility, to supply the relevant services and to collect the revenue generated by that activity. Such a facility may already be in existence or may have been specially built by the private entity concerned. This combination of public ownership and private operation has the essential features of arrangements that in some legal systems may be referred to as "public works concessions" or "public service concessions".

52. Another form of PPP is where a private entity is selected by the contracting authority to operate a facility that has been built by or on behalf of the Government, or whose construction has been financed with public funds. Under such an arrangement, the operator assumes the obligation to operate and maintain the infrastructure and is granted the right to charge for the services it provides. In such a case, the operator assumes the obligation to pay to the contracting authority a portion of the revenue generated by the infrastructure that is used by the contracting authority to amortize the construction cost. Such arrangements are referred to in some legal systems as "lease" or "*affermage*".

(c) Private ownership and operation

53. Under the third approach, the private entity not only operates the facility, but also owns the assets related to it. Here, too, there may be substantial differences in the treatment of such projects under domestic laws, for instance as to whether the contracting authority retains the right to reclaim title to the facility or to assume responsibility for its operation (see also chap. IV, "PPP implementation: legal framework and PPP contract", paras. 22–28).

54. Where the facility is operated pursuant to a governmental licence, private ownership of physical assets (for example, a telecommunication network) is often separable from the licence to provide the service to the public (for example, long-distance telephone services), in that the licence can be withdrawn by the competent public authority under certain circumstances. Thus, private ownership of the facility may not necessarily entail an indefinite right to provide the service.

55. There are also PPP schemes that separate the management of the facility from the provision of services to the public. These types of PPPs are typically used for the construction, expansion, refurbishment or management of facilities used non-merchant sectors (that is, not related to the remunerated provision of goods or services to the public), in connection with less profitable public activities. In those arrangements, the responsibility in providing the public service itself is not delegated to the private partner but remains in the hands of the contracting authority or other Government entity. As the private partner is not charging a fee or toll for the use of the facility by the public, the only or the main source of remuneration comes from the contracting authority or other Government entity.

4. Financing structures and sources of finance for PPPs

(a) Notion of project finance

56. Large-scale PPP projects involving the construction of new infrastructure facilities are often carried out by new corporate entities specially established for that purpose by the project promoters. Such a new entity, often called a "project company", becomes the vehicle for raising funds for the project. Because the project company lacks an established credit or an established balance sheet on which the lenders can rely, the preferred financing modality for the development of new infrastructure is called "project finance". In a project finance transaction, credit will be made available to the extent that the lenders can be satisfied to look primarily to the project's cash flow and earnings as the source of funds for the repayment of loans taken out by the project company. Other guarantees either are absent or cover only certain limited risks. To that end, the project's assets and revenue, and the rights and obligations relating to the project, are independently estimated and are strictly separated from the assets of the project company's shareholders.

57. Project finance is also said to be "non-recourse" financing, owing to the absence of recourse to the project company's shareholders. In practice, however, lenders are seldom ready to commit the large amounts needed for infrastructure projects solely on the basis of a project's expected cash flow or assets. The lenders may reduce their exposure by incorporating into the project documents a number of back-up or secondary security arrangements and other means of credit support provided by the project company's shareholders, the Government, purchasers or other interested third parties. This modality is commonly called "limited recourse" financing.

(b) Financing sources for PPP projects

58. Alternatives to traditional public financing are playing an increasing role in the development of infrastructure. In recent years, new infrastructure investment in various countries has included projects with exclusively or predominantly private funding sources. The two main types of fund are debt finance, usually in the form of loans obtained on commercial markets, and equity investment. However, financing sources are not limited to these.

(i) Equity capital

59. Equity capital for PPPs is provided in the first place by the project promoters or other individual investors interested in taking stock in the project company. However, such equity capital normally represents only a portion of the total cost of an infrastructure project. In order to obtain commercial loans or to have access to other sources of funds to meet the capital requirements of the project, the project promoters and other individual investors have to offer priority payment to the lenders and other capital providers, thus accepting that their own investment will only be paid after payment of those other capital providers. Therefore, the project promoters typically assume the highest financial risk. At the same time, they will hold the largest share in the project's profit once the initial investment is paid. Substantial equity investment by the project promoters is typically welcomed by the lenders and the Government, as it helps reduce the burden of debt service on the project company's cash flow and serves as an assurance of those companies' commitment to the project.

(ii) Commercial loans

60. Debt capital often represents the main source of funding for PPPs. Financial markets provide debt capital primarily by means of loans extended to the project company by national or foreign commercial banks, typically using funds that originate from short to medium-term deposits remunerated by those banks at floating interest rates. Consequently, loans extended by commercial banks are often subject to floating interest rates and normally have a maturity term shorter than the project

period. However, where feasible and economic, given financial market conditions, banks may prefer to raise and lend medium to long-term funds at fixed rates, so as to avoid exposing themselves and the project company over a long period to interest rate fluctuations, while also reducing the need for hedging operations. Commercial loans are usually provided by lenders on condition that their payment takes precedence over the payment of any other of the borrower's liabilities. Therefore, commercial loans are said to be "unsubordinated" or "senior" loans.

(iii) "Subordinated" debt

61. The third type of fund typically used in these projects are "subordinated" loans, sometimes also called "mezzanine" capital. Such loans rank higher than equity capital in order of payment but are subordinate to senior loans. This subordination may be general (that is, ranking generally lower than any senior debt) or specific, in which case the loan agreements specifically identify the type of debt to which it is subordinated. Subordinated loans are often provided at fixed rates, usually higher than those of senior debt are. As an additional tool to attract such capital, or sometimes as an alternative to higher interest rates, providers of subordinated loans may be offered the prospect of direct participation in capital gains, by means of the issue of preferred or convertible shares or debentures, sometimes providing an option to subscribe for shares of the project company at preferential prices.

(iv) Institutional investors

62. In addition to subordinated loans provided by the project promoters or by public financial institutions, subordinated debt may be obtained from financing companies, investment funds, insurance companies, collective investment schemes (for example, mutual funds), pension funds and other so-called "institutional investors". These institutions normally have large sums available for long-term investment and may represent an important source of additional capital for PPPs. Their main reasons for accepting the risk of providing capital to PPP projects are the prospect of remuneration and interest in diversifying investment.

(v) Capital market funding

63. PPP projects also use capital market funding. Funds may be raised by the placement of preferred shares, bonds and other negotiable instruments on a recognized stock exchange. Typically, the public offer of negotiable instruments requires regulatory approval and compliance with requirements of the relevant jurisdiction, such as requirements concerning the information to be provided in the prospectus of issuance and, in some jurisdictions, the need for prior registration. Bonds and other negotiable instruments may have no other security than the general credit of the issuer or may be secured by a mortgage or other lien on specific property.

64. Access to capital markets is usually greater for existing public utilities with an established commercial record than for companies specially established to build and operate a new infrastructure and lacking the required credit rating. Indeed, a number of stock exchanges require that the issuing company have some established record over a certain minimum period before being permitted to issue negotiable instruments.

(vi) Financing by Islamic financial institutions

65. One additional group of potential capital providers are Islamic financial institutions. Those institutions operate under rules and practices derived from the Islamic legal tradition. One of the most prominent features of banking activities under their rules is the absence of interest payments or strict limits to the right to charge interest and consequently the establishment of other forms of consideration for the borrowed money, such as profit-sharing or direct participation of the financial institutions in the results of the transactions of their clients. As a consequence of their operating methods, Islamic financial institutions may be more inclined than other commercial banks to consider direct or indirect equity participation in a project.

(vii) Financing by international financial institutions

66. International financial institutions may also play a significant role as providers of loans, guarantees or equity to PPPs. A number of projects have been co-financed by the World Bank, the International Finance Corporation or by regional development banks, which actively promote the form of PPP to conduct such projects.

67. International financial institutions may also play an instrumental role in the formation of "syndications" for the provision of loans to the project. Some of those institutions have special loan programmes under which they become the sole "lender of record" to a project, acting on its own behalf and on behalf of participating banks and assuming responsibility for processing disbursements by participants and for subsequent collection and distribution of loan payments received from the borrower, either pursuant to specific agreements or based on other rights that are available under their status of preferred creditor. Some international financial institutions may also provide equity or mezzanine capital, by investing in capital market funds specialized in securities issued by infrastructure operators. Lastly, international financial institutions may provide guarantees against a variety of political risks, which may facilitate the project company's task of raising funds in the international financial market (see chap. II, "Project planning and preparation", paras. 87–98).

(viii) Support by export credit and investment promotion agencies

68. Export credit and investment promotion agencies may provide support to the project in the form of loans, guarantees or a combination of both. The participation

of export credit and investment promotion agencies may provide a number of advantages, such as lower interest rates than those applied by commercial banks and longer-term loans, sometimes at a fixed interest rate (see chap. II, "Project planning and preparation", paras. 99–101).

(ix) Combined public and private finance

69. In addition to loans and guarantees extended by commercial banks and national or multilateral public financial institutions, in a number of cases public funds have been combined with private capital for financing PPP projects. Such public funds may originate from government income or sovereign borrowing. They may be combined with private funds as initial investment or as long-term payments, or may take the form of governmental grants or guarantees. Infrastructure projects may be co-sponsored by the Government through equity participation in the project company, thus reducing the amount of equity and debt capital needed from private sources (see chap. II, "Project planning and preparation", paras. 66 and 67).

5. Main parties involved in implementing PPP projects

70. The parties to a PPP project may vary greatly, depending on the sector, the modality of private sector participation and the arrangements used for financing the project. The following paragraphs identify the main parties in the implementation of a typical PPP project involving the construction of a new infrastructure facility and carried out under the "project finance" modality.

(a) Contracting authority and other public authorities

71. The execution of a PPP frequently involves a number of public authorities in the host country at the national, provincial or local level. The contracting authority is the main body responsible for the project within the Government. Furthermore, the implementation of the project may require active participation (for example, for the issuance of licences or permits) of other public authorities in addition to the contracting authority, at the same or at a different level of Government. Those authorities play a crucial role in the execution of PPPs.

72. The contracting authority or another public authority normally identifies the project pursuant to its own policies for infrastructure development in the sector concerned (see generally, chap. II, "Project planning and preparation") and determines the type of private sector participation that would allow the most efficient operation of the infrastructure facility (see above, paras. 48–55). Thereafter, the contracting authority conducts the process that leads to the award of the contract to the selected private partner (see chap. III, "Contract award"). Furthermore, throughout the life of the project, the Government may need to provide various forms of support – legislative, administrative, regulatory and sometimes financial

– so as to ensure that the facility is successfully built and adequately operated (see chap. II, “Project planning and preparation”, paras. 56–86). Finally, in some projects the Government may become the ultimate owner of the facility.

(b) Project company and project promoters

73. PPPs are usually carried out by a joint venture of companies including construction and engineering companies and suppliers of heavy equipment interested in becoming the main contractors or suppliers of the project. The companies that participate in such a joint venture are referred to in the *Guide* as the “promoters” of the project. Those companies will be intensively involved in the development of the project during its initial phase and their ability to cooperate with each other and to engage other reliable partners will be essential for timely and successful completion of the work. Furthermore, the participation of a company with experience in operating the type of facility being built is an important factor to ensure the long-term viability of the project. Where, as in most of the projects, an independent legal entity is established by the project promoters, other equity investors not otherwise engaged in the project (usually institutional investors, investment banks, bilateral or multilateral lending institutions, sometimes also the Government or a government-owned corporation) may also participate. The participation of local investors, where the project company is required to be established under the laws of the host country (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. 13–20), is sometimes encouraged by the Government.

(c) Lenders

74. The risks to which the lenders are exposed in project finance, be it non-recourse or limited recourse, are considerably higher than in conventional transactions. This is even more the case where the security value of the physical assets involved (for example, a road, bridge or tunnel) is difficult to realize, given the lack of a “market” where such assets could easily be sold, or act as obstacles to recovery or repossession. This circumstance affects not only the terms under which the loans are provided (for example, the usually higher cost of project finance and extensive conditions to funding), but also, as a practical matter, the availability of funds.

75. Owing to the magnitude of the investment required for a PPP project, loans are often organized in the form of “syndicated” loans with one or more banks taking the lead role in negotiating the finance documents on behalf of the other participating financial institutions, mainly commercial banks. Commercial banks that specialize in lending for certain industries are typically not ready to assume risks with which they are not familiar (for a discussion of project risks and risk allocation, see chap. II, “Project planning and preparation”, paras. 23–45). For example, long-term lenders may not be interested in providing short-term loans to finance infrastructure construction. Therefore, in large-scale projects, different lenders are often involved at

different phases of the project. With a view to avoiding disputes that might arise from conflicting actions taken by individual lenders or disputes between lenders over payment of their loans, lenders extending funds to large projects sometimes do so under a common loan agreement. Where various credit facilities are provided under separate loan agreements, the lenders will typically negotiate a so-called "inter-creditor agreement". An inter-creditor agreement usually contains provisions dealing with matters such as provisions for disbursement of payments, pro rata or in a certain order of priority; conditions for declaring events of default and accelerating the maturity of credits; and coordination of foreclosure on security provided by the project company. Key elements of the legal protection required by lenders are also discussed in chapter IV "PPP implementation: legal framework and PPP contract", Section E (Security interests), subsection 2 (Security interests in intangible assets) and in chapter VII, "Other relevant areas of law", Section B (Other relevant areas of law), subsection 3 (Security interests).

(d) International financial institutions and export credit and investment promotion agencies

76. International financial institutions and export credit and investment promotion agencies will have concerns of generally the same order as other lenders to the project. In addition to this, they will be particularly interested in ensuring that the project execution and its operation are not in conflict with particular policy objectives of those institutions and agencies. Increasing emphasis is being given by international financial institutions to the environmental impact of infrastructure projects and their long-term sustainability. The methods and procedures applied to select the private partner will also be carefully considered by international financial institutions providing loans to the project. Many global and regional financial institutions and national development funding agencies have established guidelines or other requirements governing procurement with funds provided by them, which is typically reflected in their standard loan agreements (see also chap. III, "Contract award", para. 17; see also *UNCITRAL Model Law on Public Procurement*).

(e) Insurers

77. Typically, an infrastructure project will involve casualty insurance covering its plant and equipment, third-party liability insurance and worker's compensation insurance. Other possible types of insurance include insurance for business interruption, interruption in cash flows and cost overrun (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 128 and 129). Those types of insurance are usually available on the commercial insurance markets, although the availability of commercial insurance may be limited in respect of extraordinary events outside the control of the parties (for example, war, riots, vandalism, earthquakes or hurricanes). The private insurance market is playing an

increasing role in coverage against certain types of political risk, such as contract repudiation, failure by a public authority to perform its contractual obligations or unfair calls for independent guarantees. In some countries, insurance underwriters structure comprehensive insurance packages aimed at avoiding certain risks being left uncovered owing to gaps between individual insurance policies. In addition to private insurance, guarantees against political risks may be provided by international financial institutions, such as the World Bank, the Multilateral Investment Guarantee Agency and the International Finance Corporation, by regional development banks or by export credit and investment promotion agencies (see chap. II, "Project planning and preparation", paras. 87–101).

(f) Independent experts and advisers

78. Independent experts and advisers play an important role at various stages of PPPs. Experienced companies typically supplement their own technical expertise by retaining the services of outside experts and advisers, such as financial experts, international legal counsel or consulting architectural and engineering firms. Merchant and investment banks often act as advisers to project promoters in arranging the finance and in formulating the project to be implemented, an activity that, while essential to project finance, is quite distinct from the financing itself. Independent experts may advise the lenders to the project, for example, on the assessment of project risks in a specific host country. They may also assist public authorities in devising sector-specific strategies for infrastructure development and in formulating an adequate legal and regulatory framework. Furthermore, independent experts and advisers may assist the contracting authority in the preparation of feasibility and other preliminary studies, in the formulation of requests for proposals or standard contractual terms and specifications, in the evaluation and comparison of proposals or in the negotiation of the PPP contract.

79. In addition to private entities, a number of intergovernmental organizations (for example, UNIDO and the regional commissions of the Economic and Social Council) and international financial institutions (for example, the World Bank and the regional development banks) have special programmes whereby they may either provide this type of technical assistance directly to the Government or assist the latter in identifying qualified advisers.

I. General legal and institutional framework

A. General remarks

1. PPPs are one of the options that Governments may use to develop infrastructure or procure facilities or systems required for the provision of public services or for use by a public entity. An appropriate legal framework is needed to attract private investment to those projects that the Government considers worthwhile to implement as PPP. Both countries considering the adoption of new laws, and countries where such a legal framework already exists should ensure that the relevant laws and regulations are drafted clearly, comply with fundamental principles of good governance and sustainable development, and are comprehensive yet sufficiently flexible to respond to the country's infrastructure development goals and policies and to keep pace with the technology and market developments in various infrastructure sectors. This chapter deals with some general issues that domestic legislators should consider when setting up or reviewing the legal framework for PPPs in order to achieve these objectives. Section B (paras. 2–28) discusses the guiding principles and options for a legal framework for PPPs; section C (paras. 29–36) deals with the scope of authority to carry out projects as PPPs; and section D (paras. 37–60) offers an overview of institutional and procedural arrangements for the regulation of infrastructure sectors.

B. Guiding principles and options for legal framework for PPPs

2. This section considers general guiding principles that should inspire the legal framework for PPPs. It further points out the possible implications that the constitutional law of the host country may have for the implementation of some of these projects. Lastly, this section deals briefly with available options regarding the level and type of instrument that a country may need to enact and their scope of application.

1. General guiding principles for a legal framework for PPPs

3. The Sustainable Development Goals express the commitment of United Nations member States, inter alia, to "develop quality, reliable, sustainable and resilient infrastructure, including regional and transborder infrastructure, to support economic development and human well-being, with a focus on affordable and equitable access for all."[1] The legal framework for PPPs is one of the policy tools that a country may use to carry out its strategy for the development of public infrastructure and services, and should be formulated and implemented in a manner that is consistent with the country's strategy and conducive to achieving its goals.

4. Therefore, when considering the enactment of laws and regulations to enable PPPs or in reviewing the adequacy of the existing legal framework, domestic legislators and regulators may wish to take into account some internationally recognized principles of good governance and sustainable development. The United Nations General Assembly, for instance, has recognized "the importance of fair, stable and predictable legal frameworks for generating inclusive, sustainable and equitable development, economic growth and employment, generating investment and facilitating entrepreneurship".[2] Similarly, in article 5, paragraph 1, of the nearly universally adopted United Nations Convention against Corruption,[3] the States Parties undertake to "develop and implement or maintain effective, coordinated anti-corruption policies that promote the participation of society and reflect the principles of the rule of law, proper management of public affairs and public property, integrity, transparency and accountability". These and other principles more specifically aimed at deriving most benefit of PPPs, which have inspired legislative actions in various countries, are discussed briefly in the following paragraphs.

(a) Public interest

5. As PPPs are a tool for the implementation of a country's strategies and policies for developing infrastructure and public services, the PPP legal framework must promote and protect the public interest. In the context of PPPs, public interest refers, on the one hand, to the interests of the Government as provider and regulator of infrastructure and public services, and, on the other hand, as purchaser, user

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[1] *Transforming our World: the 2030 Agenda for Sustainable Development* (United Nations General Assembly resolution 70/1 of 25 September 2015), Goal 9.1.

[2] "We recognize the importance of fair, stable and predictable legal frameworks for generating inclusive, sustainable and equitable development, economic growth and employment, generating investment and facilitating entrepreneurship, and in this regard we commend the work of the United Nations Commission on International Trade Law in modernizing and harmonizing international trade law." (Declaration of the High-level Meeting of the General Assembly on the Rule of Law at the National and International Levels, General Assembly resolution 67/1 of 24 September 2012).

[3] The Convention was adopted by the United Nations General Assembly resolution 58/4 of 31 October 2003 and entered into force on 14 December 2005.

and possibly owner or operator of the facilities or systems developed under the PPP, or party to the PPP contract. Each of these perspectives needs adequate consideration by the legislator. While the *Guide* focuses on the role of the contracting authority as party to the PPP contract (which is extensively discussed, in particular, in chap. IV, "PPP implementation: legal framework and PPP contract" and chap. V, "Duration, extension and termination of the PPP contract"), it also pays attention to the role of Government as infrastructure and public services regulator (see, in particular, this chapter, paras. 37–60 as well as manager and trustee of public property and resources (see, in particular, chap. III, "Contract award").

6. Public interest in the context of PPPs also refers to the interests of the country's citizens and companies as users of the infrastructure, as consumers and users of the services or goods it generates or as ultimate beneficiaries of the public services which are provided with the support of the facilities or systems developed under the PPP. Finally, it refers to communities that may be directly affected by the development or implementation of the project, particularly in the case of large infrastructure projects. From this perspective, the legislative framework for PPPs must take into account, and be coordinated with, the specific regulatory regime for the particular infrastructure or service sector (see, in particular, this chapter, paras. 37–60; and chap. IV, "PPP implementation: legal framework and PPP contract", paras. 88–106), and also general rules on consumer protection (see chap. VII, "Other relevant areas of law", paras. 50 and 51).

(b) Transparency

7. A transparent legal framework is characterized by clear and readily accessible rules and by efficient procedures for their application. Transparent rules and administrative procedures create predictability, enabling the private sector to estimate the costs and risks of an investment and thus to offer the most advantageous terms. Transparent rules and administrative procedures may also foster openness through provisions requiring the publication of administrative decisions, including, when appropriate, an obligation to state the grounds on which they are based and to disclose other information of public relevance. They also help to guard against arbitrary or improper actions or decisions by the contracting authority or its officials and thus help to promote confidence in a country's PPP programme.

8. Transparent rules and procedures offer a framework for the exercise of discretion in the implementation of PPP projects. Transparent rules and procedures limit the exercise of discretion, where appropriate, allowing it to be monitored and, where necessary, challenged. Transparent rules and administrative procedures are a key element of promoting accountability for actions or decisions taken by Government, thus supporting integrity and public confidence. A transparent set of rules and administrative procedures governing the planning and implementation

of PPP projects will facilitate the evaluation of a country's PPP programme and individual projects against their desired outcomes.

9. Transparency of rules and administrative procedures is needed throughout the life cycle of PPP projects, from planning and project development to the operation of the infrastructure and the delivery of services to citizens. A transparent legal framework for PPPs may mandate, for instance, the publication of key decisions on project implementation, including the justification for choosing a PPP in the concrete case in the light of the mandatory review and assessment of the project by the contracting authority (see chap. II, "Project planning and preparation", paras. 1–4 and 5–22). Transparency is particularly important for the award of PPP contracts, for which the *Guide* stresses five key aspects: the public disclosure of the legal framework; the publication of project opportunities; the prior determination and publication of the key terms of the contract against which offers are to be assessed; the visible conduct of the process according to the prescribed rules and procedures; and the existence of a system to monitor that the applicable rules are being followed and to enforce them if necessary (see chap. III, "Contract award", paras. 14–16, 27, 75–76, 133–143). Transparency during the operation of the infrastructure may also entail the disclosure to the public by the contracting authority or the regulatory agency of targeted information concerning the private partner, such as financial statements or performance reporting documents (see paras. 15–49; see also chap. IV, "PPP implementation: legal framework and PPP contract", paras. 103 and 104).

(c) Fairness, stability and predictability

10. Closely related to the principle of transparency is the requirement of a fair, stable and predictable legal framework for PPPs. Laws and regulations are the tools with which Governments regulate and ensure the provision of public services to their citizens. At the same time, they provide the means for public service providers and their customers to protect their rights. A fair legal framework takes into account the various (and sometimes conflicting) interests of the Government, the public service providers and their customers and seeks to achieve an equitable balance between them. The private sector's business considerations, the users' right to adequate services (both in terms of quality and price), the Government's responsibility for ensuring the continuous provision of essential services and its role in promoting national infrastructure development are but a few of the interests that deserve appropriate recognition in the law.

11. A stable legal framework is particularly important for PPPs in view of the typically long duration of infrastructure projects. The private partners need to be able to forecast and evaluate risks and possible changes in the life of the project in order to mobilize the resources needed and take the necessary steps to mitigate the consequences of anticipated risks. The contracting authority and the public, too, should be

able to rely on continuity of services and the conditions under which they are provided. Of course, the legal framework for PPPs must be capable of adaptation to meet changing needs (see para. 28; see also chap. IV, "PPP implementation: legal framework and PPP contract", paras. 88–102). However, unjustified, untimely or arbitrary changes of laws and regulations destabilize performance by the private partner, undermine the mutual trust basis needed for a successful PPP and ultimately jeopardize the Government's infrastructure and public service development goals and policies.

12. A stable legal framework for PPPs would contribute to enhancing the predictability of administrative or judicial decisions concerning the award and implementation of PPP projects. This would have positive effects for all parties involved. The private partner, for instance, would be able to plan and manage the project more efficiently if it were able to rely on a predictable outcome of various administrative procedures that are required during project implementation (construction and zoning permits, technical inspections or regulatory decisions). The contracting authority might itself be subject to the consequences of decisions by other authorities and would benefit likewise from a predictable process. The public, too, would find comfort in a system in which it could anticipate, for instance, that decisions concerning conditions for the provision of the public service, where this was the object of a PPP, would follow a predictable pattern, in accordance with the applicable laws and regulations, rather than being made out of extraneous considerations. Sound and clear rules are as much a condition to ensure predictability, as are the efficiency of the administrative procedures and the qualification and training of those responsible for enforcing the legal framework.

(d) Proper management, integrity and accountability

13. Depending on the type of project or the nature of the relevant facility or system, a PPP could involve the management of public property, the disbursement of public funds or both. Therefore, it is essential that the applicable laws and regulations set forth appropriate safeguards to prevent mismanagement, misappropriation or other forms of improper management of public property or funds. Most provisions to this effect may be found in laws and regulations that govern public property or administrative procedures, budgetary and accounting controls as well as criminal laws (see chap. VII, "Other relevant areas of law", paras. 55–57). In any event, given the magnitude of some PPP projects, the Government should satisfy itself that the relevant administrative and criminal laws will extend to PPPs, and those PPPs will not be misused to escape applicable controls. As regards specific laws on PPPs or on infrastructure sectors in which PPPs may be entered into, it is important to ensure that provisions on PPP planning, contract award, contract content and the operation of the infrastructure facility or system will promote best practices in property management of public property and funds and will not contain loopholes that encourage improper conduct.

14. Closely linked to the need to avoid mismanagement of public property or funds is the requirement of ensuring integrity in the award and performance of PPP contracts. Here, too, it would normally be for other bodies of law to set forth the substantive rules to uphold integrity in the form of criminal provisions, administrative law standards and codes of conduct. A central concern in order to promote integrity is the need to prevent conflicts of interest throughout the main stages of PPPs: from planning through bidding all the way to the winding up of a project. The magnitude of many PPP projects, their typically long duration, and the need for constant interaction between Government officials, agents of the contracting authority and employees or agents of the private partner may encourage and create innumerable opportunities for bribery, extortion or other corrupt practices. It is imperative to ensure that officials of the contracting authority will not benefit directly or indirectly from the project or their dealings with the private partner. The private partner, too, should not exercise improper influence on any official involved in project design, selection, implementation or regulation. Appropriate safeguards should be provided during project design by the conduct of independent studies (see chap. II, "Project planning and preparation", paras. 5–22 and 49–52), contract award through competitive procedures (see chap. III, "Contract award", paras. 85–86, 92 and 103–104) and proper monitoring and oversight during operation (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 103 and 104). Beyond economic and financial damage, corrupt practices in PPPs may have serious negative consequences for the public at large, in particular where the PPP involves the provision of a public service or the management of an infrastructure used by the public. Indeed, corrupt practices often result in improper lenience towards lowered safety, security or quality standards, which may be the cause of accidents or other hazards likely to cause damage to property or to endanger the health or lives of citizens.

15. An effective system to uphold integrity must be enforced through an effective accountability system. Here, too, the essential mechanisms are expected to be found in other areas of the law, in particular penal and administrative laws and rules governing the investigation and trial of criminal cases (see chap. VII, "Other relevant areas of law", paras. 55–57). Laws and regulations specific to PPPs can contribute to accountability by setting forth appropriate disclosure and reporting requirements, as well as the possibility for the contracting authority or other relevant Government body to audit the accounts or otherwise reasonably request relevant information from the private partner (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 103 and 104).

(e) Economy and efficiency

16. The legal and regulatory framework, including the budget and appropriation processes, should set the conditions necessary to ensure that PPP projects offer economy and efficiency throughout their life cycle (see chap. VII, "Other relevant

areas of law", paras. 44–46). Prior to embarking on the selection of a project partner, the contracting authority should be required to conduct a rigorous planning and feasibility assessment, examining, in particular, the extent to which a PPP optimizes the use of resources to achieve the intended impact of the project concerned (or a "value for money" test). PPP projects should only move forward if those tests demonstrate, for instance: *(a)* that the project offers an optimal relationship between the cost, time and other resources, and the quality of the subject matter of the project; *(b)* that, if structured as a PPP, the project is expected to deliver the required level of services at a lower level of cost, time and other resources, without reducing the quality of those services than would otherwise have been the case; and *(c)* that a PPP will deliver a better-than-required level of services or achieve a better return on investment in the project for the cost, time and other resources than would otherwise have been the case (see chap. II, "Project planning and preparation", paras. 6–16).

(f) Long-term sustainability

17. Important objectives of a country's infrastructure development policy include ensuring the long-term provision of public services, continuously improving the quality of infrastructure, and achieving economic, environmental and social sustainability. PPPs are one of the tools that a country may use to implement its policy, and therefore the laws and regulations dealing specifically with PPPs should help to promote those objectives. Proper planning and preparation are indispensable to ensure the sustainability of infrastructure projects, in particular when carried out as PPPs. Positive steps, from a general policy perspective, include the formulation of a master plan for infrastructure development, including public services, and the establishment of priority sectors, projects or types of project based on socioeconomic considerations, financial implications, effects on sustainable development, and other relevant factors.

18. Proper planning and preparation of individual projects requires careful choice of project type, based on financial and other capacity of the contracting authority (that is, whether public procurement and operation or any particular type of PPP). Unrealistic assumptions about the advantages or costs of a PPP model are likely to nullify the expectations of infrastructure development through PPPs, and should be avoided as much as possible through careful planning and project assessment at the early stages (see chap. II, "Project planning and preparation", paras. 5–22). Indeed, poor planning or ill-conceived rules or procedures may lead to inadequate contractual or regulatory arrangements for the operation and maintenance of public infrastructure, severely limit efficiency in all sectors of infrastructure, reduce service quality and increase costs for the Government or users. From a legislative perspective, it is important to ensure that the host country has the institutional capacity to undertake the various tasks entrusted

to public authorities authorized to enter into PPPs throughout their phases of implementation (see chap. II, "Project planning and preparation", paras. 46–55). One way by which a Government can ascertain the readiness of its institutions to handle PPP projects is to conduct an assessment of its public investment capabilities including a review of institutions and procedures responsible for national and sectoral planning, investment budgeting, project appraisal and selection, and managing and monitoring of project implementation. The efficiency of a country's overall institutional and administrative resources is essential to ensure the sustainability of PPP projects, and a country may wish to consider using appropriate tools reflecting best practices to assess their suitability for ensuring sustainable management of PPP projects.[4]

(g) Competition

19. Another measure to enhance the long-term sustainability of PPPs within the context of a national infrastructure policy is to achieve a correct balance between competitive and monopolistic infrastructure operation and provision of public services. Competition may reduce overall costs and provide more backup facilities for essential services. In certain sectors, competition has also helped to increase the productivity of infrastructure investment, to enhance responsiveness to the needs of the customers and to obtain better quality for public services, thus improving the business environment in all sectors of the economy (see also "Introduction and background information on PPPs", paras. 27–44).

20. For laws and regulations directly related to PPPs, competition has two dimensions. On the one hand, the scope for competition in the sector or activity concerned is one of the elements that the contracting authority should be required to examine at the project planning stage (see chap. II, "Project planning and preparation", paras. 21 and 22). The contracting authority's assessment should serve as a basis for determining whether or not the private partner should have an exclusive right to operate the infrastructure or to provide the relevant services under the PPP, or whether the sector or market could benefit from competition. On the other hand, competition is usually one of the structural elements of public procurement systems, and aims at maximizing economy (or "value for money") for the public sector. Competition for PPP contracts in the form of a rigorous contest among potential investors and private entities for the opportunity to be awarded the PPP contract can reduce overall costs and other resource demands, increase the productivity of infrastructure investment, enhance responsiveness to the needs of the customers and thus obtain better quality of public services. Competition has the potential both to improve value for money in PPPs and to increase the

[4] The International Monetary Fund, for instance, has developed a Public Investment Management Assessment (PIMA) to help countries evaluate the strength of the public investment management practices (see http://www.imf.org/external/np/fad/publicinvestment/#5).

likelihood of achieving the intended outcome of the project concerned. Competition is also one of the principles that should guide domestic public procurement systems pursuant to article 9, paragraph 1, of the United Nations Convention against Corruption. The *Guide* therefore strongly recommends the use of competitive procedures for the award of PPP contracts (see chap. III, "Contract award", paras. 1, 2, 17 and 18). Promoting potential investors' and private entity participation in PPPs is a key prerequisite for competition for PPP contracts. The procurement procedures recommended in the *Guide* recognize, however, that in the context of complex infrastructure projects, competition is most effective by limiting the number of participants. Two reasons justify this apparent paradox: first, the technical, commercial and financial complexity of most PPP projects would make it excessively cumbersome, time and resource consuming for the contracting authority to have to examine a potentially large number of proposals; second, the high costs of participating in the procedure discourage private entities from participating unless they assess their chances of winning the ultimate contract as reasonable. Consequently the procurement procedures recommended in the *Guide* start with a process to identify a limited number of high-quality potential partners (see chap. III, "Contract award", paras. 34–50).

2. Constitutional law and PPPs

21. The constitutional law of a number of countries refers to the duty of the State to ensure the provision of public services. Some of them list the infrastructure and service sectors that come under the responsibility of the State, while in others the task of identifying those sectors is delegated to the legislator. Some national constitutions reserve the provision of certain public services exclusively to the State or to specially created public entities. Other constitutions, however, authorize the State to engage private entities for the development and operation of infrastructure and the provision of public services. In some countries, there are limitations to the participation of foreigners in certain sectors or requirements that the State should participate in the capital of the companies providing public services.

22. For countries wishing to use PPPs to develop public infrastructure and services, it is important to ascertain whether existing constitutional rules impose possible restrictions to their implementation. In some countries, uncertainties regarding the legal basis for PPPs may delay or even impede their implementation. Concerns that PPPs might contravene constitutional rules on State monopolies or on the provision of public services have caused judicial disputes, with negative impact on the implementation of PPP projects.

23. It is further important to consider constitutional rules relating to the ownership of land or infrastructure facilities. The constitutional law of some countries contains limitations to private ownership of land and certain means of production.

In other countries, private property is recognized, but the constitution declares all or certain types of infrastructure to be State property. Restrictions of this nature can be an obstacle to the execution of projects that entail private operation, or private operation and ownership, of the relevant infrastructure (see further chap. IV, "PPP implementation: legal framework and PPP contract", paras. 22–28).

3. General and sector-specific legislation

24. The law plays a central role in promoting confidence in PPPs. The legal framework for PPPs will generally comprise a primary law or set of laws, secondary regulations or decrees, internal rules and guidance, drawing on the policy choices made by the legislator and the Government. The law typically embodies a political commitment, provides specific legal rights and may represent an important guarantee of stability of the legal and regulatory regime by setting forth the general rules under which those projects are awarded and implemented. Laws governing the award and implementation of PPP projects, including sector-specific legislation, are typically supplemented, and should be coordinated with laws and regulations on various other matters, including international obligations of the country on taxation or investment protection (see chap. VII, "Other relevant areas of law", paras. 4–6).

25. As a matter of constitutional law or legislative practice, some countries may need to adopt specific legislation in respect of individual projects. In other countries with a well-established tradition of awarding concessions to the private sector for the provision of public services, the Government is authorized by general legislation to award to the private sector any activity carried out by the public sector having an economic value that makes such activity capable of being exploited by private entities. General legislation of this type creates a framework for providing a uniform treatment to issues that are common to PPP in different infrastructure sectors.

26. However, by its very nature, general legislation is normally not suitable to address all the particular requirements of different sectors. Even in countries that have adopted general legislation addressing cross-sectoral issues, it has been found that supplementary sector-specific legislation allows the legislator to formulate rules that take into account the market structure in each sector (see "Introduction and background information on PPPs", paras. 28–44). It should be noted that in many countries sector-specific legislation was adopted at a time when a significant portion or even the entirety of the national infrastructure consisted of State monopolies. For countries interested in promoting private sector investment in infrastructure, it is advisable to review existing sector-specific legislation so as to ascertain its suitability for PPPs. Countries that consider the adoption of a general law on PPPs may wish to use this opportunity to review and amend, as appropriate,

existing sector-specific laws in order to ensure their consistency with the general PPP law, or otherwise clearly indicate which text prevails in case of conflict (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 5–8).

27. Sector-specific legislation may further play an important role in establishing a framework for the regulation of individual infrastructure sectors (see below, paras. 40–60). Legislative guidance is particularly useful in countries at the initial stages of setting up or developing national regulatory capacities. Such legislation represents a useful assurance that the regulators do not have unlimited discretion in the exercise of their functions, but are bound by the parameters provided by the law. However, it is generally advisable to avoid rigid or excessively detailed legislative provisions dealing with contractual aspects of the implementation of PPPs, which in most cases would not be adequate to their long-term nature (see further chap. IV, "PPP implementation: legal framework and PPP contract", paras. 2–4; and chap. V, "Duration, extension and termination of the PPP contract", paras. 2–6).

28. Many countries have used legislation to establish the general principles for the organization of infrastructure sectors and the basic policy, institutional and regulatory framework. However, the law may not be the best instrument to set detailed technical and financial requirements. Many countries have preferred to enact regulations setting forth more detailed rules to implement the general provisions of domestic laws on PPPs. Regulations are found to be easier to adapt to a change in environment, whether the change results from the transition to market-based rules or from external developments, such as new technologies or changing economic or market conditions. As stressed earlier in the *Guide* (see above, para. 11), stability of the legal framework is essential to promote confidence in a country's PPP policy. Countries that choose to limit the enabling legislation to general principles and to use regulations for detail matters should avoid too frequent changes of regulations or inconsistencies between regulations and the laws on which they are based, as these are common sources of uncertainty and disputes in PPPs (see further chap. IV, "PPP implementation: legal framework and PPP contract", paras. 131–134). Whatever the instrument used, clarity and predictability are of the essence.

C. Scope of authority to enter into PPPs

29. The implementation of PPPs may require the enactment of special legislation or regulations expressly authorizing the State to entrust the development of infrastructure or the provision of public services to private entities. The existence of express legislative authorization may be an important measure to foster the confidence of potential investors, national or foreign, in a national policy to promote private sector investment in infrastructure through PPPs.

1. Authorized agencies and relevant fields of activity

30. In some legal systems, the Government's responsibility for the development of infrastructure or the provision of public services may not be delegated without prior legislative authorization. For those countries that wish to develop public infrastructure or services through PPPs, it is particularly important to state clearly in the law the authority to entrust entities other than public authorities of the host country with the right to provide certain public services. Such a general provision may be particularly important in those countries where public services are governmental monopolies or where it is envisaged to engage private entities to provide certain services that used to be available to the public free of charge (see further chap. IV, "PPP implementation: legal framework and PPP contract", paras. 41 and 42).

31. Where general legislation is adopted, it is also advisable to identify clearly the public authorities or levels of government competent to award infrastructure projects and to act as contracting authorities. In order to avoid unnecessary delay, it is particularly advisable to have rules in place that make it possible to ascertain the persons or offices that have the authority to enter into commitments on behalf of the contracting authority (and, as appropriate, of other public authorities) at different stages of negotiation and to sign the PPP contract. It is useful to consider the extent of powers that may be needed by authorities other than the central Government to carry out projects falling within their purview. For projects involving offices or agencies at different levels of government (for example, national, provincial or local), where it is not possible to identify in advance all the relevant offices and agencies involved, other measures may be needed to ensure appropriate coordination among them (see chap. II, "Project planning and preparation", paras. 46–55).

32. For purposes of clarity, it is advisable to identify in such general legislation those sectors in which PPP contracts may be awarded. Alternatively, where this is not deemed feasible or desirable, the law might identify those activities which may not be the object of a PPP contract (for example, activities related to national defence or security).

2. Purpose and scope of PPPs

33. It may be useful for the law to define the nature and purpose of projects for which PPPs may be entered into in the country. One possible approach may be to define the various categories of projects according to the extent of the rights and obligations assumed by the private partner (for example, "build-operate-transfer", "build-own-operate", "build-transfer-operate" and "build-transfer"). However, given the wide variety of schemes that may come into play in connection with

private investment in infrastructure (see "Introduction and background information on PPPs", paras. 23 and 24), this approach is not advisable. As an alternative, the law could generally provide that PPPs may be entered into for the development of any or specific types or public infrastructure or services. The law could clarify that PPPs may involve the direct provision of services to the public by the private partner pursuant to a concession issued by the competent authority, or the management and operation of an infrastructure used by the contracting authority or other Government body for the provision of public services or to house its own activities. The law could further clarify that the private partner's remuneration may take the form of a right to charge a price for the use of the facility or premises or for the service or goods it generates, or of other payment or remuneration agreed to by the parties. Lastly, it may be useful for the law to further clarify that PPPs may be used for the construction and operation of a new infrastructure facility or system or for maintenance, repair, refurbishment, modernization, expansion and operation of existing infrastructure facilities and systems, or only for the management and delivery of a public service.

34. Another important issue concerns the nature of the rights vested in the private partner, in particular whether the right to provide the service is exclusive or whether the private partner will face competition from other infrastructure facilities or service providers. Exclusivity may concern the right to provide a service in a particular geographical region (for example, a communal water distribution company) or embrace the whole territory of the country (for example, a national railway company); it may relate to the right to supply one particular type of goods or services to one particular customer (for example, a power generator being the exclusive regional supplier to a power transmitter and distributor) or to a limited group of customers (for example, a national long-distance telephone carrier providing connections to local telephone companies).

35. The decision whether or not to grant exclusivity rights to a certain project or category of projects should be taken in the light of the host country's policy for the sector concerned. As discussed earlier, the scope for competition varies considerably in different infrastructure sectors. While certain sectors, or segments thereof, have the characteristics of natural monopolies, in which case open competition is usually not an economically viable alternative, other infrastructure sectors have been successfully opened to free competition (see "Introduction and background information on PPPs", paras 37–44).

36. It is desirable therefore to deal with the issue of exclusivity in a flexible manner. Rather than excluding or prescribing exclusive PPPs, it may be preferable for the law to authorize the granting of exclusive rights when it is deemed to be in the public interest, such as in cases where the exclusivity is justified for ensuring the technical or economic viability of the project. The contracting authority should

state the reasons for granting exclusivity in the assessment and studies that it is required to make prior to starting the procedure to select the private partner (see chap. II, "Project planning and preparation", paras. 21 and 22). Sector-specific laws may also regulate the issue of exclusivity in a manner suitable for each particular sector.

D. Authority to regulate infrastructure services

37. PPP projects that involve the direct provision or services or goods to the public by the private partner ("concession-PPPs") often relate to sectors or activities that are subject to special regulation. The applicable regulatory regime may consist of substantive rules, procedures, instruments and institutions. That framework represents an important instrument to implement the governmental policy for the sector concerned (see "Introduction and background information on PPPs", paras. 25–47). Depending on the institutional structure of the country concerned and on the allocation of powers between different levels of government, provincial or local legislation may govern some infrastructure sectors, in full or concurrently with national legislation.

38. Regulation of infrastructure services involves a wide range of general and sector-specific issues, which may vary considerably according to the social, political, legal and economic reality of each host country. While occasionally discussing some of the main regulatory issues that are encountered in a similar context in different sectors (see, for instance, chap. IV, "PPP implementation: legal framework and PPP contract", paras. 43–50 and 91–106), the *Guide* is not intended to exhaust the legal or policy issues arising out of the regulation of various infrastructure sectors. The term "regulatory agencies" refers to the institutional mechanisms required to implement and monitor the rules governing the activities of infrastructure operators. Because the rules applicable to infrastructure operation often allow for a degree of discretion, a body is required to interpret and apply them, monitor compliance, impose sanctions and settle disputes arising out of the implementation of the rules. The specific regulatory tasks and the amount of discretion they involve will be determined by the rules in question, which can vary widely.

39. The *Guide* assumes that a country that chooses to authorize PPPs in any of those sectors has satisfied itself that it has in place the proper institutional and bureaucratic structures and human resources necessary for the implementation of PPPs. Nevertheless, as a contribution to domestic legislatures considering the need for, and desirability of, establishing regulatory agencies for monitoring the provision of public services, this section discusses some of the main institutional and procedural issues that may arise in that connection. The discussion contained in this section is illustrative of different options that have been used in domestic

legislative measures to set up a regulatory framework for PPPs, but the *Guide* does not thereby advocate the establishment of any particular model or administrative structure. Practical information and technical advice may be obtained from international financial institutions that carry out programmes to assist their member countries in setting up an adequate regulatory framework (such as the World Bank and the regional development banks).

1. Sectoral competence and mandate of regulatory agencies

40. Regulatory responsibilities may be organized on a sectoral or cross-sectoral basis. Countries that have opted for a sectoral approach have in many cases decided to place closely linked sectors or segments thereof under the same regulatory structure (for example, a common regulatory agency for power and gas or for airports and airlines). Other countries have organized regulation on a cross-sectoral basis, in some cases with one regulatory entity for all infrastructure sectors and in others with one entity for utilities (water, power, gas, telecommunications) and one for transport. In some countries the competence of regulatory agencies might also extend to several sectors within a given region.

41. Regulatory agencies whose competence is limited to a particular sector usually foster the development of technical, sector-specific expertise. Sector-specific regulation may facilitate the development of rules and practices that are tailored to the needs of the sector concerned. However, the decision between sector-specific and cross-sectoral regulation depends in part on the country's regulatory capacity. Countries with limited expertise and experience in infrastructure regulation may find it preferable to reduce the number of independent structures and try to achieve economies of scale.

42. The law setting up a regulatory mechanism often stipulates a number of general objectives that should guide the actions of regulatory agencies, such as the promotion of competition, the protection of users' interests, the satisfaction of demand, the efficiency of the sector or the public service providers, their financial viability, the safeguarding of the public interest or of public service obligations and the protection of investors' rights. Having one or two overriding objectives helps clarify the mandate of regulatory agencies and establish priorities among sometimes conflicting objectives. A clear mandate may also increase a regulatory agency's autonomy and credibility.

2. Institutional mechanisms

43. The range of institutional mechanisms for the regulation of infrastructure sectors varies greatly. While there are countries that entrust regulatory functions to organs of the Government (for example, the concerned ministries or departments),

other countries have preferred to establish autonomous regulatory agencies, separate from the Government. Some countries have decided to subject certain infrastructure sectors to autonomous and independent regulation while leaving others under ministerial regulation. Sometimes, powers may also be shared between an autonomous regulatory agency and the Government, as is often the case with respect to licensing. From a legislative perspective, it is important to devise institutional arrangements for the regulatory functions that ensure to the regulatory agency an adequate level of efficiency, taking into account the political, legal and administrative tradition of the country.

44. The efficiency of the regulatory regime is in most cases a function of the objectiveness with which regulatory decisions are taken. This, in turn, requires that regulatory agencies should be able to take decisions without interference or inappropriate pressures from infrastructure operators and public service providers. To that effect, legislative provisions in several countries require the independence of the regulatory decision-making process. In order to achieve the desired level of independence it is advisable to separate the regulatory functions from operational ones by removing any regulatory functions that may still be vested with the public service providers and entrust them to a legally and functionally independent entity. Regulatory independence is supplemented by provisions to prevent conflicts of interest, such as prohibitions for staff of the regulatory agency to hold mandates, accept gifts, enter into contracts or have any other relationship (directly or through family members or other intermediaries) with regulated companies, their parents or affiliates.

45. This leads to a related issue, namely, the need to minimize the risk of decisions being made or influenced by a body that is also the owner of enterprises operating in the regulated sector or a body acting on political rather than technical grounds. In some countries it was felt necessary to provide the regulatory agency with a certain degree of autonomy vis-à-vis the political organs of government. Independence and autonomy should not be considered solely on the basis of the institutional position of the regulatory function, but also on the basis of its functional autonomy (that is, the availability of sufficient financial and human resources to discharge their responsibilities adequately).

3. Powers of regulatory agencies

46. Regulatory agencies may have decision-making powers, advisory powers or purely consultative powers or a combination of these different levels of powers depending on the subject matter. In some countries, regulatory agencies were initially given limited powers, which were expanded later as the agencies established a track record of independence and professionalism. The legislation often specifies which powers are vested with the Government and which with a

regulatory agency. Clarity in this respect is important to avoid unnecessary conflicts and confusion. Investors, as well as consumers and other interested parties, should know to whom to turn with various requests, applications or complaints.

47. Selection of public service providers, for example, is in many countries a process involving the Government as well as the regulatory agency. If the decision to award a project involves broad judgment of a political rather than technical nature, which may often be the case in the context of infrastructure privatization, final responsibility often rests with the Government. If, however, the award criteria are more technical, as may be the case with a liberal licensing regime for power generation or telecommunication services, many countries entrust the decision to an independent regulatory agency. In other cases, the Government may have to ask the regulatory agency's opinion prior to awarding a contract. On the other hand, some countries exclude direct involvement of regulatory agencies in the award process on the basis that it could affect the way they later regulate the provision of the service concerned.

48. The jurisdiction of regulatory agencies normally extends to all enterprises operating in the sectors they regulate, with no distinction between private and public enterprises. The use of some regulatory powers or instruments may be limited by law to the dominant public service providers in the sector. A regulatory agency may, for example, have price policing powers only vis-à-vis the incumbent or dominant public service provider, while new entrants may be allowed to set prices freely.

49. The matters on which regulatory agencies have to make decisions range from normative responsibilities (for example, rules on contract award and conditions for certification of equipment) to the actual award of contracts; the approval of contracts or decisions proposed by the regulated entities (for example, a schedule or contract on network access); the definition and monitoring of an obligation to provide certain services; the oversight over public service providers (in particular compliance with licence conditions, norms and performance targets); the disclosure to the public, for the sake of transparency, of targeted financial information related to the private partner (for example, its shareholding structure or the base-case financial model used on the project); price setting or adjustments; vetting of subsidies, exemptions or other advantages that could distort competition in the sector; sanctions; and dispute settlement.

4. Composition, staff and budget of regulatory agencies

50. When setting up a regulatory agency, a few countries have opted for an agency comprised of a single officer, whereas most others have preferred a regulatory commission. A commission may provide greater safeguards against undue influence or

lobbying and may limit the risk of rash regulatory decisions. A one-person regulatory agency, on the other hand, may be able to reach decisions faster and may be held more accountable. To improve the management of the decision-making process in a regulatory commission, the number of members is often kept small (typically three or five members). Even numbers are often avoided to prevent a deadlock, though the chairman could have a casting vote.

51. To increase the regulatory agency's autonomy, different institutions may be involved in the nomination process. In some countries regulatory agencies are appointed by the head of State based on a list submitted by parliament; in others the executive branch of the Government appoints the regulatory agency but subject to confirmation by parliament or upon nominations submitted by parliament, user associations or other bodies. Minimum professional qualifications are often required of the officials of the regulatory agencies, as well as the absence of conflicts of interest that might disqualify them from the function. Terms of office of members of regulatory boards may be staggered in order to prevent total turnover and appointment of all members by the same administration; staggering also promotes continuity in regulatory decision-making. Terms of office are often for a fixed term, may be non-renewable and may be terminated before the expiry of the term for limited reasons only (such as criminal conviction, mental incapacitation, gross negligence or dereliction of duty). Regulatory agencies are often faced with experienced lawyers, accountants and other experts working for the regulated industry and need to be able to acquire the same level of expertise, skills and professionalism, either in-house or by hiring outside advisers as needed.

52. Stable funding sources are critical in order for the regulatory agency to function adequately. In many countries, the budget of the regulatory agency is funded by fees and other levies on the regulated industry. Fees may be set as a percentage of the turnover of the public service providers or be levied for the award of licences, contracts or other authorizations. In some countries, the agency's budget is complemented as needed by budget transfers provided in the annual finance law. However, this may create an element of uncertainty that may reduce the agency's autonomy.

5. Regulatory process and procedures

53. The regulatory framework typically includes procedural rules governing the way the institutions in charge of the various regulatory functions have to exercise their powers. The credibility of the regulatory process requires transparency and objectivity, irrespective of whether regulatory authority is exercised by a government department or minister or by an autonomous regulatory agency. Rules and procedures should be objective and clear so as to ensure fairness, impartiality and timely action by the regulatory agency. For purposes of transparency, the law

should require that they be made public. Regulatory decisions should state the reasons on which they are based and should be made accessible to interested parties, through publication or other appropriate means.

54. Transparency may be further enhanced, as required by some laws, by the publication by the regulatory agency of an annual report on the sector, including, for example, the decisions taken during the exercise, the disputes that have arisen and the way they were settled. Such an annual report may also include the accounts of the regulatory agency and an audit thereof by an independent auditor. Legislation in many countries further requires that this annual report be submitted to a committee of parliament.

55. Regulatory decisions may have an impact on the interests of diverse groups, including the concerned public service provider, its current or potential competitors and business or non-business users. In many countries, the regulatory process includes consultation procedures for major decisions or recommendations. In some countries, that consultation takes the form of public hearings, in others of consultation papers on which comments from interested groups are solicited. Some countries have also established consultative bodies comprised of users and other concerned parties and require that their opinion be sought before major decisions and recommendations are made. To enhance transparency, comments, recommendations or opinions resulting from the consultation process may have to be published or made publicly available.

6. Recourse against decisions of the regulatory agency

56. Another important element of the host country's regulatory regime are the mechanisms whereby public service providers may request a review of regulatory decisions. As with the whole regulatory process, a high degree of transparency and credibility is essential. To be credible, the review should be entrusted to an entity that is independent from the regulatory agency taking the original decision, from the political authorities of the host country and from the public service providers.

57. Review of decisions of regulatory agencies is often in the jurisdiction of courts, but in some legal systems recourse against decisions by regulatory agencies is in the exclusive jurisdiction of special tribunals dealing solely with administrative matters, which in some countries are separate from the judicial system. If there are concerns over the review process (for example, as regards possible delays or the capacity of courts to make evaluations of the complex economic issues involved in regulatory decisions) review functions may be entrusted to another body, at least in the first instance, before a final recourse to courts or administrative tribunals. In some countries, requests for review are considered by a high-level cross-sectoral

independent oversight body. There are also countries where requests for review are heard by a panel composed of persons holding specified judicial and academic functions. As to the grounds on which a request for review may be based, in many cases there are limits, in particular as to the right of the appellate body to substitute its own discretionary assessment of facts for the assessment of the body whose decision is being reviewed.

7. Settlement of disputes between public service providers

58. Disputes may arise between competing private partners (for example, two operators of cellular telephony systems) or between private partners providing services in different segments of the same infrastructure sector. Such disputes may involve allegations of unfair trade practices (for example, price dumping), uncompetitive practices inconsistent with the country's infrastructure policy (see "Introduction and background information on PPPs", paras. 25–36) or violation of specific duties of public service providers (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 91–104). In many countries, legislative provisions have been found necessary in order to establish an appropriate framework for the settlement of these disputes.

59. Firstly, the various parties may not have contractual arrangements with one another that could provide for an appropriate dispute settlement mechanism. Even where it would be possible to establish a contractual mechanism, the host country may have an interest that disputes involving certain issues (for example, conditions of access to a given infrastructure network) be settled by a specific body in order to ensure consistency in the application of the relevant rules. Furthermore, certain disputes between public service providers may involve issues that, under the laws of the host country, are not considered able to be settled through arbitration.

60. Domestic laws often establish administrative procedures for handling disputes between public service providers. Typically, public service providers may file complaints with the regulatory agency or with another governmental agency responsible for the application of the rules alleged to have been violated (for example, a governmental body in charge of enforcing competition laws and regulations), which in some countries has the authority to issue a binding decision on the matter. Such mechanisms, even where mandatory, do not necessarily preclude resort by the aggrieved persons to courts, although in some legal systems the courts may only have the power to control the legality of the decision (for example, observance of due process) but not its merits.

II. Project planning and preparation

A. General remarks

1. PPPs are one of the means that Governments use to develop infrastructure or systems needed to provide a public service or support the functions of a Government entity. When properly designed and implemented, PPPs can create opportunities for reducing the commitment of public funds and other resources for infrastructure development or the provision of public services. They also make it possible to transfer to the private sector a number of risks that the private sector may be able to control or mitigate in more efficient or economical terms than the Government.

2. The extent to which those expected benefits would actually materialize depends on various factors. They include the adequacy and stability of the overall legal and regulatory framework (see chap. I, "General legal and institutional framework", paras. 10–12), the selection of a qualified private partner (see chap. III, "Contract award", paras. 6–9), the technical and commercial feasibility of the project, the soundness of the contractual arrangements and their fitness during the entire life of the project (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 130–144). While some of the factors that compose this equation may be outside the control of the parties, an essential prerequisite for the success of a PPP is a comprehensive, rigorous and professionally conducted planning and preparation phase that tests the projects assumptions and anticipates risks and contingencies throughout the entire life cycle of a PPP.

3. As discussed in section B, the legal framework for PPPs should therefore require, and provide the mechanisms for, a mandatory review of the project's assumptions in order for the competent authorities to assess accurately whether a PPP is the adequate option for developing the infrastructure or service concerned, as compared to direct procurement, financing and management by the Government (paras. 5–22). These preliminary studies should also analyse the main risks encountered in PPPs, including common contractual solutions for risk allocation, and the degree of flexibility that will be needed to allocate project risks efficiently (see section C, paras. 23–45). Section D (paras. 46–55), discusses institutional and administrative aspects of project preparation and coordination. Section E (paras. 56–86) sets out policy considerations that the Government may wish to take into account when considering the level of direct governmental support that may be

provided to infrastructure projects, such as the degree of public interest in the execution of any given project and the need to avoid the assumption by the Government of open-ended or excessive contingent liabilities. Lastly, sections F (paras. 87–98) and G (paras. 99–101) outline guarantees and support measures that may be provided by export credit agencies and investment promotion agencies.

4. Other chapters of this *Guide* deal with related aspects of the host Government's legal regime that are of relevance to the credit and risk analysis of a project. The reader is referred in particular to chapter IV, "PPP implementation: legal framework and PPP contract"; chapter V, "Duration, extension and termination of the PPP contract"; chapter VI, "Settlement of disputes"; and chapter VII, "Other relevant areas of law".

B. Project assessment and options

5. One important measure to ensure the successful implementation of PPPs is to require the relevant public authority to conduct a preliminary assessment of the project's advisability and feasibility, including economic and financial aspects, such as expected economic advantages of the project, estimated cost and potential revenue anticipated from the operation of the infrastructure facility, as well as the social and environmental impact of the project. The studies prepared by the contracting authority should, in particular, identify clearly the expected output of the project, provide sufficient justification for the investment, propose a modality for private sector participation and describe a particular solution to the output requirement. These studies, when properly conducted, should not only serve to substantiate the policy choices made as regards the type of PPP project and the structure of the contract awards procedures. Indeed, a thorough project assessment and planning phase should consider the entire life cycle of a PPP project and provide a basis for crucial decisions on contract design and contract management (including mechanisms for contract monitoring and adjustment).

1. Value for money ("economy and efficiency")

6. One of the main objectives of any system for the award of public contracts, and a central concern of the UNCITRAL Model Law on Public Procurement, for instance, is to maximize economy and efficiency. The *Guide to Enactment of the Model Law* explains, in this connection, that "economy" (which is often termed "best value"), means an optimal relationship between the price paid and other factors, including the quality of the subject matter of the procurement, and presupposes that the public purchaser's needs are in fact met. "Efficiency" in procurement means that the relationship between the transaction costs and administrative time of each procurement procedure and its value are proportionate. "Efficiency" also

includes the notion that the costs of the procurement system as a whole are also proportionate to the value of all procurement conducted through that system. Applied to PPP projects, the economy and efficiency principles have been embodied in the concept know as “value for money”.

7. Obtaining value for money is a central concern in all PPP projects. Some of them may fall under the scope of general public procurement law, in particular those where the contracting authority undertakes to make direct payments to the private partner. Other types of PPP projects, however, do not involve the disbursement of public funds to pay the project partner, and the role of the contracting authority as an overall project manager may be quite different from the role of Government in traditional public procurement. This means that the notions of value for money applicable in PPPs have a broader meaning than in a narrow public procurement context.

8. Indeed, in the context of PPPs, rather than focusing mainly on the price paid for works or services performed by the private partner, the Government needs to be able to demonstrate that carrying out the project as a PPP is not only more economical, but also a more efficient option than, for example, through public procurement of works or services or through public operation of the infrastructure or service system. Poorly conceived or ill-designed PPP projects may lead to project failure, public service disruption, cost overruns or fears of undue profit making by the private sector at the cost of the public interest. With a view to ensuring transparency and good governance, the contracting authority needs to show that carrying out the project as a PPP offers the best value for money. Therefore, the law should require a thorough assessment of the project’s value for money as a mandatory step in the approval process of any proposed project, and as a condition precedent in order for the contracting authority to proceed with preparations for the selection of the project partner.

9. Generally, the test should include a quantitative and qualitative analysis of the costs, benefits and quality of the project that conclusively shows that carrying out the project as a PPP is the best available option. A PPP project should be considered to offer value for money only if operating the project as a PPP would result in a better quality delivered at lower cost than using any other method or arrangement to carry out the project or deliver a comparable outcome. It may even be useful to repeat the test after the bidding process in order to ensure a full consistency in the calculation method and in the results (see chap. III, “Contract award”, paras. 30 and 31).

10. The contracting authority may use various tools to conduct a value for money assessment. A common and widely used tool is the so-called “public sector comparator”. This test consists of an estimate of the hypothetical cost of a public sector

project throughout its life cycle if were to be carried out by the Government. The public sector comparator uses the proposed output specification and the proposed risk allocation as a basis to compare the PPP option with a hypothetical model of the project costs if it were to be carried out under the most efficient modality for project delivery through the public sector offering the same level and quality of service expected of the private sector, and taking into account the life cycle risks of the project. The starting point is typically the best estimate of the capital cost and lifetime operations and maintenance cost of implementing the project if delivered by the public sector.

11. The methodology for conducting a value for money test and the exact matrix of factors to be taken into account may vary according to the nature of the project, and it may evolve over time. Where a central approving authority, coordinating or advising body exists (see paras. 46 and 47), the host country might consider setting up dedicated structures to review periodically or systematically the methodology used and set appropriate parameters therefor. It should be noted, however, that the usefulness and accuracy of a value for money assessment depends on the availability and reliability of public sector comparators, which may be limited in countries with little experience in PPPs or in advanced Government accounting and management practices, as may be the case in some developing countries. Moreover, an accurate value for money analysis might be beyond the capacity of some public authorities, as there might be insufficient or incomplete data to undertake the assessment. Furthermore, the efficiency of the Government entity to be used as a public sector comparator would have a significant bearing on the project costs, and the contracting authority may not have the expertise to factor public sector performance adequately as part of a comparative analysis. These potential limitations underscore the importance of ensuring that the contracting authority or other bodies in charge of planning for PPPs have the required human and technical resources needed to conduct this assessment. The Government will also be well advised the keep abreast with current international standards and guidance for an adequate value for money assessment.[1]

12. The need for an accurate and realistic confirmation of the project's business case is even more important in view of the financing structure of most PPP projects. In the past, debt financing for infrastructure development was obtained on

[1] To support Governments in early stage identification and selection of projects suitable to be delivered on a PPP basis, the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) designed the PPP qualitative value-for-money toolkit, which is an online instrument allowing Governments and public authorities to undertake the right PPP project selection based on value for money. The toolkit is available at the following address: https://ppp.unescap.org/. See also World Bank, 2017, *Public-Private Partnerships: Reference Guide Version 3*, Section 3.2.4, Assessing Value for Money of the PPP. World Bank, Washington, D.C. © World Bank; World Bank Institute; Public-Private Infrastructure Advisory Facility, 2013, *Value-for-Money Analysis-Practices and Challenges: How Governments Choose When to Use PPP to Deliver Public Infrastructure and Services*. World Bank, Washington, D.C. © World Bank.

the basis of credit support from project sponsors, multilateral and national export credit agencies, Governments and other third parties. Those traditional sources have not been able to meet the growing needs for infrastructure capital. Indeed, PPP projects have been increasingly funded on a project finance basis.

13. Project finance, as a method of financing, seeks to establish the creditworthiness of the private partner on a "stand alone" basis, even before construction has begun or any revenues have been generated, and to borrow on the basis of that credit. Commentators have observed that project finance may hold the key to unlocking the vast pools of capital theoretically available in the capital markets for investment in infrastructure and services. However, project finance has distinctive and demanding characteristics from a financial point of view. Principal among these is that, in a project finance structure, financing parties must rely mainly upon the private partner's assets and cash flows for repayment. If the project fails they will have no recourse, or only limited recourse, to the financial resources of a sponsor company or other third party for repayment (see also "Introduction and background information on PPPs", paras. 56 and 57).

14. The financial methodology of project financing requires a precise projection of the capital costs, revenues and projected costs, expenses, taxes and liabilities of the project. In order to predict these numbers precisely and with certainty and to create a financial model for the project, it is typically necessary to project the "base case" amounts of revenues, costs and expenses of the private partner over a long period – often 20 years or more – in order to determine the amounts of debt and equity the project can support. Central to this analysis is the identification and quantification of risks. For this reason, the identification, assessment, allocation and mitigation of risks is at the heart of project financing from a financial point of view. Indeed, risk allocation is at the core of every PPP, and a thorough understanding of the risk allocation arrangements is a precondition to drafting the PPP contract. The appropriate application of risk allocation principles is what determines whether a given PPP project will be capable of attracting finance and will be sustainable throughout its life cycle (a summary presentation of the most common risks in PPPs and general consideration on risk allocation is set out in section C, paras. 23–45).

2. *Fiscal impact assessment*

15. Another important reason for requiring an accurate and realistic confirmation of the project's business case as a condition precedent for the project to move ahead as a PPP is the need to avoid unexpected costs for the public sector ("fiscal risk"). In many countries, investment projects have been carried out as PPPs not for efficiency reasons, but to circumvent budget constraints and postpone recording the fiscal costs of providing infrastructure services. Hence, some Governments

ended up carrying out projects that either could not be funded within their budgetary means, or that exposed public finances to excessive fiscal risks in the form of contingent liabilities not accurately estimated and not properly accounted for. It is therefore advisable for the contracting authority or any central unit with overall responsibility for PPP-related policy (see below, para. 47) to assess at this early stage the potential fiscal costs and risks arising from a proposed PPP project, where this assessment was not already an integral party of the mandatory "value for money" test (see paras. 6–14). A thorough fiscal risk assessment should consider a wide variety of factors likely to affect the overall financial balance of the project (see below, paras. 23–36), as well as the options for risk allocation through the contractually agreed rights and obligations (see below, paras. 37–45). Moreover, in order to fully estimate the expected outcomes and budgetary implications of the project throughout its life cycle, the assessment should consider at least four main variables of PPP projects:

(a) *The initiator of a project:* The impact of main fiscal indicators (that is, deficit and debt) varies depending on the public entity ultimately responsible for the project (for example,, central, local governments, state-owned enterprises, etc.);

(b) *Who controls the asset:* The likelihood and extent of fiscal risk level varies depending on the government's ability to control the PPP-related asset – either through ownership, lease, right of use or other interest;

(c) *Who ultimately pays for the infrastructure:* The funding structure of the project (that is, whether the government pays for the infrastructure facility or system using public funds; whether the private partner collects fees directly from users of the infrastructure facility or system; or whether there is a combination of both) is crucial to assess the project's implication on main fiscal aggregates;

(d) *Whether the Government provides additional support to the project:* Governments can fund PPP projects directly but they can also support the project in a variety of ways, including providing guarantees, equity capital, or tax and customs benefits (see below, paras. 56–86). Such an early assessment of the fiscal impact of any Government support envisaged for a PPP project including the cost of support measures such as compulsory acquisition of land for project development will be crucial to avoid exposure to open-ended liabilities and secure a long-term commitment of public resources that promotes the sustainability of the country's infrastructure development strategy and policies.

16. Governments may use various methods and tools for conducting this assessment. The International Monetary Fund and the World Bank have developed an analytical tool to help Governments quantify the macro-fiscal implications of PPP projects. Designed to be used mostly by PPP units in ministries of finance, the PPP Fiscal Risk Assessment Model (P-FRAM) uses standard software to process project-specific and macroeconomic data and automatically generate standardized outcomes,

including: *(a)* project cash flows; *(b)* fiscal tables and charts both on a cash and accrual basis; *(c)* debt sustainability analysis with and without the PPP project; *(d)* sensitivity analysis of main fiscal aggregates to changes in macroeconomic and project-specific parameters; and *(e)* a summary risk matrix of the project.[2]

3. *Welfare and social impact assessment*

17. The purpose of the "value for money" test is to permit an informed preliminary decision as to whether PPP is at all an efficient and economically justifiable alternative to other forms of project development through public procurement. Failure of a proposed project to pass the value for money test does not necessarily mean that the project as such is not feasible, but should prompt the contracting authority to consider other options that are more affordable than a PPP. Likewise, the fact that a proposed project shows value for money does not necessarily mean that the project is worthwhile pursuing as a PPP. The Government must be satisfied that the project meets its overall infrastructure and public service development needs and strategies (see chap. I, "General legal and institutional framework", paras. 17 and 18), as well as the Government's broader economic and social policies, with due regard being paid to commitments undertaken to achieve its sustainable development goals.

18. Indeed, essential as it is, the value for money test emphasizes monetarily quantifiable parameters of good governance in infrastructure and public service development. In order to fully assess the benefits – but also potential risks of a PPP – the Government should consider conducting an alternative assessment of the project. Firstly, from a purely financial viewpoint, the authorities involved may wish to calculate the impact of the availability of the infrastructure concerned, as much as the fiscal returns on the investment in addition to the cash-flow position. Secondly, as the PPPs projects are by nature of great importance for the public in terms of size and service rendered, the social impact of the project should be addressed by the public authority during the preparatory phase. An assessment should be made to predict and mitigate negative impacts and identify ways to enhance benefits for local communities and society. Of particular importance is a consideration by the Government of the extent to which the project, whether or not carried as a PPP, is in line with relevant United Nations Sustainable Development Goals. It is recommended to assess at the planning stages the sustainability of the project and its environmental, economic and social impact. From the viewpoint of good governance and transparency, it is further advisable at this stage to consider the interests of the non-commercial partners and stakeholders – possibly through an adequate consultation mechanism – in order to foster public support for the project and reduce the risk of challenges or even litigation at later stages.

[2] P-FRAM is available on the following address: http://www.imf.org/external/np/fad/publicinvestment/#5.

4. *Environmental impact assessment*

19. The analysis of a project's welfare and social impact should be complemented with a thorough assessment of its environmental impact. An environmental impact assessment should identify environmental risks, integrate environmental concerns into project planning and development, and promote sustainable development. The Rio Declaration on Environment and Development expressly calls for environmental impact assessment, as a national instrument, to be undertaken "for proposed activities that are likely to have a significant adverse impact on the environment and are subject to a decision of a competent national authority".[3] Where a project is also likely to have a "significant adverse transboundary environmental effect", States are further called upon to "provide prior and timely notification and relevant information to potentially affected States" and to "consult with those States at an early stage and in good faith."[4] Such environmental impact assessments in projects likely to have a significant adverse impact in a transboundary context, in particular on shared resource, have gained a wide acceptance among States that they might be considered as a requirement under general international law. An environmental impact assessment (EIA) is a "systematic process that seeks to identify and evaluate the potential environmental consequences, impacts (and to a lesser extent the social and economic impacts also) and effects of a proposed project, such that information can be provided to decision makers and other stakeholders in order to minimize, mitigate, or eliminate altogether, any adverse potential impacts arising from the proposed development project".[5] Good governance and transparency principles in environmental matters call for an open and inclusive EIA process, through a mechanism that ensures access to information and the involvement of all potentially affected stakeholders in the decision-making process in accordance with relevant international standards.[6]

20. Carrying an EIA is essential to ensure that projects are sustainable and do not detrimentally affect people's lives or the natural environment (using mitigation

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[3] *Report of the United Nations Conference on Environment and Development* (Rio de Janeiro, 3–14 June 1992) (A/CONF/151/26 (vol. I)), Annex I, "Rio Declaration on Environment and Development", Principle 17.

[4] Ibid., Principle 19. In some regions, this obligation has received a treaty-based legal framework, such as through the Convention on Environmental Impact Assessment in a Transboundary Context (Espoo, Finland, 25 February 1991), negotiated under the auspices of the United Nations Economic Commission for Europe (United Nations, *Treaty Series*, vol. 1989, p. 309).

[5] United Nations Environment Programme, *An Introduction to Environmental Assessment*, 2015, p. 23 (http://apps.unep.org/publications/index.php?option=com_pub&task=download&file=011945_en).

[6] For instance, the Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters (Aarhus Convention), adopted at the Fourth "Environment for Europe" Ministerial Conference (Aarhus, Denmark, 25 June 1998), which was negotiated under the auspices of the United Nations Economic Commission for Europe, requires States Parties to guarantee the rights of access to information, public participation in decision-making and access to justice in environmental matters in order to contribute to the protection of the right of every person of "present and future generations" to live in an environment adequate to his or her health and well-being (United Nations, *Treaty Series*, vol. 2161, p. 447).

measures to achieve this where necessary). The EIA should help understand the consequences or impacts of proposed projects on the environment and identify ways in which projects can be improved, for example, by minimizing negative environmental impacts. For that purpose, the EIA should examine and evaluate the impact that the proposed project is likely to have on the natural environment, local environment and local communities and set out the measures required to avoid, reduce or compensate for environmental effects after implementation of the project. Those measures should be reflected in corresponding obligations for the private partner during both the construction and the operation phase of the project (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 85 and 91–92 respectively). An increasingly important element of an EIA is an assessment of the likely obsolescence of the facilities or their technology and the need for developing an environmentally sound decommissioning plan and to integrate decommissioning measures into the PPP contract (see chap. V, "Duration, extension and termination of the PPP contract", paras. 68 and 69).

5. *Impact on competition*

21. The contracting authority needs further to consider at the planning stages the extent to which the private partner should obtain exclusive rights for the operation of the infrastructure or provision of the relevant service, or whether the private partner might even need such exclusivity as a guarantee for the recovery of the original investment. This preliminary assessment should consider the geographic scope of the exclusivity – if any should be granted – and take into account the country's policies for the sector concerned (see "Introduction and background information on PPPs", paras 28–36 and chap. I, "General legal and institutional framework", paras. 19–20 and 24–28). The issue of exclusivity will play a central role in assessing the project's financial and commercial viability and its economic and social impact. From a practical point of view, exclusivity will be one of the central contract provisions (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 99–102), and it will also impact the level of Government support that the private partner may require (see section E, Government support, *(f)* Protection from competition).

22. The contracting authority should consider carefully the macroeconomic impact and policy disadvantages of granting exclusive rights to the private partner as well as the overall welfare costs of eliminating competition. As private partners may have a keen interest in exclusivity, the risk of collusion and corruption in this context may be particularly high. Laws and regulations may establish appropriate parameters for granting exclusivity, and should generally require the contracting authority to provide a justification for its recommendation to grant exclusivity.

C. Project risks and risk allocation

23. The precise allocation of risks among the various parties involved is typically defined after consideration of a number of factors, including the public interest in the development of the infrastructure in question and the level of risk faced by the private partner, other investors and lenders (and the extent of their ability and readiness to absorb those risks at an acceptable cost). Adequate risk allocation is essential to reducing project costs and to ensuring the successful implementation of the project. Conversely, an inappropriate allocation of project risks may compromise the project's financial viability or hinder its efficient management, thus increasing the cost of the service.

24. As used in this chapter, the notion of "project risks" refers to those circumstances which, in the assessment of the parties, may have a negative effect on the benefit they expect to achieve with the project. While there may be events that would represent a serious risk for most parties (for example, the physical destruction of the facility by a natural disaster), each party's risk exposure will vary according to its role in the project.

25. The expression "risk allocation" refers to the determination of which party or parties should bear the consequences of the occurrence of events identified as project risks. This is generally the subject of negotiation between the parties, although a country's regulations, policies or administrative guidance often establishes parameters for the allocation of some risks. The agreement of the parties in this respect is then translated into rights and obligations in the PPP contract. For example, if the private partner is obliged to deliver the infrastructure facility to the contracting authority with certain equipment in functioning condition, the private partner is bearing the risk that the equipment may fail to function at the agreed performance levels. The occurrence of that project risk, in turn, may have a series of consequences for the private partner, including its liability for failure to perform a contractual obligation under the PPP contract or the applicable law (for example, payment of damages to the contracting authority for delay in bringing the facility into operation); certain losses (for example, loss of revenue as a result of delay in beginning operating the facility); or additional cost (for example, cost of repair of faulty equipment or of securing replacement equipment).

26. The party bearing a given risk may take preventive measures with a view to limiting the likelihood of the risk, as well as specific measures to protect itself, in whole or in part, against the consequences of the risk. Such measures are often referred to as "risk mitigation". In the previous example, the private partner will carefully review the reliability of the equipment suppliers and the technology proposed. The private partner may require its equipment suppliers to provide independent guarantees concerning the performance of their equipment. The

supplier may also be liable to pay penalties or liquidated damages to the private partner for the consequences of failure of its equipment. In some cases, a more or less complex chain of contractual arrangements may be made to mitigate the consequences of a project risk. For instance, the private partner may combine the guarantees provided by the equipment supplier with commercial insurance covering some consequences of the interruption of its business because of equipment failure.

1. Overview of main categories of project risk

27. For purposes of illustration, the following paragraphs provide an overview of the main categories of project risks and give examples of certain contractual arrangements used for risk allocation and mitigation. For further discussion on this subject, the reader is advised to consult other sources of information, such as the *UNIDO BOT Guidelines*.[7]

(a) Project disruption caused by events outside the control of the parties

28. The parties face the risk that the project may be disrupted by unforeseen or extraordinary events outside their control, which may be of a physical nature, such as natural disasters – floods, storms or earthquakes – or the result of human action, such as war, riots or terrorist attacks. Such unforeseen or extraordinary events may cause a temporary interruption of the project execution or the operation of the facility, resulting in construction delay, loss of revenue and other losses. Severe events may cause physical damage to the facility or even destruction beyond repair (for a discussion of the legal consequences of the occurrence of such events, see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 145–154).

(b) Project disruption caused by adverse acts of Government ("political risk")

29. The private partner and the lenders face the risk that the project execution may be negatively affected by acts of the contracting authority, another agency of the Government or the host country's legislature. Such risks are often referred to as "political risks" and may be divided into three broad categories: "traditional" political risks (for example, nationalization of the private partner's assets or imposition of new taxes that jeopardize the private partner's prospects of debt repayment and investment recovery); "regulatory" risks (for example, introduction of more stringent standards for service delivery or opening of a sector to competition) and "quasi-commercial" risks (for example, breaches by the contracting authority or project interruptions due to changes in the contracting authority's priorities and plans) (for a discussion of the legal consequences of the occurrence of such events, see chap. IV, "PPP implementation: legal framework and PPP contract",

[7] See *Introduction and background information on PPPs*, footnote 2.

paras. 131–134). In addition to political risks originating from the host country, some political risks may result from acts of a foreign Government, such as blockades, embargoes or boycotts imposed by the Governments of the investors' home countries.

(c) Construction and operation risks

30. The main risks that the parties may face during the construction phase are the risks that the facility cannot be completed at all or cannot be delivered according to the agreed schedule (completion risk); that the construction cost exceeds the original estimates (construction cost overrun risk); or that the facility fails to meet performance criteria at completion (performance risk). Similarly, during the operational phase the parties may face the risk that the completed facility cannot be effectively operated or maintained to produce the expected capacity, output or efficiency (performance risk); or that the operating costs exceed the original estimates (operation cost overrun). It should be noted that construction and operation risks do not affect only the private sector. The contracting authority and the users in the host country may be severely affected by an interruption in the provision of needed services. The Government, as representative of the public interest, will be generally concerned about safety risks or environmental damage caused by improper operation of the facility.

31. Some of these risks may be brought about by the private partner or its contractors or suppliers. For instance, construction cost overrun and delay in completion may be the result of inefficient construction practices, waste, insufficient budgeting or lack of coordination among contractors. Failure of the facility to meet performance criteria may also be the result of defective design, inadequacy of the technology used or faulty equipment delivered by the private partner's suppliers. During the operational phase, performance failures may be the consequence, for example, of faulty maintenance of the facility or negligent operation of mechanical equipment. Operation cost overruns may also derive from inadequate management.

32. However, some of these risks may also result from specific actions taken by the contracting authority, by other public authorities or even the host country's legislature. Performance failures or cost overruns may be the consequence of the inadequacy of the technical specifications provided by the contracting authority during the PPP contract award. Delays and cost overruns may also be brought about by actions of the contracting authority subsequent to the award of the contract (delays in obtaining approvals and permits, additional costs caused by changes in requirements due to inadequate planning, interruptions caused by inspecting agencies or delays in delivering the land on which the facility is to be built). General legislative or regulatory measures, such as more stringent safety or labour

standards, may also result in higher construction or operating costs. Shortfalls in production may be caused by the non-delivery of the necessary supplies (for example, power or gas) on the part of public authorities.

(d) Commercial risks

33. "Commercial risks" relate to the possibility that the project cannot generate the expected revenue because of changes in market prices or demand for the goods or services it generates. Both of these forms of commercial risk may seriously impair the private partner's capacity to service its debt and may compromise the financial viability of the project.

34. Commercial risks vary greatly according to the sector and type of project. The risk may be regarded as minimal or moderate where the private partner has a monopoly over the service concerned or when it supplies a single client through a standing off-take agreement. However, commercial risks may be considerable in projects that depend on market-based revenues, in particular where the existence of alternative facilities or supply sources makes it difficult to establish a reliable forecast of usage or demand. This may be a serious concern, for instance, in toll road projects, since toll roads face competition from toll-free roads. Depending on the ease with which drivers may have access to toll-free roads, the toll revenues may be difficult to forecast, especially in urban areas where there may be many alternative routes and roads may be built or improved continuously. Furthermore, traffic usage has been found to be even more difficult to forecast in the case of new toll roads, especially those which are not an addition to an existing toll facility system, because there is no existing traffic to use as an actuarial basis.

(e) Exchange rate and other financial risks

35. Exchange rate risk relates to the possibility that changes in foreign exchange rates alter the exchange value of cash flows from the project. Prices and user fees charged to local users or customers will most likely be paid for in local currency, while the loan facilities and sometimes also equipment or fuel costs may be denominated in foreign currency. This risk may be considerable, since exchange rates are particularly unstable in many developing countries or countries whose economies are in transition. In addition to exchange rate fluctuations, the private partner may face the risk that foreign exchange control or lowering reserves of foreign exchange may limit the availability in the local market of foreign currency needed by the private partner to service its debt or repay the original investment.

36. Another risk faced by the private partner concerns the possibility that interest rates may rise, forcing the project to bear additional financing costs. This risk may be significant in infrastructure projects given the usually large sums borrowed and the long duration of projects, with some loans extending over a period of several

years. Loans are often given at a fixed rate of interest (for example, fixed-rate bonds) to reduce the interest rate risk. In addition, the finance package may include hedging facilities against interest rate risks, for example, by way of interest rate swaps or interest rate caps.

2. *Contractual arrangements for risk allocation and mitigation*

37. It follows from the above that the parties need to take into account a wide range of factors to allocate project risks effectively. For this reason, it is generally not advisable to have in place statutory provisions that limit unnecessarily the negotiators' ability to achieve a balanced allocation of project risks, as appropriate to the needs of individual projects. Nevertheless, it may be useful for the Government to provide some general guidance to officials acting on behalf of domestic contracting authorities, for instance, by formulating advisory principles on risk allocation.

38. Practical guidance provided to contracting authorities in a number of countries often refers to general principles for the allocation of project risks. One such principle is that specific risks should normally be allocated to the party best able to assess, control and manage the risk. Additional guiding principles envisage the allocation of project risks to the party with the best access to hedging instruments (that is, investment schemes to offset losses in one transaction by realizing a simultaneous gain on another) or the greatest ability to diversify the risks or to mitigate them at the lowest cost. In practice, however, risk allocation is often a factor of both policy considerations (for example, the public interest in the project or the overall exposure of the contracting authority under various projects) and the negotiating strength of the parties. Furthermore, in allocating project risks it is important to consider the financial strength of the parties to which a specific risk is allocated and their ability to bear the consequences of the risk, should it occur.

39. It is usually for the private partner and its contractors to assume ordinary risks related to the development and operation of the infrastructure. For instance, completion, cost overrun and other risks typical of the construction phase are usually allocated to the construction contractor or contractors through a turnkey construction contract, whereby the contractor assumes full responsibility for the design and construction of the facility at a fixed price, within a specified completion date and according to particular performance specifications (see chap. IV, "PPP implementation: legal framework and PPP contract", para. 78). The construction contractor is typically liable to pay liquidated damages or penalties for any late completion. In addition, the contractor is also usually required to provide a guarantee of performance, such as a bank guarantee or a surety bond. Separate equipment suppliers are also usually required to provide guarantees in respect of the performance of

their equipment. Guarantees of performance provided by contractors and equipment suppliers are often complemented by similar guarantees provided by the private partner to the benefit of the contracting authority. Similarly, the private partner typically mitigates its exposure to operation risks by entering into an operation and maintenance contract in which the operating company undertakes to achieve the required output and assumes the liability for the consequences of operational failures. In most cases, arrangements of this type will be an essential requirement for a successful project. The lenders, for their part, will seek protection against the consequences of those risks, by requiring the assignment of the proceeds of any bonds issued to guarantee the contractor's performance, for instance. Loan agreements typically require that the proceeds from contract bonds be deposited in an account pledged to the lenders (that is, an "escrow account"), as a safeguard against misappropriation by the private partner or against seizure by third parties (for example, other creditors). Nevertheless, the funds paid under the bonds are regularly released to the private partner as needed to cover repair costs or operating and other expenses.

40. The contracting authority, on the other hand, will be expected to assume those risks which relate to events attributable to its own actions, such as inadequacy of technical specifications provided during the selection process or delay caused by failure to provide agreed supplies on time. The contracting authority may also be expected to bear the consequences of disruptions caused by acts of Government, for instance by agreeing to compensate the private partner for loss of revenue due to price control measures (see chap. IV, "PPP implementation: legal framework and PPP contract", para. 42). While some political risks may be mitigated by procuring insurance, such insurance, if at all available for projects in the country concerned, may not be obtainable at an acceptable cost. Thus, prospective investors and lenders may turn to the Government, for instance, to obtain assurances against expropriation or nationalization and guarantees that proper compensation will be payable in the event of such action (see para. 76). Depending on their assessment of the level of risk faced in the host country, prospective investors and lenders may not be ready to pursue a project in the absence of those assurances or guarantees.

41. Most of the project risks referred to in the preceding paragraphs can, to a greater or lesser extent, be regarded as falling within the control of one party or the other. However, a wide variety of project risks result from events outside the control of the parties, or are attributable to the acts of third parties, and other principles of risk allocation may thus need to be considered.

42. For example, the private partner could expect that the interest rate risk, together with the inflation risk, would be passed on to the end users or customers of the facility through price increases, although this may not always be possible

because of market-related circumstances or price control measures. The price structure negotiated between the private partner and the contracting authority will determine the extent to which the private partner will avoid those risks or whether it will be expected to absorb some of them (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. 40–50).

43. Another category of risk that may be allocated under varying schemes concerns extraneous events such as war, civil disturbance, natural disasters or other events wholly outside the control of the parties. In traditional infrastructure projects carried out by the public sector, the public entity concerned usually bears the risk, for example, of destruction of the facility by natural disasters or similar events, to the extent that those risks may not be insurable. In PPP projects the Government may prefer this type of risk to be borne by the private partner. However, depending on their assessment of the particular risks faced in the host country, the private sector may not be ready to bear those risks. Therefore, in practice there is not a single solution to cover this entire category of risk and special arrangements are often made to deal with each of them. For example, the parties may agree that the occurrence of some of those events may exempt the affected party from the consequences of failure to perform under the PPP contract and there will be contractual arrangements providing solutions for some of their adverse consequences, such as contract extensions to compensate for delay resulting from events or even some form of direct payment under special circumstances (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. 145–154 and chap. V, “Duration, extension and termination of the PPP contract”, paras. 9–10). Those arrangements will be supplemented by commercial insurance purchased by the private partner, where available at an acceptable cost (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. 128 and 129).

44. Special arrangements may also need to be negotiated for the allocation of commercial risks. PPP projects such as mobile telecommunication projects usually have a relatively high direct cost recovery potential and in most cases the private partner is expected to carry out the project without sharing those risks with the contracting authority and without recourse to support from the Government. In other infrastructure PPP projects, such as power-generation projects, the private partner may revert to contractual arrangements with the contracting authority or other public authority in order to reduce its exposure to commercial risks, for example, by negotiating long-term off-take agreements that guarantee a market for the product at an agreed price. Payments may take the form of actual consumption or availability charges or combine elements of both; the applicable rates are usually subject to escalation or indexation clauses in order to protect the real value of revenues from the increased costs of operating an ageing facility (see also chap. IV, “PPP implementation: legal framework and PPP contract”, paras. 58 and 59). Lastly, there are relatively capital-intensive projects with more slowly developing

cost recovery potential, such as water supply and some toll road projects, which the private sector may be reluctant to carry out without some form of risk-sharing with the contracting authority, for example, through fixed revenue assurances or agreed capacity payments regardless of actual usage (see also chap. IV, "PPP implementation: legal framework and PPP contract", paras. 53–57).

45. The risk allocation eventually agreed to by the contracting authority and the private partner will be reflected in their mutual rights and obligations, as set forth in the PPP contract. The possible legislative implications of certain provisions commonly found in project agreements are discussed in other chapters of the *Guide* (see chap. IV, "PPP implementation: legal framework and PPP contract", and chap. V, "Duration, extension and termination of the PPP contract"). Various other agreements will also be negotiated by the parties to mitigate or reallocate the risks they assume (for example, loan agreements; construction, equipment supply, operation and maintenance contracts; direct agreement between the contracting authority and the lenders; and off-take and long-term supply agreements, where applicable).

D. Administrative coordination

46. Depending on the administrative structure of the host country, PPPs may require the involvement of several public authorities at various levels of government. For instance, the competence to lay down regulations and rules for the activity concerned may rest in whole or in part with a public authority at a level different from the one that is responsible for providing the relevant service. It may also be that both the regulatory and the operational functions are combined in one entity, but that the authority to award government contracts is centralized in a different public authority. For projects involving foreign investment, it may also happen that certain specific competences fall within the mandate of an agency responsible for approving foreign investment proposals.

47. International experience has demonstrated the usefulness of entrusting a central unit within the host country's administration with the overall responsibility for formulating policy and providing practical guidance on PPPs. Such a central unit may also be responsible for coordinating the input of the main public authorities that interface with the private partner. It is recognized, however, that such an arrangement may not be possible in some countries, owing to their particular administrative organization. Where it is not feasible to establish such a central unit, other measures may be considered to ensure an adequate level of coordination among the various public authorities involved, as discussed in the following paragraphs.

1. Coordination of preparatory measures

48. Following the identification of the future project, and a positive evaluation of the proposed PPP as the best option for implementing it, it is for the Government to establish the project's relative priority and to assign human and other resources for its implementation. At that point, it is desirable that the contracting authority review existing statutory or regulatory requirements relating to the operation of infrastructure facilities of the type proposed with a view to identifying the main public authorities whose input will be required for the implementation of the project. It is also important at this stage to consider the measures that may be required in order for the contracting authority and the other public authorities involved to perform the obligations they may reasonably anticipate in connection with the project. For instance, the Government may need to make advance budgeting arrangements to enable the contracting authority or other public authorities to meet financial commitments that extend over several budgetary cycles, such as long-term commitments to purchase the project's output (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 55–59). Furthermore, a series of administrative measures may be needed to implement certain forms of support provided to the project, such as tax exemptions and customs facilitation (see below, paras. 77–80), which may require considerable time.

2. Preparations for the selection of the private partner

49. The choice of the best private partner capable of developing the project to the contracting authority's satisfaction is the central condition for the success of the project. This is why the contracting authority must turn its attention as early as possible to preparing a selection procedure appropriate to ensure that result (see chap. III, "Contract award"). As do most modern laws on public procurement, the UNCITRAL Model Procurement Law generally allows the procuring entity the flexibility to determine what will constitute value for money in each procurement and how to conduct the procurement procedure in a way that will achieve it. Specifically, the UNCITRAL Model Law on Public Procurement gives the procuring entity a broad discretion to decide what to purchase, and in determining what will be considered responsive to the procuring entity's needs (art. 10), who can participate and on what terms (arts. 9, 18 and 49) and the criteria that will be applied in selecting the winning submission (art. 11). This level of flexibility is also desirable for the selection of the private partner to carry out a PPP project.

50. Flexibility does not mean, however, that the contracting authority should be free to make those decisions at any time or alter the nature of the procedure without proper justification. To the contrary, it is already essential at the planning stage

for the contracting authority to identify and study in detail the appropriate selection procedure from among those provided for in the country's general public procurement laws or any specific laws on PPPs (see chap. III, "Contract award", paras. 17 and 18). Indeed the choice of the appropriate procedure will depend on a number of practical aspects that the contracting authority needs to consider in conjunction at the project preparation phase. Indeed the choice of the PPP modality (see chap. I, "General legal and institutional framework", para. 16), the ownership and maintenance arrangements envisaged for the facility (see "Introduction and background information on PPPs", paras. 48–55), the payment model (for example, whether user fees, government payments or a combination of both) and other essential elements of project design will determine, for instance, the degree of interest of the contracting authority for the physical aspects of work and may, in turn, influence the extent to which the contracting authority wishes to control technical aspects by preparing a set of specifications, or prefers instead to allow bidders until the end to propose their own solutions to meet the expected output. Different selection processes may be available to meet the contracting authority's preferences (see chap. III, "Contract award").

51. The contracting authority will also need to consider important aspects of the contract award process already at this stage. The contracting authority will have to consider the need for, or desirability of, a preselection process, in light of the level of competition actually available in the market and the need for ensuring a robust and transparent selection process. The contracting authority will need to consider carefully the preselection criteria in light of both the desired output but also the nature of the PPP envisaged. The contracting authority will also need to prepare appropriate evaluation criteria to permit a ranking of proposals leading to the choice of the bidder offering the best value for money. From a practical point of view, the contracting authority will have to ensure that it will be able to avail itself of the required technical expertise to evaluate proposals, both in technical, as well as financial and commercial aspects.

52. Another crucial step in the preparatory process is for the contracting authority to refine the risk allocation assumptions considered when doing the "value for money" test and determine the essential terms of the contract, including the non-negotiable ones, as this will constitute a central element of the selection process and one of the bases for comparing the proposals received (see chap. III, "Contract award", paras. 75–79). The time needed for concluding the PPP contract after the selection of the private partner is often excessively long, adding to the overall project cost. The contracting authority can help shorten that time and make the final negotiations more structured and efficient by using as much as possible standards documents that, based on previous experience and practice, reflect the essential terms of the PPP (adapted, of course, to the circumstances of the project in question).

3. Arrangements for facilitating the issuance of licences and permits

53. Legislation may play a useful role in facilitating the issuance of licences and permits that may be needed in the course of a project (such as licences under foreign exchange regulations; licences for the incorporation of the private partner; authorizations for the employment of foreigners; registration and stamp duties for the use or ownership of land; import licences for equipment and supplies; construction licences; licences for the installation of cables or pipelines; licences for bringing the facility into operation; and spectrum allocation for mobile communication). The required licences or permits may fall within the competence of various organs at different levels of the administration and the time required for their issuance may be significant, in particular when the approving organs or offices were not originally involved in conceiving the project or negotiating its terms. Delays in bringing an infrastructure project into operation because of missing licences or permits for reasons not attributable to the private partner is likely to result in an increase in the cost of the project and in the price paid by the users.

54. Thus, it is advisable to conduct an early assessment of licences and permits needed for a particular project in order to avoid delay in the implementation phase. A possible measure to enhance the coordination in the issuance of licences and permits might be to entrust one organ with the authority to receive the applications for licences and permits, to transmit them to the appropriate agencies and to monitor the issuance of all licences and permits listed in the request for proposals and other licences that might be introduced by subsequent regulations. The law may also authorize the relevant agencies to issue provisional licences and permits and set forth a period beyond which those licences and permits are deemed to be granted unless they are rejected in writing.

55. However, it should be noted that the distribution of administrative authority among various levels of government (for example, local, regional and central) often reflects fundamental principles of a country's political organization. Therefore, there are instances where the central government would not be in a position to assume responsibility for the issuance of all licences and permits or to entrust one single body with such a coordinating function. In those cases, it is important to introduce measures to counter the possibility of delay that might result from such distribution of administrative authority, such as, for instance, agreements between the contracting authority and the other public authorities concerned to facilitate the procedures for a given project or other measures intended to ensure an adequate level of coordination among the various public authorities involved and to make the process of obtaining licences more transparent and efficient. Furthermore, the Government might consider providing some assurance that it will assist the private partner as much as possible in obtaining licences required by domestic

law, for instance by providing information and assistance to bidders regarding the required licences, as well as the relevant procedures and conditions. From a practical point of view, in addition to coordination among various levels of government and various public authorities, there is a need to ensure consistency in the application of criteria for the issuance of licences and for the transparency of the administrative process.

E. Government support

56. The discussion in section C shows that the parties may use various contractual arrangements to allocate and mitigate PPP project risks. Nevertheless, those arrangements may not always be sufficient to ensure the level of comfort required by private investors to participate in PPP projects. It may also be found that certain additional government support is needed to enhance the attractiveness of private investment in PPP projects in the host country.

57. Government support may take various forms. Generally, any measure taken by the Government to enhance the investment climate for PPP projects may be regarded as governmental support. From that perspective, the existence of legislation enabling the Government to award PPP contracts or the establishment of clear lines of authority for the negotiation and follow-up of PPP contracts (see chap. I, "General legal and institutional framework", paras. 29–36) may represent important measures to support the execution of infrastructure projects. As used in the *Guide*, however, the expression "government support" has a narrower connotation and refers in particular to special measures, in most cases of a financial or economic nature, that may be taken by the Government to enhance the conditions for the execution of a given project or to assist the private partner in meeting some of the project risks, above and beyond the ordinary scope of the contractual arrangements agreed to between the contracting authority and the private partner to allocate project risks. Government support measures, where available, are typically an integral part of governmental programmes to attract private investment for infrastructure projects.

1. Policy considerations relating to government support

58. In practice, a decision to support the implementation of a project is based on an assessment by the Government of the economic or social value of the project and whether that justifies additional governmental support. The Government may estimate that the private sector alone may not be able to finance certain projects at an acceptable cost. The Government may also consider that particular projects may not materialize without certain support measures that mitigate some of the project risks. Indeed, the readiness of private investors and lenders

to carry out large projects in a given country is not only based on their assessment of specific project risks but is also influenced by their comfort with the investment climate in the host country, in particular in the infrastructure sector. Factors to which private investors may attach special importance include the host country's economic system and the degree of development of market structures and the degree to which the country has already succeeded with PPP projects over a period of years.

59. For the above reasons, a number of countries have adopted a flexible approach for dealing with the issue of governmental support. In some countries, this has been done by legislative provisions that tailor the level and type of support to the specific needs of individual infrastructure sectors. In other countries, this has been achieved by providing the host Government with sufficient legislative authority to extend certain types of assurance or guarantee while preserving its discretion not to make them available in all cases. However, the host Government will be interested in ensuring that the level and type of support provided to the project does not result in the assumption of open-ended liabilities. Indeed, over-commitment of public authorities through guarantees given to a specific project may prevent them from extending guarantees in other projects of perhaps even greater public interest.

60. The efficiency of governmental support programmes for private investment in infrastructure may be enhanced by the introduction of appropriate techniques for budgeting for governmental support measures or for assessing the total cost of other forms of governmental support. For example, loan guarantees provided by public authorities usually have a cost lower than the cost of loan guarantees provided by commercial lenders. The difference (less the value of fees and interests payable by the private partner) represents a cost for the Government and a subsidy for the private partner. Therefore, a Government envisaging to offer some form of governmental support for a PPP should consider carefully their overall fiscal implications to avoid the risk of unanticipated contingent liabilities (see above, paras. 15 and 16). For instance, loan guarantees are often not recorded as expenses until such time as a claim is made. Thus, the actual amount of the subsidy granted by the Government is not recorded, which may create the incorrect impression that loan guarantees entail a lesser liability than direct subsidy payments. Similarly, the financial and economic cost of tax exemptions granted by the Government may not be apparent, which makes them less transparent than other forms of direct governmental support. For these reasons, countries that are contemplating establishing support programmes for PPP projects may need to devise special methods for estimating the budgetary cost of support measures such as tax exemptions, loans and loan guarantees provided by public authorities that take into account the expected present value of future costs or loss of revenue.

2. Forms of government support

61. The availability of direct governmental support, be it in the form of financial guarantees, public loans or revenue assurances, may be an important element in the financial structuring of the project. The following paragraphs briefly describe forms of governmental support that are sometimes authorized under domestic laws and discuss possible legislative implications they may have for the host country, without advocating the use of any of them in particular.

62. Generally, besides the administrative and budgetary measures that may be needed to ensure the fulfilment of governmental commitments throughout the duration of the project, it is advisable for the legislature to consider the possible need for an explicit legislative authorization to provide certain forms of support. Where government support is found advisable, it is important for the legislature to bear in mind the host country's obligations under international agreements on regional economic integration or trade liberalization, which may limit the ability of public authorities of the contracting States to provide support, financial or otherwise, to companies operating in their territories. Furthermore, where a Government is contemplating support for the execution of an infrastructure project, that circumstance should be made clear to all prospective bidders at an appropriate time during the selection proceedings (see chap. III, "Contract award", para. 76 *(c)* and *(i)*).

(a) Public loans and loan guarantees

63. In some cases, the law authorizes the Government to extend interest-free or low-interest loans to the private partner to lower the project's financing cost. Depending on the accounting rules to be followed, some interest-free loans provided by public agencies can be recorded as revenue in the private partner's accounts, with loan payments being treated as deductible costs for tax and accounting purposes. Moreover, subordinate loans provided by the Government may enhance the financial terms of the project by supplementing senior loans provided by commercial banks without competing with senior loans for repayment. Governmental loans may be generally available to all private partners in a given sector or they may be limited to providing temporary assistance to the private partner in the event that certain project risks materialize. The total amount of any such loan may be further limited to a fixed sum or to a percentage of the total project cost.

64. In addition to public loans, some national laws authorize the contracting authority or other agency of the host Government to provide loan guarantees for the repayment of loans taken by the private partner. Loan guarantees are intended to protect the lenders (and, in some cases, investors providing funds to the project as well) against default by the private partner. Loan guarantees do not entail an

immediate disbursement of public funds and they may appear more attractive to the Government than direct loans. However, loan guarantees may represent a substantial contingent liability and the Government's exposure may be significant, especially in the event of total failure by the private partner. Indeed, the Government would in most cases find little comfort in a possible subrogation in the rights of the lenders against an insolvent private partner.

65. Thus, in addition to introducing general measures to enhance the efficiency of governmental support programmes (see para. 60), it may be advisable to consider concrete provisions to limit the Government's exposure under loan guarantees. Rules governing the provision of loan guarantees may provide a maximum ceiling, which could be expressed as a fixed sum or, if more flexibility is needed, a certain percentage of the total investment in any given project. Another measure to circumscribe the contingent liabilities of the guaranteeing agency may be to define the circumstances under which such guarantees may be extended, taking into account the types of project risk the Government may be ready to share. For instance, if the Government considers sharing only the risks of temporary disruption caused by events outside the control of the parties, the guarantees could be limited to the event that the private partner is rendered temporarily unable to service its loans owing to the occurrence of specially designated unforeseeable events outside the private partner's control. If the Government wishes to extend a greater degree of protection to the lenders, the guarantees may cover the private partner's permanent failure to repay its loans for the same reasons. In such a case, however, it is advisable not to remove the incentives for the lenders to arrange for the continuation of the project, for instance by identifying another suitable private partner or by stepping in through an agent appointed to remedy the private partner's default (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 162–165). The call on the governmental guarantees could thus be conditional upon the prior exhaustion of other remedies available to the lenders under the PPP contract, the loan agreements or their direct agreements with the contracting authority, if any. In any event, full loan guarantees by the Government amounting to a total protection of the lenders against the risk of default by the private partner are not a common feature of infrastructure projects carried out under the project finance modality.

(b) Equity participation

66. Another form of additional support by the Government may consist of direct or indirect equity participation in the private partner. Equity participation by the Government may help achieve a more favourable ratio between equity and debt by supplementing the equity provided by the project sponsors, in particular where other sources of equity capital, such as investment funds, cannot be tapped by the private partner. Equity investment by the Government may also be useful to satisfy

legal requirements of the host country concerning the composition of locally established companies. The company laws of some jurisdictions, or special legislation on infrastructure projects, require a certain amount of participation of local investors in locally established companies. However, it may not always be possible to secure the required level of local participation on acceptable terms. Local investors may lack the interest or financial resources to invest in large infrastructure projects; they may also be averse to or lack experience in dealing with specific project risks.

67. Governmental participation may involve certain risks that the Government may wish to consider. In particular, there is a risk that such participation may be understood as an implied guarantee by the Government, so that the parties, or even third parties, may expect the Government to back the project fully or eventually even take it over at its own cost if the private partner fails. Where such an implied guarantee is not intended, appropriate provisions should be made to clarify the limits of governmental involvement in the project.

(c) Subsidies

68. Tariff subsidies are used in some countries to supplement the private partner's revenue when the actual income of the project falls below a certain minimum level. The provision of the services in some areas where the private partner is required to operate may not be a profitable undertaking, because of low demand or high operational costs or because the private partner is required to provide the service to a certain segment of the population at low cost. Thus, the law in some countries authorizes the Government to undertake to extend subsidies to the private partner in order to make it possible to provide the services at a lower price.

69. Subsidies usually take the form of direct payments to the private partner, either lump-sum payments or payments calculated specifically to supplement the private partner's revenue. In the latter case, the Government should ensure that it has in place adequate mechanisms for verifying the accuracy of subsidy payments made to the private partner, by means, for example, of audit and financial disclosure provisions in the project agreement. An alternative to direct subsidies may be to allow the private partner to cross-subsidize less profitable activities with revenue earned in more profitable ones. This may be done by combining in the same PPP contract both profitable and less profitable activities or areas of operation, or by granting to the private partner the commercial exploitation of a separate and more profitable ancillary activity (see below, paras. 84–86).

70. However, it is important for the legislature to consider practical implications and possible legal obstacles to the provision of subsidies to the private partner. For example, subsidies are found to distort free competition and the competition laws of many countries prohibit the provision of subsidies or other forms of direct

financial aid that are not expressly authorized by legislation. Subsidies may also be inconsistent with the host country's international obligations under international agreements on regional economic integration or trade liberalization.

(d) Sovereign guarantees

71. In connection with PPP projects, the term "sovereign guarantees" is sometimes used to refer to any of two types of guarantee provided by the host Government. The first type includes guarantees issued by the host Government to cover the breach of obligations assumed by the contracting authority under the PPP contract. A second category includes guarantees that the private partner will not be prevented by the Government from exercising certain rights that are granted to it under the PPP contract or that derive from the laws of the country, for example, the right to repatriate profits at the end of the project. Whatever form such guarantees may take, it is important for the Government and the legislature to consider the Government's ability to assess and manage efficiently its own exposure to project risks and to determine the acceptable level of direct or contingent liabilities it can assume.

(i) Guarantees of performance by the contracting authority

72. Performance guarantees may be used where the contracting authority is a separate or autonomous legal entity that does not engage the responsibility of the Government itself. Such guarantees may be issued in the name of the Government or of a public financial institution of the host country. They may also take the form of a guarantee issued by international financial institutions that are backed by a counter-guarantee by the Government (see below, paras. 88–92). Guarantees given by the Government may be useful instruments to protect the private partner from the consequences of default by the contracting authority or other public authority assuming specific obligations under the PPP contract. The most common situations in which such guarantees are used include the following:

(a) *Off-take guarantees.* Under these arrangements, the Government guarantees payment of goods and services supplied by the private partner to public entities. Payment guarantees are often used in connection with payment obligations under off-take agreements in the power-generation sector (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 58 and 59). Such guarantees may be of particular importance where the main or sole customer of the private partner is a government monopoly. Additional comfort is provided to the private partner and lenders when the guarantee is subscribed by an international financial institution;

(b) *Supply guarantees.* Supply guarantees may also be provided to protect the private partner from the consequences of default by public sector entities providing goods and supplies required for the operation of the facility – fuel, electricity or water, for example – or to secure payment of indemnities for which the contracting authority may become liable under the supply agreement;

(c) *General guarantees.* These are guarantees intended to protect the private partner against any form of default by the contracting authority, rather than default on specifically designated obligations. Although general performance guarantees may not be very frequent, there are cases in which the private partner and the lenders may regard them as a condition necessary for executing the project. This may be the case, for example, where the obligations undertaken by the contracting authority are not commensurate with its creditworthiness, as may happen in connection with large PPP contracts awarded by municipalities or other autonomous entities. Guarantees by the Government may be useful to ensure specific performance, for example, when the host Government undertakes to substitute for the contracting entity in the performance of certain acts (for example, delivery of an appropriate site for disposal of by-products).

73. Generally, it is important not to overestimate the adequacy of sovereign guarantees alone to protect the private partner against the consequences of default by the contracting authority. Except when their purpose is to ensure specific performance, sovereign guarantees usually have a compensatory function. Thus, they may not substitute for appropriate contractual remedies in the event of default by the contracting authority (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. 156 and 157). Different types of contractual remedies, or combinations thereof, may be used to deal with various events of default, for example, liquidated damages in the event of default and price increases or contract extensions in the event of additional delay in project execution caused by acts of the contracting authority. Furthermore, in order to limit the Government’s exposure and to reduce the risk of calls on the guarantee, it is advisable to consider measures to encourage the contracting authority to live up to its obligations under the PPP contract or to make efforts to control the causes of default. Such measures may include express subrogation rights of the guarantor against the contracting authority or internal control mechanisms to ensure the accountability of the contracting authority or its agents in the event, for instance, of wanton or reckless breach of its obligations under the PPP contract resulting in a call on the sovereign guarantee.

(ii) Guarantees against adverse acts of Government

74. Unlike performance guarantees, which protect the private partner against the consequences of default by the contracting authority, the guarantees considered here relate to acts of other authorities of the host country that are detrimental to the rights of the private partner or otherwise substantially affect the implementation of the PPP contract. Such guarantees are often referred to as “political risk guarantees”.

75. One type of guarantee contemplated in national laws consists of foreign exchange guarantees, which usually fulfil three functions: to guarantee the convertibility of the local earnings into foreign currency, to guarantee the availability of the required foreign currency and to guarantee the transferability abroad of the converted sums. Foreign exchange guarantees are common in PPP projects involving a substantial amount of debt denominated in currencies other than the local currency, in particular in those countries which do not have freely convertible currencies. Some laws also provide that such a guarantee may be backed by a bank guarantee issued in favour of the private partner. A foreign exchange guarantee is not normally intended to protect the private partner and the lenders against the risks of exchange rate fluctuation or market-induced devaluation, which are considered to be ordinary commercial risks. However, in practice, Governments have sometimes agreed to assist the private partner in cases where the private partner is unable to repay its debts in foreign currency owing to extreme devaluation of the local currency.

76. Another important type of guarantee may be to assure the company and its shareholders that they will not be expropriated without adequate compensation. Such a guarantee would typically extend both to confiscation of property owned by the private partner in the host country and to the nationalization of the private partner itself, that is, confiscation of shares of the private partner's capital. This type of guarantee is usually provided for in laws dealing with direct foreign investment and in bilateral investment protection treaties (see chap. VII, "Other relevant areas of law", paras. 4–6).

(e) Tax and customs benefits

77. Another method for the host Government to support the execution of PPP projects could be to grant some form of tax and customs exemption, reduction or benefit. Domestic legislation on foreign direct investment often provides special tax regimes to encourage foreign investment and in some countries it has been found useful expressly to extend such a taxation regime to foreign companies participating in PPP projects (see also chap. VII, "Other relevant areas of law", paras. 35–40).

78. Typical tax exemptions or benefits include exemption from income or profit tax or from property tax on the facility, or exemptions from income tax on interest due on loans and other financial obligations assumed by the private partner. Some laws provide that all transactions related to a PPP project will be exempted from stamp duties or similar charges. In some cases, the law establishes some preferential tax treatment or provides that the private partner will benefit from the same favourable tax treatment generally given to foreign investments. Sometimes the tax benefit takes the form of a more favourable income tax rate, combined with a decreasing

level of exemption during the initial years of the project. Such exemptions and benefits are sometimes extended to the contractors engaged by the private partner, in particular foreign contractors.

79. Further taxation measures sometimes used to promote PPP projects are exemptions from withholding tax to foreign lenders providing loans to the project. Under many legal systems, any interest, commission or fee in connection with a loan or indebtedness that is borne directly or indirectly by locally established companies or is deductible against income earned locally is deemed to be local income for taxation purposes. Therefore, both local and foreign lenders to infrastructure projects may be liable to the payment of income tax in the host country, which the private partner may be required to withhold from payments to foreign lenders, as non-residents of the host country. Income tax due by the lenders in the host country is typically taken into account in the negotiations between the private partner and the lenders and may result in a higher financial cost for the project. In some countries, the competent organs are authorized to grant exemptions from withholding tax in connection with payments to non-residents that are found to be made for a purpose that promotes or enhances the economic or technological development of the host country or are otherwise deemed to be related to a purpose of public relevance.

80. Besides tax benefits or exemptions, national laws sometimes facilitate the import of equipment for the use of the private partner by means of exemption from customs duties. Such exemption typically applies to the payment of import duties on equipment, machinery, accessories, raw materials and materials imported into the country for purposes of conducting preliminary studies, designing, constructing and operating infrastructure projects. In the event that the private partner wishes to transfer or sell the imported equipment on the domestic market, the approval of the contracting authority usually needs to be obtained and the relevant import duties, turnover tax or other taxes need to be paid in accordance with the laws of the country. Sometimes the law authorizes the Government either to grant an exemption from customs duty or to guarantee that the level of duty will not be raised to the detriment of the project.

(f) Protection from competition

81. An additional form of governmental support may consist of assurances that no competing infrastructure project will be developed for a certain period or that no agency of the Government will compete with the private partner, directly or through another private partner. Assurances of this sort serve as a guarantee that the exclusivity rights that may be granted to the private partner (see chap. I, "General legal and institutional framework", paras. 19 and 20) will not be nullified during the life of the project. Protection from competition may be regarded by the

private partner and the lenders as an essential condition for participating in the development of infrastructure in the host country. Some national laws contain provisions whereby the Government undertakes not to facilitate or support the execution of a parallel project that might generate competition to the private partner. In some cases, the law contains an undertaking by the Government that it will not alter the terms of such exclusivity to the detriment of the private partner without the private partner's consent.

82. Provisions of this type may be intended to foster the confidence of the project sponsors and the lenders that the basic assumptions under which the project was awarded will be respected. However, they may be inconsistent with the host country's international obligations under agreements on regional economic integration and trade liberalization. Furthermore, they may limit the ability of the Government to deal with an increase in the demand for the service concerned as the public interest may require to ensure the availability of the services to various categories of user. It is therefore important to consider carefully the interests of the various parties involved. For instance, the required price level to allow profitable exploitation of a toll road may exceed the paying capacity of low-income segments of the public. Thus, the contracting authority may have an interest in maintaining open to the public a toll-free road as an alternative to a new toll road. At the same time, however, if the contracting authority decides to improve or upgrade the alternative road, the traffic flow may be diverted from the toll road built by the private partner, thus affecting its flow of income. Similarly, the Government may wish to introduce free competition for the provision of long-distance telephone services in order to expand the availability and reduce the cost of telecommunication services (for a brief overview of issues relating to competition, see "Introduction and background information on PPPs", paras. 28–32). The consequence of such a measure, however, may be a significant erosion of the income anticipated by the private partner.

83. Generally, it may be useful to authorize the Government, where appropriate, to give assurances that the private partner's exclusive rights will not be unduly affected by subsequent changes in governmental policies without appropriate compensation. However, it may not be advisable to adopt statutory provisions that rule out the possibility of subsequent changes in the Government's policy for the sector concerned, including a decision to promote competition or to build parallel infrastructure. The possible consequences of such future changes for the private partner should be dealt with by the parties in contractual provisions dealing with changes in circumstances (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 130–144). It is particularly advisable to provide the contracting authority with the necessary power to negotiate with the private partner the compensation that may be due for loss or damage that may result from a competing infrastructure project subsequently launched by the contracting authority or from

any equivalent measure of the Government that adversely affects the private partner's exclusive rights.

(g) *Ancillary revenue sources*

84. One additional form of support to the execution of PPP projects may be to allow the private partner to diversify its investment through the provision of ancillary services or the exploitation of other activities. In some cases, alternative sources of revenue may also be used as a subsidy to the private partner for the purpose of pursuing a policy of low or controlled prices for the main service. Provided that the ancillary activities are sufficiently profitable, they may enhance the financial feasibility of a project: the right to collect tolls on an existing bridge, for example, may be an incentive for the execution of a new toll bridge project. However, the relative importance of ancillary revenue sources should not be overemphasized.

85. In order to allow the private partner to pursue ancillary activities, it may be necessary for the Government to receive legislative authorization to grant the private partner the right to use property belonging to the contracting authority for the purposes of such activities (for example, land adjacent to a highway for construction of service areas) or the right to charge fees for the use of a facility built by the contracting authority. Where it is felt necessary to control the development and possibly the expansion of such ancillary activities, the approval of the contracting authority might be required in order for the private partner to undertake significant expansion of facilities used for ancillary activities.

86. Under some legal systems, certain types of ancillary revenue source offered by the Government may be regarded as a concession separate from the main concession and it is therefore advisable to review possible limitations to the private partner's freedom to enter into contracts for the operation of ancillary facilities (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 109 and 110).

F. Guarantees provided by international financial institutions

87. Besides guarantees given directly by the host Government, there may be guarantees issued by international financial institutions, such as the World Bank, the Multilateral Investment Guarantee Agency and the regional development banks. Such guarantees usually protect the private partner against certain political risks, but under some circumstances they may also cover breach of the project agreement, for instance, where the private partner defaults on its loans as a result of the breach of an obligation by the contracting authority.

1. Guarantees provided by multilateral lending institutions

88. In addition to lending to Governments and public authorities, multilateral lending institutions, such as the World Bank and the regional development banks, have developed programmes to extend loans to the private sector. Sometimes they can also provide guarantees to commercial lenders for public and private sector projects. In most cases, guarantees provided by those institutions require a counter-guarantee from the host Government.

89. Guarantees by multilateral lending institutions are designed to mitigate the risks of default on sovereign contractual obligations or long-maturity loans that private lenders are not prepared to bear and are not equipped to evaluate. For instance, guarantees provided by the World Bank may typically cover specified risks (the partial risk guarantee) or all credit risks during a specified part of the financing term (the partial credit guarantee), as summarized below. Most regional development banks provide guarantees under terms similar to those of the World Bank.

(a) Partial risk guarantees

90. A partial risk guarantee covers specified risks arising from non-performance of sovereign contractual obligations or certain political force majeure events. Such guarantees ensure payment in the case of debt service default resulting from the non-performance of contractual obligations undertaken by Governments or their agencies. They may cover various types of non-performance, such as failure to maintain the agreed regulatory framework, including price formulas; failure to deliver inputs, such as fuel supplied to a private power company; failure to pay for outputs, such as power purchased by a government utility from a power company or bulk water purchased by a local public distribution company; failure to compensate for project delays or interruptions caused by government actions or political events; procedural delays; and adverse changes in exchange control laws or regulations.

91. When multilateral lending institutions participate in financing a project, they sometimes provide support in the form of a waiver of recourse that they would otherwise have to the private partner in the event that default is caused by events such as political risks. For example, a multilateral lending institution taking a completion guarantee from the private partner may accept that it cannot enforce that guarantee if the reason for failure to complete was a political risk.

(b) Partial credit guarantees

92. Partial credit guarantees are provided to private sector borrowers with a government counter-guarantee. They are designed to cover the portion of financing that falls due beyond the normal tenure of loans provided by private lenders. These

guarantees are generally used for projects involving private sector participation that need long-term funds to be financially viable. A partial credit guarantee typically extends maturities of loans and covers all events of non-payment for a designated part of the debt service.

2. Guarantees provided by the Multilateral Investment Guarantee Agency

93. The Multilateral Investment Guarantee Agency (MIGA) offers long-term political risk insurance coverage to new investments originating in any member country and destined for any developing member country other than the country from which the investment originates. New investment contributions associated with the expansion, modernization or financial restructuring of existing projects are also eligible, as are acquisitions that involve the privatization of State enterprises. Eligible forms of foreign investment include equity, shareholder loans and loan guarantees issued by equity holders, provided the loans and loan guarantees have terms of at least three years. Loans to unrelated borrowers can also be insured, as long as a shareholder investment in the project is concurrently insured. Other eligible forms of investment are technical assistance, management contracts and franchising and licensing agreements, provided they have terms of at least three years and the remuneration of the investor is tied to the operating results of the project. MIGA insures against the following risks: foreign currency transfer restrictions, expropriation, breach of contract, war and civil disturbance, non-honouring of financial obligations.

(a) Transfer restrictions

94. The purpose of guarantees of foreign currency transfer extended by MIGA is similar to that of sovereign foreign exchange guarantees that may be provided by the host Government (see para. 75). This guarantee protects against losses arising from an investor's inability to convert local currency (capital, interest, principal, profits, royalties and other remittances) into foreign exchange for transfer outside the host country. The coverage insures against excessive delays in acquiring foreign exchange caused by action or failure to act by the host Government, by adverse changes in exchange control laws or regulations and by deterioration in conditions governing the conversion and transfer of local currency. Currency devaluation is not covered. On receipt of the blocked local currency from an investor, MIGA pays compensation in the currency of its contract of guarantee.

(b) Expropriation

95. This guarantee protects against loss of the insured investment as a result of acts by the host Government that may reduce or eliminate ownership of, control over or rights to the insured investment. In addition to outright nationalization

and confiscation, "creeping" expropriation – a series of acts that, over time, have an expropriatory effect – is also covered. Coverage is provided on a limited basis for partial expropriation (for example, confiscation of funds or tangible assets). Bona fide, non-discriminatory measures taken by the host Government in the exercise of legitimate regulatory authority are not covered. For total expropriation of equity investments, MIGA pays the net book value of the insured investment. For expropriation of funds, MIGA pays the insured portion of the blocked funds. For loans and loan guarantees, the Agency insures the outstanding principal and any accrued and unpaid interest. Compensation is paid upon assignment of the investor's interest in the expropriated investment (for example, equity shares or interest in a loan agreement) to MIGA.

(c) Breach of contract

96. This guarantee protects against losses arising from the host Government's breach or repudiation of a contract with the investor. In the event of an alleged breach or repudiation, the investor must be able to invoke a dispute resolution mechanism (for example, arbitration) under the underlying contract and obtain an award for damages. If, after a specified period of time, the investor has not received payment or if the dispute resolution mechanism fails to function because of actions taken by the host Government, MIGA will pay compensation.

(d) War and civil disturbance

97. This guarantee protects against loss from damage to, or the destruction or disappearance of, tangible assets caused by politically motivated acts of war or civil disturbance in the host country, including revolution, insurrection, coup d'état, sabotage and terrorism. For equity investments, MIGA will pay the investor's share of the least of the book value of the assets, their replacement cost or the cost of repair of damaged assets. For loans and loan guarantees, MIGA will pay the insured portion of the principal and interest payments in default as a direct result of damage to the assets of the project caused by war and civil disturbance. War and civil disturbance coverage also extends to events that, for a period of one year, result in an interruption of project operations essential to overall financial viability. This type of business interruption is effective when the investment is considered a total loss; at that point, MIGA will pay the book value of the total insured equity investment.

(e) Non-honouring of financial obligations

98. This guarantee protects against losses incurred from the failure of sovereign and sub-sovereign entities, as well as state-owned enterprises to make a payment when due under an unconditional financial payment obligation or guarantee related to an eligible investment. The primary beneficiaries are commercial lenders that

provide loans to the public-sector entities involved in development investments. This coverage may be made available to investors only if the financial payment obligation is unconditional and not subject to any defences – meaning that there are no grounds on which the sovereign, sub-sovereign or state-owned enterprise could defend legally against the fact that the obligation is due and payable. A further advantage of MIGA's non-honouring of financial obligations is that it does not require an investor to obtain an arbitral award to file a claim for compensation with MIGA.

G. Guarantees provided by export credit agencies and investment promotion agencies

99. Insurance against certain political, commercial and financial risks, as well as direct lending, may be obtained from export credit agencies and investment promotion agencies. Export credit agencies and investment promotion agencies have typically been established in a number of countries to assist in the export of goods or services originating from that country. Export credit agencies act on behalf of the Governments of the countries supplying goods and services for the project. Most export credit agencies are members of the International Union of Credit and Investment Insurers (Berne Union), whose main objectives include promoting international cooperation and fostering a favourable investment climate; developing and maintaining sound principles of export credit insurance; and establishing and sustaining discipline in the terms of credit for international trade.

100. While the support available differs from country to country, export credit agencies typically offer two lines of coverage:

(a) *Export credit insurance.* In the context of the financing of PPP projects, the essential purpose of export credit insurance is to guarantee payment to the seller whenever a foreign buyer of exported goods or services is allowed to defer payment. Export credit insurance may take the form of "supplier credit" or "buyer credit" insurance arrangements. Under the supplier credit arrangements the exporter and the importer agree on commercial terms that call for deferred payment evidenced by negotiable instruments (for example, bills of exchange or promissory notes) issued by the buyer. Subject to proof of creditworthiness, the exporter obtains insurance from an export credit agency in its home country. Under the buyer credit modality, the buyer's payment obligation is financed by the exporter's bank, which in turn obtains insurance coverage from an export credit agency. Export credits are generally classified as short-term (repayment terms of usually under two years), medium-term (usually two to five years) and long-term (over five years). Official support by export credit agencies may take the form of "pure cover", by which is meant insurance or guarantees given to exporters or lending institutions without financing support. Official support may also be given in the form of "financing support", which is defined as including direct credits to the overseas buyer, refinancing and all forms of interest rate support;

(b) *Investment insurance.* Export credit agencies may offer insurance coverage either directly to a borrower or to the exporter for certain political and commercial risks. Typical political and commercial risks include war, insurrection or revolution; expropriation, nationalization or requisition of assets; non-conversion of currency; and lack of availability of foreign exchange. Investment insurance provided by export credit agencies typically protects the investors in a private partner established abroad against the insured risks, but not the private partner itself. Investment insurance cover tends to be extended to a wide range of political risks. Export credit agencies prepared to cover such risks will typically require sufficient information on the legal system of the host country.

101. The conditions under which export credit agencies of most member countries of the Organization for Economic Cooperation and Development (OECD) offer support to both supplier and buyer credit transactions have to be in accordance with the OECD Arrangement on Guidelines for Officially Supported Export Credits (also referred to as the "OECD consensus"). The main purpose of the arrangement is to provide a suitable institutional framework to prevent unfair competition by means of official support for export credits. In order to avoid market-distorting subsidies, the Arrangement regulates the conditions of terms of insurances, guarantees or direct lending supported by Governments.

III. Contract award

A. General remarks

1. The present chapter deals with methods and procedures recommended for use in the award of PPP contracts. In line with the advice of international organizations, such as UNIDO[1] and the World Bank,[2] the *Guide* expresses an obvious and strong preference for the use of competitive award procedures, which are widely recognized as being best suited for promoting economy, efficiency and transparency, among other general principles that should guide PPP laws and regulations (see chap. I, "General legal and institutional framework", paras. 3–20). This is also consistent with article 9, paragraph 1, of the United Nations Convention against Corruption, which requires its States Parties to take the necessary steps "to establish appropriate systems of procurement, based on transparency, competition and objective criteria in decision-making, that are effective, inter alia, in preventing corruption." The *Guide* recognizes, however, that under exceptional circumstances contracts may be awarded without competitive procedures in consideration of the specific aspects of the project but subject to the safeguards recommended herein (see paras. 99–131).

2. The award procedures recommended in this chapter present some of the features of the request for proposals with dialogue (RFP with dialogue) under article 49 of the UNCITRAL Model Law on Public Procurement.[3] In addition to the request for proposals with dialogue, the UNCITRAL Model Law on Public Procurement provides for other procurement methods, such as two-stage tendering (art. 48) or competitive negotiations (art. 51), which may also be used for the award of PPP contracts, depending on the project characteristics and the assessment made by the contracting authority during the planning phase (see chap. II, "Project planning and preparation", paras. 49–52). Where appropriate, this chapter refers the reader to those, as well as to various other provisions of the UNCITRAL Model Law on Public Procurement that usefully supplement the award procedure described herein. When choosing the most appropriate contract

[1] *Guidelines for Infrastructure Development through Build-Operate-Transfer (BOT) Projects*, United Nations Industrial Development Organization, p. 91 seq. (UNIDO publication, Sales No. UNIDO.95.6.E).

[2] *Public-Private Partnerships Reference Guide – Version* 3, World Bank and its partners, p. 160 seq. (International Bank for Reconstruction and Development/The World Bank, 2017).

[3] UNCITRAL Model Law on Public Procurement (2011).

award methods and deciding on the structure and practical manner of conducting it, the contracting authority should also bear in mind the general principles of PPP laws and regulations and the objectives that an adequate PPP contract award process should attain (see below, paras. 5–16).

1. *Award procedures covered by the* Guide

3. Through PPP projects a contracting authority is able to bundle together several activities that it would otherwise have procured separately (namely, design, construction, operation and maintenance, but also financing and the general management of the whole life cycle of the infrastructure or service). The overall objective is to reallocate risks between the public and private sector in a manner that offers incentives to enhance the provision of public infrastructure or services. Nevertheless, even in those projects intended to be entirely funded by the private sector, and repaid through user fees and other charges, the Government remains ultimately accountable for the quality and cost of the infrastructure and services. Accordingly, except for some matters peculiar to PPPs and therefore not usually regulated in public procurement procedures, the main part of the selection of the private partner should be aligned or coexists with the relevant principles and best practices for public procurement.

4. This chapter deals primarily with award procedures suitable for use in relation to infrastructure projects that involve an obligation, on the part of the selected private partner, to undertake finance, design and physical construction, repair or expansion works in the infrastructure concerned with a view to subsequent private operation and provision of services to the public by the private partner. The award procedures discussed in this chapter may also serve for the award of PPPs contracts under which the facility to be built or refurbished would be used by the contracting authority or other public body for its own needs, or to house public services, but would be operated and maintained by the private partner. This chapter does not deal specifically with other methods of selecting providers of public services through licensing or similar procedures, or of merely disposing of State property or State-owned corporations through capital increases or offerings of shares.

2. *General objectives of award procedures*

5. For the award of PPP contracts, the contracting authority may either apply methods and procedures already provided in the laws of the country or establish procedures specifically designed for that purpose. The law of the country may specify and regulate the most appropriate method for selecting the private partner for PPP in order to ensure transparency in the process. In all cases, it is important to ensure that such procedures are generally conducive to attaining the fundamental objectives of rules governing the award of public contracts. Those objectives are discussed briefly below.

(a) Economy and efficiency

6. In connection with PPP projects, "economy" refers to the selection of a private partner that is capable of performing works and delivering services of the desired quality at the most advantageous price or that offers the best commercial proposal. Experience shows that one of the best ways to achieve economy is to promote competition among bidders. Competition provides them with incentives to offer their most advantageous terms and it can encourage them to adopt efficient or innovative technologies or production methods in order to do so.

7. It should be noted, however, that competition does not necessarily require the participation of a large number of bidders in a given contract award process. For large projects, there may be even reasons for the contracting authority to wish to limit the number of bidders to a manageable number (see paras. 19 and 34–35). Provided that appropriate procedures are in place, the contracting authority can take advantage of effective competition even where the competitive base is limited.

8. Economy can often be promoted through participation by foreign companies in award proceedings. Not only can foreign participation expand the competitive base, it can also lead to the acquisition by the contracting authority and its country of technologies that are not available locally. Foreign participation in award proceedings may be necessary where there exists no domestic expertise of the type required by the contracting authority. A country wishing to achieve the benefits of foreign participation should ensure that its relevant laws and procedures are conducive to such participation.

9. "Efficiency" refers to selection of a private partner within a reasonable amount of time, with minimal administrative burdens and at reasonable cost both to the contracting authority and to participating bidders. In addition to the losses that can accrue directly to the contracting authority from inefficient award procedures (owing, for example, to delayed selection or high administrative costs), excessively costly and burdensome procedures can lead to increases in the overall project costs or even discourage competent companies from participating in the contract award proceedings altogether, which would endanger the final objective that is to attract the best potential economic operators for the project.

(b) Promotion of the integrity of and confidence in the award process

10. Another important objective of rules governing the selection of the private partner is to promote the integrity of and confidence in the process. Thus, an adequate selection system will usually contain provisions designed to ensure fair treatment of bidders, to reduce or discourage unintentional or intentional abuses of the contract award process by persons administering it or by companies participating in it and to ensure that selection decisions are taken on a proper basis.

11. Promoting the integrity of the contract award process will help to promote public confidence in the process and in the public sector in general. Bidders will often refrain from spending the time and sometimes substantial sums of money to participate in award proceedings unless they are confident that they will be treated fairly and that their proposals or offers have a reasonable chance of being accepted. Those which do participate in award proceedings in which they do not have that confidence would probably increase the project cost to cover the higher risks and costs of participation. Ensuring that award proceedings are run on a proper basis could reduce or eliminate that tendency and result in more favourable terms to the contracting authority.

12. To guard against corruption by government officials, including employees of the contracting authorities, the host country should have in place an effective system of sanctions. These could include sanctions of a criminal nature that would apply to unlawful acts of officials conducting the award process and of participating bidders, such as debarment or suspension from the award process. Conflicts of interest should also be avoided, for instance by requiring that officials of the contracting authority or each member of the evaluation commission or single evaluator fill a declaration of the absence of conflicts of interest at the beginning of the process. Officials, their spouses, relatives and associates shall be barred from owning a debt or equity interest in a company participating in a award process or accepting to serve as a director or employee of such a company. Furthermore, in line with the provisions of the UNCITRAL Model Law on Public Procurement (art. 21), the law governing the award proceedings should obligate the contracting authority to reject offers or proposals submitted by a party who gives or agrees to give, directly or indirectly, to any current or former officer or employee of the contracting authority or other public authority a gratuity in any form, an offer of employment or any other thing or service of value, as an inducement with respect to an act or decision of or procedure followed by the contracting authority in connection with the award proceedings. This obligation shall be applicable at any time in the award proceeding and not limited to the tender period. These provisions may be supplemented by other measures, such as the requirement that all companies invited to participate in the award process undertake neither to seek to influence unduly the decisions of the public officials involved in the award process nor otherwise to distort the competition by means of collusive or other illicit practices (that is, the so called "integrity agreement"). Also, in the procurement practices adopted by some countries, bidders are required to guarantee that no official of the procuring entity has been or shall be admitted by the bidder to any direct or indirect benefit arising from the contract or the award thereof. Breach of such a provision typically constitutes a breach of an essential term of the contract.

13. The confidence of investors may be further fostered by adequate provisions to protect the confidentiality of proprietary information submitted by them during the

award proceedings. This should include sufficient assurances that the contracting authority will treat applications to pre-qualify or for pre-selection, as well as proposals eventually received in such a manner as to avoid the disclosure of their contents to competing bidders or to any unauthorized person; that any discussions or negotiations will be confidential; and that trade or other information that bidders might include in their proposals will not be made known to their competitors.

(c) Transparency of laws and procedures

14. Transparency of laws and procedures, including judicial decisions and administrative rulings with precedent value, governing the award of the private partner will help to achieve a number of the policy objectives already mentioned. Transparent laws are those in which the rules and procedures to be followed by the contracting authority and by bidders are fully disclosed, are not unduly complex and are presented in a systematic and understandable way. Transparent procedures are those which enable the bidders to ascertain what procedures have been followed by the contracting authority and the basis of decisions taken by it. The publication of upcoming opportunities by the public authority is another means to achieve transparency, as it helps potential bidders to know what is to be procured and how.

15. One of the most important ways to promote transparency and accountability is to include provisions requiring that the contracting authority maintain a record of the award proceedings (see paras. 134–141). A record summarizing key information concerning those proceedings facilitates the exercise of the right of aggrieved bidders to seek review. That in turn will help to ensure that the rules governing the award proceedings are, to the extent possible, self policing and self enforcing. Furthermore, adequate record requirements in the law will facilitate the work of public authorities exercising an audit or control function and promote the accountability of contracting authorities to the public-at-large as regards the award of infrastructure projects. Indeed, domestic laws increasingly require the disclosure of awarded contracts for transparency and accountability purposes (see para. 109 below). Disclosure obligations for contracting or regulatory authorities may not be limited to the key terms of the PPP contract and may also extend to some essential elements of contract performance, such as the level of payments made by Government agencies to the private partner, or an evaluation of the private partner performance against contractual or regulatory benchmarks (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 52, 103 and 104).

16. An important corollary of the objectives of economy, efficiency, integrity and transparency is the availability of administrative and judicial procedures for the review of decisions made by the authorities involved in the award proceedings (see paras. 142 and 143).

3. Special features of award procedures for PPPs

17. Modern procurement systems provide public authorities with a broad range of procurement methods and greater freedom to choose the best procedure to meet their needs. The formal procedures and the objectivity and predictability that characterize the competitive award procedures generally provide optimal conditions for competition, transparency and efficiency. Thus, the use of competitive award procedures in PPPs has been recommended by UNIDO, which has formulated detailed practical guidance on how to structure those procedures.[4] The procurement policies of the World Bank also advocate the use of competitive award procedures at national level, when such national legislation is correctly developed. A private partner selected pursuant to bidding procedures acceptable to the World Bank is generally free to adopt its own procedures for the award of contracts required to implement the project.

18. It should be noted, however, that no international legislative model has thus far been specifically devised for competitive award procedures in PPPs. Newly drafted domestic laws on award procedures for public procurement services may be suitable for PPPs or sometimes contain specific provisions applicable to PPPs. In small-scale projects, or where the contracting authority's requirements are so straight-forward that it is possible to formulate specifications and evaluation criteria without the need for any form of consultation or dialogue with potential bidders, it may be possible to use the procedures generally available for open tendering. In most cases, however, it is advisable for the Government to consider reviewing the suitability of existing procedures for the selection of the private partner in a PPP project, in view of the particular issues raised by PPPs, which are briefly discussed below.

(a) Range of bidders to be invited

19. The award of PPP projects typically involves complex, time consuming and expensive proceedings, and the sheer scale of most infrastructure projects reduces the likelihood of obtaining proposals from a large number of suitably qualified bidders. In fact, competent bidders may be reluctant to participate in bid for high value projects if the competitive field is too large and where they run the risk of having to compete with unrealistic proposals or proposals submitted by unqualified bidders. Open tendering without a pre-selection phase is therefore usually not advisable for the award of most PPP contracts.

(b) Definition of project requirements

20. In traditional public procurement of construction works the procuring authority usually assumes the position of a *maître d'ouvrage* or employer, while the

[4] See *UNIDO BOT Guidelines*.

selected contractor carries out the function of the performer of the works. The procurement procedures emphasize the inputs to be provided by the contractor, that is, the contracting authority establishes clearly what is to be built, how and by what means. It is therefore common for invitations to tender for construction works to be accompanied by extensive and very detailed technical specifications of the type of works and services being procured. In those cases, the contracting authority will be responsible for ensuring that the specifications are adequate to the type of infrastructure to be built and that such infrastructure will be capable of being operated efficiently.

21. However, for many PPPs, the contracting authority may envisage a different allocation of responsibilities between the public and the private sector. In those cases, after having established a particular need, the contracting authority may prefer to leave to the private sector the responsibility for proposing the best solution for meeting such a need, subject to certain requirements that may be established by the contracting authority (for example, regulatory performance or safety requirements, sufficient evidence that the technical solutions proposed have been previously tested and have met internationally acceptable safety and other standards). The award procedure used by the contracting authority may thus give more emphasis to the output expected from the project (that is, the services or goods to be provided) than to technical details of the works to be performed or means to be used to provide those services (see paras. 70–72).

(c) Evaluation criteria

22. For projects to be financed, owned and operated by public authorities, goods, construction works or services are typically purchased with funds available under approved budgetary allocations. With the funding sources usually secured, the main objective of the procuring entity is to obtain the best value for the funds it spends. Therefore, in those types of procurement the decisive factor in establishing the winner among the responsive and technically acceptable proposals (that is, those which have passed the threshold with respect to quality and technical aspects) is often the global price offered for the construction works, which is calculated on the basis of the cost of the works and other costs incurred by the contractor, plus a certain margin of profit.

23. Many PPPs, in turn, are expected to be financially self sustainable, with the development and operational costs being recovered from the project's own revenue, although some projects ("non-concession PPPs") may involve a specific payment by the contracting authority (see "Introduction and background information on PPPs", paras. 15–16). Therefore, a number of other factors linked with the capacity of the potential private partner to handle certain risks of the project that the public sector is not willing to assume (mainly – but not only – in connection with the technology

or the specific sector), will need to be considered in addition to the construction and operation cost and the price to be paid by the users or the public authority. For instance, the contracting authority will need to consider carefully the financial and commercial feasibility of the project as presented by the bidders in the frame of the preliminary assessment undertaken by the public authority, the soundness of the financial arrangements proposed by the bidders and the reliability of the technical solutions used and their adaptability to the local context. Such interest exists even where no governmental guarantees or payments are involved, because unfinished projects or projects with large cost overruns or higher than expected maintenance costs often have a negative impact on the overall availability of needed services and on the public opinion in the host country. Also, the contracting authority will aim at formulating qualification and evaluation criteria that give adequate weight to the need to ensure the continuous provision of and, as appropriate, universal access to the public service concerned. Furthermore, given the usually long duration of PPP contracts, the contracting authority will need to satisfy itself as to the soundness and acceptability of the arrangements proposed for the operational phase and will weigh carefully the service elements of the proposals (see para. 72). In accordance with good practices followed in large construction projects, whole life cycle costs should also be considered among the evaluation criteria. This is even more relevant in PPP projects where bidders are free to offer a range of technical proposals to meet the outputs, some of which may be much costlier to operate than others.

(d) Negotiations with bidders

24. Laws and regulations governing tendering proceedings for the procurement of goods and services often prohibit negotiations between the contracting authority and the contractors concerning a proposal submitted by them. The rationale for such a strict prohibition, which is also contained in article 44 of the UNCITRAL Model Law on Public Procurement, is that negotiations might result in an "auction", in which a proposal offered by one contractor is used to apply pressure on another contractor to offer a lower price or an otherwise more favourable proposal. Owing to that strict prohibition, contractors selected to provide goods or services pursuant to traditional procurement procedures are typically required to sign standard contract documents provided to them during the procurement proceedings.

25. The situation is different in the award of PPP contracts. The complexity and long duration of such projects makes it unlikely that the contracting authority would be in a position to determine in advance the technical and other requirements of the project without discussing the needs and the various available options to meet them with the qualified bidders. This is the reason why the *Guide* recommends the use of an award procedure such as the request for proposals with dialogue set forth in article 49 of the UNCITRAL Model Law on Public Procurement, which provides a transparent structure for negotiations between the contracting authority and the

bidders at a stage of the process that does not lead to changes to the basis on which the competition was carried out (see paras. 95–98; on the importance of proper project planning and preparation to clarify the scope for negotiations at the selection stage, see also chapter II, "Project planning and preparation", para. 52 and the need for preserving the basis for the award during contract implementation, chapter IV, "PPP implementation: legal framework and PPP contract", paras. 140–144).

4. *Preparations for the award proceedings*

26. The award of PPP contracts is in most cases a complex exercise requiring careful planning and coordination among the offices involved. By ensuring that adequate administrative and personnel support is available to conduct the type of award proceeding that it has chosen, the Government plays an essential role in promoting confidence in the award process. Additionally, the involvement of a PPP unit or a PPP office at national or local level is widely seen as a good practice in order to streamline the preparation for the award proceedings.

(a) Early information on forthcoming PPP projects

27. Countries that include PPP projects in their medium- and long-term infrastructure planning, as the *Guide* encourages them to do (see chap. II, "Project planning and preparation", para. 17), may wish to publish information regarding planned or possible future selection proceedings for PPP projects for the forthcoming months or years, as contemplated in article 6 of the UNCITRAL Model Law on Public Procurement. The purpose of this early notice is to enable more suppliers and contractors to learn about contract opportunities, assess their interest in participation and plan their participation in advance accordingly. Publication of such information may also have a positive impact in the broader governance context, in particular in opening up procurement to general public review and civil society and local community participation. In practice, such advance notices may be useful, for example, to investigate whether the market could respond to the contracting authority's needs before any selection process is initiated. This type of market investigation may prove useful in rapidly evolving markets (such as in the information and telecommunication sector) to allow the public sector to assess whether there are recent or envisaged innovative solutions. Responses to the advance notice might reveal that it would not be feasible or desirable to carry out the project as planned by the public authority. Based on the data collected, the contracting authority may take a more informed decision concerning the most appropriate selection method to award the forthcoming contact. This advance notice should not be confused with a notice seeking expressions of interest that is usually published in conjunction with request-for-proposals proceedings (see section C, paras. 51–64) since publishing such expression of interest notice does not oblige the contracting authority to request proposals from all those that expressed interest.

(b) Appointment of the award committee

28. One important preparatory measure is the appointment of the committee that will be responsible for evaluating the proposals and making an award recommendation to the contracting authority. The appointment of qualified and impartial members to the award committee is not only a requirement for an efficient evaluation of the proposals but may further foster the confidence of bidders in the award process.

29. Another important preparatory measure is the appointment of the independent advisers who will assist the contracting authority in the award procedures. The contracting authority may need, at this early stage, to retain the services of independent experts or advisers to assist in establishing appropriate qualification and evaluation criteria, defining performance indicators (and, if necessary, project specifications) and preparing the documentation to be issued to bidders. Consultant services and advisers may also be retained to assist the contracting authority in the evaluation of proposals, drafting and negotiation of the project agreement. Consultants and advisers can be particularly helpful by bringing a broad range of technical expertise that may not always be available in the public administration of the contracting authority, such as technical or engineering advice (for example, on technical assessment of the project or installations and technical requirements of contract); environmental advice (for example, environmental assessment and operation requirements); or legal and financial advice (for example, on financial projections, review of financing sources, assessing the adequate ratio between debt and equity and drafting of contractual and financial information documents).

(c) Feasibility and other studies

30. As indicated earlier (see chap. II, "Project planning and preparation", paras. 5–21), one of the initial steps that should be taken by the Government in relation to a proposed infrastructure project is to conduct a preliminary assessment of its feasibility, including economic and financial aspects such as expected economic advantages of the project, estimated cost and potential revenue anticipated from the operation of the infrastructure facility, and its social and environmental impact. The option to develop infrastructure as a PPP requires a positive conclusion on the feasibility and financial viability of the project under such PPP form to the exclusion of any other procurement method. In some countries, it has been found useful to provide for some public participation in the preliminary assessment of the project's social and environmental impact and the various options available to minimize it.

31. Prior to starting the proceedings leading to the selection of a prospective private partner, it is advisable for the contracting authority to review and, in most cases, expand those initial studies. In some countries contracting authorities are

advised to formulate model projects for reference purposes (typically including a combination of estimated capital investment, operation and maintenance costs) prior to inviting proposals from the private sector. The purpose of such model projects is to demonstrate the viability of the commercial operation of the infrastructure and the affordability of the project in terms of total investment cost and cost to the public. They will also provide the contracting authority with a useful tool for comparison and evaluation of proposals. The confidence of bidders will be promoted by evidence that the technical, economic and financial assumptions of the project, as well as the proposed role of the private sector, have been carefully considered by the contracting authority.

(d) Preparation of documentation

32. Selection proceedings for the award of PPP contracts typically require the preparation of extensive documentation, including a project outline, pre-selection documents, the request for proposals, instructions for preparing proposals and a draft of the PPP contract. The quality and clarity of the documents issued by the contracting authority plays a significant role in ensuring an efficient and transparent award procedure. Here too, the work of PPP units has been widely described as very positive in the process, by gathering the publication of clear and concise documents that are in line with the practice of the bidders.

33. Standard documentation prepared in sufficiently precise terms may be an important element to facilitate the negotiations between bidders and prospective lenders and investors. It may also be useful for ensuring consistency in the treatment of issues common to most projects in a given sector. However, in using standard contract terms it is advisable to bear in mind the possibility that a specific project may raise issues that had not been anticipated when the standard document was prepared or that the project may need solutions that might be at variance with the standard terms. Careful consideration should be given to the need to achieve an appropriate balance between the level of uniformity desired for project agreements of a particular type and the flexibility that might be needed for finding project specific solutions.

B. Pre-selection of bidders

34. Given the technical nature of most PPP projects and the complexity of many of them, the contracting authority should seek proposals only from bidders who satisfy certain qualification criteria. In traditional government procurement, the pre-qualification proceedings may consist of the verification of certain formal requirements, such as adequate proof of technical capability or prior experience in the type of procurement, so that all bidders who meet the pre-qualification criteria

are automatically admitted to the tendering phase. The pre-selection proceedings for complex procurement or PPP projects may, in turn, involve elements of comparison and selection. This may be the case, for example, where the contracting authority establishes a ranking of pre-selected bidders.

35. In some countries, practical guidance on award procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, three or four). For that purpose, those countries apply a quantitative rating system for technical, managerial, environmental, ethical and other compliance standards such as clean debarment record, anti-corruption status criteria, taking into account the nature of the project. Quantitative pre-selection criteria are found to be more easily applicable and transparent than qualitative criteria involving the use of merit points. However, in devising a quantitative rating system, it is important to avoid unnecessary limitation of the contracting authority's discretion in assessing the qualifications of bidders. The contracting authority may also need to take into account the fact that the procurement guidelines of some multilateral financial institutions may restrict the use of pre-selection proceedings for the purpose of limiting the number of bidders to a predetermined number. In any event, where such a rating system is to be used, that circumstance should be clearly stated in the pre-selection documents. In some small and less complex projects, it may be difficult for the contracting authority to screen potential bidders through a quantitative scoring system because of the large number of suppliers or contractors possessing essentially equal qualifications who could be eligible for bidding. Such highly competitive situations would make it difficult for the contracting authority to formulate bidding criteria and devise methods for bidder qualification that would ensure an efficient award process. In some countries, contracting authorities try to achieve that result by screening suppliers or contractors through random extraction, for instance by drawing lots from among pre-qualified suppliers or contractors included in an existing suppliers' list. The UNCITRAL Model Law on Public Procurement, in turn, does not provide for suppliers' lists because it was felt that the very flexible provisions on framework agreements set out in chapter VII of the Model Law allow for the benefits of suppliers' lists to be achieved without running the elevated risks to transparency and competition that suppliers' lists are considered to raise.

1. Invitation to the pre-selection proceedings

36. In order to promote transparency and competition, it is advisable to advertise the invitation to the pre-selection proceedings in a manner that reaches an audience wide enough to provide an effective level of competition. The laws of many countries identify publications, usually the official gazette or other official publication, in which the invitation to the pre-selection proceedings is to be published. The electronic publication of the invitation through specially dedicated portals,

including through the website of the PPP unit – if any – is also a widely used and effective means of circulating the invitation to the pre-qualification. With a view to fostering participation of foreign companies and maximizing competition, the contracting authority may wish to have the invitations to the pre-selection proceedings internationally, so as to be widely accessible to potentially interested international bidders, such as industry journals, conferences, Government websites and international newspapers. Another possible medium is *Development Business*[5] of the United Nations.

37. Pre-selection documents should contain enough information for bidders to be able to ascertain whether the works and services entailed by the project are of a type that they can provide and, if so, how they can participate in the selection proceedings. The invitation to the pre-selection proceedings should, in addition to identifying the infrastructure to be built or renovated, contain information on other essential elements of the project, such as the services to be delivered by the private partner, the financial arrangements envisaged by the contracting authority (for example, whether the project will be entirely financed by user fees or tolls or whether public funds may be provided as direct payments, loans or guarantees) and, where already known, a summary of the main required terms of the project agreement to be entered into as a result of the selection proceedings (risk allocation).

2. Pre-selection criteria

38. In addition, the invitation to the pre-selection proceedings should include general information similar to the information typically provided in pre-selection documents under general rules on public procurement.[6]

39. Generally, bidders should be required to demonstrate that they possess the professional, technical and environmental qualifications, financial and human resources, equipment and other physical facilities, managerial capability, reliability and experience necessary to carry out the project. Additional criteria that might be particularly relevant for PPPs may include the ability to manage the financial aspects of the project and previous experience in operating public infrastructure or in providing services under regulatory oversight (for example, quality indicators of their past performance, size and type of previous projects carried out by the bidders); the level of experience of the key personnel to be engaged in the project; sufficient organizational ability (including minimum levels of construction, operation and maintenance equipment); ability to sustain the financing requirements for the engineering, construction and operational phases of the project (demonstrated, for instance, by evidence of the bidders' ability to provide an adequate

[5] https://devbusiness.un.org/.

[6] See UNCITRAL Model Law on Public Procurement, arts. 7, 8 and 10.

amount of equity to the project and sufficient evidence from reputable banks attesting the bidder's good financial standing). In line with high level political commitments or treaty obligations towards sustainable development, good governance, transparency and business ethics, contracting authorities often request the bidders to demonstrate that they meet recognized ethical standards (environmental certification, clean anti-corruption records, labour policy declarations). Qualification requirements should cover all phases of an infrastructure project, including financing management, engineering, construction, operation and maintenance, where appropriate. In addition, the bidders should be required to demonstrate that they meet such other qualification criteria as would typically apply under the general procurement laws of the country.[7] Pre-selection criteria should be objectively justifiable and adequate to the subject matter of the PPP contract. Moreover, they should not be used in a discriminatory manner to automatically exclude potential bidders from certain jurisdictions

40. One important aspect to be considered by the contracting authority relates to the relationship between the award of one particular project and the governmental policy pursued for the sector concerned (see "Introduction and background information on PPPs", paras. 28–32). Where competition is sought, the Government may be interested in ensuring that the relevant market or sector is not dominated by one enterprise. To implement such a policy and to avoid market domination by bidders who may have already been awarded a PPP contract within a given sector of the economy, the contracting authority may wish to include in the pre-selection documents for new PPPs provisions that limit the participation of or prevent another award to such bidders. For purposes of transparency, it is desirable for the law to provide that, where the contracting authority reserves the right to reject a proposal on those or similar grounds, adequate notice of that circumstance must be included in the invitation to the pre-selection proceedings.

41. Qualification requirements should apply equally to all bidders. A contracting authority should not impose any criterion, requirement or procedure with respect to the qualifications of bidders that has not been set forth in the pre-selection documents. When considering the professional, technical and environmental qualifications of bidding consortia, the contracting authority should consider the

[7] For example, that they have legal capacity to enter into the PPP contract; that they are not insolvent, in receivership, bankrupt or being wound up, their affairs are not being administered by a court or a judicial officer, their business activities have not been suspended and they are not the subject of legal proceedings for any of the foregoing; that they have fulfilled their obligations to pay taxes and social security contributions in the State; that they have not, and their directors or officers have not, been convicted of any criminal offence related to their professional conduct or the making of false statements or misrepresentations as to their qualifications to enter into a procurement contract within a certain period of years preceding the commencement of the selection proceedings or have not been otherwise disqualified pursuant to administrative suspension or disbarment proceedings (see UNCITRAL Model Law on Public Procurement, art. 9, para. 2).

individual specialization of the consortium members and assess whether the combined qualifications of the consortium members are adequate to meet the needs of all phases of the project.

3. *Issues relating to the participation of bidding consortia*

42. Given the large scale of most infrastructure projects, the interested companies typically participate in the award proceedings through consortia especially formed for that purpose. Therefore, information required from members of bidding consortia should relate both to the consortium as a whole as well as to its individual participants. For facilitating the liaison with the contracting authority, it may be useful to require in the pre-selection documents that each consortium designate one of its members as a focal point for all communications with the contracting authority. It is generally advisable for the contracting authority to require that the members of bidding consortia submit a sworn statement undertaking that, if awarded the contract, they shall bind themselves jointly and severally for the obligations assumed in the name of the consortium under the PPP contract, at least until the consortium members form and capitalize the project company, as a special purpose vehicle, and the project company enters into the PPP contract with the contracting authority. It is indeed unusual for members of the bidding consortia to be willing to carry the project in their own names. The contracting authority itself may prefer to see the project implemented by a legal entity with its seat in the host country and especially established for that purpose, being thus unconstrained by pre-existing liabilities or parallel activities. This is why, in practice, the contracting authority typically reserves the right to require at a later stage that the members of the selected consortium establish an independent legal entity to carry out the project (see also chap. IV, "PPP implementation: legal framework and PPP contract", paras. 13 and 14).

43. It is also advisable for the contracting authority to review carefully the composition of consortia and their parent companies. It may happen that one company, directly or through subsidiary companies, joins more than one consortium to submit proposals for the same project. Such a situation should not be allowed, since it raises the risk of leakage of information or collusion between competing consortia, thus undermining the credibility of the award proceedings. It is therefore advisable to provide in the invitation to the pre-selection proceedings that each of the members of a qualified consortium may participate, either directly or through subsidiary companies, in only one bid for the project. A violation of this rule should cause the disqualification of the consortium and of the individual member companies, save for exceptional situations in which participation in multiple consortia might be authorized, for instance, because the project in question requires know-how or a proprietary method or technology that only one or a few companies possess.

4. Pre-selection and domestic preferences

44. The laws of some countries provide for some sort of preferential treatment for domestic entities or afford special treatment to bidders that undertake to use national goods or employ local labour. Such preferential or special treatment is sometimes provided as a material qualification requirement (for example, a minimum percentage of national participation in the consortium) or as a condition for participating in the award procedure (for example, to appoint a local partner as a leader of the bidding consortium). The preferential treatment given to domestic operators, or even the outright exclusion of foreign entities, is also sometimes justified for strategic and sensitive sectors, such as national defence and security operations. The contracting authority should disclose any such limitation among eligibility criteria from the outset of the process, include them in the record of the award proceedings and make the reasons available to any person upon request, in accordance with article 8 of the UNCITRAL Model Law on Public Procurement.

45. Domestic preferences may give rise to a variety of issues. Firstly, their use is not permitted under the guidelines of some international financial institutions and might be inconsistent with international obligations entered into by many States pursuant to agreements on international trade or regional economic integration or trade facilitation. Furthermore, from the perspective of the host country it is important to weigh the expected advantages against the disadvantage of depriving the contracting authority of the possibility of obtaining better options to meet the national infrastructure needs. It is also important not to allow total insulation from foreign competition so as not to perpetuate lower levels of economy, efficiency and competitiveness of the concerned sectors of national industry. This is the reason why many countries that wish to provide some incentive to national suppliers, while at the same time taking advantage of international competition, do not contemplate a blanket exclusion of foreign participation or restrictive qualification requirements. Domestic preferences may take the form of special evaluation criteria establishing margins of preference for national bidders or bidders who offer to procure supplies, services and products in the local market. The margin of preference technique, which is provided in article 11, paragraph 3, of the UNCITRAL Model Law on Public Procurement, is more transparent than subjective qualification or evaluation criteria. Furthermore, it allows the contracting authority to favour local bidders that are capable of approaching internationally competitive standards, and it does so without simply excluding foreign competition. Additionally, it has been witnessed that forced use of local content may lead to reduction of liability of the bidders regarding quality or even final output of the project. Where domestic preferences are envisaged, they should be announced in advance, preferably in the invitation to the pre-selection proceedings.

5. Contribution towards costs of participation in the award proceedings

46. According to articles 38 and 49, paragraph 4, of the UNCITRAL Model Law on Public Procurement, the price charged for the pre-selection documents should only reflect the cost of providing them to the bidders. In recognition of the high cost of the preliminary studies and preparatory work, including for the formulation of the request for proposals, standard contracts and other relevant bidding documents, in international practice it is not uncommon for a contracting authority to seek at least partial recovery of those costs through so-called "development fees" set above the mere cost of printing the bidding documents. A contracting authority should attempt to align the level of those fees with similar projects, bearing in mind market practices and expectations. Indeed, development fees should not be used as an additional tool to limit the number of bidders. Such a practice is both ineffective and adds to the already considerable cost of participation in the pre-qualification proceedings. The high costs of preparing proposals for infrastructure projects and the relatively high risks that an award procedure may not lead to a contract award may function as a deterrent for some companies to join in a consortium to submit a proposal, in particular when they are not familiar with the award procedures applied in the host country.

47. Therefore, some countries authorize the contracting authority to consider arrangements for compensating pre-qualified bidders if the project cannot proceed for reasons outside their control or for contributing to the costs incurred by them after the pre-selection phase, when justified in a particular case by the complexity involved and the prospect of significantly improving the quality of the competition. When such contribution or compensation is envisaged, appropriate notice should be given to potential bidders at an early stage, preferably in the invitation to the pre-selection proceedings.

6. Pre-selection procedures

48. The contracting authority should respond to any request by a bidding consortium for clarification of the pre-selection documents that is received by the contracting authority within a reasonable time prior to the deadline for the submission of applications to enable the bidders to make a timely submission of their application. The response to any request that might reasonably be expected to be of interest to other bidders should, without identifying the source of the request, be communicated to all bidders to which the contracting authority provided the pre-selection documents.

49. Upon completion of the pre-selection phase, the contracting authority usually draws up a short list of the pre-selected bidders that will subsequently be invited

to submit proposals. One practical problem sometimes faced by contracting authorities concerns proposals for changes in the composition of bidding consortia during the award proceedings. From the perspective of the contracting authority, it is generally advisable to exercise caution in respect of proposed substitutions of individual members of bidding consortia after the closing of the pre-selection phase. Changes in the composition of consortia may substantially alter the basis on which the pre-selected bidding consortia were short listed by the contracting authority and may give rise to questions about the integrity of the award proceedings. As a general rule, only pre-selected bidders should be allowed to participate in the award phase, unless a new consortium member meets the pre-selection criteria to substantially the same extent as the exiting member of the consortium.

50. While the criteria used for pre-selecting bidders should not be weighted again at the evaluation phase, the contracting authority may wish to reserve itself the right to require, at any stage of the award process, that the bidders again demonstrate their qualifications in accordance with the same criteria used to pre-select them.

C. Procedures for requesting proposals

51. This section discusses the procedures for requesting proposals from the pre-selected bidders. As stated above, the procedures follow the main features of the of procurement methods provided in the UNCITRAL Model Law on Public Procurement, with some adaptations needed to fit the needs of contracting authorities.

1. Structure and phases of the procedure

52. Following the pre-selection of bidders, it is advisable for the contracting authority to review its original feasibility study and the definition of the output and performance requirements and to consider whether a revision of those requirements is needed in the light of the information obtained during the pre-selection proceedings. At this stage, the contracting authority should already have determined whether a single or a two stage procedure will be used to request proposals, or whether it would be most efficient to use a request for proposals with dialogue.

(a) Single-stage procedure

53. The choice of the procedure for requesting proposals will depend on the nature of the contract, on how precisely the contracting authority can determine the technical requirements and whether output results (or performance indicators) are used for selection of the private partner. If it is both feasible and desirable for the contracting authority to formulate performance indicators or project specifications to the necessary degree of precision or finality, the award process may be structured as a

single stage procedure. In that case, after having concluded the pre-selection of bidders, the contracting authority would proceed directly to issuing a final request for proposals (see paras. 65–79). The contract would be awarded to the bidder submitting the proposal that offers the best combined terms of *(a)* criteria other than price specified in the request for proposals and *(b)* price (see UNCITRAL Model Law on Public Procurement, art. 47, para. 10). Some flexibility may be added to the process (for instance, where the contracting authority needs to consider and negotiate the financial aspects of proposals only after assessing their technical, quality and performance characteristics) by allowing a final round of consecutive negotiations with bidders submitting responsive proposals, in the order of their ranking (see UNCITRAL Model Law on Public Procurement, art. 50).

54. Single-stage bidding may be appropriate for relatively simple, small-scale projects where the contracting authority possesses enough sufficient technical knowledge and does not expect the private sector to come forward with alternative solutions, technology or know-how. In most PPP projects, however, it may not be feasible for the contracting authority to formulate its requirement in sufficiently detailed and precise project specifications or performance indicators to permit proposals to be formulated, evaluated and compared uniformly on the basis of those specifications and indicators. This may be the case, for instance, when the contracting authority has not determined the type of technical and material input that would be suitable for the project in question (for example, the type of construction material to be used in a bridge). The larger the project, and the greater its complexity, the less likely it is that single-stage award procedures would be adequate or lead to a satisfactory result. In such cases, it might be considered undesirable, from the standpoint of obtaining the best value for money, for the contracting authority to proceed on the basis of specifications or indicators it has drawn up in the absence of discussions with bidders as to the exact capabilities and possible variations of what is being offered. Therefore, in most cases, the contracting authority considers that interaction with suppliers or contractors is necessary *(a)* to refine its statement of needs and present them in a common description (two-stage tendering) or *(b)* to define its statement of needs and invite proposals to meet them (request for proposals with dialogue).

(b) Two-stage procedure

55. Where the award procedure is divided into two stages,[8] the initial request for proposals typically calls upon the bidders to submit proposals relating to output specifications and other characteristics of the project as well as to the proposed contractual terms. The invitation for bids would allow bidders to offer their own

[8] Article 48 of the UNCITRAL Model Law on Public Procurement sets forth procedures for two-stage tendering.

solutions for meeting the particular need in accordance with defined standards of service. The proposals submitted at this stage would typically consist of solutions on the basis of a conceptual design or performance indicators without indication of financial elements, such as the expected price or level of remuneration. They shall not be considered as binding proposals and the contracting authority should not even solicit price commitment at this stage.[9]

56. To the extent the terms of the contractual arrangements are already known by the contracting authority, they should be included in the request for proposals, possibly in the form of a draft of the PPP contract. Knowledge of certain contractual terms, such as the risk allocation envisaged by the contracting authority, is important in order for the bidders to formulate their proposals and discuss the "bankability" of the project with potential lenders (see chap. II, "Project planning and preparation", para. 26). The initial response to those contractual terms, in particular the risk allocation envisaged by the contracting authority, may help the contracting authority reassess the feasibility of the project as originally conceived. However, it is important to distinguish between the procedure to request proposals and the negotiation of the final contract, after the project has been awarded. The purpose of this initial stage is to enable the contracting authority to formulate its requirement subsequently in a manner that enables a final competition to be carried out on the basis of a single set of parameters. The invitation of initial proposals at this stage should not lead to a negotiation of the terms of the contract prior to its final award.

57. The contracting authority may then convene a meeting of bidders to clarify questions concerning the request for proposals and accompanying documentation. The contracting authority may, at the first stage, engage in discussions with any bidder concerning any aspect of its proposal. The contracting authority should treat proposals in such a manner as to avoid the disclosure of their contents to competing bidders or any other person not expressly authorized to obtain such information. Any discussions need to be confidential and one party to the discussions should not reveal to any other person any technical, financial or other information relating to the discussions without the consent of the other party.

58. Following those discussions, the contracting authority should review and, within the limits allowed by the law, revise the initial project specifications on their technical, quality or performance aspects. In formulating those revised specifications, the contracting authority should not modify the subject matter of the project but could delete or modify any aspect of the technical, quality or performance characteristics of the project originally set forth in the request for proposals. The contracting authority could also at this stage delete or modify any criterion for

[9] See *Guide to Enactment of the UNCITRAL Model Law on Procurement,* p. 188.

examining or evaluating proposals initially provided and adding any new criterion, if necessary as a result of changes made in the technical, quality or performance characteristics of the project. Any such deletion, modification or addition should be communicated to bidders in the invitation to submit final proposals. Bidders not wishing to submit a final proposal should be allowed to withdraw from the award proceedings without forfeiting any security that they may have been required to provide.

(c) Request for proposals with dialogue

59. Another procedure that the contracting authority may use to select the private partner for a PPP project is the request for proposals with dialogue.[10] This is a procedure designed for the procurement of relatively complex items and services. The typical use for this method is procurement aimed at seeking innovative solutions to technical issues such as saving energy, achieving sustainable procurement, or infrastructure needs. In such cases, there may be different technical solutions: the material may vary and may involve the use of one source of energy as opposed to another (wind vs. solar vs. fossil fuels).

60. Request for proposals with dialogue is procedurally similar to two-stage tendering, but with several distinguishing features. The method allows the technical, quality and performance characteristics and financial aspects of the contracting authority's needs to be discussed between the contracting authority and potential suppliers or contractors, again within the framework of a transparent and structured process. The process results in a request for a "best and final offer" (BAFO) to meet the contracting authority's needs, but there is no single, common set of technical specifications beyond stated minimum technical requirements. BAFOs can present a variety of technical solutions to those needs; in this sense, the suppliers and contractors are responsible for designing the technical solutions. The contracting authority examines those solutions to ascertain whether they meet its needs; evaluating them on a competitive but equal basis is a more complex procedure than in two-stage tendering.

61. In summary, the objective is to enable suppliers and contractors to understand, through the dialogue with the contracting authority, the needs of the contracting authority as outlined in its request for proposals. The dialogue, which may involve several stages, is an interaction between the contracting authority and the suppliers or contractors on both technical, quality and performance characteristics of their proposals and the financial aspects of their proposals. The dialogue may involve a discussion of the financial implications of particular technical solutions, including the price or price range. However, as in two-stage

[10] See UNCITRAL Model Law on Public Procurement, article 49.

tendering, it is not intended to involve binding negotiations or bargaining from any party to the dialogue. Upon conclusion of the dialogue, the suppliers and contractors make BAFOs to meet the contracting authority's needs. BAFOs of different suppliers or contractors may be similar in some respects while significantly different in others, in particular as regards proposed technical solutions. The method therefore gives the contracting authority the opportunity to compare different technical solutions to meet its needs.

62. Methods based on this type of dialogue have proved to be beneficial to the contracting authority in the procurement of relatively complex items and services where the opportunity cost of not engaging in dialogue with suppliers or contractors is high, while the economic gains of engaging in the process are evident. In addition to the typical uses described above, they may be appropriate for example in the procurement of architectural or construction works, where there are many possible solutions to the contracting authority's needs and in which the personal skill and expertise of the supplier or contractor can be evaluated only through dialogue. The complexity need not be at the technical level: in infrastructure projects, for example, there may be different locations and types of construction as the main variables. The method has enabled the contracting authority in such situations to identify and obtain the best solution to its procurement needs.

63. The procedure itself involves two stages. At the first stage, the contracting authority issues a solicitation setting out a description of its needs expressed as terms of reference to guide suppliers or contractors in drafting their proposals. The needs can be expressed in functional, performance or output terms but are required to include minimum technical requirements. By comparison with two-stage tendering, it is not intended that the procedure will involve the contracting authority in setting out a full technical description of the subject matter of the procurement.

64. The method requires the contracting authority to issue a statement of needs with minimum technical requirements, to understand technical solutions that are proposed and to evaluate them on a comparative basis, and so may require capacity in procurement officials that is not required in other procurement methods, particularly to avoid the method's use as an alternative to appropriate preparation for the procurement. A particular risk is that the responsibility of defining procurement needs may be shifted to suppliers and contractors or the market. Although the suppliers or contractors, not the contracting authority, make proposals to meet the contracting authority's needs, they should not take a lead in defining those needs. Generally, it is essential to ensure that all bidders receive the same information at every stage of the dialogue and that the entire process is duly documented and supported by appropriate safeguards to prevent abuse or improper conduct.

2. Content of the request for proposals

65. The contracting authority should invite the bidders to submit proposals with respect to the project specifications, performance indicators and contractual terms. The request for proposals should generally include all information necessary to provide a basis to enable the bidders to submit proposals that meet the needs of the contracting authority and that the contracting authority can compare in an objective and fair manner. The content and level of detail of the information provided to bidders at this stage will vary according to the type of PPP envisaged and the nature of the award procedure used by the contracting authority. The information may be less detailed and would be typically less focused on technical aspects in cases where the contracting authority has used the procedure of request for proposals with dialogue provided for in article 49 of the UNCITRAL Model Law on Public Procurement. However, where the contracting authority has instead used a two-stage procedure, the contracting authority would already have previously issued a less detailed initial solicitation for bids without price and engaged in discussions with the bidders whose bids had not been rejected. Thus, at this stage, the contracting authority would have prepared a more extensive set of terms and conditions, as provided in article 48, paragraphs 2 and 3, of the UNCITRAL Model Law on Public Procurement.[11]

(a) General information to bidders

66. General information to bidders should cover, as appropriate, those items which are ordinarily included in solicitation documents or requests for proposals for the procurement of goods, construction and services.[12] Particularly important is the disclosure of the criteria to be used by the contracting authority in determining the successful proposal and the relative weight or order of importance of such criteria (see paras. 82–87). Electronic platforms for uploading and sharing

[11] "2. The solicitation documents shall call upon suppliers or contractors to present, in the first stage of two-stage-tendering proceedings, initial tenders containing their proposals without a tender price. The solicitation documents may solicit proposals relating to the technical, quality or performance characteristics of the subject matter of the procurement, as well as to contractual terms and conditions of supply and, where relevant, the professional and technical competence and qualifications of the suppliers or contractors. 3. The procuring entity may, in the first stage, engage in discussions with suppliers or contractors whose initial tenders have not been rejected pursuant to provisions of this Law concerning any aspect of their initial tenders. When the procuring entity engages in discussions with any supplier or contractor, it shall extend an equal opportunity to participate in discussions to all suppliers or contractors."

[12] For example, instructions for preparing and submitting proposals, including the manner, place and deadline for the submission of proposals and the period of time during which proposals shall be in effect and any requirements concerning tender securities; the means by which bidders may seek clarifications of the request for proposals, and a statement as to whether the contracting authority intends, at this stage, to convene a meeting of bidders; the place, date and time for the opening of proposals and the procedures to be followed for opening and examining proposals; the manner in which the proposals will be evaluated; the minimum requirements that proposals must meet in order to be considered responsive (see UNCITRAL Model Law on Public Procurement Law, art. 47, para. 2 and art. 49, para. 2).

documents and information to bidders may be particularly useful to enhance efficiency and expedite the procedure, given the large amount of information that the bidders will typically require. Pre-bid meetings open to all interested bidders are also useful to clarify questions that they may have in a transparent manner.

(i) Information on feasibility studies

67. It is advisable to include in the general information provided to bidders instructions for the preparation of feasibility studies they may be required to submit with their proposals. Such feasibility studies should not substitute for the "value for money", financial risk and other feasibility and impact assessment studies that the contracting authority is required to conduct prior to obtaining approval for the project (see chap. II, "Project planning and preparation", paras. 5–22). The bidders' own feasibility study would typically cover, for instance, the following aspects:

(a) *Commercial viability*. In particular in projects financed on a non recourse or limited recourse basis, it is essential to establish the need for the project outputs and to evaluate and project such needs over the proposed operational life of the project, including expected demand (for example, traffic forecasts for roads) and pricing (for example, tolls). In order to facilitate the contracting authority's examination, bidders should also describe the scenarios used to justify the commercial viability of their proposal;

(b) *Engineering design and operational feasibility.* Bidders should demonstrate the suitability of the technology they propose, including equipment and processes, to national, local and environmental conditions, the likelihood of achieving the planned performance level and the adequacy of the construction methods and schedules. This study should also define the proposed organization, methods and procedures for operating and maintaining the completed facility, and provide information on the anticipated technology development;

(c) *Financial viability.* Bidders should indicate the proposed sources of financing for the construction and operation phases, including debt capital and equity investment. While the loan and other financing agreements in most cases are not executed until after the signing of the PPP contract, the bidders should be required to submit sufficient evidence of the lenders' intention to provide the specified financing. In some countries, bidders are also required to indicate the expected financial internal rate of return in relation to the effective cost of capital corresponding to the financing arrangements proposed. Such information is intended to allow the contracting authority to consider the reasonableness and affordability of the proposed prices or fees to be charged by the private partner and the potential for subsequent increases therein;

(d) *Environmental impact.* This study should identify possible negative or adverse effects on the environment resulting from the project and indicate corrective measures that need to be taken to ensure compliance with the applicable environmental standards. Such a study should consider, as appropriate, the relevant environmental standards of international financial institutions and of national, provincial and local authorities.

(ii) Information on bid securities

68. It is advisable for the request for proposals to indicate any requirements of the contracting authority with respect to the issuer and the nature, form, amount and other principal terms of any bid security that the bidders may be required to provide so as to cover those losses which may result from withdrawal of proposals or failure by the selected bidder to conclude a PPP contract. In order to ensure fair treatment of all bidders, requirements that refer directly or indirectly to the conduct by the bidder submitting the proposal should not relate to conduct other than withdrawal or modification of the proposal after the deadline for submission of proposals or before the deadline if so stipulated in the request for proposals; failure to achieve financial closing; failure to sign the PPP contract if required by the contracting authority to do so; and failure to provide required security for the fulfilment of the PPP contract after the proposal has been accepted or to comply with any other condition prior to signing the PPP contract specified in the request for proposals. Safeguards should be included to ensure that a bid security requirement is only imposed fairly and for the purpose intended.[13] The need for, and the terms of, a bid security should be considered in the light of the award process chosen and, as required, adapted to its needs. For example, bid securities are not appropriate in request for proposals with dialogue, as the security would not provide a workable solution to the issue of ensuring sufficient participation in dialogue or binding suppliers or contractors as regards their evolving proposals during the dialogue stage (to be contrasted with the best and final offer stage of the procedure).[14]

(iii) Qualification of bidders

69. In the rare cases in which no pre-selection of bidders was carried out prior to the issuance of the request for proposals or when the contracting authority has retained the right to require the bidders to demonstrate again their qualifications, the request for proposals should set out the information that needs to be provided by the bidders to substantiate their qualifications (see paras. 38–41).

[13] Article 17, paragraph 2 of the UNCITRAL Model Law on Public Procurement provides certain important safeguards, including, inter alia, the requirement that the contracting authority should make no claim to the amount of the tender security and should promptly return, or procure the return of, the tender security document, after whichever of the following that occurs earliest: *(a)* the expiry of the tender security; *(b)* the entry into force of the project agreement and the provision of a security for the performance of the contract, if such a security is required by the request for proposals; *(c)* the termination of the selection process without the entry into force of a project agreement; or *(d)* the withdrawal of the proposal prior to the deadline for the submission of proposals, unless the request for proposals stipulates that no such withdrawal is permitted.

[14] *Guide to Enactment of the UNCITRAL Model Law on Public Procurement*, p. 99, para. 5.

(b) Project specifications and performance indicators

70. The type of PPP project, the ownership of the infrastructure and the envisaged allocation of risks and responsibilities between the public and the private sectors will determine whether the contracting authority has an interest in controlling the input and technical specifications of the works that the private partner will carry out, or whether it prefers to leave it for bidders to propose their own options for best meeting the needs of the contracting authority. This, in turn, will have a bearing on the contracting authority's decision as to whether it will conduct a two-staged tendering with a view to arriving at a common set of terms, technical, quality or performance characteristics against which the bidders will be asked to submit final proposals, or whether it will leave the bidders greater freedom to develop their own solutions. Ideally, the contracting authority will have thoroughly considered these options during its preparations for bidding (see chap. II, "Project planning and preparations", paras. 49–52), as they are essential for determining the appropriate balance between the input and output elements in the project description.

71. It is generally advisable for the contracting authority to bear in mind the long term needs of the project and to formulate its specifications in a manner that allows it to obtain enough information to select the bidder that offers the highest quality of services under the best economic terms.

72. Thus, the contracting authority may find it useful to formulate the project specifications in a way that defines adequately the output and performance required without being overly prescriptive in how that is to be achieved. Project specifications and performance indicators typically cover items such as the following:

(a) *Description of project and expected output.* If the services require specific buildings, such as a transport terminal or an airport, the contracting authority may wish to provide no more than outline planning concepts for the division of the site into usage zones on an illustrative basis, instead of plans indicating the location and size of individual buildings, as would normally be the case in traditional procurement of construction services. However, where in the judgment of the contracting authority it is essential for the bidders to provide detailed technical specifications, the request for proposals should include, at least, the following information: description of the works and services to be performed, including technical specifications, plans, drawings and designs; time schedule for the execution of works and provision of services; and the technical requirements for the operation and maintenance of the facility;

(b) *Minimum applicable design and performance standards, including appropriate environmental standards.* Performance standards are typically formulated in terms of the desired quantity and quality of the outputs of the facility. Proposals that deviate from the relevant performance standards should be regarded as non-responsive;

(c) *Quality of services.* For projects involving the provision of public services, the performance indicators should include a description of the services to be provided and the relevant standards of quality to be used by the contracting authority in the evaluation of the proposals. Where appropriate, reference should be made to any general obligations of public service providers as regards expansion and continuity of the service so as to meet the demand of the community or territory served, ensuring non discriminatory availability of services to the users and granting non discriminatory access of other service providers to any public infrastructure network operated by the private partner, under the terms and conditions established in the PPP contract (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 91–102).

73. Bidders should be instructed to provide the information necessary in order for the contracting authority to evaluate the technical soundness of proposals, their operational feasibility and responsiveness to standards of quality and technical requirements, including the following information:

(a) Preliminary engineering design, including proposed schedule of works;

(b) Project cost, including operating and maintenance cost requirements and proposed financing plan (for example, proposed equity contribution or debt);

(c) The proposed organization, methods and procedures for the operation and maintenance of the project under bidding;

(d) Description of quality of services.

74. Each of the above mentioned performance indicators may require the submission of additional information by the bidders, according to the project being awarded. For the award of a PPP contract for distribution of electricity in a specific region, for example, indicators may include minimum technical standards such as: *(a)* specified voltage (and frequency) fluctuation at the consumer level; *(b)* duration of outages (expressed in hours per year); *(c)* frequency of outages (expressed in a number per year); *(d)* losses; *(e)* number of days to connect a new customer; and *(f)* commercial standards for customer relationship (for example, number of days to pay bills, to reconnect installations or to respond to customers' complaints).

(c) Contractual terms

75. Following from the "value-for-money" and other preliminary studies conducted at the stage of project planning and feasibility assessment (see chap. II, "Project planning and preparation", paras. 5–22) the contracting authority should be in a position to indicate in the bidding documents how it expects to allocate the project risks (see also chap. II, "Project planning and preparation", and chap. IV, "PPP implementation: legal framework and PPP contract"). This is important in order to set the terms of

debate for dialogue and clarifications during the award process (see paras. 92–94), but also to establish boundaries for fine-tuning of the contract, after selection of the private partner (see paras. 95–98). If risk allocation is left entirely open, the bidders may respond by seeking to minimize the risks they accept, which may frustrate the purpose of seeking private investment for developing the project.

76. For that reason, the contracting authority should circulate a draft of the PPP contract setting out the proposed contract terms. This would also help minimize the risk that the selected consortium could attempt to re-open discussions on the main terms of the contract and draw out the negotiations. If it is not feasible to prepare a complete draft of the PPP contract this stage, the request of proposals should at least contain information on essential elements of the contractual arrangements envisaged by the contracting authority, including any clauses of the PPP contract that the contracting authority considers to be non-negotiable. Essential elements typically included in the request for proposals at this stage may include matters such as:

(a) The duration of the contract or invitations to bidders to submit proposals for the duration of the contract;

(b) Formulas and indices to be used in adjustments to prices;

(c) Government support and investment incentives, if any;

(d) Bonding requirements;

(e) Requirements of regulatory agencies, if any;

(f) Monetary rules and regulations governing foreign exchange remittances;

(g) Revenue-sharing arrangements, if any;

(h) Indication, as appropriate, of the categories of assets that the private partner would be required to transfer to the contracting authority or make available to a successor private partner at the end of the project period;

(i) Where a new private partner is being selected to operate an existing infrastructure, a description of the assets and property that will be made available to the private partner;

(j) The possible alternative, supplementary or ancillary revenue sources (for example, concessions for exploitation of existing infrastructure), if any, that may be offered to the successful bidder;

(k) The indication of the main conditions under which the rights and obligations of the selected private partner might be assigned to third parties, any restriction to or conditions for the hiring of subcontractors, and any restrictions on the transfer of shares in the capital of the private partner to third parties;

(l) Any contract terms required by the law of the country.

77. Bidders should be instructed to provide the information necessary in order for the contracting authority to evaluate the technical, financial and commercial elements of the proposals and their responsiveness to the proposed contractual terms. Furthermore, the bidders should be required to disclose which consortium members or subcontractors would be responsible for carrying out works during the construction phase, as well as the operation and maintenance of the facility after its commissioning, and to provide the contracting authority with full information on the qualifications of any subcontractor that is not already a member of the bidding consortium. The financial proposals should normally include the following information:

(a) For projects in which the private partner's income is expected to consist primarily of tolls, fees or charges paid by the customers or users of the infrastructure facility (concession-PPPs), the financial proposal should indicate the proposed price structure. For projects in which the private partner's income is expected to consist primarily of payments made by the contracting authority or another public authority to amortize the private partner's investment or by the addition of such payments from the public partner and the tolls, fees or charges paid by the customers or users, the financial proposal should indicate the proposed amortization payments and repayment period as well as the repartition foreseen between the public partner and the users contribution;

(b) The present value of the proposed prices or direct payments based on the discounting rate and foreign exchange rate prescribed in the bidding documents;

(c) If it is estimated that the project would require financial support by the Government, the level of such support, including, as appropriate, any subsidy or guarantee expected from the Government or the contracting authority;

(d) The extent of risks assumed by the bidders during the construction and operation phase (including unforeseen events, economic or regulatory changes), together with information, as appropriate, on insurance, equity investment and other guarantees envisaged against those risks, as well as an indication of the level of financial support, compensation or other contractual adjustments, if any, that the bidders propose to offset the financial consequences of those risks.

78. In order to limit and establish clearly the scope of the negotiations that will take place during the dialogue following the evaluation of proposals (see paras. 95–98), the final request for proposals should indicate which are the terms of the PPP contract that are deemed not negotiable by the contracting authority.

79. It is useful for the contracting authority to require that the final proposals submitted by the bidders contain evidence showing the comfort of the bidder's main lenders with the proposed commercial terms and allocation of risks, as

outlined in the request for proposals. Such a requirement might play a useful role in resisting pressures to reopen commercial terms at the stage of final negotiations. In some countries , bidders are required to initial and return to the contracting authority the draft PPP contract together with their final proposals as a confirmation of their acceptance of all terms in respect of which they did not propose specific amendments.

3. Clarifications and modifications

80. The right of the contracting authority to modify the request for proposals is important in order to enable it to obtain what is required to meet its needs. It is therefore advisable to authorize the contracting authority, whether on its own initiative or as a result of a request for clarification by a bidder, to modify the request for proposals by issuing an addendum at any time prior to the deadline for submission of proposals. However, when amendments are made that would reasonably require bidders to spend additional time preparing their proposals, such additional time should be granted by extending the deadline for submission of proposals accordingly. Moreover, the contracting authority should avoid material changes to the award process, in particular those likely to affect the pool of potential bidders, such as when the project characteristics have changed so significantly that the original documents no longer put prospective suppliers or contractors fairly on notice of the true requirements of the contracting. Where such a material change is necessary, the contracting entity may have to cancel and re-start the award process.[15]

81. Generally, clarifications, together with the questions that gave rise to the clarifications, and modifications must be communicated promptly by the contracting authority to all bidders to whom the contracting authority provided the request for proposals. If the contracting authority convenes a meeting of bidders, it should prepare minutes of the meeting containing the requests submitted at the meeting for clarification of the request for proposals and its responses to those requests and should send copies of the minutes to the bidders.

4. Evaluation criteria

82. The contracting authority must formulate evaluation criteria that permit a thorough and effective assessment of the technical aspects of the proposals (covering not only the physical investment – such as construction or refurbishing works – but also the operation and maintenance of the infrastructure and the quality of services to be provided by the private partner), on the one hand; and of the

[15] *Guide to Enactment of the UNCITRAL Model Law on Public Procurement*, p. 95, para. 4.

commercial and financial aspects of the proposals (including not only the level of fees, prices or other charges proposed by the bidders, but also the soundness of the financing arrangements and funding structure), on the other hand. Adequate emphasis should be given to the long-term needs of the contracting authority, in particular the need to ensure the continuous delivery of the service at the required level of quality and safety.

(a) Evaluation of technical aspects of the proposals

83. Technical evaluation criteria are designed to facilitate the assessment of the technical, operational, environmental and financial viability of the proposal vis-à-vis the specifications, indicators and requirements prescribed in the request for proposals. To the extent practicable, the technical criteria should be objective and quantifiable, to enable the contracting authority to evaluate the proposals objectively and compare them on a common basis. This reduces the scope for discretionary or arbitrary decisions. Regulations governing the award process might spell out how such factors are to be formulated and applied. Technical proposals for PPPs are usually evaluated in accordance with the following criteria:

(a) Technical soundness. Where the contracting authority has established minimum engineering design and performance specifications or standards, the basic design of the project should conform to those specifications or standards. Bidders should be required to demonstrate the soundness of the proposed construction methods and schedules;

(b) Operational feasibility. The proposed organization, methods and procedures for operating and maintaining the completed facility must be well defined, should conform to the prescribed performance standards and should be shown to be workable;

(c) Quality of services. Evaluation criteria used by the contracting authority should include an analysis of the manner in which the bidders undertake to maintain and expand the service, including the guarantees offered for ensuring its continuity;

(d) Environmental standards. The proposed design and the technology of the project to be used should be in accordance with the environmental standards set forth in the request for proposals. Any negative or adverse effects on the environment as a consequence of the project as proposed by the bidders should be properly identified, including the corresponding corrective or mitigating measures;

(e) Enhancements. These may include other terms the author of the project may offer to make the proposals more attractive, such as revenue sharing with the contracting authority, fewer governmental guarantees or reduction in the level of government support;

(*f*) *Potential for social and economic development.* Under this criterion, the contracting authority may take into account the potential for social and economic development offered by the bidders, including benefits to underprivileged groups of persons and businesses, domestic investment or other business activity, the encouragement of employment, the reservation of certain production for domestic suppliers, the transfer of technology and the development of managerial, scientific and operational skills;

(*g*) *Qualification of bidders.* At the evaluation stage, the contracting authority should have the right to request the bidders to submit evidence that they still possess the qualifications demonstrated at the pre-selection stage.

(*b*) *Evaluation of financial and commercial aspects of the proposals*

84. In addition to criteria for the technical evaluation of proposals, the contracting authority needs to define criteria for assessing and comparing the financial proposals. Criteria typically used for the evaluation and comparison of the financial and commercial proposals include, as appropriate, the following:

(*a*) *The present value of the proposed tolls, fees, unit prices and other charges over the contract period.* For projects in which the private partner's income is expected to consist primarily of tolls, fees or charges paid by the customers or users of the infrastructure facility, the assessment and comparison of the financial elements of the final proposals is typically based on the present value of the proposed tolls, fees, rentals and other charges over the contract period;

(*b*) *The present value of the proposed direct payments by the contracting authority, if any.* For projects in which the private partner's income is expected to consist primarily of payments made by the contracting authority to amortize the private partner's investment, the assessment and comparison of the financial elements of the final proposals is typically based on the present value of the proposed schedule of amortization payments for the facility assuming construction and operation according to the prescribed minimum design and performance standards, plans and specifications;

(*c*) *The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs.* It is advisable for the contracting authority to include these items among the evaluation criteria to permit an assessment of the financial feasibility of the proposals;

(*d*) *The extent of financial support, if any, expected from the Government.* Government support measures expected or required by the bidders should be included among the evaluation criteria as they may entail significant immediate or contingent financial liability for the Government (see chap. II, "Project planning and preparation", paras. 56–86);

(e) *Soundness of the proposed financial arrangements.* The contracting authority should assess whether the proposed financing plan, including the proposed ratio between equity investment and debt, is adequate to meet the construction, operating and maintenance costs of the project. The contracting authority should also assess the creditworthiness of the capital providers and lenders, the extent of their commitment, the capitalization plan proposed for the project company and the time envisaged for financial closing;

(f) *The extent of acceptance of the proposed contractual terms.* Proposals for changes or modifications in the contractual terms circulated with the request for proposals (such as in those dealing with risk allocation or compensation payments) may have substantial financial implications for the contracting authority and should be carefully examined.

85. A comparison of the proposed tolls, fees, unit prices or other charges is an important factor for ensuring objectiveness and transparency in the choice between equally responsive proposals. However, it is important for the contracting authority to consider carefully the relative weight of this criterion in the evaluation process. The notion of "price" usually does not have the same value for the award of PPP contracts as it has in the procurement of goods and services. Indeed, the remuneration of the private partner is often the combined result of charges paid by the users, ancillary revenue sources and direct subsidies or payments made by the public entity awarding the contract.

86. It flows from the above that, while the unit price for the expected output retains its role as an important element of comparison of proposals, it may not always be regarded as the most important factor. Of particular importance is the overall assessment of the financial feasibility of the proposals since it allows the contracting authority to consider the bidders' ability to carry out the project and the likelihood of subsequent increases in the proposed prices. This is important with a view to avoiding project awards to bidders that offer attractive but unrealistically low prices in the expectation of being able to raise such prices once a contract is awarded.

87. It is important for the contracting authority to disclose the relative weight to be accorded to each evaluation criterion and the manner in which criteria are to be applied in the evaluation of proposals. Two possible approaches might be used to reach an appropriate balance between financial and technical aspects of the proposals. One possible approach is to consider as most advantageous the proposal that obtains the highest combined rating in respect of both price and non price evaluation criteria. Alternatively, the price proposed for the output (for example, the water or electricity price, the level of tolls, the maintenance charges or rental fee payable by the contracting authority) might be the deciding factor in establishing the winning proposal among the responsive proposals.

5. Submission and opening of proposals

88. Proposals should be required to be submitted in writing, signed and placed in sealed envelopes. Where the request for proposals accepts submissions by electronic means, it should require the bidders to submit their proposals in a manner that is capable of being displayed to the contracting authority and that offers reliable assurance as to the integrity of the information since the time when it was first generated in its final form.[16] A proposal received by the contracting authority after the deadline for the submission of proposals should not be opened and should be returned to the bidder that submitted it. For the purpose of ensuring transparency, national laws often prescribe formal procedures for the opening of proposals, usually at a time previously specified in the request for proposals, and require that the bidders that have submitted proposals, or their representatives, be permitted by the contracting authority to be present at the opening of the proposals or to receive confirmation that the proposal was opened guaranteeing integrity requirements. Such a requirement helps to minimize the risk that the proposals might be altered or otherwise tampered with and represents an important guarantee of the integrity of the proceedings.

89. In view of the complexity of PPP projects and the variety of evaluation criteria usually applied in the award of a project, it may be advisable for the contracting authority to apply a two step evaluation process whereby non financial criteria would be taken into consideration separately from, and perhaps before, financial criteria so as to avoid situations where undue weight would be given to certain elements of the financial criteria (such as the unit price) to the detriment of the non financial criteria.

90. To that end, in some countries bidders are required to formulate and submit their technical and financial proposals in two separate envelopes. The two envelope system is sometimes used because it permits the contracting authority to evaluate the technical quality of proposals without being influenced by their financial components. However, the method has been criticized as being contrary to the objective of economy in the award of public contracts. In particular, there is said to be a danger that, by selecting proposals initially on the basis of technical merit alone and without reference to price, a contracting authority might be tempted to select, upon the opening of the first envelope, proposals offering technically superior works and to reject proposals offering less sophisticated solutions that nevertheless meet the contracting authority's needs at an overall lower cost.

91. As an alternative to the use of a two envelope system, the contracting authorities may require both technical and financial proposals to be contained in one single proposal but structure their evaluation in two stages. At an initial stage, the

[16] See UNCITRAL Model Law on Electronic Commerce, article 8, para. 1.

contracting authority typically establishes a threshold with respect to quality and technical aspects to be reflected in the technical proposals, in accordance with the criteria as set out in the request for proposals and rates each technical proposal in accordance with such criteria and the relative weight and manner of application of those criteria as set forth in the request for proposals. The contracting authority then compares the financial and commercial proposals that have attained a rating at or above the threshold. When the technical and financial proposals are to be evaluated consecutively, the contracting authority should initially ascertain whether the technical proposals are prima facie responsive to the request for proposals (that is, whether they cover all items required to be addressed in the technical proposals). Incomplete proposals, as well as proposals that deviate from the request for proposals, should be rejected at this stage. While the contracting authority may ask bidders for clarifications of their proposals, no change in a matter of substance in the proposal, including changes aimed at making a non-responsive proposal responsive, should be sought, offered or permitted at this stage.

6. Dialogue with bidders

92. Where the contracting authority has used a request for proposals with dialogue of the type provided for in article 49 of the UNCITRAL Model Law on Public Procurement, it would, at this stage, engage in a dialogue with the responsive bidders. Article 49, paragraph 8, of the UNCITRAL Model Law on Public Procurement, sets out two requirements for the format of dialogue: that it should be held on a concurrent basis and that the same representatives of the contracting authority should be involved to ensure consistent results.

93. The dialogue may involve several rounds or phases. At the end of each round or phase, the contracting authority may refine its needs and give the participating suppliers or contractors a chance to modify their proposals in the light of those refined needs and the questions and comments put forward by the contracting authority during dialogue. During the course of the dialogue, the contracting authority should not modify the subject matter of the procurement, any qualification or evaluation criterion, any minimum requirements established pursuant to article 49, paragraph 2 *(f)*, of the UNCITRAL Model Law on Public Procurement, any element of the description of the PPP project or any term or condition of the PPP contract that is not subject to the dialogue as specified in the request for proposals. Any requirements, guidelines, documents, clarifications or other information generated during the dialogue that is communicated by the contracting authority to a supplier or contractor should be communicated at the same time and on an equal basis to all other participating suppliers or contractors, unless such information is specific or exclusive to that supplier or contractor or such communication would be in breach of the confidentiality provisions. Concerns over confidentiality are particularly relevant in the dialogue phase in the light of its format

and comprehensive scope. The general rule is that no information pertinent to any particular bidder or its proposal should be disclosed to any other participating bidder or contractor without consent of the former.

94. Following the dialogue, the contracting authority should request all suppliers or contractors remaining in the proceedings to present a best and final offer with respect to all aspects of their proposals. The request should be in writing and specify the manner, place and deadline for presenting best and final offers. One of the main distinct features of this procurement method is the absence of any complete single set of terms and conditions of the procurement beyond the minimum requirements against which final submissions are evaluated.

7. Final negotiations and contract award

95. The award committee should rate the technical and financial elements of each proposal in accordance with the predisclosed rating systems for the technical evaluation criteria and specify in writing the reasons for its rating. In order to promote the transparency of the award process and to avoid improper use of non price evaluation criteria, a detailed justification may be particularly important where the awarding committee recommends selecting a proposal primarily on the basis of technical aspects rather than merely on price. The contracting authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals.

(a) Two-stage procedure

96. Where the contracting authority has used a two-stage procedure of the type set forth in article 48 of the UNCITRAL Model Law on Public Procurement, the contracting authority would at this stage invite the best-rated bidder for final negotiation of certain elements of the PPP contract. If two or more proposals obtain the highest rating, or if there is only an insignificant difference in the rating of two or more proposals, the contracting authority should invite for negotiations all the bidders that have obtained essentially the same rating. The final negotiations should be limited to fixing the final details of the transaction documentation and satisfying the reasonable requirements of the selected bidder's lenders. One particular problem faced by contracting authorities is the danger that the negotiations with the selected bidder might lead to pressures to amend, to the detriment of the Government or the consumers, the price or risk allocation originally contained in the proposal. Changes in essential elements of the proposal should not be permitted, as they may distort the assumptions on the basis of which the proposals were submitted and rated. Therefore, the negotiations at this stage may not concern those elements of the contract which were deemed not negotiable in the final request for proposals (see para. 76). The risk of reopening commercial terms at this late stage could be further minimized by insisting

that the selected bidder's lenders indicate their comfort with the risk allocation embodied in their bid at a stage where there is competition among bidders (see para. 79 above). The contracting authority's financial advisers might contribute to this process by advising whether bidders' proposals are realistic and what levels of financial commitment are appropriate at each stage. The process of reaching financial close can itself be quite lengthy.

97. The contracting authority should inform the remaining responsive bidders that they may be considered for negotiation if the negotiations with the bidder with better ratings do not result in a PPP contract. If it becomes apparent to the contracting authority that the negotiations with the invited bidder will not result in a PPP contract, the contracting authority should inform that bidder that it is terminating the negotiations and then invite for negotiations the next bidder on the basis of its ranking until it arrives at a PPP contract or rejects all remaining proposals. To avoid the possibility of abuse and unnecessary delay, the contracting authority should not reopen negotiations with any bidder with whom they have already been terminated.

(b) Request for proposals with dialogue

98. As a general rule, no negotiations with bidders would take place where the contracting authority has used a request for proposals with dialogue of the type provided for in article 49 of the UNCITRAL Model Law on Public Procurement. Indeed, article 49, paragraph 12, of the UNCITRAL Model Law on Public Procurement expressly provides that "no negotiations shall take place between the contracting authority and suppliers or contractors with respect to their best and final offers." The rationale for this strict prohibition is that the dialogue phase would have already afforded ample opportunity for the bidders to offer improvements on all aspects of their proposals. The "best-and-final-offer" stage puts an end to the dialogue stage and freezes all the specifications and contract terms offered by bidders so as to restrict an undesirable situation in which the contracting authority uses the offer made by one bidder to pressure another, in particular as regards the price offered. Otherwise, in anticipation of such pressure, bidders may be led to raise the prices offered, and there is a risk to the integrity of the process.[17]

D. Contract award through direct negotiations

99. The *Guide* recommends the use of competitive, structured procedures for the award of PPP contracts, as such procedures are widely recognized as being best suited for protecting public interest and promoting the objectives of value for money (economy and efficiency), integrity and transparency (see chap. I, "General

[17] *Guide to Enactment of the UNCITRAL Model Law on Public Procurement*, p. 209, para. 27

legal and institutional framework", paras. 5–9 and 13–16 ; see also above, paras. 5–16). At the same time, the contract award procedures recommended by the *Guide* avoid the rigidity that characterize some open procedures (such as traditional tendering for goods and services) and afford the contracting authority ample flexibility for choosing the operator who best suits its need, in terms of professional qualifications, financial strength, ability to ensure the continuity of the service, equal treatment of the users and quality of the proposal.

100. Direct negotiations do not ensure the level of transparency and objectivity that can be achieved by more structured competitive procedures. Moreover, in some countries there might be concerns that the higher level of discretion in those negotiations might carry with it a higher risk of abusive or corrupt practices. In view of the above, the *Guide* recommends that the law should prescribe the use of competitive award procedures as a rule for the award of PPP contracts and to reserve direct negotiations (that is, without prior recourse to competitive award procedures of the type described herein) to exceptional and objectively justifiable situations, and subject to procedures to ensure transparency and fairness in the conduct of the award process.

1. Authorizing circumstances

101. For purposes of transparency as well as for ensuring discipline in the award of PPP contracts, the law should identify the exceptional circumstances under which the contracting authority may be authorized to select the private partner through direct negotiations. They may include, for example, the following:

(a) When there is an urgent need for ensuring immediate provision of the service and engaging in a competitive award procedure would therefore be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the contracting authority nor the result of dilatory conduct on its part. Such an exceptional authorization may be needed, for instance, in cases of interruption in the provision of a given service or where an incumbent private partner fails to provide the service at acceptable standards or if the PPP contract is rescinded by the contracting authority, when engaging in a competitive award procedure would be impractical in view of the urgent need to ensure the continuity of the service;

(b) In the case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount;

(c) Reasons of national defence or security;

(d) Cases where there is only one private operator capable of providing the required service (for example, because it can be provided only by using patented technology or unique know how) including certain cases of unsolicited proposals

(see paras. 114–118). In the interest of transparency, the contracting authority should be encouraged to use a suitable competitive contract award procedure, as an alternative to the elaborate provisions set forth in the *Guide*.

2. Measures to enhance transparency in the award of contracts through direct negotiations

102. Procedures to be followed in procurement through negotiation outside structured competitive procedures are typically characterized by a higher degree of flexibility than the procedures applied to other methods of procurement. Few rules and procedures are established to govern the process by which the parties negotiate and conclude their contract. In some countries, procurement laws allow contracting authorities virtually unrestricted freedom to conduct negotiations as they see fit. The laws of other countries establish a procedural framework for negotiation designed to maintain fairness and objectivity and to bolster competition by encouraging participation of bidders. Provisions on procedures for contract award through negotiation address a variety of issues discussed below, in particular, requirements for approval of the contracting authority's decision to select the private partner through negotiation, selection of negotiating partners, criteria for comparison and evaluation of offers, and recording of the contract award proceedings.

(a) Approval

103. A threshold requirement found in many countries is that a contracting authority must obtain the approval of a higher authority prior to engaging in contract award through negotiations outside structured competitive procedures. Such provisions generally require the application for approval to be in writing and to set forth the grounds necessitating the use of negotiation. Approval requirements are intended, in particular, to ensure that the contract award without competitive procedures is used only in appropriate circumstances.

(b) Selection of negotiating partners

104. In order to make the award proceedings as competitive as possible, it is advisable to require the contracting authority to engage in negotiations with as many companies judged susceptible of meeting the need as circumstances permit. Beyond such a general provision, there is no specific provision in the laws of some countries on the minimum number of contractors or suppliers with whom the contracting authority is to negotiate. The laws of some other countries, however, require the contracting authority, where practicable, to negotiate with, or to solicit proposals from, a minimum number of bidders (three being as well a common number). The contracting authority is permitted to negotiate with a smaller number in certain circumstances, in particular, when fewer than the minimum number of potential bidders were available.

105. For the purpose of enhancing transparency, it is also advisable to require a notice of the negotiation proceedings to be given to bidders in a specified manner. For example, the contracting authority may be required to publish the notice in a particular publication normally used for that purpose. Such notice requirements are intended to bring the procurement proceedings to the attention of a wider range of bidders than might otherwise be the case, thereby promoting competition.

106. Given the magnitude of most infrastructure projects, the notice should normally contain certain minimum information (a description of the project, for example, or qualification requirements) and should be issued in sufficient time to allow bidders to prepare offers. Generally, the formal eligibility requirements applicable to bidders in competitive award proceedings should also apply in negotiation proceedings.

(c) Conduct of negotiations

107. Where authorized by domestic laws, direct negotiations are a typically flexible procurement method. Nevertheless, the *Guide to Enactment to the UNCITRAL Model Law on Public Procurement,* invites enacting States to consider imposing additional requirements for the use of competitive negotiations. For instance, the procurement regulations or rules or guidance from the public procurement agency or other body "may require that the procuring entity take steps such as: establishing basic rules and procedures for the conduct of the negotiations in order to help ensure that they proceed in an efficient manner; preparing various documents to serve as the basis for the negotiations, including documents setting out a description of the subject matter to be procured, and the desired contractual terms and conditions; and requesting the suppliers or contractors with which it negotiates to itemize their prices so as to assist the procuring entity in comparing offers."[18]

108. Whereas no single set of terms and conditions of the procurement against which final submissions are evaluated is typically issued in direct negotiations, the negotiations may be more effective if the contracting authority's negotiating team receives guidance in the form of general criteria that proposals are requested to meet (for example, general performance objectives or output specifications), as well as criteria for evaluating offers made during the negotiations and for selecting the winning private partner (for example, the technical merit of an offer, prices, operating and maintenance costs and the profitability and development potential of the PPP contract). The contracting authority should engage in discussions with the bidders in order to refine and improve upon the proposal to the point where

[18] *Guide to Enactment of the UNCITRAL Model Law on Public Procurement,* p. 216, para. 6.

it is satisfactory to the contracting authority. The price of each proposal could enter into those discussions. When the proposals have been finalized, the contracting authority should seek a best and final offer on the basis of the clarified proposals. It is recommendable that bidders should include with their final offer evidence that the risk allocation that the offer embodies would be acceptable to their proposed lenders. The best and final offer concludes the negotiation process. No negotiations should take place between the procuring entity and suppliers or contractors with respect to their best and final offers. The contract would then be awarded to the party offering the "most economical" or "most advantageous" offer.

(d) Notice of contract award

109. The contracting authority should be required to establish a record of the award proceedings (see paras. 134–136) and should publish a notice of the contract award, which, except in cases involving national defence or national security interests, should disclose, in particular, the specific circumstances and reasons for the award of the contract without a proper competitive procedure (see para. 101). In many countries, it has become a well-established practice to publish the full PPP contract in the interest of promoting transparency and accountability. This practice is often supplemented by additional disclosure and transparency measures, such as the publication of evaluation reports on the performance of private partners against targets set in the PPP contract, and for the government to have a mechanism for publication of such performance targets (whether on contracting authority website or other) (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 103 and 104).

E. Unsolicited proposals[19]

110. PPP projects sometimes result from proposals submitted directly by the private sector. These proposals are usually referred to as "unsolicited proposals", since they do not relate to a project for which the public sector has initiated a contract award process. Unsolicited proposals may result from the identification by the private sector of an infrastructure need that may be met by a PPP. They may also involve innovative proposals for infrastructure management and offer the potential for transfer of new technology to the host country. However, they may give rise to various concerns of transparency, accountability and value for money. Countries that nevertheless wish to allow the consideration of unsolicited proposals should carefully ponder those concerns and devise appropriate safeguards.

[19] For recommendations of the World Bank Group on how to manage unsolicited proposals in infrastructure projects, see "Policy Guidelines for Managing Unsolicited Proposals in Infrastructure Projects", The World Bank Group, 2018.

1. Policy considerations

111. One possible reason sometimes cited for allowing the consideration of unsolicited proposals is to provide an incentive for the private sector to submit proposals involving the use of new concepts or technologies to meet the contracting authority's needs. By the very nature of competitive award procedures, no bidder has an assurance of being awarded the project, unless it wins the competition. The cost of formulating proposals for large infrastructure projects may be a deterrent for companies concerned about their ability to match proposals submitted by competing bidders. In contrast, the private sector may see an incentive for the submission of unsolicited proposals in rules that allow a contracting authority to negotiate such proposals directly with their authors. The contracting authority, too, may have an interest in the possibility of engaging in direct negotiations in order to stimulate the private sector to formulate innovative proposals for infrastructure development.

112. At the same time, however, the award of projects pursuant to unsolicited proposals and without competition from other bidders may expose the Government to serious criticism. Best practices of good governance require public authorities to anticipate their infrastructure needs and systematically plan for meeting them. They should build the capability to conceive and plan their own projects, rather than relying on the private sector to initiate them (see chap. II, "Project planning and preparation", paras. 5–20 and 47). Owing to inadequate evaluation or poor planning, unsolicited proposals have been found, in practice, to generate significant contingent liabilities for host countries that had not been properly anticipated in their longer-term public expenditure and budget control systems. In addition, prospective lenders, including multilateral and bilateral financial institutions, may have difficulty in lending or providing guarantees for projects that have not been the subject of competitive award proceedings. They may fear the possibility of challenge and cancellation by future Governments (for example, because the project award may be deemed subsequently to have been the result of favouritism or because the procedure did not provide objective parameters for comparing prices, technical elements and the overall effectiveness of the project) or legal or political challenge by other interested parties, such as customers dissatisfied with increased prices or competing companies alleging unjust exclusion from a competitive award procedure.

113. These are a few reasons why countries have preferred not to regulate unsolicited proposals or to expressly prohibit them. Countries that nevertheless wish to permit the consideration of unsolicited proposals should consider the need for, and the desirability of, devising special procedures for evaluating and handling unsolicited proposals so as to avoid their use to circumvent public investment management mechanisms. For that purpose, it may be useful to analyse two situations most commonly mentioned in connection with unsolicited proposals,

namely, unsolicited proposals claiming to involve the use of new concepts or technologies to address the contracting authority's infrastructure needs and unsolicited proposals claiming to address an infrastructure need not already identified by the contracting authority.

(a) Unsolicited proposals claiming to involve the use of new concepts or technologies to address the contracting authority's infrastructure needs

114. Generally, for projects that require the use of some kind of industrial process or method, the contracting authority would have an interest in stimulating the submission of proposals incorporating the most advanced processes, designs, methodologies or engineering concepts with demonstrated ability to enhance the project's outputs (by significantly reducing construction costs, for example, accelerating project execution, improving safety, enhancing project performance, extending economic life, reducing costs of facility maintenance and operations or reducing negative environmental impact or disruptions during either the construction or the operational phase of the project).

115. The contracting authority's legitimate interests might also be achieved through appropriately modified competitive award procedures instead of a special set of rules for handling unsolicited proposals. For instance, if the contracting authority is using award procedures that emphasize the expected output of the project, without being prescriptive about the manner in which that output is to be achieved (see para. 72), the bidders would have sufficient flexibility to offer their own proprietary processes or methods. In such a situation, the fact that each of the bidders has its own proprietary processes or methods would not pose an obstacle to competition, provided that all the proposed methods are technically capable of generating the output expected by the contracting authority.

116. Adding the necessary flexibility to the competitive award procedures may in these cases be a more satisfactory solution than devising special non competitive procedures for dealing with proposals claiming to involve new concepts or technologies. With the possible exception of proprietary concepts or technologies whose uniqueness may be ascertained on the basis of the existing intellectual property rights, a contracting authority may face considerable difficulties in defining what constitutes a new concept or technology. Such a determination may require the services of costly independent experts, possibly from outside the host country, to avoid allegations of bias. A determination that a project involves a novel concept or technology might also be met by claims from other interested companies also claiming to have appropriate new technologies.

117. However, a somewhat different situation may arise if the uniqueness of the proposal or its innovative aspects are such that it would not be possible to

implement the project without using a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights, either worldwide or regionally. The existence of intellectual property rights in relation to a method or technology may indeed reduce or eliminate the scope for meaningful competition. This is why the procurement laws of most countries authorize procuring entities to engage in single source procurement if the goods, construction or services are available only from a particular supplier or contractor or if the particular supplier or contractor has exclusive rights over the goods, construction or services and no reasonable alternative or substitute exists (see the UNCITRAL Model Law on Public Procurement, art. 30, para. 5).

118. In such a case, it would be appropriate to authorize the contracting authority to negotiate the execution of the project directly with the proponent of the unsolicited proposal. The difficulty, of course, would be how to establish, with the necessary degree of objectivity and transparency, that there exists no reasonable alternative or substitute to the method or technology contemplated in the unsolicited proposal. For that purpose, it is advisable for the contracting authority to establish procedures for obtaining elements of comparison for the unsolicited proposal. In this situation, the use of provisions set for in the request for proposals with dialogue under the UNCITRAL Model Law on Public Procurement is in line with the need to ensure a fair and objective treatment of the unsolicited proposals.

(b) Unsolicited proposals claiming to address an infrastructure need not already identified by the contracting authority

119. The merit of unsolicited proposals of this type consists of the identification of a potential for infrastructure development that has not been considered by the authorities of the host country. However, in and of itself this circumstance should not normally provide sufficient justification for a directly negotiated project award in which the contracting authority has no objective assurance that it has obtained the most advantageous solution for meeting its needs. An unsolicited proposal, however well justified, should not substitute for the Government's own assessment of its infrastructure needs and the planning and assessment measures required by law (see chap. II, "Project planning and preparation", paras. 5–20).

2. Procedures for handling unsolicited proposals

120. In the light of the above considerations, it is advisable for the contracting authority to establish transparent procedures for determining whether an unsolicited proposal meets the required conditions and whether it is in the contracting authority's interest to pursue it.

(a) Restrictions to the receivability of unsolicited proposals

121. In the interest of ensuring proper accountability for public expenditures, some domestic laws provide that no unsolicited proposal may be considered if the execution of the project would require significant financial commitments from the contracting authority or other public authority such as guarantees, subsidies or equity participation. The reason for such a limitation is that the procedures for handling unsolicited proposals are typically less elaborate than ordinary award procedures and may not ensure the same level of transparency and competition that would otherwise be achieved. However, there may be reasons for allowing some flexibility in the application of this condition. In some countries, the presence of government support other than direct government guarantees, subsidy or equity participation (for example, the sale or lease of public property to authors of project proposals) does not necessarily disqualify a proposal from being treated and accepted as an unsolicited proposal.

122. Another condition for consideration of an unsolicited proposal is that it should relate to a project for which no award procedures have been initiated or announced by the contracting authority. The rationale for handling an unsolicited proposal without using a competitive award procedure is to provide an incentive for the private sector to identify new or unanticipated infrastructure needs or to formulate innovative proposals for meeting those needs. This justification may no longer be valid if the project has already been identified by the authorities of the host country and the private sector is merely proposing a technical solution different from the one envisaged by the contracting authority. In such a case, the contracting authority could still take advantage of innovative solutions by applying an award procedure involving dialogue with bidders (see paras. 92–94). However, it would not be consistent with the principle of fairness in the award of public contracts to entertain unsolicited proposals outside award proceedings already started or announced.

(b) Procedures for determining the admissibility of unsolicited proposals

123. A company or group of companies that approaches the Government with a suggestion for private infrastructure development should be requested to submit an initial proposal containing sufficient information to allow the contracting authority to make a prima facie assessment of whether the conditions for handling unsolicited proposals are met, in particular whether the proposed project is in the public interest. The initial proposal should include, for instance, the following information: a statement of the author's previous project experience and financial standing; a description of the project (type of project, location, regional impact, proposed investment, operational costs, financial assessment and resources needed from the Government or third parties); details about the site (ownership and whether land or other property will have to be expropriated); and a description of the service and the works.

124. Following a preliminary examination, the contracting authority should inform the company, within a reasonably short period, whether or not there is a potential public interest in the project. If the contracting authority reacts positively to the project, the company should be invited to submit a formal proposal, which, in addition to the items covered in the initial proposal, should contain a technical and economic feasibility study (including characteristics, costs and benefits) and an environmental impact study. Furthermore, the author of the proposal should be required to submit satisfactory information regarding the concept or technology contemplated in the proposal. The information disclosed should be in sufficient detail to allow the contracting authority to evaluate the concept or technology properly and to determine whether it meets the required conditions and is likely to be successfully implemented on the scale of the proposed project. The company submitting the unsolicited proposal should retain title to all documents submitted throughout the procedure and those documents should be returned to it in the event the proposal is rejected.

125. Once all the required information is provided by the author of the proposal, the contracting authority should decide, within a reasonably short period, whether it intends to pursue the project and, if so, what procedure will be used. Choice of the appropriate procedure should be made on the basis of the contracting authority's preliminary determination as to whether or not the implementation of the project would be possible without the use of a process, design, methodology or engineering concept for which the proposing company or its partners possess exclusive rights.

(c) Approval

126. As with other exceptions to a competitive bidding process of the type recommended in the *Guide*, for transparency and accountability purposes, the decision to handle unsolicited proposals should not vest in the contracting authority alone. Therefore, once the contracting authority has determined that it is in the public interest to pursue the project, it should obtain the approval of a higher authority both for proceeding with the consideration of the unsolicited proposal and for the proposed procedure that will be used for that purpose. The application for approval should be made in writing and set forth the grounds for proceeding in the manner proposed by the contracting authority. Approval requirements are intended, in particular, to ensure that the contract award on the basis of an unsolicited proposal is used only in appropriate circumstances.

(d) Procedures for handling unsolicited proposals that do not involve proprietary concepts or technology

127. If the contracting authority, upon examination of an unsolicited proposal, decides that there is public interest in pursuing the project, but the implementation

of the project is possible without the use of a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights, the contracting authority should be required to award the project by using the procedures that would normally be required for the award of PPP contracts, such as, for instance, the competitive award procedures described in this *Guide* (see paras. 51–98). However, some countries have included special features in the award procedures so as to provide an incentive to the submission of unsolicited proposals. These incentives may consist of the following measures:

(a) The contracting authority could undertake not to initiate award proceedings regarding a project in respect of which an unsolicited proposal was received without inviting the company that submitted the original proposal;

(b) The original bidder might be given some form of premium for submitting the proposal. In some countries that use a merit point system for the evaluation of financial and technical proposals the premium takes the form of a margin of preference over the final rating (that is, a certain percentage over and above the final combined rating obtained by that company in respect of both financial and non-financial evaluation criteria). One possible difficulty of such a system is the risk of setting the margin of preference so high as to discourage competing meritorious bids, thus resulting in the receipt of a project of lesser value in exchange for the preference given to the innovative bidder. A preferable alternative form of incentive may be the reimbursement, in whole or in part, of the costs incurred by the original author in the preparation of the unsolicited proposal. For purposes of transparency, any such incentive should be announced in the request for proposals.

128. It should be noted, however, that such incentives can discourage other potential bidders from going through the expense of submitting proposals. Therefore, when considering the desirable level of incentives for the unsolicited proponent, the contracting authority would be well advised to seek to ensure meaningful competition and to avoid weighing them so heavily in favour of the unsolicited proponent that other potential bidders might be discouraged. Notwithstanding the incentives that may be provided, the author of the unsolicited proposal should be required to meet the same qualification criteria as would be required of the bidders participating in a competitive award proceeding (see paras. 82–87).

(e) Procedures for handling unsolicited proposals involving proprietary concepts or technology

129. If it appears that the innovative aspects of the proposal are such that it would not be possible to implement the project without using a process, design, methodology or engineering concept for which the author or its partners possess exclusive rights, either worldwide or regionally, it may be useful for the contracting authority to confirm that preliminary assessment by applying a procedure for

obtaining elements of comparison for the unsolicited proposal. One such procedure may consist of the publication of a description of the essential output elements of the proposal (for example, the capacity of the infrastructure facility, quality of the product or the service or price per unit) with an invitation to other interested parties to submit alternative or comparable proposals within a certain period. Such a description should not include input elements of the unsolicited proposal (the design of the facility, for example, or the technology and equipment to be used), in order to avoid disclosing proprietary information of the unsolicited proponent to potential competitors. The period for submitting proposals should be commensurate with the complexity of the project and should afford the prospective competitors enough time to formulate their proposals. This may be a crucial factor for obtaining alternative proposals, for example, if the bidders would have to carry out detailed subsurface geological investigations that might have been carried out over many months by the original bidder, who would want the geological findings to remain secret.

130. The invitation for comparative or competitive proposals should be published with a minimum frequency (for example, once every week for three weeks) in at least one publication of general circulation. It should indicate the time and place where bidding documents may be obtained and should specify the time during which proposals may be received. It is important for the contracting authority to protect the intellectual property rights of the original author and to ensure the confidentiality of proprietary information received with the unsolicited proposal. Any such information should not form part of the bidding documents. Both the original bidder and any other company that wishes to submit an alternative proposal should be required to submit a bid security (see para. 68). Two possible avenues may then be pursued, according to the reactions received to the invitation:

(a) If no alternative proposals are received, the contracting authority may reasonably conclude that there is no reasonable alternative or substitute to the method or technology contemplated in the unsolicited proposal. This finding of the contracting authority should be appropriately recorded and the contracting authority could be authorized to engage in direct negotiations with the original proponent. It may be advisable to require that the decision of the contracting authority be reviewed and approved by the same authority whose approval would normally be required in order for the contracting authority to select a private partner through direct negotiation (see para. 103). Some countries whose laws mandate the use of competitive procedures have used these procedures to establish the necessary transparency required to avoid future challenges to the award of a PPP contract following an unsolicited proposal. In those countries and according the Model Law, the mere publication of an invitation to bid would permit an award to the bidder who originally submitted the unsolicited proposal, even if its bid were

the only one received. This is so because compliance with competitive procedures typically requires that the possibility of competition should have been present and not necessarily that competition actually occurred. Publicity creates such a possibility and adds a desirable degree of transparency;

(b) If alternative proposals are submitted, the contracting authority should invite all the bidders to negotiations with a view to identifying the most advantageous proposal for carrying out the project (see paras. 102–109). In the event that the contracting authority receives a sufficiently large number of alternative proposals, which appear prima facie to meet its infrastructure needs, there may be scope for engaging in full fledged competitive award procedures (see paras. 34–98), subject to any incentives that may be given to the author of the original proposal (see para. 127 *(b)*).

131. The contracting authority should be required to establish a record of the award proceedings (see para. 138) and to publish a notice of the award of the project (see para. 133).

F. Confidentiality

132. In order to prevent abuse of the award procedures and to promote confidence in the process, it is important that confidentiality be observed by all parties, especially where negotiations are involved. Such confidentiality is important in particular to protect any intellectual property, trade secret or other sensitive information that bidders might include in their proposals and that they would not wish to be made known to their competitors. Confidentiality should be kept regardless of the contract award method used by the contracting authority. Concretely, this means that an official of the contracting authority negotiating with two bidders must not disclose to either bidder the content of the negotiations with the other bidder. Confidentiality is also important to avoid collusion among bidders, as would be the case, for instance if bidders shared the contracting authority's cost structure to adjust their proposals and split among themselves a series of contract opportunities.

G. Notice of project award

133. PPP contracts frequently include provisions that are of direct interest for parties other than the contracting authority and the private partner and who might have a legitimate interest in being informed about certain essential elements of the project. This is the case in particular for projects involving the provision of a service directly to the general public. For purposes of transparency, it may be advisable to

establish procedures for publicizing those terms of the PPP contract which may be of public interest. Such a requirement should apply regardless of the method used by the contracting authority to select the private partner (for example, whether through competitive award procedures, direct negotiations or as a result of an unsolicited proposal). One possible procedure may be to require the contracting authority to publish a notice of the award of the project, indicating the essential elements of the proposed agreements, such as: *(a)* the name of the private partner; *(b)* a description of the works and services to be performed by the private partner; *(c)* the duration of the contract; *(d)* the price structure; *(e)* a summary of the essential rights and obligations of the private partner and the guarantees to be provided by it; *(f)* a summary of the monitoring rights of the contracting authority and remedies for breach of the PPP contract; *(g)* a summary of the essential obligations of the Government, including any payment, subsidy or compensation offered by it; and *(h)* any other essential term of the PPP contract, as provided in the request for proposals.

H. Record of contract award proceedings

134. In order to ensure transparency and accountability and to facilitate the exercise of the right of aggrieved bidders to seek review of decisions made by the contracting authority, the contracting authority should be required to keep an appropriate record of key information pertaining to the contract award proceedings. The laws and regulations of the host country typically set forth the form and means in which the record must be maintained, as well as the extent of the disclosure, and the recipients of relevant information, from the record.

135. The record to be kept by the contracting authority should contain, as appropriate, such general information concerning the award proceedings as is usually required to be recorded for public procurement (such as the information listed in art. 25 of the UNCITRAL Model Law on Public Procurement), as well as information of particular relevance for PPPs. Such information may include the following:

(a) A description of the project for which the contracting authority requested proposals;

(b) The names and addresses of the companies participating in bidding consortia and the name and address of the members of the bidders with whom the PPP contract has been entered into; and a description of the publicity requirements, including copies of the publicity used or of the invitations sent;

(c) A statement of the reasons and circumstances relied upon by the contracting authority to justify the procedure chosen for the contract award;

(d) If changes to the composition of the pre-selected bidders are subsequently permitted, a statement of the reasons for authorizing such changes and a finding as to the qualifications of any substitute or additional consortia concerned;

(e) Information relative to the qualifications, or lack thereof, of bidders and a summary of the evaluation and comparison of proposals, including the application of any margin of preference;

(f) A summary of the conclusions of the preliminary feasibility studies commissioned by the contracting authority and a summary of the conclusions of the feasibility studies submitted by the qualified bidders;

(g) A summary of any requests for clarification of the pre-selection documents or the request for proposals, the responses thereto, as well as a summary of any modification of those documents;

(h) A summary of the principal terms of the proposals and of the PPP contract;

(i) If the contracting authority has found most advantageous a proposal other than the proposal offering the lowest unit price for the expected output, a justification of the reasons for that finding by the awarding committee;

(j) If all proposals were rejected, a statement to that effect and the grounds for rejection;

(k) If the negotiations with the consortium that submitted the most advantageous proposal and any subsequent negotiations with remaining responsive consortia did not result in a PPP contract, a statement to that effect and of the grounds therefor.

136. As indicated in the *Guide to Enactment of the UNCITRAL Model Law on Public Procurement*, "such goals as transparency and accountability, and the need to provide suppliers and contractors with the information necessary to permit them to assess their performance and consider a challenge where appropriate, must be balanced with the need to protect the legitimate commercial interests of the suppliers or contractors."[20] Therefore, article 25, paragraph 2 of the UNCITRAL Model Law on Public Procurement requires the portion of the record containing the type of information referred to in subparagraphs *(a)*, *(b)* and *(c)* above to be made available, on request, "to any person after the successful submission has been accepted or the procurement has been cancelled". However, in line with article 25, paragraph 3 of the Model Law, the portion of the record containing the type of information referred to in subparagraphs *(d)* to *(k)* above would only be made available to suppliers or contractors that presented submissions and that request such information, after the decision on acceptance of the successful submission has become known to them.

[20] *Guide to Enactment of the UNCITRAL Model Law on Public Procurement*, p. 123, para. 5.

137. For contract awards without competitive procedures (see para. 101), it may be useful to include in the record of those proceedings, in addition to requirements referred to in paragraph 121 that may be applicable, the following additional information:

(a) A statement of the grounds and circumstances on which the contracting authority relied to justify the direct negotiation;

(b) The type of publicity used or the name and address of the company or companies directly invited to the negotiations;

(c) The name and address of the company or companies that requested to participate and those which were excluded from participating, if any, and the grounds for their exclusion;

(d) If the negotiations did not result in a PPP contract, a statement to that effect and of the grounds therefor;

(e) The justification given for the selection of the final private partner.

138. For award proceedings engaged in as a result of unsolicited proposals (see paras. 110–119), it may be useful to include in the record of those proceedings, in addition to requirements referred to in paragraph 135, that may be applicable, the following additional information:

(a) The name and address of the company or companies submitting the unsolicited proposal and a brief description of it;

(b) A certification by the contracting authority that the unsolicited proposal was found to be of public interest and to involve new concepts or technologies, as appropriate;

(c) The type of publicity used or the name and address of the company or companies directly invited to the negotiations;

(d) The name and address of the company or companies that requested to participate and those which were excluded from participating, if any, and the grounds for their exclusion;

(e) If the negotiations did not result in a PPP contract, a statement to that effect and of the grounds therefor;

(f) The justification given for the selection of the final private partner.

139. It is advisable for the rules on record requirements for award proceedings involving unsolicited proposals to specify the extent and the recipients of the disclosure. Setting the parameters of disclosure involves balancing factors such as the

general desirability, from the standpoint of the accountability of contracting authorities, of broad disclosure; the need to provide bidders with information necessary to enable them to assess their performance in the proceedings and to detect instances in which there are legitimate grounds for seeking review; and the need to protect the bidders' confidential trade information. In view of these considerations, it may be advisable to provide two levels of disclosure, as envisaged in article 25 of the UNCITRAL Model Law on Public Procurement. The information to be provided to any member of the general public may be limited to basic information geared to the accountability of the contracting authority to the general public. However, it is advisable to provide for the disclosure for the benefit of bidders of more detailed information concerning the conduct of the award proceedings, since that information is necessary to enable the bidders to monitor their relative performance in the contract award proceedings and to monitor the conduct of the contracting authority in implementing the requirements of the applicable laws and regulations.

140. Moreover, appropriate measures should be taken to avoid the disclosure of confidential trade information of suppliers and contractors. This is true in particular with respect to what is disclosed concerning the evaluation and comparison of proposals, as excessive disclosure of such information may be prejudicial to the legitimate commercial interests of bidders. As a general rule, the contracting authority should not disclose more detailed information relating to the examination, evaluation and comparison of proposals and proposal prices, except when ordered to do so by a competent court.

141. Provisions on limited disclosure of information relating to the award process would not preclude the applicability to certain parts of the record of other statutes in the enacting State that confer on the public at large a general right to obtain access to government records. Disclosure of the information in the record to legislative or parliamentary oversight bodies may be mandated pursuant to the law applicable in the host country.

I. Review procedures

142. The existence of fair and efficient review procedures is one of the basic requirements for attracting serious and competent bidders and for reducing the cost and the length of award proceedings. An important safeguard of proper adherence to the rules governing the award procedure is that bidders have the right to seek review of actions by the contracting authority in violation of those rules or of the rights of bidders. Various remedies and procedures are available in different legal systems and systems of administration, which are closely linked to the question of review of governmental actions. Whatever the exact form of review

procedures, it is important to ensure that an adequate opportunity and effective procedures for review are provided. It is particularly useful to establish a workable "pre contract" recourse system (that is, procedures for reviewing the contracting authority's acts as early in the award proceedings as feasible). Such a system increases the possibility of taking corrective actions by the contracting authority before loss is caused and helps to reduce cases where monetary compensation is the only option left to redress the consequences of an improper action by the contracting authority. Elements for the establishment of an adequate review system are contained in chapter VIII of the UNCITRAL Model Law on Public Procurement.

143. Article 9 of the United Nations Convention against Corruption requires (among other things) procurement systems to address "[a]n effective system of domestic review, including an effective system of appeal, to ensure legal recourse and remedies in the event that the rules or procedures established [...] are not followed." Consistent with that mandate, chapter VIII of the UNCITRAL Model Law on Public Procurement offers several review provisions, which enacting States are encouraged to incorporate into their procurement laws to the extent that their legal system so permits. They include the possibility of an optional request to the procuring entity to reconsider a decision taken in the procurement process, giving the aggrieved supplier or contractor in such case the possibility to apply either to the procuring entity, to an independent body or to the court. However, the Model Law acknowledges that the sequence of application to review bodies will very much depend on legal traditions of enacting States. Given the requirements in the Convention against Corruption, States must have both a review and an appeal mechanism, but the Model Law is flexible so that enacting States can implement its provisions in accordance with their legal traditions. Under the Model Law, any decision or action by the procuring entity allegedly not in compliance with the provisions of the procurement law may be challenged by suppliers or contractors that claim to have suffered or claim that they may suffer loss or injury because of such alleged non-compliance. This broad challenge mechanism comes with various mechanisms to ensure the efficacy of the procedure, and to appropriately balance the need to preserve the rights of suppliers and contractors and the integrity of the procurement process on the one hand and, on the other, the need to limit disruption of the procurement process. Thus, article 65 of the Model Law provides for a general prohibition against taking any step to bring the procurement contract into force while a challenge remains pending, except where urgent public interest considerations call for lifting that prohibition. The Model Law also offers provisions for suspension of procurement proceedings, as well as supporting measures to encourage early and timely resolution of issues and disputes that enable challenges to be addressed before stages of the procurement proceedings would need to be undone.

IV. PPP implementation: legal framework and PPP contract

A. General provisions of the PPP contract

1. The "PPP contract" between the contracting authority and the private partner is the central contractual document in a PPP. The PPP contract defines the scope and purpose of the project as well as the rights and obligations of the parties; it provides details on the execution of the project and sets forth the conditions for the operation of the infrastructure or the delivery of the relevant services. In concession PPPs, the contract will also cover the conditions under which the private partner will deliver the public service and primarily receive payment from users and the contracting authority. In non-concession PPPs, the contract must ensure that the infrastructure, facility or service is developed and operated in exchange for the payment by the contracting authority of the remuneration agreed. PPP contracts may consist of a single document or of various separate agreements concluded between the contracting authority and the private partner or any related entities involved in the project. Legislative provisions may offer guidance for avoiding inconsistencies between various contractual documents, such as public policy principles and interpretation rules. This section discusses the relationship between the PPP contract and the local or domestic regulation on PPPs. It also discusses procedures and formalities for the conclusion and entry into force of the PPP contract.

1. Legislative approaches

2. Domestic legislation often contains provisions dealing with the content of the PPP contract. In some countries, the law merely refers to the need for an agreement between the private partner and the contracting authority, while the laws of other countries contain extensive mandatory provisions concerning the content of clauses to be included in the agreement. An intermediate approach is taken by those laws which list several issues that need to be addressed in the PPP contract without regulating in detail the content of its clauses.

3. Legislative provisions on certain essential elements of the PPP contract may serve the purpose of establishing a general framework for the allocation of rights and obligations between the parties, to give effect to the risk allocation on the basis

of which the project was designed (see chap. II, "Project planning and preparation", paras. 37–45). Legislative provisions may be intended to ensure consistency in the treatment of certain contractual issues and to provide guidance to the public authorities involved in the negotiation of PPP contracts at different levels of government (national, provincial or local). Such guidance may be particularly useful for contracting authorities lacking experience in the negotiation of PPP contracts. Lastly, legislation may sometimes be required to provide the contracting authority with the power to agree on certain types of provisions.

4. However, general legislative provisions dealing in detail with the rights and obligations of the parties might deprive the contracting authority and the private partner of the necessary flexibility to negotiate an agreement that takes into account the needs and particularities of the specific project. Therefore, it is advisable to limit the scope of general legislative provisions concerning the PPP contract to those strictly necessary, such as, provisions on matters for which the parties need prior legislative authorization, those that might affect the interests of third parties, or provisions relating to essential policy matters that do not admit variation by agreement.

2. The law governing the PPP contract

5. Statutory provisions on the law applicable to the PPP contract are not frequently found in domestic legislation on PPPs. This is so because the laws of many countries treat PPPs as a category of public contracts, being therefore governed by the national law of the contracting authority (see "Introduction and background information on PPPs", para. 15). PPP legislation that deals with this matter usually leads to the application of the laws of the host country by a general reference to domestic law or by mentioning special statutory or regulatory texts that apply to the PPP contract. In some legal systems there may be an implied submission to the laws of the host country, even in the absence of a statutory provision to that effect. However, in the case of cross-border PPPs, for instance, when the infrastructure or services span more than one jurisdiction, there may be a need to determine the law or laws that will govern the contract.

6. The law applicable to the PPP contract includes laws of the host country that apply to the various issues that arise during the execution of a PPP project, which in some countries may be subject to special rules of public contracts (see generally chap. VII, "Other relevant areas of law", section B). When the law applicable to the PPP contract includes rules of an administrative or other public law nature, their application in the host country may be mandatory, such as those dealing with environmental protection measures and health and labour standards. Some domestic laws expressly identify the matters that are subject to rules of mandatory application. However, various issues arising out of the PPP contract or the

operation of the facility may not be the subject of mandatory rules of a public law nature. This is typically the case for most contractual issues arising under the PPP contract (for example, formation, validity and breach of contract, including liability and compensation for breach of contract and wrongful termination).

7. Host countries wishing to adopt legislation on PPPs where no such legislation exists may need to address the various issues raised by such projects in more than one statutory instrument. Other countries may wish to introduce legislation dealing only with certain issues that have not already been addressed in a satisfactory manner in existing laws and regulations. For instance, specific legislation on PPPs could establish the particular features of the procedures to select the private partner and refer, as appropriate, to existing legislation on the award of government contracts for details on the administration of the process. By the same token, when adopting legislation on PPPs, host countries may need to repeal the application of certain laws and regulations that, in the view of the legislature, constitute obstacles to their implementation and to ensure their consistency with such general PPP legislation (see chap. I, "General legal and institutional framework", paras. 25–28).

8. For purposes of clarity, it may be useful to provide information to potential investors concerning those statutory and regulatory texts which are directly applicable to the execution of PPPs and, as appropriate, those whose application has been repealed by the legislature. However, as it would not be possible to list exhaustively in the law all the statutes or regulations of direct or subsidiary relevance for PPPs, such a list might best be provided in a non-legislative document, such as a promotional brochure prepared by the PPP unit when such PPP unit exists (see chap. II, "Project planning and preparation", para. 47) or by the agency in charge of promoting investment. The relevant regulation might also be provided to bidders at the time of the issuance of the request for proposals (see chap. III, "Contract award", para. 66 and 70–76).

3. Conclusion of the PPP contract

9. For projects as complex as infrastructure projects, it is not unusual for several months to elapse between the selection of the winning bidder and the finalization and signing of all contractual documents (see chap. III, "Contract award", paras. 95–98). The quality of the feasibility and other studies conducted during the planning phase, as well as the existence of detailed and adequate contract templates and guidelines (see chap. II, "Project planning and preparation", para. 52) will be crucial to facilitating closing and reducing unnecessary delay. However, firm and final commitments by the lenders and other capital providers cannot reasonably be expected to be available prior to the final award of the PPP contract, and the parties will still need to take into account the terms and conditions of financing when finalizing the PPP contract. Additional time may also be needed to

accomplish certain formalities that are often prescribed by law, such as approval of the PPP contract by a higher authority. The entry into force of the PPP contract or of certain categories of PPP contract is in some countries subject to an act of parliament or even the adoption of special legislation. It is often the case in the concession-PPP related to the provision of a public service. Given the cost entailed by delay in the implementation of the PPP contract, it is advisable to find ways of expediting the final adjustments in order to avoid unnecessary delay in the conclusion of the PPP contract.

10. The parties may reduce that risk of delay by establishing at the planning stage a timetable setting forth important steps and benchmarks, which may even constitute conditions precedent to the entry into force of the PPP contract. Elements that may be used as steps and benchmarks could include mandatory approval by public authorities (see chap. II, "Project planning and preparation", para. 54), establishment of the project company within the established deadline (see paras. 13–20), securing of the required financial means (see chap. III, "Contract award", para. 79; see also "Introduction and background information on PPPs", paras. 56–59), obtaining licences or permits required for pursuing the activity that is the object of the PPP (see chap. II, "Project planning and preparation", paras. 53–55). During the final stage itself, several factors have been found to delay conclusion of the contract, such as inexperience of the parties, poor coordination between different public authorities, uncertainty as to the extent of governmental support and difficulties in establishing security arrangements acceptable to the lenders. The Government may make a significant contribution by providing adequate guidance to representatives acting on behalf of the contracting authority in the country. In that respect, the role of a PPP unit or similar coordination agency is of paramount importance to keep the conclusion process on track and facilitate a swift way forward (see chap. II, "Project planning and preparation", para. 47). The clearer the understanding of the parties as to the provisions to be included in the PPP contract, the greater the chances that the conclusion of the PPP contract will be conducted successfully. Conversely, where important issues remain open after the contract award and little guidance is provided to the parties as to the substance of the PPP contract, there may be considerable risk of costly and protracted discussions as well as of justified complaints that the selection process was not sufficiently transparent and competitive.

11. Various international organizations, such as the World Bank[1] or the International Federation of Consulting Engineers,[2] provided advice on PPP contract drafting or compiled standard clauses that can be used as a starting point in the drafting of the PPP contract or some elements of it. Those templates are widely accepted

[1] "Guidance on PPP contractual provisions", 2017 edition, International Bank for reconstruction and Development, The World Bank.

[2] Information is available on the website of FIDIC: http://fidic.org/.

and used around the world and they are updated regularly by the institutions. Moreover, guidance is provided as to their meaning and interpretation, which ensure uniformity and reduce the risk accordingly.

12. The procedures for conclusion and entry into force of the PPP contract should also be reviewed with a view to expediting matters and avoiding the adverse consequences of delays in the project's timetable. In some countries the power to bind the contracting authority or the Government, as appropriate, is delegated in the relevant legislation to designated officials, so that the entry into force of the PPP contract occurs upon signature or upon the completion of certain formalities, such as publication in the official gazette. In countries where such a procedure would not be feasible or where final approvals by another entity may still be required, it would be desirable to consider streamlining the approval procedures. Where such procedures are perceived as arbitrary or cumbersome, the Government may be requested to provide sufficient guarantees to the private partner and the lenders against such risk (see chap. II, "Project planning and preparation", paras. 71–76). In some countries where approval requirements exist, contracting authorities have sometimes been authorized to compensate the selected bidder for costs incurred during the selection process and in preparations for the project, should final approval be withheld for reasons not attributable to the selected bidder.

B. Corporate structure of the private partner

13. Certain requirements concerning the corporate structure of the private partner are often found in domestic legislation and are elaborated upon by detailed provisions in PPP contracts. They typically deal with issues such as the establishment of the private partner as a legal entity, its capital, scope of activities, statutes and by-laws. In most cases, the selected bidders establish a project company as an independent legal entity with its own juridical personality, often referred to as "special purpose vehicle" or "special purpose entity" which then becomes the private partner under the PPP contract. A project company established as an independent legal entity is the vehicle typically used for raising financing under the project finance modality (see "Introduction and background information on PPPs", para. 56). Such separate project company facilitates coordination in the execution of the project and provides a mechanism for protecting the interests of the project which does not necessarily coincide with the interest of the parent company or, as the case may be, the consortium members or other project promoters. This aspect may be crucial where members of the project consortium undertake to provide significant portions of the services or supplies required by the project.

14. When not already incorporated, the project company is usually required to be established shortly after the selection of the winning consortium. Since a

substantial part of the liabilities and obligations of the private partner, including long-term ones (PPP contract, loan and security agreements and construction contracts), are usually agreed upon at an early stage, the project may benefit from being independently represented at the time those instruments are negotiated. Also, from a long-term perspective, it is important that the shareholding structure of the project company reflects the agreement among the members of the winning consortium as regards their individual levels of commitment and equity participation in the project (see chap. III, "Contract award", para. 42). Some countries where foreign investment is subject to specific rules and case-by-case approval by the competent authorities have found it useful to merge the requirements for investment registration and PPP project authorization into a single procedure in order to save time and costs.

15. Entities providing public services are often required to be established as legal entities under the laws of the host country. This requirement reflects the legislature's interest to ensure, inter alia, that public service providers comply with domestic accounting and publicity provisions (such as publication of financial statements or requirements to make public certain corporate acts). However, this emphasizes the need for the host country to have adequate company laws in place (see chap. VII, "Other relevant areas of law", paras. 31–34). The ease with which the project company can be established, with due regard to reasonable requirements deemed to be of public interest, may help to avoid unnecessary delay in the implementation of the project.

Another important issue concerns the equity investment required for the establishment of the project company. The contracting authority has a legitimate interest in seeking an equity level that ensures a sound financial basis for the project company and guarantees its capability to meet its obligations. However, as the total investment needed, as well as the ideal proportion of debt and equity capital, vary from project to project, it may be undesirable to require in legislation a fixed sum as minimum capital for all companies carrying out PPP projects in the country. The contracting authority might instead be given more flexibility to arrive at a desirable amount of equity investment commensurate with the project's financial needs. For instance, the expected equity investment might be expressed as a desirable ratio between debt and equity in the request for proposals and might be included among the evaluation criteria for financial and commercial proposals, so as to stimulate competition among the bidders (see chap. III, "Contract award", paras. 84–86).

16. In any event, it is advisable to review legislative provisions or regulatory requirements relating to the organization of the private partner to ensure their consistency with international obligations assumed by the host country. Provisions that restrict or require specific types of legal entity or joint venture through which

a service supplier may supply a service and limitations on the participation of foreign capital in terms of a maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment may be inconsistent with specific obligations undertaken by the signatory States of certain international agreements on economic integration or the liberalization of trade in services.

17. The above considerations on the corporate structure of the private partner also apply to the award of PPP contracts to an existing legal entity, to a subsidiary of a legal entity that operates other PPP projects in the country, or to the award of a PPP contract to a State-owned enterprise, which is often the case in some countries. Where State-owned enterprises carry out PPP projects, it is important to consider carefully – ideally as early as at the planning stage – measures to mitigate potential conflicts of interest between the State, as controlling shareholder of the project company, and the minority shareholders. It is also important to consider lenders' concerns about political risks owing to the proxy relationship between State and the project company. Furthermore, the accounting treatment of debt assumed by a State-owned corporation and its possible impact on the State balance sheet as a potential subsidiary or indirect liability should also be considered (see chap. II, "Project planning and preparation", paras. 15–16; see also chap. VII, "Other relevant areas of law", paras. 44–46).

18. Domestic laws sometimes contain provisions concerning the scope of activities of the project company, requiring, for instance, that they be limited to the development and operation of a particular project. Such restrictions may serve the purpose of ensuring the transparency of the project's accounts and preserving the integrity of its assets, by segregating the assets, proceeds and liabilities of this project from those of other projects or other activities not related to the project. Also, such a requirement may facilitate the assessment of the performance of each project since deficits or profits could not be covered with, or set off against, debts or proceeds from other projects or activities. However, the possibility given to the private partner to expand its activities to associated projects or ancillary activities (for instance, the development of a shopping mall or a real estate project near a train station in association with the construction of a subway line) can be a strong incentive for private partners or consortium members having the expertise in such associated projects (see chap. II, "Project planning and preparation", paras. 84–86).

19. The contracting authority might also wish to be assured that the statutes and by-laws of the project company will adequately reflect the obligations assumed by the company in the PPP contract. For this reason, PPP contracts sometimes provide that the entry into force of changes in the statutes and by-laws of the project company is effective upon approval by the contracting authority. Where the contracting authority or another public authority participates in the project

company, provisions are sometimes made to the effect that certain decisions necessitate the positive vote of the contracting authority in the meeting of the shareholders or board. In any event, it is important to weigh the public interests represented through the contracting authority against the need to afford the project company the flexibility necessary for the conduct of its business. Where it is deemed necessary to require the contracting authority's approval to proposed amendments to the statutes and by-laws of the project company, it is advisable to limit such a requirement to cases concerning provisions deemed to be of fundamental importance (for example, amount of capital, classes of shares and their privileges or liquidation procedures), which should be identified in the PPP contract.

C. The project site, assets and easements

20. Provisions relating to the site of the project are an essential part of most PPP contracts. They typically deal with issues such as title to land and project assets, acquisition of land, and easements required by the private partner to carry out works or to operate the infrastructure. To the extent that the PPP contract contemplates transfer of public property to the private partner or the creation of a right of use regarding public property, prior legislative authority may be required. Legislation may also be needed to facilitate the acquisition of the required property or easements when the project site is not located on public property.

1. Ownership of project assets

21. As indicated earlier, PPP projects may involve situations where project-related assets are publicly owned or situations where the facility is entirely owned and operated by private interests (see "Introduction and background information on PPPs", paras. 48–55). Irrespective of the host country's general or sectoral policy, it is important that the ownership regime of the various assets involved be clearly defined and based on sufficient legislative authority. However, there may be no compelling need for detailed legislative provisions on this matter. In various countries it has been sufficient to provide a legislative framework outlining the matters that need to be addressed in the PPP contract.

22. In some legal systems, physical infrastructure required for the provision of public services under a concession-type PPP (see "Introduction and background information on PPPs", paras. 14–16), is generally regarded as public property, even where it was originally acquired or created with private funds. This would typically include any property especially acquired for the construction of the facility in addition to any property that might have been made available to the private partner by the contracting authority. However, during the life of the project the private partner may make extensive improvements or additions to the facility. It may not

always be easily ascertainable under the applicable law whether or not such improvements or additions become an integral part of the public assets held in possession by the private partner or whether some of them may be separable from the public property held by the private partner and become the private partner's private property. It is therefore advisable for the PPP contract to specify, as appropriate, which assets will be public property, and which will become the private property of the private partner.

23. The need for clarity in respect of ownership of project assets is not limited to legal systems where physical infrastructure required for the provision of public services is regarded as public property. Generally, where the contracting authority provides the land or facility required to execute the project, it is advisable for the PPP contract to specify, as appropriate, which assets will remain public property and which will become the private property of the private partner. The private partner may either receive title to such land or facilities or be granted only a leasehold interest or the right to use the land or facilities and build upon it, in particular where the land remains public property. In either case, the nature of the private partner's rights should be clearly established, as this will directly affect the private partner's ability to create security interests in project assets for the purpose of raising financing for the project (see paras. 60 and 61).

24. In addition to the ownership of assets during the duration of the PPP contract period, it is important to consider the ownership regime upon expiry or termination of the PPP contract. In concession-type PPPs, the contracting authority looks for continuity of service and therefore has an interest in the physical assets related to the project, which would require the handover of all project assets at the end of the contract. In the non-concession-type PPP, in turn, the PPP contract is regarded primarily as a means of procuring services over a specified period, rather than of building physical facilities. Thus, in the case of non-concession-type PPPs, the law could limit the private partner's handover obligations to public assets and property originally received from the contracting authority or other public body or certain other assets deemed to be necessary to ensure provision of the service. In the event of a new private partner being designated, such property is transferred directly from the private partner to another private partner who succeeds it in the provision of the service (see also chap. V, "Duration, extension and termination of the PPP contract", paras. 42 and 43).

25. Differences in legislative approaches often reflect the varying role of the public and private sectors under different legal and economic systems but may also be the result of practical considerations on the part of the contracting authority. One practical reason for the contracting authority to allow the private partner to retain certain assets at the end of the project period may be the desire to lower the cost at which the service will be provided. If the project assets are likely to have a residual value

for the private partner and if that value can be considered during the selection process, the contracting authority may expect the tariffs charged for the service to be lower. Indeed, if the private partner does not expect to have to cover the entire cost of the assets over the life of the project, but can recover part of it by selling them, or using them for other purposes, after the PPP contract expires, there is a possibility that the service may be provided at a lower cost than if the private partner had to amortize all its costs over the life of the project. Moreover, certain assets may require such extensive refurbishing or technological upgrading at the end of the project period that it might not be cost effective for the contracting authority to claim them. There may also be residual liabilities or consequential costs, for instance, because of liability for environmental damage or demolition costs.

26. For these reasons, the laws of some countries do not contemplate an unqualified transfer of all assets to the contracting authority in all types of PPPs, but allow a distinction between three main categories of assets:

(a) Assets that must be transferred to the contracting authority. This category typically includes public property that was used by the private partner to provide the service concerned. Assets may include both facilities made available to the private partner by the contracting authority and new facilities built by the private partner pursuant to the PPP contract, although in non-concession type PPPs, there may not always be a public interest in retaining those assets. Some laws also require the transfer of assets, goods and property subsequently acquired by the private partner for the purpose of operating the facility, in particular where they become part of, or are permanently affixed to, the infrastructure facility to be handed over to the contracting authority;

(b) Assets that may be purchased by the contracting authority, at its option. This category usually includes assets originally owned by the private partner, or subsequently acquired by it, which, without being indispensable or strictly necessary for the provision of the service, may enhance the convenience or efficiency of operating the facility or the quality of the service;

(c) Assets that remain the private property of the private partner. These are assets owned by the private partner that do not fall under *(b)* above. Typically, the contracting authority is not entitled to such assets, which may be freely removed or disposed of by the private partner.

27. In the light of the above, it is useful for the law to require that the PPP contract specify, as appropriate, which assets will be public property, and which will be the private property of the private partner. The PPP contract should identify which assets the private partner is required to transfer to the contracting authority or to a new private partner upon expiry or termination of the PPP contract; which assets the contracting authority, at its option, may purchase from the private partner; and

which assets the private partner may freely remove or dispose of upon expiry or termination of the PPP contract. These provisions should be complemented by contractual criteria for establishing, as appropriate, the compensation to which the private partner may be entitled in respect of assets transferred to the contracting authority or to a new private partner or purchased by the contracting authority upon expiry or termination of the PPP contract (see chap. V, “Duration, extension and termination of the PPP contract”, paras. 40–43).

2. Acquisition of land required for execution of the project

28. Where a new infrastructure facility is to be built on public land (that is, land owned by the contracting authority or another public authority) or an existing infrastructure facility is to be modernized or rehabilitated, it will normally be for the owner of such land or facility to make it available to the private partner. The situation is more complex when the land is not already owned by the contracting authority and needs to be purchased from its owners. In most cases, the private partner would not be in the best position to assume responsibility for purchasing the land needed for the project, in view of the potential delay and expense involved in negotiations with a possibly large number of individual owners, nor, as may be necessary in some jurisdictions, to undertake complex searches of title deeds and review of chains of previous property transfers so as to establish the validity of the title of individual owners. It is therefore typical for the contracting authority to assume responsibility for providing the land required for the implementation of the project, so as to avoid unnecessary delay or increase in project cost because of the acquisition of land. The environmental and social impact studies that were undertaken at the preparation stage of the project should have estimated the cost of acquiring the required land, such as identifying the procedure to be followed, the time needed and all possible obstacles or sources of delays (see chap. II, “Project planning and preparation”, para. 15). The contracting authority may purchase the required land from its owners or, if necessary, acquire it compulsorily.

29. The procedure whereby private property is compulsorily acquired by the Government against the payment of appropriate compensation to the owners, which is referred to in domestic legal systems by various technical expressions, such as “expropriation”, is referred to in the present *Guide* as “compulsory acquisition”. The law of most countries sets conditions and limits for the compulsory acquisition of private property by the Government, including the payment of compensation to the owner (see chap. VII, “Other relevant areas of law”, paras. 7–10). In countries where the law contemplates more than one type of procedure for compulsory acquisition, it may be desirable to authorize the competent public authorities to carry out all acquisitions required for PPPs pursuant to the most efficient of those procedures, such as the special procedures that in some countries apply for reasons of compelling public need (see chap. VII, “Other relevant areas of law”, paras. 23 and 24).

30. The power to acquire property compulsorily is usually vested in the Government. However, for concession-type PPPs, some legal systems authorize infrastructure operators or public service providers (such as railway companies or electricity authorities) to perform certain actions for the compulsory acquisition of private property required for providing or expanding their services to the public. In those countries in particular where the award of compensation to the owners of the property compulsorily acquired is adjudicated in court proceedings, it has been found useful to delegate to the private partner the authority to carry out certain acts relating to the compulsory acquisition, while the Government remains responsible for accomplishing those acts which, under the relevant legislation, are preconditions to the initiation of the acquisition proceedings. Upon acquisition, the land often becomes public property, although in some cases the law may authorize the contracting authority and the private partner to agree on a different arrangement, considering their respective shares in the cost of acquiring the property.

3. Easements

31. Special arrangements may be required in cases where the private partner needs to transit on or through the property of third parties to access the project site or to perform or maintain any works required for the provision of the service (for example, to place traffic signs on adjacent lands; to install poles or electric transmission lines above third parties' property; to install and maintain transforming and switching equipment; to trim trees that interfere with telephone lines placed on abutting property; or to lay oil, gas or water pipes).

32. The right to use another person's property for a specific purpose or to do work on it is often referred to by the word "easement". Easements usually require the consent of the owner of the property to which they pertain, unless such rights are provided by the law. Usually it is not an expeditious or cost-effective solution to leave it to the private partner to acquire easements directly from the owners of the properties concerned. Instead, it is more frequent for those easements to be compulsorily acquired by the contracting authority simultaneously with the project site.

33. A somewhat different alternative might be for the law itself to empower public service providers to enter, pass through or do work or affix installations upon the property of third parties, as required for the construction, operation and maintenance of public infrastructure. Such an approach, which may obviate the need to acquire easements in respect of individual properties, may be used in sector-specific legislation where it is deemed possible to determine, in advance, certain minimum easements that may be needed by the private partner. For instance, a law specific to the power generation sector may lay down the conditions under which the private partner obtains a right of cabling for the purpose of placing and operating basic and distribution networks on property belonging to third parties. Such a right

may be needed for several measures, such as establishing or placing underground and overhead cables, as well as establishing supporting structures and transforming and switching equipment; maintaining, repairing and removing any of those installations; establishing a safety zone along underground or overhead cables; or removing obstacles along the wires or encroaching on the safety zone. Where the laws of the host country do not expressly set forth the extent of compensation that may be due to the owners of the property affected by the service provider's easements, it is advisable to do so in general or sector-specific PPP legislation, as appropriate, should the extent of the rights granted to the private partner be such that the use of the properties by their owners is substantially hindered (for instance, in case of disturbance due to the operation or maintenance of the infrastructure; in case of reduction in the market value of the property due to the easements rights granted to the private partner).

D. Financial arrangements

34. Financial arrangements for PPP projects usually follow the project finance structure and typically include provisions concerning the private partner's obligations to raise funds for the project, the mechanisms for disbursing and accounting for funds, the remuneration of the private partner and the types of security interests that may be established in favour of the private partner's creditors and equity providers. Financial arrangements for concession-PPPs may have little in common with non-concession PPPs, and even within those two categories different sectors and projects may require different financial arrangements. It is important to ensure that the laws of the host country take that diversity into account and facilitate or at least not pose obstacles to the financial management of the project.

1. Financial obligations of the private partner

35. The private partner in a PPP is typically responsible for raising and providing the funds required to construct and operate the infrastructure facility. The private partner's obligations in this regard are typically set forth in detailed provisions in the PPP contract. In most cases, the contracting authority or other public authorities would be interested in limiting their financial obligations to those specifically expressed in the PPP contract or those forms of direct support that the Government has agreed to extend to raise funds for the project (see chap. II, "Project planning and preparation", paras. 61–86).

36. The amount of private capital contributed directly by the project company's shareholders typically represents only a portion of the total proposed investment. A far greater portion derives from loans extended to the private partner by commercial banks and international financial institutions and from the proceeds

of the placement of bonds and other negotiable instruments on the capital market (see "Introduction and background information on PPPs", paras. 56–69). It is therefore important to ensure that the law does not unnecessarily restrict the private partner's ability to enter into the financial arrangements it sees fit for the purpose of financing the infrastructure.

2. *Payment sources and methods*

37. The financial compensation to which the private partner is entitled, and the methods for calculating and ensuring its payment, are central elements of the project, as conceived during the planning and feasibility assessment phase (see chap. II, "Project planning and preparation", paras. 6–16). The PPP contract and related document will usually contain detailed provisions dealing with those issues, and, depending on the type of project, legislation may play an important role in facilitating or even making possible the financial arrangements envisaged by the parties.

38. Payment sources and methods will vary according to the type of project and sector. In concession-PPPs, the project's cash flow is primarily assured by payments made by the end users of the infrastructure facility operated by the private partner (for example, drivers passing a toll bridge), or by the customers that purchase the services or commodities it provides (for example, households paying for electricity or potable water). In non-concession PPPs, in turn, the contracting authority directly pays the private partner for the construction of the infrastructure and, as appropriate, for the use or operation of such infrastructure or service. These are obviously two extreme paradigms based on the preponderant form of remuneration. In practice, they are often combined when necessary to ensure the successful implementation of the project and the agreed investment recovery and profit rate for the private partner. Bearing in mind both that general distinction, as well as the possible combination of various payment methods, the following paragraphs set out the main options available and points out, as appropriate, the role of legislation in enabling or facilitating them.

(a) User charges

39. In concession-PPPs, tariffs or usage fees charged by the private partner may be the main (sometimes even the sole) source of revenue to recover the investment made in the project in the absence of subsidies or payments by the contracting authority (see paras. 51–59) or the Government (see chap. II, "Project planning and preparation", paras. 56–86). The private partner will therefore seek to be able to set and maintain tariffs and fees at a level that ensures sufficient cash flow for the project. However, in some legal systems there may be limits to the private partner's freedom to establish tariffs and fees. The cost at which public services are provided is typically an element of the Governments' infrastructure policy and a

matter of immediate concern for large sections of the public. Thus, the regulatory framework in many countries includes special rules to control tariffs and fees for the provision of public services. Furthermore, statutory provisions or general regulations in some legal systems establish parameters for pricing goods or services, for instance by requiring that tariffs meet certain standards of "reasonableness", "fairness" or "equity".

(i) The private partner's authority to collect tariffs

40. In several countries prior legislative authorization may be necessary for a private partner to collect tariffs for the provision of public services or to demand a fee for the use of public infrastructure facilities. The absence of such a general provision in legislation has, in some countries, given rise to judicial disputes challenging the private partner's authority to charge a tariff for the service.

41. Where it is deemed necessary to include in general legislation provisions concerning the level of tariffs and user fees, those provisions should seek to achieve a balance between the interests of investors and current and future users. It is advisable that statutory criteria for determining tariffs and fees take into account, in addition to social factors the Government regards as relevant, the private partner's interest in achieving a level of cash flow that ensures the economic viability and commercial profitability of the project. Good practice in that respect call for including the tentative tariff calculations in the feasibility studies and in the bidding documents. Furthermore, it is advisable to provide the parties with the necessary authority to negotiate appropriate arrangements, including compensation provisions, to address situations where the application of tariff control rules directly or indirectly related to the provision of public services may result in the fixing of tariffs or fees below the level required for the profitable operation of the project (see para. 133).

(ii) Tariff control methods

42. Domestic laws often subject tariffs or user fees to some control mechanism. Many countries have chosen to set only broad tariff principles in legislation, leaving their actual implementation to the regulatory agency concerned and to the terms and conditions of licences or PPP contracts. This approach is advisable because formulas are sector-specific and may require adaptation during the life of a project. Where tariff control measures are used, the law typically requires the tariff formula to be advertised with the request for proposals and incorporated into the PPP contract. Tariff control systems typically consist of formulas for the adjustment and monitoring of tariff provisions to ensure compliance with the parameters for tariff adjustment. The most common tariff control methods used in domestic laws are based on rate-of-return and price-cap principles. There are also hybrid regimes that have elements of both. It should be noted that a well-functioning tariff control mechanism requires

detailed commercial and economic analysis and that the brief discussion that follows offers only an overview of selected issues and possible solutions.

a. Rate-of-return method

43. Under the rate-of-return method, the tariff adjustment mechanism is devised to allow the private partner an agreed rate of return on its investment. The tariffs for any given period are established on the basis of the private partner's overall revenue requirement to operate the facility, which involves determining its expenses, the investments undertaken to provide the services and the allowed rate of return. Reviews of the tariffs are undertaken periodically, sometimes whenever the contracting authority or other interested parties consider that the actual revenue is higher or lower than the revenue requirement of the facility. For that purpose, the contracting authority verifies the expenses of the facility, determines to what extent investments undertaken by the private partner are eligible for inclusion in the rate base and calculates the revenues that need to be generated to cover the allowable expenses and the return on investment agreed upon. The rate-of-return method is typically used in connection with the supply of public services for which a constant demand can be forecast, such as power, gas or water supply. For facilities or services exposed to greater elasticity of demand, such as toll roads, it might not be possible to keep the private partner's rate of return constant by way of regular tariff adjustments.

44. The rate-of-return method has been found to provide a high degree of security for infrastructure operators, since the private partner is assured that the tariffs charged will be sufficient to cover its operating expenses and allow the agreed rate of return. Because tariffs are adjusted regularly, thus keeping the private partner's rate of return essentially constant, investment in companies providing public services is exposed to little market risk. The result is typically lower costs of capital. The possible disadvantage of the rate-of-return method is that it provides little incentive for infrastructure operators to minimize their costs because of the assurance that those costs will be recovered through tariff adjustments. However, some level of incentive may exist if the tariffs are not adjusted instantaneously or if the adjustment does not apply retroactively. It should be noted that the implementation of the rate-of-return method requires a substantial amount of information, as well as extensive negotiations (for example, on eligible expenditures and cost allocation).

b. Price-cap method

45. Under the price-cap method, a tariff formula is set for a given period (such as four or five years) taking into account future inflation and future efficiency gains expected from the facility. Tariffs are allowed to fluctuate within the limits set by the formula. In some countries, the formula is a weighted average of various indices, in others it is a consumer price index minus a productivity factor. Where substantial

new investments are required, the formula may include an additional component to cover these extra costs. The formula can apply to all services of the company or to selected groups of services only, and different formulas may be used for different groups. The periodic readjustment of the formula is, however, based on the rate-of-return type of calculations, requiring the same type of detailed information as indicated above, though on a less frequent basis.

46. The implementation of the price-cap method may be less complex than the rate-of-return method. The price-cap method has been found to provide greater incentives for public service providers, since the private partner retains the benefits of lower than expected costs until the next adjustment period. At the same time, however, public service providers are typically exposed to more risk under the price-cap method than under the rate-of-return method. In particular, the private partner faces the risk of loss when the costs turn out to be higher than expected, since the private partner cannot raise the tariffs until the next tariff adjustment. The greater risk exposure increases the costs of capital. If the project company's returns are not allowed to rise, there may be difficulties in attracting new investment. Also, the company may be tempted to lower the quality of the service in order to reduce costs.

c. Hybrid methods

47. Many tariff adjustment methods currently being used combine elements of both the rate-of-return and the price-cap methods with a view to both reducing the risk borne by the service providers and providing sufficient incentives for efficiency in the operation of the infrastructure. One such hybrid method employs sliding scales for adjusting the tariffs that ensure upward adjustment when the rate of return falls below a certain threshold and downward adjustment when the rate of return exceeds a certain maximum, with no adjustment for rates of return falling between those levels. Other possible approaches to balancing the rate-of-return and price-cap methods include a review by the contracting authority of the investments made by the private partner to ensure that they meet the criteria of usefulness in order to be considered when calculating the private partner's revenue requirement. Another tariff adjustment technique that may be used to set tariffs, or more generally to monitor tariff levels, is benchmark or yardstick pricing. By comparing the various cost components of one public service provider with those of another and with international norms, the contracting authority may be able to judge whether tariff adjustments requested by the public service provider are reasonable.

(iii) Policy considerations on tariff control

48. Each of the main tariff adjustment methods discussed above has its own advantages and disadvantages and varying impact on private sector investment decisions. Legislators, regulators and the contracting authority, as appropriate,

should bear in mind these issues when considering the appropriateness of tariff control methods to domestic circumstances. Different methods may also be used for different infrastructure sectors. Some laws indeed authorize the contracting authority to apply either a price-cap or rate-of-return method in the selection of private partners, according to the scope and nature of investments and services. In choosing a tariff control method, it is important to consider the impact of the various policy options on private sector investment decisions. Whatever mechanism is chosen, the capacity of the contracting authority or the regulatory agency to monitor adequately the performance of the private partner and to implement the adjustment method satisfactorily should be carefully considered (see also chap. I, "General legal and institutional framework", paras. 37–60). Notwithstanding the private partner's interest, the public authority should also ensure an adequate level of transparency vis-à-vis the final users in concession PPPs. The choice of the tariff control method should be made and clearly communicated at an early stage, for instance in the feasibility studies, the preselection criteria or the request for proposals, as the case may be, and the contracting authority or regulatory agency should enable public access to the calculation and the decision process.

49. It is important to bear in mind that tariff adjustment formulas cannot be set once and for all, as technology, exchange rates, wage levels, productivity and other factors are bound to change significantly, sometimes even unpredictably, over the PPP contract period. Furthermore, tariff adjustment formulas are typically drawn up assuming a certain level of output or demand and may lead to unsatisfactory results if the volume of output or demand changes considerably. Therefore, many countries have established mechanisms for revision of tariff formulas, including periodic revisions (for example, every four or five years) of the formula or ad hoc revisions whenever it is demonstrated that the formula has failed to ensure adequate compensation to the private partner (see also para. 133). The tariff regime will also require adequate stability and predictability to enable public service providers and users to plan accordingly and to allow financing based on a predictable revenue stream. Investors and lenders may be particularly concerned about regulatory changes affecting the tariff adjustment method. Thus, they typically require the tariff adjustment formula to be incorporated into the PPP contract.

(b) Payments by the contracting authority

50. The function and nature of payments by the contracting authority could differ according to the type of PPP arrangement. They may include direct payments for services actually provided, direct payment for space or production capacity made available, public subsidies, or other form of financial transfers agreed between the contracting authority and the private partner. In non-concession PPPs, direct payments by the contracting authority may be the sole source of revenue for the private partner, where the private partner does not charge the final user for the

infrastructure or service (for example, when the private partner operates a publicly accessible facility). Also, where the private partner produces a commodity for further transmission or distribution by another service provider, the contracting authority may undertake to purchase that commodity wholesale at an agreed price and on agreed conditions. In concession-PPPs, in turn, direct payments are not the primary source of funding for the project because the private partner would normally generate operating income by charging the end users of the facility or purchasers of the services or product it offers. Nevertheless, in some concession-PPPs the contracting authority or other public authority may undertake to make direct payments to the private partner as a substitute for, or in addition to, service charges to be paid by the users (for example, in the form of so called "shadow tolls", intended to secure the income stream anticipated in the agreed travel forecasts). In either situation, the financial standing of the contracting authority and its rating by financial institutions, if applicable, are crucial for securing financing at an adequate cost.

51. Many PPP projects may not be feasible without direct payments, be it because there is no direct market demand for the services or facilities developed outside the public sector (such as for waste collection, correctional facilities, or sewage treatment plants), because the demand may be insufficient to cover the project costs (such as bridges or tunnels in low traffic regions) or because the contracting authority is the actual customer of the private sector (such as when a government agency uses office space built and managed by the private partner, or when the private partner builds and maintains a hospital operated by the country's health and social security system). In non-concession PPPs, direct payments are made by the contracting authority to the private partner. Accordingly, the private partner is not exposed to the demand risk (the level of payment is not correlated to the level of demand) but only to the availability risk (for example, the risk that the private partner may be unable to provide the service at the level agreed in the PPP contract). The position of the private partner is different in concession-PPPs, where the remuneration is primarily secured by payments made by the users of the facility, which exposes the private partner to the risk of a demand lower than anticipated. In any event, the type, amount and methods for calculating payments should be performance-based and consistent with the financial model prepared during the project assessment and at the time of the contract award (see chap. II, "Project planning and preparation", paras. 6–14 and chap. III, "Contract award", paras. 30, 31, 67 and 76). In addition, transparency may require that the contracting authority, or the Government as the case may be, report on a periodic basis on payments made directly to the private partner in support of the project and provide justification therefor, such as quantities measured or performance evaluation reports (see below, para. 104 and chap. II, "Project planning and preparation", para. 69). The main examples of such arrangements are discussed briefly below.

(i) Upfront or rental payments

52. Upfront or rental payments are often used in non-concession PPPs that do not envisage payments by the end users. In these cases, the contracting authority pays the private partner for the construction, renovation or other work done under the PPP contract, and, as appropriate for the operation and management of the infrastructure facility and service, according to the formulas agreed in the contract. The most common method would link monthly or yearly payments to an agreed schedule of development of the infrastructure. Once works are completed and the facility becomes operational, the contract would provide for payment for the availability or actual usage of the facility, according to a schedule of fees for surface or similar physical parameters.

53. Regardless of the type of PPP, the contracting authority should carefully consider the need for upfront and rental payments, as they provide a significant incentive for the private partner to bid for a PPP project, and many potential investors may include such payments in their initial financial simulations. While they may be indispensable in some types of non-concession PPPs (such as where the private partner makes facilities available for use by the contracting authority), in other projects, such as many concession-PPPs, upfront payments may run counter to the very purpose of a PPP arrangement and remove incentives for efficiency in construction and operation of the facility. It is advisable to link such payments to the performance monitoring mechanisms provided in the contract (see below, paras. 91 and 92), for instance through deductions and bonuses to stimulate efficient performance. Furthermore, as payments may require prior budget appropriation and may be subject to audit and other forms of public control, it is important to ensure that the formula is unambiguous and that contractual mechanisms and parameters for monitoring and measurements of the private partner's performance are verifiable and objective.

(ii) Capacity and usage-based payments

54. Some projects contemplate an obligation for the contracting authority to make payments to compensate the private partner for making available a certain service or use capacity. Capacity and usage-based payments typically use formulae based on the number of units of service provided, multiplied by the agreed price of each unit. In non-concession PPPs, these payments are provided as the sole source of remuneration of the private partner, or in connection with other types of direct payment made by the contracting authority (such as upfront or rental payments). In concession-PPPs, this is typically done to supplement an actual level of payment by end users that falls short of the contractual estimates.

55. A well-known example of usage-based payments in the transportation sector is the mechanism known as "shadow tolling". Shadow tolls are arrangements

whereby the private partner assumes the obligation to develop, build, finance and operate a road or another transportation facility for a set number of years in exchange for periodic payments in place of, or in addition to, real or explicit tolls paid by users. Shadow toll schemes may be used to address risks that are specific to transportation projects, such as the risk of lower than expected traffic levels (see chap. II, "Project planning and preparation", para. 34). Furthermore, shadow toll schemes may be politically more acceptable than direct tolls, for example, where it is feared that the introduction of toll payments on public roads may give rise to protests by road users. However, where such arrangements involve some form of subsidy to the project company, their conformity with certain obligations of the host country under international agreements on regional economic integration or trade liberalization should be carefully considered (see chap. VII, "Other relevant areas of law", paras. 4–6).

56. Shadow tolls (and any similar supplemental payment based on an estimate of usage) may involve a substantial expenditure for the contracting authority and require close and extensive monitoring. In countries that have used shadow tolls for the development of new road projects, payments by the contracting authority to the private partner are based primarily on actual traffic levels, as measured in vehicle miles. It is considered advisable to provide that payments are not made until traffic begins, so that the private partner has an incentive to open the road as quickly as possible. At the same time, it has been found useful to calculate payments on the basis of actual traffic for the duration of the PPP contract. This system gives the private partner a reason to ensure that usage of the road will be disrupted as little as possible by repair works. Alternatively, the PPP contract could contain a penalty or liquidated damages clause for lack of lane availability resulting from repair works. The private partner is typically required to perform continuous traffic counts to calculate annual vehicle miles, which are verified periodically by the contracting authority. A somewhat modified system may combine both shadow tolls and direct tolls paid by the users. In such a system, shadow tolls are only paid by the contracting authority if the traffic level over a certain period falls below the agreed minimum level necessary for the private partner to operate the road profitably.

(iii) Purchase commitments

57. Where the private partner operates a facility that generates goods or services capable of being delivered on a long-term basis to an identified purchaser (such as an independent power plant), the contracting authority or other public authority often assume an obligation to purchase such goods and services, at an agreed rate, as they are offered by the private partner. Contracts of this type are usually referred to as "off-take agreements". Off-take agreements often include two types of payments: payments for the availability of the production capacity and payments for

units of actual consumption. In a power generation project, for example, the power purchase agreement may contemplate the following charges:

(a) *Capacity charges.* These are charges payable regardless of actual output in a billing period and are calculated to be sufficient to pay all of the private partner's fixed costs incurred to finance and maintain the project, including debt service and other ongoing financing expenses, fixed operation and maintenance expenses and a certain rate of return. The payment of capacity charges is often subject to the observance of certain performance or availability standards;

(b) *Consumption charges.* These charges are not intended to cover all of the private partner's fixed costs, but rather to pay the variable or marginal costs that the private partner has to bear to generate and deliver a given unit of the relevant service or good (such as a kilowatt hour of electricity). Consumption charges are usually calculated to cover the private partner's variable operating costs, such as that of fuel consumed when the facility is operating, water treatment expenses and costs of consumables. Variable payments are often tied to the private partner's own variable operating costs or to an index that reasonably reflects changes in operating costs.

58. From the perspective of the private partner, a combined scheme of capacity and consumption charges is particularly useful to ensure cost recovery where the transmission or distribution function for the goods or services generated by the private partner is subject to a monopoly. However, the capacity charges provided in the off-take agreement should be commensurate with the other sources of generating capacity available to, or actually used by, the contracting authority. In order to ensure the availability of funds for payments by the contracting authority under the off-take agreement, it is advisable to consider whether advance budgeting arrangements are required. Payments under an off-take agreement may be backed by a guarantee issued by the host Government or by a national or international guarantee agency (see chap. II, "Project planning and preparation", paras. 72 and 73).

E. Security interests

59. Security interests in personal property provide the secured creditor with essentially two kinds of rights: a property right allowing the secured creditor, in principle, to repossess the property or have a third party repossess and sell it, and a priority right to receive payment with the proceeds from the sale of the property in the event of default by the debtor (for reference to laws on security interests, including standards prepared by UNCITRAL, such as the UNCITRAL Model Law on Secured Transactions, see chap. VII, "Other relevant areas of law", paras. 11–17). Security arrangements in project finance generally play a defensive or preventive role by ensuring that, in the event a third party acquires the debtor's operations (for example, by

foreclosure, in bankruptcy or directly from the debtor) all proceeds resulting from the sale of those assets will go first to repayment of outstanding loans. Nevertheless, lenders would generally aim at obtaining security interests that allow them to foreclose and take possession of a project they can take over and operate either to restore its economic viability with a view to reselling at an appropriate time or to retaining the project indefinitely and collecting ongoing revenue.

60. Security arrangements are crucial for financing infrastructure projects, in particular where the financing is structured under the "project finance" modality. The financing documents for PPPs typically include both security over physical assets related to the project and security over intangible assets held by the private partner. A few of the main requirements for the successful closure of the security arrangements are discussed below. It should be noted, however, that, in some legal systems, any security given to lenders that makes it possible for them to take over the project is only allowed under exceptional circumstances and under certain specific conditions, namely, that the creation of such security requires the agreement of the contracting authority; that the security should be granted for the specific purpose of facilitating the financing or operation of the project; and that the security interests should not affect the obligations undertaken by the private partner. Those conditions often derive from general principles of law or from statutory provisions and cannot be waived by the contracting authority through contractual arrangements.

1. Security interests in physical assets

61. The negotiation of security arrangements required to obtain financing for the project may face legal obstacles where project assets are public property. If the private partner lacks title to the property it will in many legal systems have no (or only limited) power to encumber such property. Where limitations of this type exist, the law may still facilitate the negotiation of security arrangements for instance by indicating the types of asset in respect of which such security interests may be created or the type of security interest that is permissible. In some legal systems, a private partner that is granted a leasehold interest or right to use certain property may create a security interest over the leasehold interest or right to use.

62. Furthermore, security interests may also be created where the PPP contract encompasses different types of public property, such as when title to adjacent land (and not only the right to use it) is granted to a railway company in addition to the right to use the public infrastructure. Where it is possible to create any form of security interests in respect of assets owned by, or required to be handed over to, the contracting authority or assets in relation to which the contracting authority has a contractual option of purchase (see para. 28), the law may require the approval of the contracting authority in order for the private partner to create such security interests.

2. Security interests in intangible assets

63. The main intangible asset in a concession-PPP infrastructure project is the concession itself, that is, the concessionaire's right to operate the infrastructure or to provide the relevant service and charge the public for its use of services it delivers. In most legal systems, the concession attached to the PPP contract provides its holder with the authority to control the entire project and entitles the private partner to earn the revenue generated by the project. Thus, the value of the concession exceeds the combined value of all the physical assets involved in a project. Because the private partner would usually have the right to possess and dispose of all project assets (with the possible exception of those which are owned by other parties, such as public property in the possession of the private partner), the concession would typically encompass both present and future assets of a tangible or intangible nature. The lenders may therefore regard the concession as an essential component of the security arrangements negotiated with the private partner. A pledge of the concession itself may have various practical advantages for the private partner and the lenders, in particular in legal systems that would not otherwise allow the creation of security over all of a company's assets or which do not generally recognize non-possessory security interests. These advantages may include avoiding the need to create separate security interests for each project asset, allowing the private partner to continue to deal with those assets in the ordinary course of business and making it possible to pledge certain assets without transferring actual possession of the assets to the creditors. Furthermore, a pledge of the concession may entitle the lenders, in case of breach by the private partner, to avert termination of the project by taking over the concession and making arrangements for continuation of the project under another private partner. A pledge of the concession may, therefore, represent a useful complement to or, under certain circumstances, a substitute for a direct agreement between the lenders and the contracting authority concerning the lenders' step-in rights (see paras. 162–165).

64. However, in some legal systems there may be obstacles to a pledge of the concession in the absence of express legislative authorization. Under various legal systems, security interests may only be created in respect of assets that can be freely transferable by the grantor of the security. Since the right to operate the infrastructure is, in most cases, not transferable without the consent of the contracting authority (see paras. 70 and 71), in some legal systems it may not be possible for the private partner to create security interests over the concession itself. Recent legislation in some civil law jurisdictions has removed that obstacle by creating a special category of security interest, sometimes referred to by expressions such as "*hipoteca de concesión de obra pública*" or "*prenda de concesión de obra pública*" ("public works concession mortgage" or "pledge of public works concession"), which generally provides the lenders with an enforceable security interest covering all of the rights granted to the private partner under the PPP contract. However, in order

to protect the public interest, the law requires the consent of the contracting authority for any measure by the lenders to enforce such a right, under conditions to be provided in an agreement between the contracting authority and the lenders. A somewhat more limited solution has been achieved in some common law jurisdictions in which a distinction has been made between the non-transferable right to carry out a certain activity under a governmental licence (that is, the "public rights" arising under the licence) and the right to claim proceeds received by the licensee (the latter's "private rights" under the licence).

3. Security interests in trade receivables

65. Another form of security typically given in connection with most PPPs is an assignment to lenders of proceeds from contracts with customers of the private partner. Those proceeds may consist of the proceeds of a single contract (such as a power purchase commitment by a power distribution entity or rental payments by the contracting authority in non-concession PPPs) or of a large number of individual transactions (such as monthly payment of gas or water bills). In concession-type PPPs, those proceeds typically include the tariffs charged to the public for the use of the infrastructure (for example, tolls on a toll road) or the price paid by the customers for the goods or services provided by the private partner (electricity charges, for example). They may also include the revenue of ancillary PPP contracts. Security of this type is a typical element of the financing arrangements negotiated with the lenders and the loan agreements often require the proceeds of infrastructure projects to be deposited in an escrow account managed by a trustee appointed by the lenders. Such a mechanism may also play an essential role in the issuance of bonds and other negotiable instruments by the private partner.

66. Security over trade receivables plays a central role in financing arrangements involving the placement of bonds and other negotiable instruments. Those instruments may be issued by the private partner itself, in which case the investors purchasing the security will become its creditors, or they may be issued by a third party to whom the project receivables have been assigned through a mechanism known as "securitization". Securitization involves the creation of financial securities backed by the project's revenue stream, which is pledged to pay the principal and interest of that security. Securitization transactions usually involve the establishment of a legal entity separate from the private partner and especially dedicated to the business of securitizing assets or receivables. This legal entity is often referred to as a "special-purpose vehicle". The private partner assigns project receivables to the special-purpose vehicle, which, in turn, issues to investors interest bearing instruments that are backed by the project receivables. The securitized bondholders thereby acquire the right to the proceeds of the private partner's transactions with its customers. The private partner collects the tariffs from the customers and transfers the funds to the special-purpose vehicle, which then transfers it to the

securitized bondholders. In some countries, recent legislation has expressly recognized the private partner's authority to assign project receivables to a special-purpose vehicle, which holds and manages the receivables for the benefit of the project's creditors. With a view to protecting the bondholders against the risk of insolvency of the private partner, it may be advisable to adopt the necessary legislative measures to enable legal separation between the private partner and the special-purpose vehicle.

67. In most cases it would not be practical for the private partner to specify individually the receivables being assigned to the creditors. Assignment of receivables in project finance therefore typically takes the form of a bulk assignment of future receivables. Statutory provisions recognizing the private partner's authority to pledge the proceeds of infrastructure projects have been included in domestic legislation in various legal systems. However, there may be considerable uncertainty in various legal systems about the validity of the wholesale assignment of receivables and of future receivables. It is therefore important to ensure that domestic laws on security interests do not hinder the ability of the parties to assign trade receivables effectively in order to obtain financing for the project (see chap. VII, "Other relevant areas of law", paras. 16–17).

4. *Security interests in the project company*

68. Where the concession may not be assigned or transferred without the consent of the contracting authority (see paras. 70 and 71), the law sometimes prohibits the establishment of security over the shares of the project company. It should be noted, however, that security over the shares of the project company is commonly required by lenders in project finance transactions and that general prohibitions on the establishment of such security may limit the project company's ability to raise funding for the project. As with other forms of security, it may therefore be useful for the law to authorize the private partner's shareholders to create such security, subject to the contracting authority's prior approval, where an approval would be required for the transfer of equity participation in the project company (see paras. 72–76).

F. Assignment of rights by the private partner

69. Concessions contained in PPP contracts are granted in view of the particular qualifications and reliability of the private partner and in most legal systems they are not freely transferable. Indeed, domestic laws often prohibit the assignment of rights acquired by the private partner after the contract award without the consent of the contracting authority. The purpose of these restrictions is typically to ensure the contracting authority's control over the qualifications of infrastructure

operators or public service providers. Some countries also preclude such assignment before the construction of the project facility has been completed.

70. Some countries have found it useful to mention in the legislation the conditions under which approval for the transfer of a concession prior to its expiry may be granted, such as, for example, acceptance by the new private partner of all obligations under the PPP contract and evidence of the new private partner's technical and financial capability to provide the service. General legislative provisions of this type may be supplemented by specific provisions in the PPP contract setting forth the scope of those restrictions, as well as the conditions under which the consent of the contracting authority may be granted. In that respect, early disclosure of the draft PPP contract at the bidding stage would allow the prospective investors to be fully informed of the conditions in which transfer of the concession may be granted (see chap. III, "Contract award", para. 76). It should be noted that restrictions typically apply to the voluntary transfer of its rights by the private partner; they do not preclude the compulsory transfer of the concession to an entity appointed by the lenders, with the consent of the contracting authority, for the purpose of averting termination due to serious breach by the private partner (see also paras. 158–161). In any case, restrictions to the assignment of rights should be consistent with the restrictions imposed on the transfer of controlling interest in the project company, (see paras. 72–76).

G. Transfer of controlling interest in the project company

71. The contracting authority may be concerned that the original members of the bidding consortium maintain their commitment to the project throughout its duration and that effective control over the project company will not be transferred to entities unknown to the contracting authority. Private partners are selected to carry out infrastructure projects at least partly on the basis of their experience and capabilities for that sort of project (see chap. III, "Contract award", paras. 38–41). Contracting authorities are therefore concerned that, if the private partner's shareholders are entirely free to transfer their investment in a given project, there will be no assurance as to who will actually be delivering the relevant services. However, in practical terms, such commitment from the private partner and the bidding consortium is only meaningful to the extent of their capacity to meet their obligations.

72. Contracting authorities may draw reassurance from the experience that the selected bidding consortium demonstrated in the preselection phase and from the performance guarantees provided by the parent organizations of the original consortium and its subcontractors. In practice, however, the reassurance that may result

from the apparent expertise of the shareholders in the private partner should not be overemphasized. Where a separate legal entity is established to carry out the PPP, which is often the case (see para. 13), the backing of the private partner's shareholders, should the project run into difficulties, may be limited to their maximum liability. Thus, restrictions on the transferability of investment, in and of themselves, may not represent sufficient protection against the risk of performance failure by the private partner. In particular, these restrictions are not a substitute for appropriate contractual remedies under the PPP contract, such as monitoring the level of service provided (see paras. 85–86) or termination without full compensation in case of unsatisfactory performance (see chap. V, "Duration, extension and termination of the PPP contract", paras. 49 and 50).

73. In addition to the above, imposing restrictions on the transferability of shares in companies providing public services may also present some disadvantages for the contracting authority. As noted earlier (see "Introduction and background information on PPPs", paras. 56–69), there are numerous types of funding available from different investors for different risk and reward profiles. The initial investors, such as construction companies and equipment suppliers, will seek to be rewarded for the higher risks they assume, while subsequent investors may require a lesser return commensurate with the reduced risks they bear. Most of the initial investors have finite resources and need to recycle capital to be able to participate in new projects. Therefore, those investors might not be willing to tie up capital in long-term projects. At the end of the construction period, the initial investors might prefer to sell their interest on to a secondary equity provider whose required rate of return is lower. Once usage is more certain, another refinancing could take place. However, if the investors' ability to invest and reinvest capital for project development is restricted by constraints on the transferability of shares in infrastructure projects, there is a risk of a higher cost of funding. In some circumstances it may not be possible to fund a project at all, as some investors whose involvement may be crucial for the implementation of the project may not be willing to participate. From a long-term perspective, the development of a marketplace for investment in public infrastructure may be hindered if investors' freedom to transfer their interest in PPPs is unnecessarily constrained.

74. For the above reasons, it may be advisable for the law to limit the restrictions placed on the transfer of a controlling interest in the project company to a certain period of time (for example, a certain number of years after the conclusion of the PPP contract, or after completion of the construction phase) or to situations where such restrictions are justified by reasons of public interest (for example, where the contracting authority considers that the continued presence of a certain member of the consortium in the shareholding structure of the private partner is essential for the operation of the infrastructure or the provision of the service according to the contract and regulatory requirements). One such situation may be where the

private partner is in possession of public property or where the private partner receives loans, subsidies, equity or other forms of direct governmental support. In these cases, the contracting authority's accountability for the proper use of public funds requires assurances that the funds and assets are entrusted to a solid company, to which the original investors remain committed for a reasonable period. Another situation that may justify imposing limitations on the transfer of shares of private partner companies may be where the contracting authority has an interest in preventing transfer of shares to particular investors. For example, the contracting authority may wish to control acquisition of controlling shares of public service providers to avoid the formation of oligopolies or monopolies in liberalized sectors. Or it may not be thought appropriate for a company that had defrauded one part of Government to be employed by another through a newly acquired subsidiary.

75. In these exceptional cases it may be advisable to require that the initial investors seek the prior consent of the contracting authority before transferring their equity participation. It should be made clear in the PPP contract that any such consent should not be unreasonably withheld or unduly delayed. For transparency purposes, it may also be advisable to establish the grounds for withholding approval and to require the contracting authority to specify in each instance the reasons for any refusal. The appropriate duration of such limitations – whether for a particular phase of the project or for the entire PPP contract term – may need to be considered on a case-by-case basis. In some projects, it may be possible to relax such restrictions after the facility has been completed. It is also advisable to clarify in the PPP contract whether these limitations, if any, should apply to the transfer of any participation in the private partner, or whether the concerns of the contracting authority will focus on one particular investor (such as a construction company or the facility designer) while the construction phase lasts or for a significant time beyond.

H. Construction works

76. In traditional procurement, contracting authorities purchasing construction works typically acted as the employer under a construction contract and retained extensive monitoring and inspection rights, including the right to review the construction project and request modifications to it, to follow closely the construction work and schedule, to inspect and formally accept the completed work and to give final authorization for the operation of the facility. Consequently, contracting authorities typically assumed the risks of cost and schedule overruns and the performance of the construction project upon its completion.

77. In PPP projects, it is the private partner that assumes the responsibility of the timely completion of the project at the standards and cost specified in the PPP

contract, with the financial risk attached to it (see chap. II, "Project planning and preparation", paras. 30–32). Therefore, the private partner is interested in ensuring that the project is completed on time and that the cost estimate is not exceeded, and will typically negotiate fixed-price, fixed-time turnkey contracts that include guarantees of performance by the construction contractors.

78. For these reasons, legislative provisions regarding the construction of facilities under the form of PPP are in some countries limited to a general definition of the private partner's obligation to perform the public works in accordance with the provisions of the PPP contract. The law may give the contracting authority the general right to monitor the progress of the work with a view to ensuring that it conforms to the provisions of the agreement, but the exercise of such monitoring right does not entail a transfer of construction risks agreed in the PPP contract from the private partner back to the contracting authority. In those countries, more detailed provisions are then left to the PPP contract.

1. Review and approval of construction plans

79. It is advisable to devise procedures in the PPP contract that help to keep completion time and construction costs within estimates and lower the potential for disputes between the private partner and the public authorities involved. Where statutory provisions require the contracting authority to review and approve the construction project, the PPP contract should establish a procedure and a deadline for the review to take place and provide that the approval shall be deemed to be granted if no objections are made by the contracting authority within the relevant period. It may also be useful to set out in the PPP contract the grounds on which the contracting authority may raise objections to or request modifications in the project, such as safety, defence, security, environmental concerns or non-conformity with the specifications.

2. Variation in the construction terms

80. During construction of an infrastructure facility, it is common for situations to arise that make it necessary or advisable to alter certain aspects of the construction. The contracting authority may therefore wish to retain the right to order changes in respect of such aspects as the scope of construction, the technical characteristics of equipment or materials to be used in the work or the construction services required under the specifications, drawings and standards of the works. Such changes are referred to in this *Guide* as "variations" and generally include a change in an aspect of the construction of the works from that required under the original contract documents. Variations are typically provided by the contract and do not entail contract modification or amendment. Moreover, variations do not include tariff adjustments or price revisions made because of cost changes or

currency fluctuations, and revision of the payment conditions, although a variation may lead to an adjustment of the price, under the conditions set forth in the PPP contract (see para. 140). Likewise, renegotiation of the PPP contract in cases of substantial change in conditions, exempting impediments or for other reasons (see paras. 141–144 and 150–151) is not regarded in the *Guide* as a variation.

81. Given the complexity of most infrastructure projects, it is not possible to exclude the need for variations of the construction specifications or other requirements of the project. However, such variations often cause delay in the execution of the project or in the delivery of the public service; they may also render the performance under the PPP contract more onerous for the private partner. Furthermore, the cost of implementing extensive change orders may exceed the private partner's own financial means, thus requiring substantial additional funding that may not be obtainable at an acceptable cost. It is therefore advisable for the contracting authority to consider measures to control the possible need for variation. The quality of the feasibility studies required by the contracting authority and of the specifications provided during the selection process (see chap. III, "Contract award", paras. 67 and 70–74) play an important role in avoiding subsequent changes in the project.

82. The PPP contract should set forth the specific circumstances under which the contracting authority may order variations in respect of construction specifications and the compensation that may be due to the private partner, as appropriate, to cover the additional cost and delay entailed by implementing the variations. The PPP contract should also clarify the extent to which the private partner is obliged to implement those variations and whether the private partner may object to variations and, if so, on which grounds. According to the contractual practice of some legal systems, the private partner may be released of its obligations when the amount of additional costs entailed by the variation exceeds a set maximum limit. It should be noted that not all variations are necessarily initiated by the contracting authority. In practice, variations could also result from the contracting authority's agreement to implement suggestions made by the private partner, for instance, to introduce more efficient technics or materials at the construction stage, to reduce costs or improve performance. To encourage suggestions to enhance efficiency or reduce cost, it may be useful for the parties to recognize, in the PPP contract, the private partner's right to propose technical changes to that effect, subject to the agreement of the contracting authority. In addition, many countries regard it as good policy to make the variations that exceed a certain individual or cumulative value subject to the approval of a higher authority.

83. Various contractual approaches for dealing with variations have been used in large construction contracts to establish the extent of the contractor's obligation to implement changes and the required adjustments in the contract price or

contract duration. Such solutions may also be used, mutatis mutandis, to deal with variations sought by the contracting authority under the PPP contract.[3] It should be noted, however, that in infrastructure PPP contracts the project company's payment consists of user fees or prices for the output of the facility, rather than a global price for the construction work. Thus, compensation methods used in connection with infrastructure PPP contracts sometimes include a combination of various methods, ranging from lump-sum payments to tariff increases, or extensions of the PPP contract period. For instance, there may be changes that result in an increase in the cost that the private partner may be able to absorb and finance itself and amortize by means of an adjustment in the tariff or payment mechanism, as appropriate. If the private partner cannot refinance or fund the changes itself, the parties may wish to consider lump-sum payments as an alternative to an expensive and complicated refinancing structure. In any case, the parties may have to resort to direct renegotiation.

3. *Monitoring powers of the contracting authority*

84. In some legal systems, public authorities purchasing construction works customarily retain the power to order the suspension or interruption of the works for reasons of public interest. However, with a view to providing some reassurance to potential investors, it may be useful to limit the possibility of such intervention and to provide that no such interruption should be of a duration or extent greater than is necessary, taking into consideration circumstances that gave rise to the requirement to suspend or interrupt the work. The definition in the legislation of events characterized as reasons of public interest, such as environmental issues at a large scale or endangerment of the population located in the zone where the PPP is being built, may reassure potential investors in that regard. It may also be useful to agree on a maximum period of suspension or to provide for appropriate compensation to the private partner. Furthermore, guarantees may be provided to ensure payment of compensation or to indemnify the private partner for loss resulting from suspension of the project and restoration of the economic and financial equilibrium of the PPP contract after the suspension is lifted (see also para. 140 below and chap. II, "Project planning and preparation", paras. 74–76).

85. In some legal systems, facilities built for use in connection with the provision of certain public services become public property once construction is finished (see para. 26). In such cases, the law often requires the completed facility to be formally accepted by the contracting authority or another public authority. Such formal acceptance is typically given only after inspection of the completed facility

[3] For a discussion of approaches and possible solutions used in construction contracts for complex industrial works, see the *UNCITRAL Legal Guide on Drawing Up Contracts for the Construction of Industrial Works* (United Nation publication, Sales No. E.87.V.10), chap. XXIII, "Variation clauses".

and satisfactory conclusion of the necessary tests to ascertain that the facility is operational and meets the specifications and technical and safety requirements. Even where formal acceptance by the contracting authority is not required (for example, where the facility remains the property of the private partner), provisions concerning final inspection and approval of the construction work by the contracting authority are often required in order to ensure compliance with health, safety, building or labour regulations. The PPP contract should set out in detail the nature of the completion tests or the inspection of the completed facility; the timetable for the tests (for instance, it may be appropriate to undertake partial tests over a period, rather than a single test at the end); the consequences of failure to pass a test; and the responsibility for organizing the resources for the test, in particular the use of independent engineering to perform the test, and covering the corresponding costs. In some countries, it has been found useful to authorize operation of the facility on a provisional basis, pending final approval by the contracting authority, and to provide an opportunity for the private partner to rectify defects that might be found at that juncture.

4. Guarantee period

86. The construction contracts negotiated by the private partner will typically provide for a quality guarantee under which the contractors assume liability for defects in the works and for inaccuracies or insufficiencies in technical documents supplied with the works, except for reasonable exclusions (such as normal wear and tear or faulty maintenance or operation by the private partner). Additional liability may also derive from statutory provisions or general principles of law under the applicable law, such as a special extended liability period for structural defects in works, which exists in some legal systems. The PPP contract should provide that final approval or acceptance of the facility by the contracting authority will not release the construction contractors from any liability for defects in the works and for inaccuracies or insufficiencies in technical documents that may arise under the construction contracts and the applicable law.

I. Operation of infrastructure

87. The completion of the construction phaseremoves one of the most important risks associated with a PPP, namely the failure to complete the project (see para. 78 and chap. II, “Project planning and preparation”, paras. 30–32). Therefore, it is not unusual for the PPP contract to allow construction companies to leave the project company at the end of the first phase (see para. 74).

88. Conditions for the operation and maintenance of the facility, as well as for quality and safety standards, are often enumerated in the law and spelled out in detail in

the PPP contract. In addition, especially in the areas of electricity, water and sanitation and public transportation, the contracting authority or an independent regulatory agency may exercise an oversight function over the operation of the facility. An exhaustive discussion of legal issues relating to the conditions of operation of infrastructure facilities would exceed the scope of this *Guide*. The following paragraphs therefore contain only a brief presentation of some of the main issues.

89. Regulatory provisions on infrastructure operation and legal requirements for the provision of public services are intended to achieve various objectives of public relevance. Given the usually long duration of infrastructure projects, there is a possibility that such provisions and requirements may need to be changed during the life of the PPP contract. Accordingly, the changes requested by the contracting authority or otherwise agreed upon by the parties at the operational stage could be more significant than at the construction stage. They will be particularly important and elaborate in projects when the private partner provides services or commodities to end users, such as concession-PPPs. It is important, however, to bear in mind the private sector's need for a stable and predictable regulatory framework. Changes in regulations or the frequent introduction of new and stricter rules may have a disruptive impact on the implementation of the project and compromise its financial viability. Therefore, while contractual arrangements may be agreed by the parties to counter the adverse effects of subsequent regulatory changes (see paras. 131–134), regulatory agencies or government, when the case may be, would be well advised to avoid excessive regulation or unreasonably frequent changes in existing rules.

1. *Technical and service standards*

90. Public service providers generally have to meet a set of technical and service standards. Such standards are in most cases too detailed to figure in legislation and may be included in implementing decrees, regulations or other instruments. Legislation should generally set the principles that will guide the formulation of detailed standards, or require compliance with international standards such as Performance Standards of the International Finance Corporation[4] (see chap. VII, "Other relevant areas of law", para. 49). Service standards are often spelled out in detail as part of the requirement of the contracting authority that were communicated to bidders during the contract award procedure (see chap. III, "Contract award", paras. 70–74) and are also reflected subsequently in the PPP contract itself. They include quality standards, such as requirements with respect to water purity and pressure; ceilings on the length of time to perform repairs; ceilings on the number of defects or complaints; timely performance of transport services; continuity in supply; and environmental, social, labour, health, and safety standards.

[4] International Finance Corporation, Performance Standards, 2012, available at https://www.ifc.org/.

91. The contracting authority typically retains the power to monitor the adherence of the project company to the regulatory performance standards. The private partner will be interested in avoiding as much as possible any interruption in the operation of the facility and in protecting itself against the consequences of any such interruption. It will seek assurances that the exercise by the contracting authority of its monitoring or regulatory powers does not cause undue disturbance or interruption in the operation of the facility and that it does not result in undue additional costs to the private partner.

2. Extension of services

92. In some legal systems, an entity operating under a governmental PPP contract to provide certain essential services such as electricity or potable water to a community or territory and its inhabitants is held to assume an obligation to provide a service system that is reasonably adequate to meet the demand of the community or territory. That obligation often relates not only to the historic demand at the time the PPP contract was awarded but implies an obligation to keep pace with the growth of the community or territory served and gradually to extend the system as may be required by the reasonable demand of the community or territory. In some legal systems, the obligation has the nature of a public duty that may be invoked by any resident of the relevant community or territory. In other legal systems, it has the nature of a statutory or contractual obligation that may be enforced by the contracting authority or by a regulatory agency, as the case may be.

93. In some legal systems, this obligation is not absolute and unqualified. The private partner's duty to extend its service facilities may indeed depend upon various factors, such as the need and cost of the extension and the revenue that may be expected as a result of the extension; the private partner's financial situation; the public interest in effecting such an extension; and the scope of the obligations assumed by the private partner in that regard under the PPP contract. In some legal systems, the private partner may be under an obligation to extend its service facilities even if the extension in question is not immediately profitable or even if, as a result of the extensions being carried out, the private partner's territory might eventually include unprofitable areas. That obligation is nevertheless subject to some limits, since the private partner is not required to carry out extensions that place an unreasonable burden on it or its customers. Depending on the particular circumstances, the cost of carrying out extensions of service facilities may be absorbed by the private partner, passed on to the customers or end users in the form of tariff increases or extraordinary charges or absorbed in whole or in part by the contracting authority or other public authority by means of subsidies or grants. Given the variety of factors that may need to be taken into account in order to assess the reasonableness of any particular extension, the PPP contract should define the circumstances under which the private partner may be required to carry

out extensions in its service facilities and the appropriate methods for financing the cost of any such extension.

3. Continuity of service

94. Another obligation of public service providers is to ensure the continuous provision of the service under most circumstances, except for narrowly defined exempting events (see also paras. 146–148). In some legal systems, that obligation has the nature of a statutory duty that applies even if it is not expressly stated in the PPP contract. The corollary of that rule, in legal systems where it exists, is that various circumstances that under general principles of contract law might authorize a contract party to suspend or discontinue the performance of its obligations, such as economic hardship or breach by the other party, cannot be invoked by the private partner as grounds for suspending or discontinuing, in whole or in part, the provision of a public service. In some legal systems, the contracting authority may even have special enforcement powers to compel the private partner to resume providing service in the event of unlawful discontinuance.

95. That obligation, too, is subject to a general rule of reasonableness. Various legal systems recognize the private partner's right to fair compensation for having to deliver the service under situations of hardship (see para. 153). Moreover, in some legal systems, it is held that a public service provider may not be required to operate where its overall operation results in a loss. Where the public service as a whole, and not only one or more of its branches or territories, ceases being profitable, the private partner may have the right to direct compensation by the contracting authority or, alternatively, the right to terminate the PPP contract. However, termination typically requires the consent of the contracting authority or a judicial decision. In legal systems that allow such a solution, it is advisable to clarify in the PPP contract which extraordinary circumstances would justify the suspension of the service or even release the private partner from its obligations under the PPP contract (see paras. 145–154 and also chap. V, "Duration, extension and termination of the PPP contract", para. 37).

4. Equal treatment of customers or users

96. Entities that provide certain services to the general public are, in some jurisdictions, under a specific obligation to ensure the availability of the service under essentially the same conditions to all users and customers falling within the same category. However, differentiation based on a reasonable and objective classification of customers and users is accepted in those legal systems as long as like contemporaneous service is rendered to consumers and users engaged in like operations under like circumstances. It may thus not be inconsistent with the principle of equal treatment to charge different prices or to offer different access conditions to

different categories of users (for example, domestic consumers, on the one hand, and business or industrial consumers, on the other), provided that the differentiation is based on objective criteria and corresponds to actual differences in the situation of the consumers or the conditions under which the service is provided to them. Nevertheless, where a difference in charges or other conditions of service is based on actual differences in service (such as higher charges for services provided at hours of peak consumption), it typically has to be commensurate with the amount of difference.

97. In addition to differentiation established by the private partner itself, different treatment of certain users or customers may be the result of legislative action. In many countries, the law requires that specific services must be provided at particularly favourable terms to certain categories of users and customers, such as discounted transport for schoolchildren or senior citizens, or reduced water or electricity rates for lower-income or rural users. Public service providers may recoup these service burdens or costs in several ways, including through government subsidies, through funds or other official mechanisms created to share the financial burden of these obligations among all public service providers or through internal cross-subsidies from more profitable services (see chap. II, "Project planning and preparation", paras. 68–70) .

5. Interconnection and access to infrastructure networks

98. Companies operating infrastructure networks in sectors such as railway transport, telecommunications or power or gas supply are sometimes required to allow other companies to have access to the network. That requirement may be stated in the PPP contract or in sector-specific laws or regulations. Interconnection and access requirements have been introduced in certain infrastructure sectors as a complement to reforms in the structure of a given sector; in others, they have been adopted to foster competition in sectors that remained fully or partially integrated (for a brief discussion of market structure issues, see "Introduction and background information on PPPs", paras. 27–47).

99. Network operators are often required to provide access on terms that are fair and non-discriminatory from a financial as well as a technical point of view. Non-discrimination implies that the new entrant or service provider should be able to use the infrastructure of the network operator on conditions that are not less favourable than those granted by the network operator to its own services or to those of competing providers. It should be noted, however, that many pipeline access regimes, for example, do not require completely equal terms for the carrier and rival users. The access obligation may be qualified in some way. It may, for instance, be limited to spare capacity only or be subject to reasonable, rather than equal, terms and conditions.

100. While access pricing is usually cost-based, regulatory agencies often retain the right to monitor access tariffs to ensure that they are high enough to give adequate incentive to invest in the required infrastructure and low enough to allow new entrants to compete on fair terms. Where the network operator provides services in competition with other providers, there may be requirements that its activities be separated from an accounting point of view in order to determine the actual cost of the use by third parties of the network or parts of it.

101. Technical access conditions may be equally important and network operators may be required to adapt their network to satisfy the access requirements of new entrants. Access may be to the network as a whole or to monopolistic parts or segments of the network (sometimes also referred to as bottleneck or essential facilities). Many Governments allow service providers to build their own infrastructure or to use alternative infrastructure where available. In such cases, the service provider may only need access to a small part of the network and cannot, under many regulations, be forced to pay more than the cost corresponding to the use of the specific facility it needs, such as the local telecommunications loop, transmission capacity for the supply of electricity or the use of a track section of railway.

6. *Disclosure requirements and transparency obligations*

102. Many domestic laws impose on public service providers an obligation to provide to the regulatory agency accurate and timely information on their operations and to grant it specific enforcement rights. The latter may encompass inquiries and audits, including detailed performance and compliance audits, sanctions for non-cooperative companies and injunctions or penalty procedures to enforce disclosure.

103. Public service providers are normally required to maintain and disclose to the regulatory agency their financial accounts and statements and to maintain detailed cost accounting allowing the regulatory agency to track various aspects of the company's activities separately. Financial transactions between the private partner company and affiliated companies may also require scrutiny, as private partner companies may try to transfer profits to non-regulated businesses or foreign affiliates. Infrastructure operators may also have detailed technical and performance reporting requirements. As a general rule, however, it is important to define reasonable limits by reference to the extent and type of information that infrastructure operators are required to submit. Furthermore, appropriate measures should be taken to protect the confidentiality of any proprietary information that the private partner and its affiliated companies may submit to the regulatory agency. In addition to information that the private partner may be required to provide to the contracting authority or regulators, in the interest of transparency and to ensure that performance-based payments made to the private partner are justified,

contracting authorities themselves may be under an obligation to disclose to the public some elements of the performance evaluation (see para. 52 and see also chap. III, "Contract award", para. 15).

7. Enforcement powers of the private partner

104. In countries with a well-established tradition of awarding PPP contracts for the provision of public services, the private partner may have the power to establish rules designed to facilitate the provision of the service (such as instructions to users or safety rules), take reasonable measures to ensure compliance with those rules and suspend the provision of service for emergency or safety reasons. For that purpose, general legislative authority, or even case-by-case authorization from the legislature, may be required in most legal systems. The extent of powers given to the private partner is usually defined in the PPP contract, however, and may not need to be provided in detail in legislation. It may be advisable to provide that the rules issued by the private partner become effective upon approval by the regulatory agency or the contracting authority, as appropriate. However, the right to approve operating rules proposed by the private partner should not be arbitrary and the private partner should have the right to appeal a decision to refuse approval of the proposed rules (see also chap. I, "General legal and institutional framework", paras. 56 and 57).

105. Of particular importance is the question whether the private partner may discontinue the service because of default or non-compliance by its users notwithstanding the general obligation to ensure service continuity (see paras. 95 and 96). Many legal systems recognize that entities providing public services may establish and enforce rules that permit cutting off services for consumers or users having failed to pay for them or seriously infringed the conditions for using them. The power to do so is often regarded as crucial in order to prevent abuse and ensure the economic viability of the service. However, given the essential nature of certain public services, that power may require legislative authority in some legal systems. Furthermore, there may be several expressed or implied limitations upon or conditions for the exercise of that power, such as special notice requirements and specific consumer remedies. Additional limitations and conditions may derive from the application of general consumer protection rules (see chap. VII, "Other relevant areas of law", paras. 50 and 51).

J. General contractual arrangements

106. This section discusses selected contractual arrangements that typically appear in PPP contracts in various sectors and are often reflected in standard contract clauses used by domestic contracting authorities. Although essentially

contractual in nature, the arrangements discussed in this section may have some important implications for the legislation of the host country, according to its particular legal system.

1. Subcontracting

107. Given the complexity of infrastructure projects, the private partner typically retains the services of one or more construction contractors to perform some or the bulk of the construction work under the PPP contract. The private partner may also wish to retain the services of contractors with experience in the operation and maintenance of infrastructure during the operational phase of the project. The laws of some countries generally acknowledge the private partner's right to enter into contracts as needed for the execution of the construction work. A legislative provision recognizing the private partner's right to subcontract may be particularly useful in countries where there are limitations to the ability of government contractors to subcontract. Depending on the type of facility built or managed under the PPP contract, the contracting authority may wish to know who is present at building sites on which works are being performed for them, or on which contractors are providing services, or at buildings, infrastructure or areas (such as town halls, municipal schools, sports facilities, ports or motorways) for which the contracting authorities are responsible or over which they have an oversight.

(a) Choice of subcontractors

108. The private partner's freedom to hire subcontractors is in some countries restricted by rules that prescribe the use of tendering and similar procedures for the award of subcontracts by public service providers. Such statutory rules have often been adopted when infrastructure facilities were primarily or exclusively operated by the Government, with little or only marginal private sector investment. The purpose of such statutory rules is to ensure economy, efficiency, integrity and transparency in the use of public funds. However, in the case of PPPs, such provisions may discourage the participation of potential investors, since the project sponsors might find these rules too cumbersome or restrictive of their flexibility in hiring subcontractors.

109. Whether or not such explicit limitations are in place, the private partner's freedom to select its subcontractors is still not unlimited, however. An obligation of disclosure by the main contractor of information related to the subcontractors is always applicable, whether it is at the tender process or in the construction phase. In some countries, the private partner must identify in its proposals which contractors will be retained, including information on their technical capability, financial standing and corporate governance (see chap. III, "Contract award", para. 77). Other countries either require that such information be provided at the time the

PPP contract is concluded or subject such contracts to prior review and approval by the contracting authority. Transparency in the subcontracting chain serves various purposes. The contracting authority has an interest in knowing the subcontractors and having assurances that they comply with applicable obligations in the fields of environmental, social and labour law and regulatory measures ordered by labour inspection agencies or environmental protection agencies. Disclosure of information about subcontractors would also allow the contracting authority to verify that subcontractors are not themselves in any of the situations which would have barred the private partner from bidding for the PPP contract. This would ensure that companies barred from bidding for PPP contracts (for instance, because of violations of anti-corruption or money-laundering laws, see chap. III, "Contract award", para. 39) would not bypass those statutory restrictions and illegally benefit from a public contract. Transparency in the subcontracting chain would also help prevent conflicts of interest between the contracting authority and subcontractors, for instance where persons or companies in an undesirable proxy relationship to agents of the contracting authority hold shares or other interest in a subcontractor. There are also possible conflicts of interest between the project company and its shareholders, a point that would normally also be of interest to the lenders, who may wish to ensure that the project company's contractors are not overpaid. In any event, if it is deemed necessary for the contracting authority to have the right to review and approve the project company's subcontracts, the PPP contract should clearly define the purpose of such review and approval procedures and the circumstances under which the contracting authority's approval may be withheld. As a general rule, the level of scrutiny power delegated to the contracting authority should be limited and the approval should not normally be withheld unless the subcontracts are found to contain provisions manifestly contrary to the public interest (for example, provisions for excessive payments to subcontractors or unreasonable limitations of liability, evidence of corruption) or the subcontractors do not comply with mandatory rules having the nature of public law that apply to the execution of PPPs in the host country (such as international or national environmental, social and labour laws). In other words, it is important that any limitations imposed on the public authority on the choice of the private partner are also applied to the choice of subcontractors by the private partner.

(b) Governing law

110. It is common for the private partner and its contractors to choose a law that is familiar to them and that in their view adequately governs the issues addressed in their contracts. Depending upon the type of contract, different issues concerning the governing law clause will arise. For example, equipment supply and other contracts may be entered into with foreign companies and the parties may wish to choose a law known to them as providing, for example, an adequate warranty regime for equipment failure or non-conformity of equipment. In turn, the private

partner may agree to the application of the laws of the host country in connection with contracts entered into with local customers.

111. Domestic laws specific to PPPs seldom contain provisions concerning the law governing the contracts entered into by the private partner. In fact, most countries have found no compelling reason for devising specific provisions concerning the law governing contracts between the private partner and its contractors. Accordingly, in most countries those contracts are governed by the applicable law to the parties pursuant to a choice-of-law clause in their contracts or to the applicable rules of private international law. It should be noted, however, that the freedom to choose the applicable law for contracts and other legal relationships is in some legal systems subject to conditions and restrictions pursuant to rules of private international law or certain rules of public law of the host country. For instance, States parties to some regional economic integration agreements are obliged to enact harmonized provisions of private international law dealing, inter alia, with contracts between public service providers and their contractors. While rules of private international law often allow considerable freedom to choose the law governing commercial contracts, that freedom is in some countries restricted for contracts and legal relationships that are not qualified as commercial, such as, for instance, certain contracts entered into by public authorities of the host country (for example, guarantees and assurances by the Government, power purchase or fuel supply commitments by a public authority) or contracts with consumers. The choice of foreign law in contracts between the private partner and its subcontractors should not release them from the obligation to comply with the country's mandatory laws governing the construction or operation of the facility (such as environment, labour, safety or security laws and regulations).

112. In some cases, provisions have been included in domestic legislation for the purpose of clarifying, as appropriate, that the contracts entered into between the private partner and its contractors are governed by private law and that the contractors are not agents of the contracting authority. A provision of that type may in some countries have several practical consequences, such as no subsidiary liability of the contracting authority for the acts of the subcontractors or no obligation on the part of the responsible public entity to pay worker's compensation for work-related illness, injury or death to the subcontractors' employees.

2. Liability with respect to users and third parties

113. Defective construction or operation of an infrastructure facility may result in the death of or personal injury to employees of the private partner, users of the facility or other third parties or in damage to their property. The issues concerning damages to be paid to third parties in such cases are complex and may be governed not by rules of the law applicable to the PPP contract governing contractual

liability, but rather by applicable legal rules governing extra-contractual liability, which are often mandatory. Also, in some legal systems, there are special mandatory rules governing the extra-contractual liability of public authorities to which the contracting authority may be subject, in particular when the PPP belongs to the public services domain. Moreover, the PPP contract cannot limit the liability of the private partner or the contracting authority to compensate third parties who are not parties to the PPP contract. It is therefore advisable for the contracting authority and the private partner to provide for the internal allocation of risks between them as regards damages to be paid to third parties due to death, personal injury or damage to their property, to the extent that this allocation is not governed by mandatory rules. It is also advisable for the parties to provide for insurance against such risks (see paras. 128 and 129).

114. If a third party suffers personal injury or damage to its property as a result of the construction or operation of the facility and brings a claim against the contracting authority, the law may provide that the private partner alone should bear any responsibility in that regard and that the contracting authority should not bear any liability as regards such third-party claims, except where the damage was caused by the serious breach or recklessness of the contracting authority. It may be useful to provide, in particular, that the mere approval of the design or specification of the facility by the contracting authority or its acceptance of the construction works or final authorization for the operation of the facility or its use by the public does not entail assumption by the contracting authority of any liability for damage sustained by users of the facility or other third parties arising out of the construction or operation of the facility or the inadequacy of the approved design or specifications. Moreover, since provisions on the allocation of liability may not be enforceable against third parties under the applicable law, it may be advisable for the PPP contract to provide that the contracting authority should be protected and indemnified in respect of compensation claims brought by third parties who sustain injury or damage to their property resulting from the construction or operation of the infrastructure facility.

115. The PPP contract should also provide that the parties should inform each other of any claim or proceedings or anticipated claims or proceedings against them in respect of which the contracting authority is entitled to be indemnified and give reasonable assistance to one another in the defence of such claims or proceedings to the extent permitted by the law of the country where such proceedings are instituted.

3. Performance guarantees and insurance

116. The obligations of the private partner are usually complemented by the provision of some form of guarantee of performance in the event of breach and insurance coverage against a number of risks linked with the construction (see paras. 77–87)

and operation phase (see paras. 88–106). The law in some countries generally requires that adequate performance guarantees be provided by the private partner and refers the matter to the PPP contract for further details. In other countries, the law contains more detailed provisions, for instance requiring the offer of a certain type of guarantee up to a stated percentage of the basic investment.

(a) Types, functions and nature of performance guarantees

117. Performance guarantees are generally of two types. Under one type, the monetary performance guarantee, the guarantor undertakes only to pay the contracting authority funds up to a stated limit to satisfy the liabilities of the private partner in the event of the latter's failure to perform. Monetary performance guarantees may take the form of a contract bond, a standby letter of credit or an on-demand guarantee.[5] Under the other type of guarantee, the performance bond, the guarantor chooses one of two options: *(a)* to rectify defective or finish incomplete construction itself; or *(b)* to obtain another contractor to rectify defective or finish incomplete construction and compensate the contracting authority for losses caused by the failure to perform. The value of such an undertaking is limited to a stated amount or a certain percentage of the contract value. Under a performance bond, the guarantor also frequently reserves the option to discharge its obligations solely by the payment of money to the contracting authority. Performance bonds are generally furnished by specialized guarantee institutions, such as bonding and insurance companies. A special type of performance bond is the maintenance bond, which protects the contracting authority against future failures that could arise during the start-up or maintenance period and serve as a guarantee that any repair or maintenance work during the post-completion warranty period will be duly carried out by the private partner and at its cost.

118. As regards their nature, performance guarantees may be generally divided into independent guarantees and accessory guarantees. A guarantee is said to be "independent" if the guarantor's obligation is independent from the private partner's obligations under the PPP contract. Under an independent guarantee (often called a first-demand guarantee) or a standby letter of credit, the guarantor or issuer is obligated to make payment on demand by the beneficiary and the latter is entitled to recover under the instrument if it presents the document or documents stipulated in the terms of the guarantee or standby letter of credit. Such a document might be simply a statement by the beneficiary that the contractor has failed to perform. The guarantor or issuer is not entitled to withhold payment on the ground that there has in fact been no failure to perform under the main contract; however, under the law applicable to the instrument, payment may in

[5] For more information on demand guarantees, see the International Chamber of Commerce Uniform Rules for Demand Guarantees (RUGD 758), revised in 2010 and endorsed by UNCITRAL at its 44th session; *General Assembly, Official Records, Sixty-sixth session, Supplement No. 17* (paras. 247–249).

very exceptional and narrowly defined circumstances be refused or restrained (for example, when the claim by the beneficiary is manifestly fraudulent). In contrast, a guarantee is accessory when the obligation of the guarantor involves more than the mere examination of a documentary demand for payment in that the guarantor may have to evaluate evidence of liability of the contractor for failure to perform under the works contract. The nature of the link may vary under different guarantees and may include the need to prove the contractor's liability in arbitral proceedings. By their nature, performance bonds have an accessory character to the underlying contract.

(b) Advantages and disadvantages of various types of performance guarantee

119. From the perspective of the contracting authority, monetary performance guarantees may be particularly useful in covering additional costs that may be incurred by the contracting authority because of delay or breach by the private partner. Monetary performance guarantees may also serve as an instrument to put pressure on the private partner to complete construction in time and to perform its other obligations in accordance with the requirements of the PPP contract. However, the amount of those guarantees is typically only a fraction of the economic value of the obligation guaranteed and is usually not enough to cover the cost of engaging a third party to perform instead of the private partner or its contractors.

120. From the perspective of the contracting authority, a first-demand guarantee has the advantage of assuring prompt recovery of funds under the guarantee, without evidence of failure to perform by the contractor or of the extent of the beneficiary's loss. Furthermore, guarantors furnishing monetary performance guarantees, in particular banks, prefer first-demand guarantees, as the conditions are clear as to when their liability to pay accrues. The guarantors will thus not be involved in disputes between the contracting authority and the private partner as to whether or not there has been a failure to perform under the PPP contract. Another advantage for a bank issuing a first-demand guarantee is the possibility of quick and efficient recovery of the sums paid under such a guarantee by direct access to the private partner's assets.

121. A disadvantage to the contracting authority of a first-demand guarantee or a standby letter of credit is that those instruments may increase the overall project costs, since the private partner is usually obliged to obtain and set aside large counter-guarantees in favour of the institutions issuing the first-demand guarantee or the standby letter of credit. Also, a private partner that furnishes such a guarantee may wish to take out insurance against the risk of recovery by the contracting authority under the guarantee or the standby letter of credit when there has been in fact no failure to perform by the private partner and the cost of that insurance

is included in the project cost. The private partner may further include in the project cost the potential costs of any action it may need to institute against the contracting authority to obtain the repayment of the sum improperly claimed.

122. A disadvantage to the private partner of a first-demand guarantee or a standby letter of credit is that, if there is recovery by the contracting authority when there has been no failure to perform by the private partner, the latter will suffer immediate loss when the guarantor or the issuer of the letter of credit reimburses itself from the assets of the private partner after payment to the contracting authority. The private partner may also experience difficulties and delays in recovering from the contracting authority the sum improperly claimed.

123. The terms of an accessory guarantee usually require the beneficiary to prove the failure of the contractor to perform and the extent of the loss suffered by the beneficiary. Furthermore, the defences available to the debtor if it is sued for a failure to perform are also available to the guarantor. Accordingly, there is a risk that the contracting authority may face a protracted dispute when it makes a claim under the bond. In practice, this risk may be reduced, for instance, if the submission of claims under the terms of the bond is subject to a procedure such as that provided in article 7 *(j)(i)* of the Uniform Rules on Contract Bonds, drawn up by the International Chamber of Commerce.[6] Article 7 *(j)(i)* of the Uniform Rules provides that notwithstanding any dispute or difference between the principal and the beneficiary in relation to the performance of the contract or any contractual obligation, a default for the purposes of payment of a claim under a contract bond shall be deemed to be established upon issue of a certificate of default by a third party (who may without limitation be an independent architect or engineer or referee) if the bond so provides and the service of such a certificate or a certified copy thereof upon the guarantor. Where such a procedure is adopted, the contracting authority may be entitled to obtain payment under the contract bond even though its entitlement to that payment is disputed by the private partner.

124. As a reflection of the lesser risk borne by the guarantor, the monetary limit of liability of the guarantor may be considerably higher than under a first-demand guarantee, thus covering a larger percentage of work under the PPP contract. A performance bond may also be advantageous if the contracting authority cannot conveniently arrange for the rectification of faults or completion of construction itself and requires the assistance of a third party to arrange for rectification or completion. Where, however, the construction involves the use of a technology known only to the private partner, rectification or completion by a third person may not be feasible and a performance bond may not have the last-mentioned advantage over a monetary performance guarantee. For the private partner,

[6] The text of the Uniform Rules on Contract Bonds is reproduced in document A/CN.9/459/Add.1.

accessory guarantees have the advantage of preserving the private partner's borrowing power, since accessory guarantees, unlike first-demand guarantees and standby letters of credit, do not affect the private partner's line of credit with the lenders.

125. It follows from the above considerations that different types of guarantee may be useful in connection with the various obligations assumed by the private partner. While it is useful to require the private partner to provide adequate guarantees of performance, it is advisable to leave it to the parties to determine the extent to which guarantees are needed and which guarantees should be provided in respect of the various obligations assumed by the private partner, rather than requiring in the law only one form of guarantee to the exclusion of others. It should be noted that the project company itself will require a series of performance guarantees to be provided by the contractors it chooses (see paras. 108–110) and that additional guarantees to the benefit of the contracting authority usually increase the overall cost and complexity of a project. In some countries, practical guidance provided to domestic contracting authorities advises them to consider carefully whether and under what circumstances such guarantees are required, which specific risks or loss they should cover, and which type of guarantee is best suited in each case. The ability of the project company to raise finance for the project may be jeopardized by bond requirements set at an excessive level.

(c) Duration of guarantees

126. One particular problem of PPPs concerns the duration of the guarantee. The contracting authority may have an interest in obtaining guarantees of performance that remain valid during the entire life of the project, covering both the construction and the operational phase. However, given the long duration of infrastructure projects and the difficulty in evaluating the various risks that may arise, it may be problematic for the guarantor to issue a performance bond for the whole duration of the project or to procure reinsurance for its obligations under the performance bond. In practice, this problem is compounded by stipulations that the non-renewal of a performance bond constitutes a reason for a call on the bond, so that merely allowing the project company to provide bonds for shorter periods may not be a satisfactory solution. One possible solution, used in some countries, is to require separate bonds for the construction and the operation phase, thus allowing for better assessment of risks and reinsurance prospects. Such a system may be enhanced by defining in precise terms the risk to be covered during the operation period, thus allowing for a better assessment of risks and a reduction of the total amount of the bond. Another possibility to be considered by the contracting authority may be to require the provision of performance guarantees during specific crucial periods, rather than for the entire duration of the project. For instance, a bond might be required during the construction phase and last for an appropriate

period beyond completion, so as to cover possible latent defects. Such a bond might then be replaced by a performance bond for a certain number of years of operation, as appropriate in order for the project company to demonstrate its capability to operate the facility in accordance with the required standards. If the project company's performance proves to be satisfactory, the bond requirement might be waived for the remainder of the operation phase, up to a certain period before the end of the PPP contract term, when the project company might be required to place another bond to guarantee its obligations in connection with the handing over of assets and other measures for the orderly wind-up of the project, as appropriate (see chap. V, "Duration, extension and termination of the PPP contract", paras. 55–69).

(d) Insurance arrangements

127. Insurance arrangements made in connection with PPPs typically vary according to the phase to which they apply, with certain types of insurance only being purchased during a particular project phase. Some forms of insurance, such as business interruption insurance, may be purchased by the private partner in its own interest, while other forms of insurance may be a requirement under the laws of the host country. Forms of insurance often required by law include insurance coverage against damage to the facility, third-party liability insurance, workers' compensation insurance and pollution and environmental damage insurance.

128. Mandatory insurance policies under the laws of the host country often need to be obtained from a local insurance company or from another institution admitted to operate in the country, which in some cases may pose several practical difficulties. In some countries, the type of coverage usually offered may be more limited than the standard coverage available on the international market, in which case the private partner may remain exposed to various perils that may exceed its self-insurance capacity. That risk is particularly serious in connection with environmental damage insurance. Further difficulties may arise in some countries because of limitations on the ability of local insurers to reinsure the risks on the international insurance and reinsurance markets. Therefore, the project company may often need to procure additional insurance outside the country, thus adding to the overall cost of financing the project.

4. Changes in conditions

129. PPPs normally last for a long period of time, during which many circumstances relevant to the project may change. The impact of many changes may be automatically covered in the PPP contract, either through financial arrangements such as a tariff structure that includes an indexation clause (see paras. 43–50), or by the assumption by either party, expressly or by exclusion, of certain risks

(for example, if the price of fuel or electricity supply is not taken into account in the indexation mechanisms, then the risk of higher than expected prices is absorbed by the private partner). However, it may not be feasible to include some changes in an automatic adjustment mechanism, or the parties may prefer to exclude the possibility of automatic adjustment and leave it for the parties to amend the contract by mutual agreement when they agree that the circumstances so require. Although it is generally regarded as good practice for the PPP contract to include long-term adjustment mechanisms that obviate the need for contract renegotiations, it is not advisable for the legislator to attempt to draw a list of all circumstances in which automatic contract adjustment is appropriate. Sections *(a)* and *(b)* refer to situations which often lead to contract modification, whether or not such modification results from an automatic mechanism (adjustment); or from negotiation between the parties (amendment); or through an external mechanism, such as dispute settlement (adaptation). From a legislative perspective, two particular categories deserve special attention: legislative or regulatory changes and unexpected changes in economic conditions.

(a) Legislative and regulatory changes

130. Given the long duration of PPPs, the private partner may face additional costs in meeting its obligations under the PPP contract because of future, unforeseen changes in legislation applying to its activities. In extreme cases, legislation could even make it financially or physically impossible for the private partner to carry on with the project. For the purpose of considering the appropriate solution for dealing with legislative changes, it may be useful to distinguish between legislative changes having a particular incidence on PPPs or on one specific project, on the one hand, and general legislative changes affecting other economic activities also, and not only infrastructure operation, on the other.

131. All business organizations, in the private and public sectors alike, are subject to changes in law and generally must deal with the consequences that such changes may have for business, including the impact of changes on the price of or demand for their products. Possible examples might include changes in the structure of capital allowances that apply to entire classes of assets, whether owned by the public or private sector and whether related to infrastructure projects or not; regulations that affect the health and safety of construction workers on all construction projects, not just infrastructure projects; and changes in the regulations on the disposal of hazardous substances. General changes in law may be regarded as an ordinary business risk rather than a risk specific to the private partner's activities and it may be difficult for the Government to undertake to protect infrastructure operators from the economic and financial consequences of changes in legislation that affect other business organizations equally. This is particularly true when the PPP is undertaken by a local authority not under the direct oversight of the central

government, which retains the power to regulate the sector concerned. Thus, there may not be a prima facie reason why the private partner should not bear the consequences of general legislative risks, including the risk of costs arising from changes in law applying to the whole business sector.

132. Where tariff control mechanisms are provided in the PPP contract, the private partner will seek to obtain assurances from the contracting authority and the regulatory agency, as appropriate, that it will be allowed to recover the additional costs entailed by changes in legislation by means of tariff increases. Where such an assurance cannot be given, it is advisable to empower the contracting authority to negotiate with the private partner the compensation to which the private partner may be entitled in the event that tariff control measures do not allow for full recovery of the additional costs generated by general legislative changes. Including such economic and financial scenario in the preparation documents issued at the planning stage (see chap. II, "Project planning and preparation", para. 14) and in the contract document is advisable.

133. A different situation arises when the private partner faces increased costs as a result of specific legislative changes that target the particular project, a class of similar projects or PPPs in general. Such changes cannot be regarded as an ordinary business risk and may significantly alter the economic and financial assumptions based on which the PPP contract was negotiated. Thus, the contracting authority often agrees to bear the additional cost resulting from specific legislation that targets the particular project, a class of similar projects or PPPs in general. For example, in highway projects, legislation aimed at a specific road project or road operating company, or at that class of privately operated road projects, might result in a tariff adjustment under the relevant provisions in the PPP contract. When the PPP involves foreign investment, the private partner may also be able to invoke the dispute settlement mechanisms of any applicable treaty on promotion or protection of investment (see chap. VII, "Other relevant areas of law", para. 5).

(b) Changes in economic conditions

134. Some legal systems have rules that allow a modification of the PPP contract following changes in the economic or financial conditions that, without preventing the performance of a party's contractual obligations, render the performance of those obligations financially hazardous compared to what was originally foreseen at the time that the PPP contract was concluded. In some legal systems, the possibility of a modification of the terms of the agreement is generally implied in all Government contracts or is expressly provided for in the relevant legislation. In some countries, the modification of the contract may also be ordered by the courts. At the same time, it is important to ensure that such general legal theories would not lead to open-ended liabilities for the contracting authorities.

(i) The circumstances leading to modification of the contract

135. The financial and economic considerations for the private partner's investment are negotiated in the light of assumptions based on the circumstances prevailing at the time of the negotiations and the reasonable expectations of the parties as to how those circumstances will evolve during the life of the project. To a certain extent, projections of economic and financial parameters and sometimes even a certain margin of risk will normally be included in the economic and financial scenario contained in the bidding documents issued by the contracting authority and in the assumption of the financial proposals submitted by the bidders (see chap. III, "Contract award", para. 73). However, certain events may occur that the parties could not reasonably have anticipated when the PPP contract was negotiated and that, had they been taken into account, would have resulted in a different risk allocation or consideration for the private partner's investment. Given the long duration of infrastructure projects, it is important to devise mechanisms to deal with the financial and economic impact of such events. Rules providing for contract modification have been applied in a number of countries and have been found useful to help parties find equitable solutions for ensuring the continued economic and financial viability of infrastructure projects, thus averting a disruptive failure of performance by the private partner. However, those rules may also have some disadvantages, in particular from the perspective of the Government.

136. As with general legislative changes, changes in economic conditions are risks to which most business organizations are exposed without having recourse to a general guarantee of the Government that would protect them against the economic and financial effects of those changes. An unqualified obligation of the contracting authority to compensate the private partner for changes of economic conditions may result in a reversion to the public sector of a substantial portion of the commercial risks originally allocated to the private partner and represent an open-ended financial liability. Furthermore, it should be noted that the proposed tariff level and the essential elements of risk allocation are important, if not decisive, factors in the selection of the private partner (see chap. III, "Contract award", paras. 84–87). An excessively generous recourse to renegotiation of the project stimulates unrealistically low proposals being submitted during the selection procedure in the expectation of tariff increases once the project has been awarded. Thus, the contracting authority may have an interest in establishing reasonable limits for modifications of the PPP contract following changes in economic conditions authorized by statutory or contractual provisions.

137. It may be desirable to provide in the PPP contract that a change in circumstances that justifies a modification of the PPP contract must have been beyond the control of the private partner and of such a nature that the private partner could not reasonably be expected to have taken it into account at the time the PPP

contract was negotiated or to have avoided or overcome its consequences. For example, a toll road operator holding an exclusive concession might not be expected to take into account and assume the risk of traffic shortfalls brought about by the subsequent opening of an alternative toll-free road by an entity other than the contracting authority. However, the private partner would normally be expected to consider the possibility of reasonable labour cost increases over the life of the project. Thus, under normal circumstances, the fact that wages turned out to be higher than expected would not be a sufficient reason for modifying the PPP contract.

138. It may also be desirable to provide in the PPP contract that a request for modification of the PPP contract requires that the alleged changes of economic and financial conditions amount to a certain minimum value in proportion to the total project cost as defined in the bidding documents (see chap. III, "Contract award", para. 73) or the private partner's revenue. Such a threshold rule might be useful in order to avoid cumbersome adjustment negotiations for small changes until the changes have accumulated to comprise a significant figure. In some countries, there are rules that establish a ceiling for the cumulative amount of periodic revisions of the PPP contract. The purpose of such rules is to avoid the misuse of the change mechanism as a means for achieving an overall financial balance that bears no relation to the one contemplated in the original PPP contract. From the perspective of the private partner and the lenders, however, such limitations may represent exposure to considerable risk in the event, for instance, of dramatic cost increases resulting from an extraordinarily radical change of circumstances. Therefore, both the desirability of introducing a ceiling and the appropriate amount of such ceiling need to be carefully considered.

(ii) The range of the admitted contract modifications

139. Contracting authorities should have the possibility to provide for modifications to a PPP contract within some reasonable limits. The best way for the parties to do so is to insert in the PPP contract specific review or option clauses providing, for instance, clear mechanisms for price adjustment or indexation (see above, paras. 43–50) or determining precisely the scope for other adaptations of the contract that become necessary because of technical difficulties that appear during operation of the facilities, such as any extraordinary maintenance interventions that might be needed in order to ensure continuation of a public service (see above, paras. 95–96).

140. In addition to modifications covered by a contractually agreed variation, indexation or adjustment mechanism, contracting authorities can also face external circumstances not originally foreseen at the time they awarded the PPP contract. It may be advisable to allow for contract modifications to ensure the continued

economic and practical sustainability of a PPP contract where performance under the existing contract becomes significantly more onerous due to events or development that the contracting authority could not have predicted despite reasonably diligent preparation of the initial award, considering the nature and characteristics of the specific project and good practices in the relevant field. At the same time, however, there should be limits to the parties' rights to amend the contract to avoid situations where the envisaged modification would produce a fundamental alteration in the nature of the overall contract. This could be the case, for instance, if the parties were to replace the works to be executed or the services to be provided by something different or fundamentally change the type of PPP arrangement (that is, from a concession-PPP to a risk-sharing arrangement entailing substantial direct payments by the contracting authority).

141. The reason for avoiding broad modifications to the contract is to uphold transparency, integrity and economy in the award and management of PPP contracts. Indeed, at least hypothetically, the outcome of the contract award procedures could have been different, had the amended terms been known or anticipated at the time of bidding so that perhaps another bidder might have submitted a more advantageous proposal leading to overall better value for money for the contract authority, than the proposal actually selected. As a matter of principle, the law should require a new contract award procedure in the case of material changes to the initial contract, in particular to the scope and content of the rights and obligations of the parties or a shift in the risk allocation originally contemplated.

142. Nevertheless, modifications to the PPP contract resulting in a minor change of the contract value up to a certain value should still be possible without the need to carry out a new contract award procedure. To that effect, and in order to ensure legal certainty, the law could provide for maximum thresholds above which modifications of the PPP contract would be possible only under exceptional and expressly defined cases. For sake of determining the threshold beyond which a new contract award would be required, the law could refer to the present value of the PPP contract as defined in the winning proposal (see chap III, "Contract award", para. 77). An example of an exceptional case leading to contract modification might be the need to accommodate requests from a contracting authority with regard to environmental, security or other requirements set forth in legislation that might evolve over time. Another example might be the need for refinancing the PPP contract. Such a situation is not unusual in large PPP projects and the government may wish to facilitate the financial arrangements that allow for continuation of the PPP project.

143. In order to prevent the circumvention of the established threshold, the law could also provide that where successive modifications are made, the value should

be assessed on the basis of the net cumulative value of the successive modifications. Such cumulative calculation may apply only for a given duration and not for the whole duration of the PPP contract.

5. Exempting impediments

144. During the life of an infrastructure project, events may occur that impede the performance by a party of its contractual obligations. The events causing such an impediment are typically outside either party's control and may be of a physical nature, such as a natural disaster, or may be the result of human action, such as war, riots or terrorist attacks. Many legal systems generally recognize that a party that fails to perform a contractual obligation because of the occurrence of certain types of event may be exempted from the consequences of any such failure to perform. This concept, sometime called "force majeure", has a long existence and a clear definition, which bears important consequences for the parties to the PPP contract.

(a) Definition of exempting impediments

145. Exempting impediments are twofold: they typically include occurrences beyond the control of a party that cause the party to be unable to perform its obligation and that the party has been unable to overcome by the exercise of due diligence. Common examples include the following: natural disasters (such as cyclones, floods, droughts, earthquakes, storms, fires or lightning); war (whether declared or not) or other military activity, including riots and civil disturbance; failure or sabotage of facilities, acts of terrorism, criminal damage or the threat of such acts; radioactive or chemical contamination or ionizing radiation; effects of the natural elements, including geological conditions that cannot be foreseen and resisted; and employees' strikes of exceptional importance.

146. Some laws make only a general reference to exempting impediments, whereas other laws contain extensive lists of circumstances that excuse the parties from performance under the PPP contract. The latter technique may serve the purpose of ensuring a consistent treatment of the matter for all projects developed under the relevant legislation, thus avoiding situations where one private partner obtains a more favourable allocation of risks than that provided in other PPP contracts. However, it is important to consider the possible disadvantages of setting forth in statutory or regulatory provisions a list of events that are to be considered exempting impediments for all cases. There is a risk that the list might be incomplete, leaving out important impediments. Furthermore, certain natural disasters, such as storms, cyclones and floods, may be normal conditions at a particular time of the year at the project site. As such, those natural disasters may represent risks that any public service provider acting in the region would be expected to assume.

147. Another aspect that may need to be carefully considered is whether and to what extent certain acts of public authorities other than the contracting authority may constitute exempting impediments. The private partner may be required to secure a licence or other official approval for the performance of its certain obligations. The PPP contract might thus provide that, if the licence or approval is refused, or if it is granted but later withdrawn because of the private partner's own failure to meet the relevant criteria for the issuance of the licence or approval, the private partner cannot rely on the refusal as an exempting impediment. However, if the licence or approval is refused or withdrawn for extraneous or improper motives, it would be equitable to provide that the private partner may rely on the refusal as an exempting impediment. A further possibility of impediment might be an interruption of the project brought about by a public authority or organ of government other than the contracting authority, for instance, because of changes in governmental plans and policies that require the interruption or major revision of the project that substantially affect the original design. In such situations, it may be important to consider the institutional relationship between the contracting authority and the public authority that brings about the impediment as well as their degree of independence from one another. An event classified as an exempting impediment may in some cases amount to an outright breach of the PPP contract by the contracting authority, depending on whether the contracting authority could reasonably control or influence the acts of the other public authority.

(b) Consequences for the parties

148. During the construction phase, the occurrence of exempting impediments usually justifies an extension of the time allowed for the completion of the facility. In that connection, it is important to consider the implications of any such extension for the overall duration of the project, in particular where the construction phase is taken into account for calculating the total PPP contract period. Delays in the completion of the facility reduce the operational period and may adversely affect the global revenue estimates of the private partner and the lenders. It may therefore be advisable to consider the circumstances that justify extension of the PPP contract period so as to take into account possible extensions that occur during the construction phase.

149. Another important question is whether the private partner will be entitled to compensation for loss of revenue or property damage that results from the occurrence of exempting impediments. The answer to that question is given by the risk allocation provided in the PPP contract. Except for cases in which the Government provides some form of direct support, PPPs are typically undertaken at the private partner's own risk, including the risk of losses that may result from natural disasters and other exempting impediments, against which the

private partner is usually required to procure adequate insurance coverage. Thus, some laws expressly exclude any form of compensation to the private partner in the event of loss or damage that results from the occurrence of exempting impediments. It does not necessarily follow, however, that an event qualified as an exempting impediment may not, at the same time, justify a revision of the terms of the PPP contract so as to restore its economic and financial balance (see also paras. 135–144).

150. However, a different type of risk allocation is sometimes contemplated for projects involving the construction of facilities that are permanently owned by the contracting authority or facilities that are required to be transferred to the contracting authority at the end of the project period. In some countries, the contracting authority is authorized to make arrangements for assisting the private partner to repair or rebuild infrastructure facilities damaged by natural disasters or similar occurrences defined in the PPP contract, provided that the possibility of such assistance was contemplated in the request for proposals. Sometimes the contracting authority is authorized to agree to pay compensation to the private partner in case of an interruption of the work for more than a certain number of days up to a maximum time limit, if the interruption is caused by an event for which the private partner is not responsible.

151. Should the private partner become unable to perform because of any such impediment and should the parties fail to achieve an acceptable revision of the contract, some national laws authorize the private partner to terminate the PPP contract, without prejudice to the compensation that might be due under the circumstances (see chap. V, "Duration, extension and termination of the PPP contract", para. 53).

152. Statutory and contractual provisions on exempting impediments also need to be considered in the light of other rules governing the provision of the service concerned. The law in some legal systems requires public service providers to make every effort to continue providing the service despite the occurrence of circumstances defined as contractual impediments (see paras. 95 and 96). In those cases, it is advisable to consider the extent to which such an obligation may reasonably be imposed on the private partner and what compensation may be due for the additional costs and hardship faced by it.

153. In addition to the mechanisms described below, some of the risks (armed conflicts and civil riots notably) can be covered in part by international financial institutions, such as the World Bank, through the Multilateral Investment Guarantee Agency (MIGA), provided that the country is eligible for MIGA coverage and that the otherwise applicable conditions are met (see "Introduction and background information on PPPs", para. 67).

6. Breach and remedies

154. Generally, there is a wide range of remedies that the parties may agree on to deal with the consequences of breach, culminating with termination of the PPP contract. The following paragraphs set out general considerations on breach and remedies by either party (see paras. 156 and 157). They consider the legislative implication of certain types of remedy intended to rectify the causes of breach and preserve the continuity of the project, in particular the intervention of the contracting authority (see paras. 158–161) or the substitution of the private partner (see paras. 162–165). The ultimate remedy of terminating the PPP contract and the consequences that may result from termination are discussed elsewhere in the *Guide* (see chap. V, "Duration, extension and termination of the PPP contract", sections D and E).

(a) General considerations

155. The remedies for breach by the private partner typically include those that are customary in construction or long-term service contracts such as forfeiture of guarantees, contractual penalties and liquidated damages.[7] In most cases, such remedies are typically contractual in nature and do not give rise to significant legislative considerations. Nevertheless, it is important to establish adequate procedures for ascertaining failures and giving opportunities for rectifying such failures. In some countries, the imposition of contractual penalties requires findings of official inspections and other procedural steps, including review by senior officials of the contracting authority prior to the imposition of more serious sanctions. Those procedures may be complemented by provisions distinguishing between defects that can be rectified and those that cannot, and by setting down the corresponding procedures and remedies. Although prior notice may not always be practicable, especially in emergency situations, as a general rule the contracting authority should be required to give notice to the private partner requiring it to remedy the breach within a reasonable period. It may also be advisable to contemplate the payment of penalties or liquidated damages by the private partner in the event of non-performance of essential obligations and to clarify that no penalties apply in case of breach of secondary or ancillary obligations for which other remedies may be obtained under national law. Furthermore, a performance monitoring system that imposes penalties or liquidated damages may be complemented by a scheme of bonuses payable to the private partner for performance over and above agreed terms.

[7] For a discussion of remedies used in construction contracts for complex industrial works, see the *UNCITRAL Legal Guide on Drawing Up Contracts for the Construction of Industrial Works*, chap. XVIII, "Delay, defects and other failures to perform".

156. While the contracting authority may protect itself against the consequences of breach by the private partner through a variety of judicially enforceable contractual arrangements, the remedies available to the private partner in case of breach by the contracting authority may be subject to a number of limitations under the applicable law. Important limitations may derive from national or international regulations that recognize the immunity of public authorities from judicial suit and enforcement measures. Depending on the legal nature of the contracting authority or of other public authorities that assume obligations vis-à-vis the private partner, the latter may be deprived of the possibility of enforcing measures of execution to secure the fulfilment of obligations entered into by those public entities (see also chap. VI, "Settlement of disputes", paras. 41–43). This situation makes it important to provide mechanisms to protect the private partner against the consequences of breach by the contracting authority, for example by means of governmental guarantees covering specific events of breach or guarantees provided by third parties, such as multilateral lending institutions (see also chap. II, "Project planning and preparation", paras. 88–98).

(b) *Step-in rights for the contracting authority*

157. Some national laws expressly authorize the contracting authority to take over temporarily the operation of the facility, normally in case of failure to perform by the private partner, in particular where the contracting authority has a statutory duty to ensure the effective delivery at all times of the service concerned. In some legal systems, such a prerogative is inherent in most government contracts and may be presumed to exist even without being expressly mentioned in legislation or in the PPP contract.

158. It should be noted that the contracting authority's right to intervene, its "step in right", is an extreme measure. Private investors may fear that the contracting authority may use it, or threaten to use it, in order to impose its own desires about the way in which the service is provided, or even to get control of the project assets. It is therefore advisable to define as clearly as possible the circumstances in which step in rights can be exercised. It is important to limit the contracting authority's right to intervene in cases of serious failure of services and not to mere cases of dissatisfaction with the private partner's performance. It may be useful to clarify in the law that the contracting authority's intervention in the project is temporary and is intended to remedy a specific, urgent problem that the private partner has failed to remedy. The private partner should resume responsibility for service delivery once the emergency situation has been remedied.

159. The contracting authority's ability to step in may be limited in that it may be difficult immediately to identify and engage a subcontractor to carry out the actions that the contracting authority is stepping in to do. Furthermore, frequent

interventions carry a risk of the reversion to the contracting authority of risks that have been transferred in the PPP contract to the private partner. The private partner should not rely on the contracting authority to step in to deal with a particular risk instead of handling it itself, as required by the PPP contract.

160. It is advisable to clarify in the PPP contract which party bears the cost of an intervention by the contracting authority. In most cases, the private partner should bear the costs incurred by the contracting authority when the intervention is caused by a performance failure attributable to the private partner's own fault. In some cases, to prevent disputes about liability and about the appropriate level of costs, the agreement may authorize the contracting authority to take steps to remedy the problem itself and then charge the actual cost of having done so (including its own administrative costs) to the private partner. However, when such intervention takes place following the occurrence of an exempting impediment (see paras. 145–154), the parties might agree on a different solution, depending on how that particular risk has been allocated in the PPP contract.

(c) Step-in rights for the lenders

161. During the life of the project situations may arise where, because of breach by the private partner or the occurrence of an extraordinary event outside the private partner's control, it may nevertheless be in the interest of the parties to avert termination of the project by allowing the project to continue under the responsibility of a different private partner. The lenders, whose main security is the revenue generated by the project, are particularly concerned about the risk of interruption or termination of the project prior to repayment of the loans. In the event of breach impediment affecting the private partner, the lenders will be interested in ensuring that the work will not be left incomplete and that the PPP contract will be operated profitably. The contracting authority, too, may be interested in allowing the project to be carried out by a new private partner, as an alternative for having to take it over and continue it under its own responsibility.

162. Clauses allowing the lenders to select, with the consent of the contracting authority, a new private partner to perform under the existing PPP contract have been included in a number of recent agreements for large infrastructure projects. Such clauses are typically supplemented by a direct agreement between the contracting authority and the lenders who are providing finance to the private partner. The main purpose of such a direct agreement is to allow the lenders to avert termination by the contracting authority when the private partner is in breach by substituting a private partner that will continue to perform under the PPP contract in place of the private partner in breach. Unlike the contracting authority's right to intervene, which relates to a specific, temporary and urgent failure of the service, lenders' step in rights are for cases where the private partner's failure to

provide the service is recurrent or can reasonably be regarded as irremediable. In the experience of countries that have recently made use of such direct agreements, it has been found that the ability to head off termination and provide an alternative private partner gives the lenders additional security against breach by the private partner. At the same time, it gives the contracting authority an opportunity to avoid the disruption entailed by terminating the PPP contract, thus maintaining continuity of service.

163. However, in some countries, the implementation of such clauses may face difficulties in the absence of legislative authorization. The private partner's inability to carry out its obligations is usually a ground for the contracting authority to take over the operation of the facility or terminate the agreement (see chap. V, "Duration, extension and termination of the PPP contract", paras. 16–26). For the purpose of selecting a new private partner to succeed the private partner in breach, the contracting authority often needs to follow the same procedures that applied to the selection of the original private partner and it might not be possible for the contracting authority to agree in consultation with the lenders on engaging a new private partner that has not been selected pursuant to those procedures. On the other hand, even where the contracting authority is authorized to negotiate with a new private partner under emergency conditions, a new PPP contract might need to be entered into with the new private partner and there may be limitations on its ability to assume the obligations of its predecessor.

164. Therefore, it may be useful for the law to acknowledge the contracting authority's right to enter into agreements with the lenders providing for the appointment, with the consent of the contracting authority, of a new private partner to perform under the existing PPP contract, when the private partner seriously fails to deliver the service required under the PPP contract or following the occurrence of other specified events that could justify the termination of the PPP contract. The agreement between the contracting authority and the lenders should, inter alia, specify the following: the circumstances in which the lenders are permitted to substitute a new private partner; the procedures for the substitution of the private partner; the grounds for refusal by the contracting authority of a proposed substitute; and the obligations of the lenders to maintain the service at the same standards and on the same terms as required by the PPP contract.

V. Duration, extension and termination of the PPP contract

A. General remarks

1. Most PPP contracts have a fixed term, at the end of which, depending on the type of project, the private partner transfers to the contracting authority the responsibility for the operation of the service or infrastructure facility, or the contract authority chooses to rebid the contract. Section B deals with elements to be considered when establishing the duration of the PPP contract. Section C deals with the question of whether and under what circumstances the PPP contract may be extended. Section D considers circumstances that may authorize termination of the PPP contract prior to the expiry of its term. Lastly, section E deals with the consequences of the expiry or termination of the PPP contract, including the transfer of project assets and the compensation to which either party may be entitled upon termination, and the winding up of the project, notably the decommissioning of the infrastructure.

B. Duration of the PPP contract

2. The laws of some countries contain provisions that limit the duration of infrastructure concessions or PPPs to a given number of years. Some laws establish a general limit for most infrastructure or PPP projects and special limits for projects in certain infrastructure sectors. In some countries there are maximum duration periods only for certain infrastructure sectors.

3. From the perspective of the private partner, the term of a PPP contract should be long enough to allow the private partner to recover its investment and make a reasonable profit. From the perspective of the contracting authority, the contract should in principle last as long as the service is likely to be required but should also be consistent with the country's investment strategy and competition policy for the sector concerned, taking into account the potential foreclosure of markets caused by long, exclusive PPP projects. In addition to those two basic considerations, the desirable duration of a PPP contract may depend on various factors that include essentially:

(a) *Engineering factors.* Engineering and other technical factors play an important role in determining the ideal duration of a PPP contract. The construction phase – which normally corresponds to the initial financing – typically carries the highest risk of disruptive events (such as completion, cost overrun and other risks discussed in chap. II, "Project planning and preparation", paras. 30–32), and they must be taken into account in establishing the overall project duration. The duration of the operational phase, in turn, should also reflect the expectation of functioning of the main or critical equipment or assets by means of an estimate of the number of years that such equipment or assets are likely to remain in service for the purpose of generating cost-effective revenues, including the likelihood that the technology required for the project will change;

(b) *Financial factors.* From a financial point of view, the optimal duration of the project will be defined by various capital budgeting methods, such as payback period, net present value, internal rate of return or time value of money. A key element is the time needed for the private partner to repay their debts and amortize the initial investment. The notion of economic "amortization", in this context, refers to the gradual charging of the investment made against project revenue on the assumption that the facility would have no residual value at the end of the project term.

4. Given the difficulty of establishing a single statutory limit for the duration of PPP projects, it is advisable to provide the contracting authority with some flexibility to negotiate, in each case, a term that is appropriate to the project in question. In some cases, the duration of the contract is a factor of a formula ("least present value of revenue") used as a basis for determining the winning bidder during the selection process (see chap. III, "Contract award", para. 84). Where this system is used, the parties agree on such a contract duration to allow the private partner to achieve the overall level of revenue anticipated in its bid. All these options call for a flexible legislative approach to contract duration. Countries that have established institutional mechanisms for monitoring PPP contracts and capacity-building in PPP negotiation and management (see chap. II, "Project planning and preparation, para. 47) may develop guidelines or advice to contracting authorities on desirable or adequate contract duration according to the nature of the project taking past experience into account.

5. Some legal systems achieve the desired flexibility through laws that require all PPP contracts to be subject to a maximum duration period, without specifying any number of years. Sometimes the law only indicates which elements are to be considered for determining the duration of the PPP, which may include the nature and amount of investment required to be made by the private partner and the normal amortization period for the particular facilities and installations concerned. Some project or sector specific laws provide for a combined system setting the maximum duration of the PPP contract either at the end of a certain period or when the debts of the private partner have been fully repaid and a certain revenue,

production or usage level has been achieved, whichever is the earliest. A flexible legislative approach to the duration of PPP contracts may permit tailor-made solutions to meet the particular needs and financial parameters of the project, such as when the contracting authority and the private partner agreed on a variable or floating project term allowing for automatic extensions under specific circumstances (see below, para. 10).

6. However, where it is found necessary to adopt statutory limits, the maximum period should be sufficiently long to allow the private partner to repay its debts fully and to achieve a reasonable profit. Furthermore, it may be useful to authorize the contracting authority, in exceptional cases, to agree to longer contract periods, considering the amount of the investment and the required recovery period, and subject to special approval procedures.

C. Extension of the PPP contract

7. In the contracting practice of some countries, the contracting authority and the private partner may agree on one or more extensions of the PPP period. More often, however, domestic laws only authorize an extension of the PPP contract under exceptional circumstances. In this case, upon expiry of the PPP contract the contracting authority is normally required to select a new private partner, normally using the same procedures applied to select the incumbent private partner (for a discussion of selection procedures, see chap. III, "Contract award").

8. A number of countries have found it useful to require that PPP contracts, in particular those that involved exclusive concessions for the provision of a public service, be rebid from time to time rather than freely extended by the parties. Periodic rebidding may give the private partner strong performance incentives. The period between the initial award and the first (and subsequent) rebidding should consider the level of investment and other risks faced by the private partner. For example, for solid waste collection PPPs not requiring substantial fixed investments, the periodicity may be relatively short (three to five years, for example), whereas longer periods may be desirable for those that require high levels of investment, such as power or water distribution PPPs in which the private partner would have built new facilities or networks or done extensive work in expanding or refurbishing existing ones. In most countries, rebidding coincides with the end of the project term, but in others a contract may be awarded for a long period (say 99 years), with periodic rebidding (for instance, every 10 or 15 years). In the latter mechanism, which has been adopted in a few countries, the first rebidding occurs before the private partner has fully recouped its investments. As an incentive to the incumbent operator, some laws provide that the private partner may be given preference over other bidders in the award of subsequent PPP contracts for the

same activity. However, the private partner may have rights to compensation if it does not win the next bidding round. Requiring that the winning bidder should pay off the incumbent private partner for any property rights and for the investment not yet recovered reduces the longer-term risk faced by investors and lenders and provides them a valuable exit option (see paras. 42 and 43).

9. Notwithstanding the above, it is advisable not to exclude entirely the option to negotiate an extension of the PPP period under certain specified circumstances. The duration of an infrastructure project is a central element for a project's feasibility and "value for money" assessment (see chap. II, "Project planning and preparation", paras. 6–14). The duration is also one of the main factors considered in the negotiation of financial arrangements and has a direct impact on the price of the services provided by the private partner. The parties may find that an extension of the PPP contract (as a substitute for or combined with other compensation mechanisms) may be a useful option to deal with unexpected impediments or other changes of circumstances arising during the life of the project. Such circumstances may include any of the following: extension to compensate for project suspension or loss of profit due to the occurrence of impeding events (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 145–154); extensions as a compensation for unexpected downside revenue flows, including those due to regulatory price and tariff control measures exceeding the margin contemplated in the contract (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 49 and 50); extension to compensate for project suspension brought about by the contracting authority or other public authorities (see chap. IV, "PPP implementation: legal framework and PPP contract", para. 148); or extension to allow the private partner to recover the cost of construction delay or cost overruns due to unanticipated adverse conditions on the construction site (for example, geological or meteorological) or of additional work required to be done on the facility and which the private partner would not be able to recover during the normal term of the PPP contract without unreasonable tariff increases (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 81–84).

10. A contract extension to cover such situations may be the object of an automatic mechanism set forth in the contract, or the result of the parties' agreement, when the contract contemplates that possibility. The former possibility, particularly where the contract links the extension to a pre-agreed level of present value of income over the PPP life cycle, may have the advantage of limiting the scope for discretion or subjective judgment in determining the appropriate length of an extension. In any event, in the interest of transparency and with a view to reducing opportunities for corrupt practices, the contract should clearly set out the circumstances that might authorize a contract extension and the private partner's performance should have been properly monitored (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 91 and 92). For the same reasons, in

some countries the extension of the PPP period is subject to a global cumulative limit or requires the approval of a specially designated public authority.

D. Termination

11. Domestic laws often deal with the grounds for termination of the PPP contract before the expiry of its term and the consequences of such termination. Usually the law authorizes the parties to terminate the PPP contract following the occurrence of certain types of event. The main interest of all parties involved in a PPP is to ensure the satisfactory completion and operation of the facility and, in case of concession PPPs, the continuous and orderly provision of the relevant public service. In practice, termination is a frequent cause of dispute and litigation and a recurrent argument for international investment claims (see chap. VI, "Settlement of disputes", para. 5 and chap. VII, "Other relevant areas of law", paras. 4–6). Given the serious consequences of termination, as provision of the service may be interrupted or even discontinued, and the cost of ensuing litigation, termination should under most circumstances be regarded as a measure of last resort. The conditions for the exercise of this right by either party should be carefully considered. While they may not need to be identical, it is generally desirable to achieve an equitable balance of rights and conditions regarding termination for both parties.

12. In addition to identifying the circumstances or types of events that may give rise to a right to terminate the PPP contract, it is advisable for the parties to consider appropriate procedures to establish whether there are valid grounds for terminating the PPP contract. Of particular importance is the question whether the PPP contract may be unilaterally terminated or whether termination requires a decision by a judicial or other dispute settlement body.

13. The private partner is usually not allowed to terminate the PPP contract without cause and in some legal systems termination by the private partner even in the event of breach by the contracting authority requires a final judicial decision. However, in some countries, pursuant to rules applicable to contracts with government entities, such a right may be exercised by public authorities, subject to payment of compensation to the private partner. In other countries, however, an exception is made in the case of public service concessions, whose contractual nature is found to be incompatible with unilateral termination rights. Lastly, some legal systems do not recognize unilateral termination rights for public authorities. However, investors and lenders would be concerned about the risk of premature or unjustified termination by the contracting authority, even where a decision to terminate might be subject to review through the dispute settlement mechanism. It should also be noted that giving the contracting authority the unilateral right to terminate the PPP contract would not be an adequate substitute for well designed contractual

mechanisms of performance monitoring or for appropriate guarantees of performance (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 88–104 and 117–129).

14. Provisions concerning termination should therefore be brought into line with the remedies for breach provided in the PPP contract. In particular, it is useful to distinguish the conditions for termination from those for step in by the contracting authority (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 158–161). It is also important to consider the contracting authority's termination rights against the background of the financing agreements negotiated by the private partner with its lenders. In most cases, events that may lead to the termination of the PPP contract would also constitute events of default under the loan agreements, with the consequence that the entire outstanding debt of the private partner may fall due immediately. It would thus be useful to attempt to avoid the risk of termination by allowing the lenders to propose another private partner when termination of the PPP contract with the original private partner appears imminent (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 162–165).

15. In the light of the above, it is generally advisable to subject the termination of the PPP contract to a final finding by the dispute settlement body provided in the contract. Such a requirement would reduce concerns about premature or unjustified recourse to termination. At the same time, it would not preclude the taking of appropriate measures to ensure the continuity of the service, pending the final decision of the dispute settlement body, as long as contractual remedies for breach, such as step in rights for the contracting authority and the lenders, are provided in the PPP contract. In countries where such a requirement would not be consistent with general principles of administrative law applicable to government contracts, it might be important to ensure, at least, that the contracting authority's right to terminate the PPP contract should be without prejudice to the private partner's right to seek subsequent judicial review of the contracting authority's decision to terminate.

1. *Termination by the contracting authority*

16. The contracting authority's termination rights usually relate to three categories of circumstances: serious breach by the private partner; insolvency of the private partner; and termination for reasons of public interest.

(a) Serious breach by the private partner

17. Where the contract involves the provision of public services by the private partner under some form of "concession" (see "Introduction and background information", paras. 18 and 19), the contracting authority has the duty to ensure

that public services are provided in accordance with applicable laws, regulations and contractual provisions. Thus, a number of domestic laws expressly recognize the contracting authority's right to terminate the PPP contract in the event of breach by the private partner. Because of the disruptive effects of termination and in the interest of preserving the continuity of the service, it is not advisable to regard termination as a sanction for every instance of unsatisfactory performance by the private partner. On the contrary, it is generally advisable to resort to such an extreme remedy only in instances of "particularly serious" or "repeated" failures to perform, especially in cases where it can no longer be reasonably expected that the private partner will be able or willing to perform under the PPP contract. Many legal systems use specific technical expressions to refer to situations where the degree of breach by one contracting party is of such a nature that the other party may terminate their contractual relation before the expiry of its term (for example, "fundamental breach", "material breach" or similar expressions). Such situations are referred to in the *Guide* as "serious breach".

18. Circumscribing the possibility of termination to cases of serious breach may give assurance to lenders and investors that they will be protected against unreasonable or premature decisions by the contracting authority. The law may generally provide for the contracting authority's right to terminate the PPP contract upon serious breach by the private partner and leave it for the PPP contract to define further the notion of serious breach and, as appropriate, provide illustrative examples of it. From a practical point of view, it is not advisable to attempt, by statute or in the PPP contract, to provide a list of the events that justify termination. Typically, the seriousness and implications of breach of the private partner's obligations will depend on the project phase in which the breach occurs (see below, paras. 21–26).

19. One category of breach that domestic laws usually treat as sufficiently serious to justify the termination of the PPP contract regardless of the project phase in which they are detected are serious violations of the country's criminal laws by the private partner and its agents, or any other criminal conviction under the private partner's national law or a third country's law. Corruption and bribery of public officials in connection with the award or management of public contract or issuance of licences or permits, whether or not specifically related to the PPP contract, are widely recognized grounds for termination of a PPP contract. Since the entry into force of the United Nations Convention against Corruption,[1] States have assumed an international obligation to fight such practices and many States would persecute corruption and bribery even if committed abroad to the extent that the perpetrators are their nationals, or the corrupt practices cause damage to domestic interests.

[1] The Convention was adopted by the United Nations General Assembly resolution 58/4 of 31 October 2003 and entered into force on 14 December 2005.

Additional examples of criminal offences that often justify termination under domestic laws include: *(a)* participation in a criminal organization; *(b)* fraud; *(c)* terrorist offences or offences linked to terrorist activities; *(d)* money-laundering or terrorist financing; or *(e)* other serious crimes in the meaning of article 2, subparagraph *(b)*, of the United Nations Convention against Transnational Organized Crime.[2] Termination in such cases would be justified whenever the private partner as a legal entity has committed such crimes, but also in instances where the person convicted by final judgment is a member of the administrative, management or supervisory body of the private partner or has powers of representation, decision or control therein.

20. Apart from the situation described in the preceding paragraph, which may call for immediate sanction, as a rule it is desirable for the contracting authority to grant the private partner an additional period to fulfil its obligations and to avert the consequences of its breach prior to resorting to remedies. For example, the private partner should be given notice specifying the nature of the relevant circumstances and requiring it to rectify them within a certain period. The possibility might also be given for the lenders and sureties, as the case may be, to avert the consequences of the private partner's breach, for instance by temporarily engaging a third party to cure the consequences of breach by the private partner, in accordance with the terms of the performance bonds provided to the contracting authority or the terms of a direct agreement between the lenders and the contracting authority (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 117–129 and 162–165). The PPP contract may also provide that, if the circumstances are not rectified before the expiry of the relevant period, the contracting authority may then terminate the PPP contract subject to first notifying the lenders and giving them an opportunity, between such notification of the termination and the effective termination date, to exercise any right of substitution that the lenders might have in accordance with a direct agreement between them and the contracting authority. The PPP contract may also provide for an extension of the termination date if the contracting authority and the lenders agree on such extension. However, reasonable deadlines need to be set, since the contracting authority cannot be expected to bear indefinitely the continuing cost of a situation of breach of the PPP contract by the private partner. Furthermore, the procedures should be without prejudice to the contracting authority's right to step in to avert the risk of disruption of service by the private partner (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 158 and 159).

[2] That is "conduct constituting an offence punishable by a maximum deprivation of liberty of at least four years or a more serious penalty" (United Nations Convention against Transnational Organized Crime, adopted by General Assembly resolution 55/25 of 15 November 2000, entered into force on 29 September 2003). Common examples of serious crimes under domestic laws include murder, rape, abduction, theft, robbery, burglary, handling stolen property, extortion, trafficking in drugs, embezzlement, bribery, fraud, counterfeiting of money, money-laundering, smuggling of firearms, child labour and other forms of trafficking in human beings.

(i) Serious breach before the beginning of construction

21. Examples of events that often justify the termination of the PPP contract before the beginning of the construction include the following instances of breach by the private partner:

(a) Failure to undertake the construction of the facility;

(b) Failure to commence development of the project; or

(c) Failure to submit the plans and designs required within a set period from the award of the PPP contract.

22. Termination should in principle be reserved for situations where the contracting authority may no longer reasonably expect that the selected private partner will take the necessary measures to commence execution of the project. In that connection, it is important for the contracting authority to consider any circumstances that may excuse the private partner's delay in fulfilling its obligations. Furthermore, the private partner should not suffer the consequences of inaction or error on the part of the contracting authority or other public authorities. For instance, the termination of the PPP contract would not normally be justified if the private partner's failure to obtain government licences and permits within the agreed schedule was not attributable to the private partner's own fault.

(ii) Serious breach during the construction phase

23. Examples of events that may justify the termination of the PPP contract during the construction phase include the following:

(a) Failure to observe building regulations, specifications or minimum design and performance standards and inexcusable failure to complete work within the agreed schedule;

(b) Failure to observe mandatory labour laws and standards of social security laws and related public policy standards;

(c) Failure to provide or renew the required guarantees in the agreed terms;

(d) Violation of other essential statutory or contractual obligations.

24. Termination should be commensurate with the degree of breach by the private partner and the consequences of breach for the contracting authority. For instance, the contracting authority may have a legitimate interest in specifying a date when the construction must be completed and may therefore be justified in regarding a delay in completion as an event of breach and hence a ground for termination. However, delay alone, in particular if it is not excessive in relation to the

specifications of the PPP contract, might not be sufficient reason for termination when the contracting authority is otherwise satisfied with the private partner's ability to complete the construction in accordance with the required quality standards and its commitment to doing so.

(iii) Serious breach during the operational phase

25. Instances of breach that typically justify the termination of the contract during the operational phase include any of the following, as appropriate:

(a) Serious failure to provide services in accordance with the statutory and contractual standards of quality, including disregard of price control measures applicable to a concession PPP;

(b) Inexcusable suspension or interruption of the provision of services required under the contract without prior consent from the contracting authority;

(c) Serious failure by the private partner to maintain the facility, its equipment and appurtenances in accordance with the agreed standards of quality or inexcusable delay in carrying out maintenance works in accordance with the agreed plans, schedules and timetables;

(d) Failure to comply with sanctions imposed by the contracting authority or the regulatory agency, as appropriate, for infringements of the private partner's duties.

26. The possibility of termination of the PPP contract if the private partner fails to comply with regulatory decisions or sanctions imposed by the contracting authority underscores the need for effective dispute avoidance and settlement mechanisms in the PPP contract (see chap. VI, "Settlement of disputes", paras. 5–9). The same holds true for termination of the PPP contract when the private partner is found guilty of tax fraud or other types of fraudulent acts, or if its agents or employees are involved in bribery of public officials and other corrupt practices (see above, para. 18). The latter situation also emphasizes the importance of designing effective mechanisms to combat corruption and bribery and to afford the private partner the possibility to file complaints against demands for illegal payments or unlawful threats by officials of the host country (see also chap. VII, "Other relevant areas of law", paras. 55–57).

(b) Insolvency of the private partner

27. Infrastructure services typically need to be provided continuously and for that reason most domestic laws require the termination of the PPP contract if the private partner is declared insolvent or bankrupt. In order to ensure the continuity of the service, the assets and property required to be handed over to the contracting

authority may be excluded from the insolvency proceedings and the law may require prior governmental approval for any act of disposition by a liquidator or insolvency administrator of any categories of assets owned by the private partner in the framework of the PPP project.

28. In legal systems that allow the establishment of security interests over the concession itself (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 64 and 65), the law provides that the contracting authority may, in consultation with the secured creditors, appoint a temporary administrator so as to ensure the continued provision of the relevant service, until the secured creditors participating in the insolvency proceedings decide, upon the recommendation of the insolvency administrator, whether the activity should be pursued or whether the right to exploit the concession should be put to a bidding process.

(c) Termination for reasons of public interest

29. In the contracting practice of some countries, public authorities procuring construction works traditionally retain the right to terminate the construction contract for reasons of public interest (that is, without having to provide any justification other than that the termination is in the Government's interest). In some common law jurisdictions, that right, which is sometimes referred to as "termination for convenience", can only be exercised if expressly provided by statute or in the relevant contract. Several legal systems belonging to the civil law tradition also recognize a similar power of public authorities to terminate contracts for reasons of "public interest" or "general interest". In some countries, such a right may be implied in the Government's contracting power, even in the absence of an explicit statutory or contractual provision to that effect. The Government's right to terminate for reasons of public interest, in those legal systems which recognize it, is regarded as essential to preserve the Government's unfettered ability to exercise its functions affecting the public good.

30. Nevertheless, the conditions for the exercise of this right, and the consequences of doing so, should be carefully considered. The authority to determine what constitutes public interest may lie within the Government's discretion, so that the contracting authority's decision to terminate the PPP contract could only be challenged under specific circumstances (for instance, improper motive, "*détournement de pouvoir*"). However, a general and unqualified right to terminate the PPP contract for reasons of public interest may represent an imponderable risk that neither the private partner nor the lenders may be ready to accept without sufficient guarantees that they will receive prompt compensation for the loss sustained. The possibility of termination for reasons of public interest, where contemplated, should therefore be made known to prospective investors on the earliest possible occasion and should be expressly mentioned in the draft PPP

contract circulated with the request for proposals (see chap. III, "Contract award", para. 76). The compensation due for termination for reasons of public interest may, in practice, cover items that are considered when calculating the compensation that is due for termination for serious breach by the contracting authority (see para. 51; for a detailed discussion on financial arrangements upon termination for reasons of public interest, see para. 54). Furthermore, it is generally advisable to limit the exercise of the right to terminate the PPP contract to situations where such termination is needed for a compelling reason of public interest, which should be restrictively interpreted (for example, where major subsequent changes in governmental plans and policies require the integration of a project into a larger network or where changes in the contracting authority's plans require major project revisions that substantially affect the original design or the project's commercial feasibility under private operation). In particular, it is not advisable to regard the right of termination for reasons of public interest as a substitute for other contractual remedies in case of dissatisfaction with the private partner's performance (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 155–165).

2. *Termination by the private partner*

31. While the contracting authority in some legal systems may retain an unqualified right to terminate the PPP contract, the grounds for termination by the private partner are usually limited to serious breach by the contracting authority or other exceptional situations and do not normally include a general right to terminate the PPP contract at will. Moreover, some legal systems do not recognize the private partner's right to terminate the PPP contract unilaterally, but only the right to request a third party, such as the competent court, to adjudicate the termination of the PPP contract.

(a) Serious breach by the contracting authority

32. Generally, the private partner's right to terminate the PPP contract is limited to situations where the contracting authority is found to be in breach of a substantial part of its obligations (such as failure to make agreed payments to the private partner, or failure to issue licences required for the operation of the facility for reasons other than the private partner's own fault). In those legal systems where the contracting authority has the right to request variations or alterations to the project, the private partner may have the right to terminate the PPP contract if the contracting authority alters or modifies the original project in such a fashion as to cause a substantial increase in the amount of investment required and the parties fail to agree on the appropriate amount of compensation (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 81–84).

33. In addition to serious breach by the contracting authority itself, it may be equitable to authorize termination by the private partner should the latter be rendered unable to perform its obligations because of acts of public authorities other than the contracting authority, such as failure to provide certain measures of support required for the execution of the PPP contract (see chap. II, "Project planning and preparation", paras. 61–86).

34. Although termination by the private partner may not always require a final finding by a judicial or other dispute settlement body, there may be limits to the remedies available to the private partner in the event of breach by the contracting authority. Pursuant to a rule of law followed in many legal systems, a party to a contract may withhold performance of its obligations in the event of breach by the other party of a substantial part of its obligations. However, in some legal systems that rule does not apply to government contracts and the law provides instead that government contractors are not excused from performing solely on the ground of breach by the contracting authority unless and until the contract is rescinded by a judicial or arbitral decision.

35. Limitations on the private partner's right to withhold performance are typically intended to ensure the continuity of public services (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 95 and 96). Nevertheless, it should be noted that while the contracting authority may mitigate the consequences of breach by the private partner by using its right to step in, the private partner does not usually have a comparable remedy. In the event of serious breach by the contracting authority, the private partner may sustain considerable or even irreparable damage, depending on the time required to obtain a final decision releasing the private partner from its obligations under the PPP contract. These circumstances underscore the importance of government guarantees in respect of obligations assumed by contracting authorities (see chap. II, "Project planning and preparation", paras. 71–76) and the need to allow the parties to choose expeditious and effective dispute settlement mechanisms (see chap. VI, "Settlement of disputes", paras. 3–49).

(b) Changes in conditions

36. Domestic laws often allow the private partner to terminate the PPP contract if the private partner's performance has been rendered substantially more onerous by the occurrence of an unforeseen change in conditions and the parties have failed to agree on an appropriate revision to adapt the PPP contract to the changed conditions (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 135–144). The private partner would also have a right to terminate the contract if the contracting authority fails to comply with contractual provisions aimed at preserving the economic balance of the contract (such as adjustment and indexation clauses).

3. Termination by either party

(a) Impediment of performance

37. Some laws provide that the parties may terminate the PPP contract if the performance of their obligations is rendered permanently impossible because of a circumstance defined in the PPP contract as an exempting impediment (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 146–148). In that connection, it is advisable to provide in the PPP contract that if the exempting impediment persists for a certain period or if the cumulative duration of two or more exempting impediments exceeds a certain time, the agreement may be terminated by either party. If the execution of the project is rendered impossible on legal grounds, because of changes in legislation or because of judicial decisions affecting the validity of the PPP contract, for instance, such a termination right might not require any period to elapse and might be exercised immediately upon the change of legislation or other legal obstacle becoming effective.

(b) Mutual consent

38. Some domestic laws authorize the parties to terminate the PPP contract by mutual consent, usually subject to the approval of a higher authority. The contracting authority may need specific legislative power in legal systems where the termination by mutual consent might amount to a discontinuation of the public service for which the contracting authority could be held accountable.

E. Consequences of expiry or termination of the PPP contract

39. The consequences of expiry or termination of the contract will vary depending on the type and structure of PPP (that is "concession" or "non-concession" PPPs) and the nature of the project (for an overview of various types of PPP arrangements, see "Introduction and background information on PPPs", paras. 14–16). For concession-type PPPs, the expiry or termination of the contract typically extinguishes the concessionaire's right to operate the facility, to provide the relevant service and to receive payments therefor. In those cases, unless the infrastructure is to be permanently owned by the concessionaire, the expiry or termination of the PPP contract often requires the transfer of assets to the contracting authority or to another concessionaire who undertakes to operate the facility. The situation may be different in non-concession PPPs, in particular where the private partner retains ownership of project assets. There may be important financial consequences that the parties will need to address in detail in the PPP contract, in particular in the event of termination by either party. The parties will also need to agree on

various winding-up measures to ensure the orderly transfer of the responsibility for operating the facility and providing the service.

1. Transfer of project related assets

40. In most cases, the assets and property originally made available to the private partner and other goods related to the PPP are to revert to the contracting authority upon expiry or termination of the PPP contract (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 22–28). In a typical "build-operate-transfer" project, the private partner would also be obliged to transfer to the contracting authority the physical infrastructure and other project-related assets upon expiry or termination of the PPP contract. The assets required to be transferred to the contracting authority often include intangible assets, such as outstanding receivables and other rights existing at the time of transfer. Depending on the project, the assets to be transferred may include specific technology or know how (see paras. 56–60). It should be noted that in some PPPs the assets are transferred directly and automatically to the newly selected private partner who will succeed the incumbent private partner in the provision of the service.

(a) Transfer of assets to the contracting authority

41. Different arrangements may be needed, depending on the type of asset to be transferred (see chap. IV, "PPP implementation: legal framework and PPP contract", para. 27):

(a) *Assets that must be transferred to the contracting authority*. In the legal tradition of some countries, at the end of the PPP project the private partner is required to transfer such assets free of any liens and encumbrances and at no cost to the contracting authority, except for compensation for improvements made to, or modernization of, the property for the purpose of ensuring the continuity of the service the cost of which has not yet been recovered by the private partner. In practice, such a rule presupposes the negotiation of a contract period sufficiently long, and a level of revenue high enough, to enable the private partner to fully amortize its investment and to repay its debts in full. Other laws allow for more flexibility by authorizing the contracting authority to compensate the private partner for the residual value, if any, of assets built or other investment in physical facilities or systems made by the private partner;

(b) *Assets that may be purchased by the contracting authority, at its option.* If the contracting authority decides to exercise its option to purchase those assets, the private partner is normally entitled to compensation corresponding to their fair market value at the time. However, if those assets were expected to be fully amortized (that is, if the private partner's financing arrangements do not envisage any expectation of residual value of the assets), then the parties typically agree that the price paid would be nominal. In the contracting practice of some countries, it is usual for contracting authorities to be granted some security interest in such assets as a guarantee for their effective transfer;

(c) *Assets that remain the private property of the private partner.* Typically, these assets may be freely removed or disposed of by the private partner.

(b) Transfer of assets to a new private partner

42. As indicated earlier, the contracting authority may wish to rebid the PPP contract at the end of its term, rather than to operate the facility itself (see para. 7). For that purpose, it may be useful for the law to require the private partner to make the assets available to a new private partner. In order to ensure an orderly transition and continuity of the service, the private partner should be required to cooperate with the new private partner in the handover. The transfer of assets between the successive private partners may require that some compensation be paid to the incumbent private partner, depending on whether or not the assets have been amortized.

43. One important element to consider in this connection is the structure of the financial proposal formulated by the private partner during the selection process (see also chap. III, "Contract award", para. 76). In public infrastructure PPPs, one of the basic assumptions of the bidders' financial proposals is that all assets required to be built or acquired for the PPP will be fully amortized (that is, their cost will be recovered in full) in the life of the PPP. Thus, the financial proposals will not normally include an expectation of residual value for the assets at the end of the PPP period. In such cases, there may not be a prima facie reason for requiring a successor private partner to pay any compensation to the original private partner, which may be required to make all assets available to its successor at no cost or only for a nominal consideration. Indeed, if the private partner has achieved its expected return, a transfer payment from a successor private partner would be an additional cost that would ultimately have to be remunerated by the prices charged by the successor under the second contract. However, if the tariff level contemplated in the private partner's original proposal assumed some residual value of the assets at the end of the PPP period or if the financial proposal assumed significant revenue from third parties, the private partner might be entitled to compensation for assets handed over to a successor private partner.

(c) Condition of assets at the time of transfer

44. Where assets are handed over to the contracting authority or transferred directly to a new private partner upon the expiry of the PPP period, the private partner is typically obliged to transfer them, free of liens or encumbrances, and in such condition as would be necessary for normal functioning of the infrastructure facility, considering the needs of the service. The contracting authority's right to

receive those assets in such operating condition is complemented in some laws by the obligation imposed upon the private partner to keep and transfer the assets in such proper condition as prudent maintenance requires and to provide some sort of guarantee to that effect (see chap. IV, "PPP implementation: legal framework and PPP contract", para. 127). Where the contracting authority requires the assets to be returned in a prescribed condition, the required conditions should be reasonable. While it may be reasonable for the contracting authority to require that the assets have some defined period of residual life, it would not be reasonable to expect them to be as new. Furthermore, these requirements may not be applicable in the event of termination of the PPP contract, in particular termination prior to successful completion of the construction phase.

45. It is advisable to devise clear procedures for evaluating and ascertaining the condition of the assets that should be transferred to the contracting authority. It may be useful, for example, to establish a committee comprised of representatives of both the contracting authority and the private partner to establish whether the facilities are in the prescribed condition and conform to the relevant requirements set forth in the PPP contract. The PPP contract may also provide for the appointment and terms of reference of such a committee, which may be given authority to request reasonable measures by the private partner to repair or eliminate any defects and deficiencies found in the facilities. It may be advisable to provide for a special inspection to take place at an appropriate stage well before the termination of the contract (at the latest one year, but in some cases even earlier), following which the contracting authority may require additional maintenance measures by the private partner so as to ensure that the goods are in proper condition at the time of the transfer. The contracting authority may wish to require in the PPP contract that the private partner provide special guarantees for the satisfactory handover of the facilities. The contracting authority might draw on such guarantees to pay the repair cost of damaged assets or property.

2. Financial arrangements upon termination

46. Termination of the PPP contract may occur before the private partner has been able to recover its investment, repay its debts and yield the expected profit, which may cause significant loss to the private partner. The contracting authority may also sustain loss, as it may need to make additional investment or incur considerable expense, for instance, to ensure the completion of the facility or the continued provision of the relevant services. In view of these circumstances, PPP contracts typically contain extensive provisions dealing with the financial rights and obligations of the parties upon termination. Contingent liabilities following termination of a PPP contract may be significant and need to be properly assessed in the contracting authority's risk matrix at the very early stages of project planning (see chap. II, "Project planning and preparation", paras. 15 and 16). Moreover,

actual payments by the contracting authority – be they as compensation for termination or as regular payment for transfer of assets – may require sufficient budgetary allocation, which the contracting authority may need to seek well in advance of the time when payments may become due.

47. The following paragraphs deal with the various factors that contracting authorities and private partners usually consider when determining the standards of compensation to which either party may be entitled in the event of termination of the PPP contract. In this context, it is important to distinguish contractually agreed compensation standards from damages payable for wrongful termination. In the latter case, payments are a substitute for full restitution and serve the purpose of placing the injured party in essentially the same situation in which it would have found itself, had the other party not wrongfully terminated the contract.[3] Contractually agreed compensation payments, in turn, do not typically have a restitution or punitive character, and normally reflect what the parties regard as equitable compensation of investment made and possible frustrated profit or benefit due to the early termination of the contract.

48. There are essentially three approaches for determining compensation payments: *(a)* an income-based approach values an undertaking on the basis of its current and prospective income using either discounted cash flow, adjusted present value or capitalized cash flow methods; *(b)* a market-based approach entails a comparison between the relevant project and the market value of a similar business or ownership interest as evidenced by the price for which it was sold; *(c)* lastly, an asset-based approach uses either the accounting value or the replacement value of the assets for which compensation is due. All three approaches may be used to set the parameters for calculating compensation for termination of a PPP contract, and they typically vary according to the stage in which termination occurs and the various grounds for termination. Nevertheless, the following factors usually play a central role in determining compensation parameters:

(a) *Outstanding debt, equity investment and anticipated profit.* Project termination is typically included among the events of default in the private partner's loan agreements. Since loan agreements usually include a so called "acceleration clause",

[3] The standard of damages under customary international law was generally defined by the Permanent Court of International Justice in the following terms: "The essential principle contained in the actual notion of an illegal act – a principle which seems to established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it – such are the principles which should serve to determine the amount of compensation due for an act contrary to international law". (*Factory at Chorzow (Germany v. Poland), Merits*, 1928 PCIJ (Ser.A) No. 17 (13 September), p. 125).

whereby the entire debt may become due upon the occurrence of an event of default, the immediate loss sustained by the private partner upon termination of the PPP contract may include the amount of debt then outstanding. Whether and to what extent such a loss might be compensated for by the contracting authority usually depends on the grounds for terminating the PPP contract. Partial compensation may be limited to an amount corresponding to the value of works satisfactorily performed by the private partner, whereas full compensation would cover the entire outstanding debt. Another category of loss that is sometimes considered in compensation arrangements refers to loss of equity investment by the private partner, to the extent that such an investment has not yet been recovered at the time of termination. Lastly, termination also deprives the private partner of future profits that the facility may generate. Although lost profits are not usually regarded as actual damage, in exceptional circumstances, such as wrongful termination by the contracting authority, the current value of expected future profit may be included in the compensation due to the private partner;

(b) Degree of completion, residual value and amortization of assets. Contractual compensation schemes for various termination grounds typically include compensation commensurate with the degree of completion of the works at the time of termination. The value of the works is usually determined on the basis of the investment required for construction (in particular if the termination takes place during the construction phase), the replacement cost or the "residual" value of the facility. The residual value means the market value of the infrastructure at the time of termination. Market value may be difficult to determine or even non-existent for certain types of physical infrastructure (such as bridges or roads) or for facilities whose operational life is close to expiry. Sometimes the residual value may be estimated taking into account the expected usefulness of the facility for the contracting authority. However, difficulties may be found in establishing the value of unfinished works, in particular if the amount of the investment still required by the contracting authority to render the facility operational would exceed the amount actually invested by the private partner. In any event, full payment of residual value seldom takes place, in particular where the project's revenue constitutes the sole remuneration for the private partner's investment. Thus, instead of full compensation for the facility's value, the private partner often receives compensation only for the residual value of assets that have not yet been fully amortized at the time of termination.

(a) Termination due to breach by the private partner

49. The private partner is not usually entitled to damages in the event of termination due to its own breach. In fact, the private partner may be under an obligation to pay damages to the contracting authority, although, in practice, a defaulting company whose debts are declared due by its creditors would seldom have sufficient remaining financial means for actual payment of such damages, which underscores the importance of bonds and other guarantees of performance that the

private partner may be required to provide (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 118 and 119).

50. It should be noted that termination due to breach, even where it is regarded as a sanction for serious performance failure, should not cause unjust enrichment of either party. Thus, even in those PPPs in which the private partner builds an infrastructure facility intended to be ultimately transferred to the contracting authority, termination does not necessarily entail a right for the contracting authority to take over assets without making any payment to the private partner. An equitable solution for dealing with this issue may be to distinguish between the different types of asset, according to the arrangements envisaged for them in the PPP contract (see para. 40):

(a) Assets that must be transferred to the contracting authority. Where the PPP contract requires the automatic transfer of project assets to the contracting authority at the end of the PPP contract, termination on breach does not usually entail the payment of compensation to the private partner for those assets, except for the residual value of work satisfactorily performed, to the extent that it has not yet been amortized by the private partner;

(b) Assets that may be purchased by the contracting authority, at its option. Financial compensation may be adequate in cases where the contracting authority has an option to buy the assets at market value on expiry of the PPP contract or the right to require that such an option be given to the winner of a new project award. However, it may be legitimate to envisage financial compensation that is less than the full value of the assets so as to stimulate performance by the private partner. By the same token, such compensation may not need to cover the full cost of repaying the private partner's outstanding debt. It is advisable to set forth the details of the formula for financial compensation in the PPP contract (that is, whether it covers the break up value of the asset or the lesser of the outstanding debt and the alternative use value);

(c) Assets that remain the property of the private partner. Assets owned by the private partner that do not fall under *(a)* or *(b)* above may usually be removed and disposed of by the private partner, so that the need for compensation arrangements seldom arises. However, a different situation may arise in the case of fully privatized projects, where all assets, including those essential for the provision of the services, are owned by the private partner. In such cases, in order to ensure the continuity of the services, the contracting authority may find it necessary to take over the assets, even though not contemplated in the PPP contract. In such cases, it is generally accepted that the contracting authority should compensate the private partner for the fair market value of the assets. The PPP contract may, however, provide that the compensation should be reduced by the costs incurred by the contracting authority in operating the facility or engaging another operator.

(b) Termination due to breach by the contracting authority

51. The private partner is usually entitled to full compensation for loss sustained because of termination on grounds attributable to the contracting authority. The compensation due to the private partner usually includes compensation for the value of the works and installations, to the extent they have not already been amortized, as well as for the loss caused to the private partner, including lost profits. Those are usually calculated on the basis of the private partner's revenue during previous financial years, when termination occurs during the operational phase, or on the basis of a projection of the expected benefit during the duration originally envisaged. The private partner may be entitled to full compensation of debt and equity, including the cost of debt servicing and lost profits.

(c) Termination on other grounds

52. When considering compensation arrangements for termination due to circumstances unrelated to breach by either party, it may be useful to distinguish exempting impediments from termination declared by the contracting authority for reasons such as public interest or other similar reasons.

(i) Termination due to exempting impediments

53. By definition, exempting impediments are events beyond the parties' control and, as a general rule, termination under such circumstances might not give rise to claims for damages by either party. However, there may be circumstances where it might be equitable to provide for some compensation to the private partner, such as fair compensation for works already completed, in particular where, because of the specialized nature of the assets, they cannot be removed by the private partner or meaningfully used by it, but may be effectively used by the contracting authority for the purpose of providing the relevant service (a bridge, for instance). However, since termination in such cases cannot be attributed to the contracting authority, the compensation due to the private partner may not necessarily need to be "full" compensation (that is, repayment of debt, equity and lost profits).

(ii) Termination for reasons of public interest

54. Where the PPP contract recognizes the contracting authority's right to terminate for reasons of public interest (see para. 30), the compensation payable to the private partner usually covers compensation for the same items included in compensation payable upon termination for breach by the contracting authority (see para. 51), although not necessarily to the full extent. In order to establish the equitable amount of compensation due to the private partner, it may be useful to distinguish between termination for reasons of public interest during the construction phase and termination during the operational phase:

(a) *Termination during the construction phase.* If the PPP contract is terminated during the construction and investment phase, the compensation arrangements may follow the standard practice in connection with large construction contracts that allow termination for convenience. In those cases, the contractor is usually entitled to the portion of the price that is attributable to the construction satisfactorily performed, as well as for expenses and losses incurred by the contractor arising from the termination. However, since the contracting authority does not normally pay a price for the construction work carried out by the private partner, the main criterion for calculating compensation would typically be the total investment effectively made by the private partner up to the time of termination, including all sums actually disbursed under the loan facilities extended to the private partner for the purpose of carrying out construction under the PPP contract, and expenses related to the cancellation of loan agreements. The risk of termination during the construction phase is a major risk for the financing of PPP projects. Some countries seek to mitigate this risk and enhance bankability of projects in which the contracting authority pays for the works performed by the private partner by issuing periodically negotiable certificates reflecting the amount of investment made in the relevant period (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 51–52). In such schemes, any amounts acknowledged but not yet paid by the contracting authority are automatically included in the residual sum due by the contracting authority as unamortized investment payment in case of early termination of the PPP contract. The overall financial implication of this form of indirect assumption of construction risk by the contracting authority, which is found in some PPP models, needs to be carefully considered at the project planning stage (see chap. II, "Project planning and preparation", paras. 30–32). One additional question is whether and to what extent the private partner may be entitled to recover lost profit for the portion of the contract that has been terminated for reasons of public interest. On the one hand, the private partner might have foregone other business opportunities in anticipation of completing and operating the facility through the anticipated duration of the PPP contract. On the other hand, an obligation of the contracting authority to compensate the private partner for its lost profit might make it financially prohibitive for the contracting authority to exercise its right of termination for convenience. One approach may be for the PPP contract to establish a scale of payments to be made by the contracting authority as compensation for lost profits and the amount of the payments depending upon the stage of the construction that has been completed when the PPP contract is terminated for convenience;

(b) *Termination during the operational phase.* As regards the construction work satisfactorily completed by the private partner, the compensation arrangements may be the same as for termination during the construction phase. However, equitable compensation for termination during the operational phase might require fair compensation for lost profits. The higher standard of compensation in this case may be justified by the fact that, unlike termination during the construction phase, when the contracting authority might need to undertake to complete the work at its own expense, upon termination during the operational phase the contracting authority might be able to receive a completed facility capable of profitable operation. Compensation for lost profits is often calculated on the basis of the private partner's revenue during a certain number of previous financial years, but in some cases other elements, such as the anticipated profit on the basis of the agreed tariffs, may need to be taken into account, since the expected revenue is a central element in the feasibility studies and financial structuring of the project (see chap. II, "Project planning and preparation", paras. 33 and 34). This is so because in some infrastructure projects such as toll roads and similar projects, which are characterized by high financial costs and relatively low income at the early stages of operation, termination may occur before the project has a history of profitability.

3. Winding up and transitional measures

55. Where the facility is transferred to the contracting authority at the end of the contract term, the parties may need to make a series of arrangements in order to ensure that the contracting authority will be able to operate the facility at the prescribed standards of efficiency and safety. The PPP contract may provide for the private partner's obligation to transfer certain technology or know how required to operate the infrastructure facility. The PPP contract may also provide for the continuation, for a certain transitional period, of certain obligations of the private partner in respect of the operation and maintenance of the facility. It may further include an obligation, on the part of the private partner, to supply or facilitate the supply of spare parts that may be needed by the contracting authority to carry out repairs in the facility. It should be noted, however, that the private partner might not be able to undertake itself some of the transitional measures referred to below, since in most cases the private partner would have been established for the sole purpose of carrying out the project and would need to procure the relevant technology or spare parts from third parties.

(a) Transfer of technology and know-how

56. In some cases, the facility transferred to the contracting authority will embody various technological processes necessary for the generation of certain goods, such as electricity or potable water, or the provision of the relevant services, such as telephone services. The contracting authority will often wish to acquire a knowledge of those processes and their application. The contracting authority will also wish to acquire the technical information and skills necessary for the operation and maintenance of the facility. Even where the contracting authority has the basic capability to undertake certain elements of the operation and maintenance (for example, building or civil engineering), the contracting authority may need to acquire knowledge of special technical processes necessary to effect the operation

in a manner appropriate to the facility in question. The communication to the contracting authority of that knowledge, information and skills is often referred to as the "transfer of technology". Obligations concerning the transfer of technology cannot be unilaterally imposed on the private partner and, in practice, these matters are the subject of extensive negotiations between the parties concerned. While the host country has a legitimate interest in gaining access to the technology needed to operate the facility, due account should be taken of the commercial interests and business strategies of the private investors.

57. Differing contractual arrangements can be adopted for the transfer of technology and the performance of the other obligations necessary to construct and operate the facility. The transfer of technology itself may occur in different ways, for example, through the licensing of industrial property, through the creation of a joint venture between the parties or the supply of confidential know-how. The *Guide* does not attempt to deal comprehensively with contract negotiation and drafting relating to the licensing of industrial property or the supply of know-how, as this subject has already been dealt with in detail in publications issued by other United Nations bodies.[4] The following paragraphs merely note certain major issues concerning the communication of skills necessary for the operation and maintenance of the facility through the training of the contracting authority's personnel or through documentation.

58. The most important method of conveying to the contracting authority the technical information and skills necessary for the proper operation and maintenance of the works is the training of the contracting authority's personnel. In order to enable the contracting authority to decide on its training requirements, in the request for proposals or during the contract negotiations the contracting authority might request the private partner to supply an organizational chart showing the personnel requirements for the operation and maintenance of the works, including the basic technical and other qualifications the personnel must possess. Such a statement of requirements should be sufficiently detailed to enable the contracting authority to determine the extent of training required in relation to the personnel available to it. The private partner will often have the capability to provide the

[4] The negotiation and drafting of contracts for the licensing of industrial property and the supply of know-how is dealt with in detail in *World Intellectual Property Organization, Licensing Guide for Developing Countries* (WIPO publication No. 620 (E), 1977). The main issues to be considered in negotiating and drafting such contracts are set forth in the *Guidelines for Evaluation of Transfer of Technology Agreements,* Development and Transfer of Technology Series, No. 12 (ID/233, 1979), and in the *Guide for Use in Drawing Up Contracts Relating to the International Transfer of Know How in the Engineering Industry* (United Nations publication, Sales No. E.70.II.E.15). Another relevant publication is the *Handbook on the Acquisition of Technology by Developing Countries* (United Nations publication, Sales No. E.78.II.D.15). For a discussion of transfer of technology in the context of contracts for the construction of industrial works, see the *UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works* (United Nations publication, Sales No. E.87.V.10), chap. VI, "Transfer of technology".

training. In some cases, however, the training may be given more effectively by a consulting engineer or through an institution specializing in training.

59. Technical information and skills necessary for the proper operation and maintenance of the facility may also be conveyed through the supply of technical documentation. The documentation to be supplied may consist of plans, drawings, formulas, manuals of operation and maintenance and safety instructions. It may be advisable to list in the PPP contract the documents to be supplied. The private partner may be required to supply documents that are comprehensive and clearly drafted in a specified language. It may be advisable to obligate the private partner, at the request of the contracting authority, to give demonstrations of procedures described in the documentation if the procedures cannot be understood without demonstrations.

60. The points in time when the documentation is to be supplied may be specified. The PPP contract may provide that the supply of all documentation is to be completed by the time fixed in the contract for completion of the construction. The parties may also wish to provide that transfer of the facility is not to be considered completed unless all documentation relating to the operation of the works and required under the contract to be delivered prior to the completion has been supplied. It may be advisable to provide that some documentation, such as operating manuals, is to be supplied during construction, as such documentation may enable the contracting authority's personnel or engineer to obtain an understanding of the working of machinery or equipment while it is being erected.

(b) Assistance in connection with operation and maintenance of the facility after its transfer

61. The degree of assistance from the private partner needed by the contracting authority will depend on the technology and skilled personnel available to the contracting authority. If the contracting authority lacks personnel sufficiently skilled for the technical operation of the facility, it may wish to obtain the private partner's assistance in operating the facility, at least for an initial period. The contracting authority may, in some cases, wish the private partner to provide the personnel to occupy many of the technical posts in the facility, while in other cases the contracting authority may wish the private partner only to provide technical experts to collaborate in an advisory capacity with the contracting authority's personnel in the performance of a few highly specialized operations.

62. In order to assist the contracting authority in operating and maintaining the facility, the PPP contract may require the private partner to submit, prior to the transfer of the facility, an operation and maintenance programme designed to keep the facility operating over its remaining lifetime at the level of efficiency required

under the PPP contract. An operation and maintenance programme would include matters such as an organizational chart showing the key personnel required for the technical operation of the facility and the functions to be discharged by each person; periodic inspection of the facility; lubrication, cleaning and adjustment; and replacement of defective or worn out parts. Maintenance may also include operations of an organizational character, such as establishing a maintenance schedule or maintenance records. The private partner may also be required by the contracting authority to supply operation and maintenance manuals setting out appropriate operation and maintenance procedures. Those manuals should be in a format and language readily understood by the contracting authority's personnel.

63. An effective means of training the contracting authority's personnel in operation and maintenance procedures may be to provide in the PPP contract that the personnel of the contracting authority are to be associated with the personnel of the private partner in carrying out the operation and maintenance for a certain period of time prior to or beyond the transfer of the facility. The positions to be occupied by the personnel employed by the contracting authority can then be identified and their qualifications and experience specified. In order to avoid friction and inefficiency, it is desirable that any authority to be exercised by the personnel of each party over the personnel of the other during the relevant period be clearly described.

(c) Supplies of spare parts

64. In projects that provide for the transfer of the facility to the contracting authority, the contracting authority will have to obtain spare parts to replace those which are worn out or damaged and to maintain, repair and operate the facility. Spare parts may not be available locally and the contracting authority may have to depend on the private partner to supply them. The planning of the parties with respect to the supply of spare parts and services after the transfer of the facility would be greatly facilitated if the parties were to anticipate and provide in the PPP contract or in a subsequent agreement for the needs of the contracting authority in that regard. However, given the long duration of most PPPs, it may be difficult for the parties to anticipate and provide in the PPP contract for the needs of the contracting authority after the transfer of the facility.

65. A possible approach may be for the parties to enter into a separate contract regulating these matters.[5] Such a contract may be entered into closer in time to the transfer of the facility, when the contracting authority may have a clearer view of

[5] The Economic Commission for Europe has prepared a *Guide on Drawing Up International Contracts for Services Relating to Maintenance, Repair and Operation of Industrial and Other Works* (ECE/TRADE/154), mutatis mutandis, which may assist parties in drafting a separate contract or contracts dealing with maintenance and repair of the facility after its transfer to the contracting authority.

its requirements. If spare parts are manufactured not by the private partner but by suppliers, the contracting authority may prefer to enter into contracts with those suppliers rather than to obtain them from the private partner or, alternatively, the contracting authority may wish to have the private partner procure them as the contracting authority's agent.

66. It is desirable for the contracting authority's personnel to develop the technical capacity to install the spare parts. For this purpose, the PPP contract may oblige the private partner to supply the necessary instruction manuals, tools and equipment. The instruction manuals should be in a format and language readily understood by the contracting authority's personnel. The contract may also require the private partner to furnish "as built" drawings indicating how the various pieces of equipment interconnect and how access can be obtained to them to enable the spare parts to be installed and to enable maintenance and repairs to be carried out. In certain cases, it may be appropriate to require the private partner to train the contracting authority's personnel in the installation of spare parts.

(d) Repairs

67. It is in the contracting authority's interest to enter into contractual arrangements that will ensure expeditious repair of the facility in the event of a breakdown. In many cases, the private partner may be better qualified than a third person to effect repairs. In addition, if the PPP contract prevents the contracting authority from disclosing to third persons the technology supplied by the private partner, this may limit the selection of third persons to effect repairs to those who provide assurances regarding non disclosure of the private partner's technology that are acceptable to the private partner. On the other hand, if major items of equipment have been manufactured for the private partner by suppliers, the contracting authority may find it preferable to enter into independent contracts for repair with them. In defining the nature and duration of repair obligations imposed on the private partner, if any, it is advisable to do so clearly and to distinguish them from obligations assumed by the private partner under quality guarantees to remedy defects in the facility.

(e) Decommissioning

68. The preceding paragraphs have discussed various winding-up and transitional measures necessary to ensure the orderly transfer of the assets or facilities to the contracting authority (or a successor private partner, as the case may be). A different type of winding-up measures is needed for the decommissioning of an infrastructure or facility that has become obsolete or that is not capable of operating within the environmental or sustainable development goals of the host country. In this context, "decommissioning" means taking the infrastructure permanently out of operation. Decommissioning may entail the dismantlement and removal of the

infrastructure from the area where the PPP project was located, and the entire process should not cause personal injury or property damage or represent an environmental hazard. Careful planning is required, and the PPP contract should set forth the procedures and methods for decommissioning the infrastructure. For instance, the parties may need to conduct independent studies to assess the potential obsolescence or the environmental or safety risks posed by the infrastructure. It is further advisable to address decommissioning costs and procedure in the environmental impact studies conducted during the preparation of the project (see chap. II, "Project planning and preparation", paras. 19–20).

69. Decommissioning an infrastructure frequently entails high costs. The PPP contract should therefore set forth the parties' respective obligations concerning the various steps to be taken for proper decommissioning, including as regards the cost of those measures and any potential liability (and corresponding insurance or other risk mitigation arrangements) arising out of environmental hazard or other damage to the site, adjacent property or any form of personal injury. In addition to the PPP contract provisions, it should be noted that general legislation on environment or waste management could supplement the provisions of the PPP contract, in particular in case of unplanned decommissioning of the infrastructure or even override them, in the not uncommon event that environmental regulations evolve to more stringent standards after the award of the PPP contract.

VI. Settlement of disputes

A. General remarks

1. An important factor for the implementation of PPPs is the legal framework in the host country for the settlement of disputes. Investors, contractors and lenders will be encouraged to participate in projects when they have the confidence that any disputes arising out of contracts forming part of the project will be resolved fairly and efficiently. By the same token, efficient procedures for avoiding disputes or settling them expeditiously will facilitate the exercise of the contracting authority's monitoring functions and reduce the contracting authority's overall administrative cost. In order to create an enabling climate for investment, the legal framework of the host country should give effect to certain basic principles, such as the following: domestic and foreign firms should be guaranteed access to the courts under substantially the same conditions; parties to private contracts should have the right to choose the law applicable to their contracts; foreign judgments and arbitral awards should be enforceable; and the law should enable the parties to choose the judicial or non-judicial dispute prevention and settlement mechanisms that they consider most appropriate and efficient.

2. PPPs typically require the establishment of a network of interrelated contracts and other legal relationships involving various parties. Legislative provisions dealing with the settlement of disputes arising in the context of these projects must take account of the diversity of relations, which may call for different dispute settlement methods depending on the phase of the project, type of dispute and the parties involved. Disputes may arise as early as during the contract award process, for instances in the form of bid protests or challenges of the contracting authority's decisions during the process, especially the ultimate choice of the private partner. Typically, these disputes will be handled in accordance with the procedures generally available for review and dispute settlement under the country's public procurement laws (see chap. III, "Contract award", paras. 142 and 143). This chapter focuses on the main disputes that may arise during the implementation phase and after completion of the project. Those disputes may be divided into three broad categories:

(a) Disputes arising under agreements between the private partner and the contracting authority and other governmental agencies. In most civil law countries, the PPP contract is governed by administrative law (see chap. VII, "Other relevant areas of law", paras. 25–28), while in other countries it is in principle governed by general contract law as supplemented by special provisions developed for government contracts for the provision of public services. This regime may have implications for the dispute settlement mechanism that the parties to the PPP contract may be able to agree upon. Similar considerations may also apply to certain contracts entered into between the private partner and governmental agencies or government owned companies supplying goods or services to the project or purchasing goods or services generated by the infrastructure facility;

(b) Disputes arising under contracts and agreements entered into by the project promoters or the private partner with related parties for the implementation of the project. These contracts usually include at least the following: *(i)* contracts between parties holding equity in the project company (for example, shareholders' agreements, agreements regarding the provision of additional financing or arrangements regarding voting rights); *(ii)* loan and related agreements, which involve, apart from the project company, parties such as commercial banks, governmental lending institutions, international lending institutions and export credit insurers; *(iii)* contracts between the project company and contractors, which themselves may be consortia of contractors, equipment suppliers and providers of services; *(iv)* contracts between the project company and the parties who operate and maintain the project facility; and *(v)* contracts between the private partner and private companies for the supply of goods and services needed for the operation and maintenance of the facility;

(c) Disputes between the private partner and other parties. These other parties include the users or customers of the facility, who may be, for example, a government owned utility company that purchases electricity or water from the project company so as to resell it to the ultimate users; commercial companies, such as airlines or shipping lines contracting for the use of the airport or port; or individual persons paying for the use of a toll road. The parties to these disputes may not necessarily be bound by any prior legal relationship of a contractual or similar nature. Disputes may also arise between the private partner and third parties, such as people living in adjacent areas, indigenous groups affected by the project or civil society representatives. Such disputes are typically resolved in the domestic judicial system. It is advisable for the law to provide consultations mechanisms whereby those parties views can be considered already at the planning stages. States may also consider a mechanism for settling disputes that may arise between them and the private partner (see chap. VII, "Other relevant areas of law", paras. 50 and 51; see also chap. II, "Project planning and preparation", para. 18).

B. Disputes between the contracting authority and the private partner

3. PPP contracts, in particular those relating to infrastructure projects, are to be performed over a long period of time, with a number of enterprises participating in the construction and in the operational phases. These projects usually involve governmental agencies and attract a high level of public interest. These circumstances emphasize the need to have mechanisms in place that avoid as much as possible the escalation of disagreements between the parties and preserve their business relationship; that prevent the disruption of the construction works or the provision of the services; and that are tailored to the particular characteristics of the disputes that may arise.

4. Some of the main considerations particular to the various phases of implementation of PPPs are discussed in this section. The settlement of the private partner's grievances in connection with decisions by regulatory agencies has been considered in the context of the authority to regulate infrastructure services (see chap. I, "General legal and institutional framework", paras. 56 and 57). The settlement of disputes arising during the process of selecting a private partner (that is, pre contractual disputes) has also been dealt with earlier in the *Guide* (see chap. III, "Contract award", paras. 142 and 143).

1. General considerations on methods for prevention and settlement of disputes

5. The issues that most frequently give rise to disputes during the life of the PPP contract are those related to possible breaches of the agreement during the construction phase, the operation of the infrastructure facility or in connection with the expiry or termination of the PPP contract. These disputes may be very complex and they often involve highly technical matters that need to be resolved speedily in order not to disrupt the construction or the operation of the infrastructure facility. For these reasons, it is advisable for the parties to devise mechanisms that allow the choice of competent experts to assist in the settlement of disputes.

6. With a view to achieving the objectives mentioned above, PPP contracts often provide for composite dispute settlement clauses designed to prevent, to the extent possible, disputes from arising, to foster reaching agreed solutions and to put in place efficient dispute settlement methods when disputes nevertheless arise. Such clauses typically provide for a sequential series of steps starting with an early warning of issues that may develop into a dispute unless the parties take action to prevent them. When a dispute does occur, the PPP contract may typically require

the parties to exchange information and discuss the dispute with a view to identifying a solution. If they are unable to resolve the dispute themselves, then either party may require participation of an independent and impartial third party to assist them to find an acceptable solution. In most cases, adversarial dispute settlement mechanisms are only used when the disputes cannot be settled by such conciliatory methods.

7. However, there may be limits to the parties' freedom to agree to certain dispute prevention or dispute settlement methods: one such limit may arise from the subject matter of the dispute; another limit may in some legal systems arise from the governmental character of the contracting authority. Some legal systems have traditionally limited the ability of the Government and its agencies to agree on certain dispute settlement methods, in particular, arbitration, depending on the subject matter of the contract. In some countries, this limitation does not apply to public enterprises of industrial or commercial character, which, in their relations with third parties, act pursuant to private law or commercial law.

8. Limitations to the freedom to agree on dispute settlement methods, including arbitration, may also relate to the legal nature of the PPP contract. Under some civil law systems where PPP contracts are regarded as administrative contracts, disputes arising thereunder may need to be settled through the judiciary or through administrative courts of the host country. Under other legal systems, similar prohibitions may be expressly included in legislation or judicial precedents directly applicable to PPP contracts, or may be the result of established contract practices, usually based on legislative rules or regulations.

9. Contracting authorities should carefully consider the respective advantages and possible disadvantages of the various dispute settlement methods discussed in the *Guide*. For countries that wish to make use of alternative dispute resolution methods, including the various methods discussed in the *Guide*, as a substitute of or a supplement to, adjudication by domestic courts, for the settlement of disputes arising in connection with PPPs, it is important to remove possible legal obstacles and to provide a clear authorization for domestic contracting authorities to agree on the dispute settlement methods they consider most appropriate and efficient. The absence of such legislative authority may give rise to questions as to the validity of the dispute settlement clause and cause delay in the settlement of disputes. If, for example, an arbitral tribunal finds that the arbitration agreement has been validly concluded despite any subsequent defence that the contracting authority had no authorization to conclude it, the question may reappear at the recognition and enforcement stage before a court in the host country or before a court of a third country where the award is to be recognized or enforced.

2. Commonly used methods for preventing and settling disputes

10. The following paragraphs set out the essential features of methods used for preventing and settling disputes and consider their suitability for the various phases of large infrastructure projects, namely, the construction phase, the operational phase and the post termination phase. Although the PPP contract usually provides for composite dispute prevention and dispute settlement mechanisms, care should be taken to avoid excessively complex procedures or to impose too many layers of different procedures. The brief presentation of selected methods for dispute prevention and dispute settlement methods contained in the following paragraphs is intended to inform legislators about the particular features and usefulness of these various methods. It should not be understood as a recommendation for the use of any particular combination of methods.

(a) Early warning

11. Early warning provisions may be an important tool to avoid disputes. Under these provisions, if one of the parties to a contract feels that events that have occurred, or claims that the party intends to make, have the potential to cause disputes, these events or claims should be brought to the attention of the other party as soon as possible. Delays in making these claims are not only a source of conflict, because they are likely to surprise the other party and therefore create resentment and hostility, but they also render the claims more difficult to prove. For that reason, early warning provisions typically require the claiming party to submit a quantified claim, along with the necessary proof, within an established time. To make the provision effective, a sanction is frequently included for non compliance with the provision, such as the loss of the right to pursue the claim or an increased burden of proof. In infrastructure projects, early warning frequently refers to events that might adversely affect the quality of the works or the public services, increase their cost, cause delays or endanger the continuity of the service. Early warning provisions are therefore useful throughout the duration of an infrastructure project.

(b) Mediation and conciliation

12. The term "mediation" is used in the *Guide* as a broad notion referring to proceedings in which a person or a panel assists the parties in an independent and impartial manner in their attempt to reach an amicable settlement of their dispute. Mediation differs from negotiations between the parties in dispute (in which the parties would typically engage after the dispute has arisen) in that mediation involves independent and impartial assistance to settle the dispute, whereas in settlement negotiations between the parties no third person assistance is involved. The difference between mediation and arbitration is that mediation ends either in the settlement of the dispute agreed by the parties or it ends unsuccessfully; in

arbitration, however, the arbitral tribunal imposes a binding decision on the parties, unless they have settled the dispute before the arbitration award is made. In practice, such mediation proceedings are referred to by various expressions, including "conciliation". Practitioners sometime draw distinctions between these expressions in terms of the methods used by the third person or the degree to which the third person is involved in the process. However, the terms "mediation" and "conciliation" are used as synonyms more frequently than not.

13. Mediation is being practiced increasingly in various parts of the world, including in regions where it was not commonly used in the past. This trend is reflected, inter alia, in the enactment of legislation on mediation in a growing number of States, often based on the UNCITRAL Model Law on International Commercial Conciliation (2002)[1] (which has been succeeded by the UNCITRAL Model Law on International Commercial Mediation and International Settlement Agreements Resulting from Mediation (2018)),[2] and the establishment of several private and public bodies offering mediation services to interested parties. The enforcement of settlement agreements resulting from mediation currently depends on domestic procedural and substantive laws, which still vary considerably on both the effects of a settlement agreement and the enforcement process. The United Nations Convention on International Settlement Agreements Resulting from Mediation[3] addresses this issue by providing an effective, uniform regime for the cross-border recognition and enforcement of settlement agreement modelled on the extremely successful Convention on Recognition and Enforcement of Foreign Arbitral Awards of 1958.[4]

14. The mediation procedure is usually informal and easily pursued, which generally makes it quick and inexpensive. The procedure is also typically private and confidential, although some jurisdictions promote transparency in mediation involving public bodies, for instance by publicizing settlement agreements. The mediator may assume multiple roles and is in general more active than a facilitator. He or she may frequently challenge the parties' position to stress weaknesses that usually facilitate agreement and, if authorized, may suggest possible settlement scenarios. The procedure is generally non binding and the mediator's responsibility is to facilitate settlement by directing the parties' attention to the issues and possible

[1] The text of the UNCITRAL Model Law on International Commercial Conciliation is reproduced in the *Official Records of the General Assembly, Fifty-seventh Session, Supplement No. 17* (A/57/17), annex I.

[2] The official text of the Model Law on International Commercial Mediation and International Settlement Agreements Resulting from Mediation, 2018, is reproduced in the *Official Records of the General Assembly, Seventy-third Session, Supplement No. 17* (A/73/17), annex II.

[3] For the official text of the "Singapore Convention on Mediation", as it is known, see General Assembly resolution 73/198 of 20 December 2018.

[4] For the official text of the "New York Convention", as it is known, see United Nations *Treaty Series*, vol. 330, No. 4739, reproduced in the *Register of Conventions and Other Instruments Concerning International Trade Law*, vol. II (United Nations publication, Sales No. E.73.V.3).

solutions, rather than passing judgment. This procedure is particularly useful when there are many parties involved and it would therefore be difficult to achieve an agreement by direct negotiations. In view of the possible financial and practical implications of a settlement agreement, and for the purpose of transparency and accountability, it may be advisable to subject the implementation of the settlement agreement by the contracting authority to prior approval of a higher body.

15. If the parties provide for mediation in the PPP contract, they will have to settle various procedural questions to increase the chance of a settlement. Settling such procedural questions is greatly facilitated by the incorporation into the contract, by reference, of a set of rules such as the UNCITRAL Conciliation Rules.[5] Other sets of mediation rules have been prepared by various international and national organizations.

(c) Review of technical disputes by independent experts

16. During the construction phase, the parties may wish to consider providing for certain types of dispute to be referred to an independent expert appointed by both parties. This method may be particularly useful in connection with disagreements relating to technical aspects of the construction of the infrastructure facility (for example, whether the works comply with contractual specifications or technical standards).

17. The parties may, for instance, appoint a design inspector or a supervisor engineer, respectively, to review disagreements relating to the inspection and approval of the design, and the progress of construction works (see chap. IV, "PPP Implementation: legal framework and PPP contract", paras. 77–87). The independent experts should have expertise in the designing and construction of similar projects. The powers of the independent expert (such as whether the independent expert makes recommendations or issues binding decisions), as well as the circumstances under which the independent expert's advice or decision may be sought by the parties, should be set forth in the PPP contract. In some large infrastructure projects, for instance, the advice of the independent expert may be sought by the private partner whenever there is a disagreement between the private partner and the contracting authority as to whether certain aspects of the design or construction works conform

[5] For the official text of the UNCITRAL Conciliation Rules, see *Official Records of the General Assembly, Thirty fifth Session, Supplement No. 17* (A/35/17), para. 106 (*Yearbook of the United Nations Commission on International Trade Law*, vol. XI, 1980, part one, chap. II, sect. A (United Nations publication, Sales No. E.81.V.8)). The UNCITRAL Conciliation Rules have also been reproduced in booklet form (United Nations publication, Sales No. E.81.V.6). Accompanying the Rules is a model conciliation clause, which reads: "Where, in the event of a dispute arising out of or relating to this contract, the parties wish to seek an amicable settlement of that dispute by conciliation, the conciliation shall take place in accordance with the UNCITRAL Conciliation Rules as at present in force". The use of the UNCITRAL Conciliation Rules was recommended by the General Assembly in its resolution 35/52 of 4 December 1980.

with the applicable specifications or contractual obligations. Referral of a matter to a design inspector or to a supervising engineer, as appropriate, may be particularly relevant in connection with provisions in the PPP contract that require prior consent of the contracting authority for certain actions by the private partner, such as final authorization for operation of the infrastructure facility (see chap. IV, "PPP Implementation: Legal Framework and PPP contract", para. 86).

18. Independent experts have often been used for the settlement of technical disputes under construction contracts, and the various mechanisms and procedures developed in the practice of the construction industry may be used, mutatis mutandis, in connection with PPPs. However, it should be noted that the scope of disputes between the contracting authority and the private partner is not necessarily the same as would be the case for disputes that typically arise under a construction contract. This is so because the respective positions of the contracting authority and the private partner under the PPP contract are not fully comparable with those of the owner and the performer of works under a construction contract. For instance, disputes concerning the amount of payment due to the contractor for the quantities of works actually performed, which are frequent in construction contracts, are not typical for the relations between contracting authority and private partner, since the latter does not usually receive payments from the contracting authority for the construction works performed.

(d) Dispute review boards

19. PPP contracts for large infrastructure projects often establish boards composed of experts appointed by both parties, possibly with the assistance of an appointing authority, to help settle disputes that may arise during the construction and the operational phases (referred to in the *Guide* as "dispute review boards"). These board may be permanent, or ad hoc, depending on the anticipated volume of disputes and the parties' assessment of the cost and efficiency of either alternative. Proceedings before a dispute review board can be informal and expeditious, and tailored to suit the characteristics of the dispute that it is called upon to settle. The appointment of a dispute review board may prevent misunderstandings or differences between the parties from developing into formal disputes that would require settlement in arbitral or judicial proceedings. In fact, its effectiveness as a tool for avoiding disputes is one of the special strengths of this procedure, but a dispute review board may also serve as a mechanism to resolve disputes, in particular when the board is given the power to render binding decisions.

20. Under the dispute review board procedure, the parties typically select, at the outset of the project, three experts renowned for their knowledge in the field of the project to constitute the board. The experts may be replaced if the project comprises different stages that may require different expertise (that is, different expertise will

be required during the construction of the facility and during the later administration of the public service), however, there may be a loss of institutional knowledge if the experts are replaced frequently. In some large infrastructure projects more than one board has been established. For example, one dispute review board may deal exclusively with disputes regarding matters of a technical nature (for example, engineering design, fitness of certain technology, compliance with environmental standards) whereas another board may deal with disputes of a contractual or financial nature (regarding, for instance, the amount of compensation due for delay in issuing licences or disagreements on the application of price adjustment formulas). Each board member should be experienced in the particular type of project, including experience in the interpretation and administration of PPP contracts, and should undertake to remain impartial and independent of the parties. These persons may be furnished with periodic reports on the progress of construction or on the operation of the infrastructure facility, as appropriate, and may be informed immediately of differences arising between the parties. They may meet with the parties, either at regular intervals or when the need arises, to consider differences that have arisen and to suggest possible ways of resolving those differences.

21. In their capacity as agents to avert disputes, the members of the board may make periodic visits to the project site, meet with the parties and keep informed of the progress of the work. These meetings may help identify any potential conflicts early, before they escalate and turn into full fledged disputes. When potential conflicts are detected, the board proposes solutions, which, given the expertise and prestige of its members, are likely to be accepted by the parties. Referral of a dispute triggers an evaluation by the board, which is done in an informal manner, typically by discussion with the parties during a regular site visit. The board controls the discussion, but each party is given a full opportunity to state its views, and the dispute review board is free to ask questions and to request documents and other evidence. The advantages of conducting hearings at the job site, soon after the events have occurred and before adversarial positions have hardened, are obvious. The board then meets privately and seeks to formulate a recommendation or a decision. If the parties do not accept these proposals and disputes do arise, the board, if authorized to do so by the parties, is in a unique position to solve them expeditiously because of its familiarity with the problems and contractual documents.

22. Given their usually long duration, many circumstances relevant to the execution of PPPs may change before the end of the concession term. While the impact of some changes may be automatically covered in the PPP contract (see chap. IV, "PPP Implementation: Legal Framework and PPP contract", paras. 135–144) there are changes that might not lend themselves easily to inclusion in an automatic adjustment mechanism or that the parties may prefer to exclude from such a mechanism. It is therefore important for the parties to establish mechanisms for dealing with disputes that may arise in connection with changing circumstances. This is of

particular significance for the operational phase of the project. Where the parties have agreed on rules that allow a revision of the terms of the PPP contract following certain circumstances, the question may arise as to whether those circumstances have occurred and, if so, how the contractual terms should be changed or supplemented. With a view to facilitating a resolution of possible disputes and avoiding a stalemate in case the parties are unable to agree on a contract revision, it is advisable for the parties to clarify whether and to what extent certain contractual terms may be changed or supplemented by the dispute review board. It may be noted, in this context, that the parties might not always be able to rely on an arbitral tribunal or a domestic court for that purpose. Indeed, under some legal systems, courts and arbitrators are not competent to change or supplement contractual terms. Under other legal systems, courts and arbitrators may do so only if they are expressly so authorized by the parties. Under yet other legal systems, arbitrators may do so but courts may not.

23. The law governing arbitral or judicial proceedings may determine the extent to which the parties may authorize arbitrators or a court to review a decision of the dispute review board. Excluding such review has the advantage that the decision of the dispute review board would be immediately final and binding. However, permitting such a review gives the parties greater assurance that the decision will be correct. Early clauses on dispute review boards did not provide that their recommendations would become binding if not challenged in arbitral or judicial proceedings. In practice, however, the combination of the persuasive force of unanimous recommendations by independent experts agreed by the parties has led both contracting authorities and project companies to accept the recommendations voluntarily rather than litigate or arbitrate. Recent contract provisions on dispute review boards usually provide that a decision of the board, while not immediately binding on the parties, becomes binding unless one or both parties refer the dispute to arbitration or initiate judicial proceedings within a specified period of time. Apart from avoiding potentially protracted litigation or arbitration, the parties often take into account the potential difficulty of overcoming what might be regarded by the court or arbitral tribunal as a powerful recommendation, inasmuch as it had been made by independent experts familiar with the project from the outset and was based on contemporaneous observation of the project prior to, and at the time of, the dispute having first arisen.

24. Although this occurs very rarely, the parties may agree to make the board's decision final and binding. It should be noted, however, that despite the parties' agreement to be bound by the board's decision, under many legal systems, the decision by the dispute review board, while binding as a contract, may not be enforceable in a summary proceeding, such as a proceeding for the enforcement of an arbitral award, since it does not have the status of an arbitral award. If the parties contemplate providing for proceedings before a dispute review board, it will be

necessary for them to settle various aspects of those proceedings in the PPP contract. It would be desirable for the PPP contract to delimit as precisely as possible the authority conferred upon the dispute review board. With regard to the nature of their functions, the PPP contract might authorize the dispute review board to make findings of fact and to order interim measures. It may specify the functions to be performed by the dispute review board and the type of issues with which they may deal. If the parties are permitted to initiate arbitral or judicial proceedings within a specified period of time after the decision is rendered, the parties might specify that findings of fact made by a dispute review board are to be regarded as conclusive in arbitral or judicial proceedings. The PPP contract might also obligate the parties to implement a decision by the dispute review board concerning interim measures or a decision on the substance of specified issues; if the parties fail to do so, they will be considered as having failed to perform a contractual obligation. Regarding the duration of the board's functions, the PPP contract may provide that the board will continue to function for a certain period beyond the expiry or termination of the PPP contract, in order to deal with disputes that may arise at that stage (for example, disputes as to the condition of and compensation due for assets handed over to the contracting authority).

(e) Dispute adjudication boards

25. In large infrastructure projects, PPP contracts may provide for a specific dispute settlement mechanism to resolve claims between parties. One such mechanism is the dispute adjudication board, in which parties resolve disputed claims using an agreed procedure whereby an adjudicator (sometimes called a member of the dispute adjudication board) or a panel of three adjudicators decides on the claim. Parties seeking to resolve disputes through a dispute resolution board will normally enter into a dispute adjudication agreement; typically, such dispute adjudication agreement is made between both parties in the original PPP contract and the sole adjudicator or the panel of three adjudicators. Generally, the dispute adjudication agreement will also describe the procedure of the adjudication, including obligations of parties in the dispute adjudication agreement, payment terms of the adjudicator(s), and disputes on the decision made by the adjudicator. Disputes arising under PPP contract may sometimes involve sensitive questions of public policy and some third parties may have a legitimate interest in the outcome of an adjudication. It is therefore advisable for the contracting authority and the private partner to bear that in mind and develop procedures, as appropriate, to allow such third parties to submit their views or have access to the proceedings.[6]

[6] Such procedures could be modelled, mutatis mutandis, on the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (for the official text of the "Rules on Transparency", see *Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17* (A/68/17), annex I. The Transparency Rules have also been reproduced in booklet form. The use of the Transparency Rules was recommended by the General Assembly in its resolution 68/109 of 16 December 2013.

The adjudication agreement can take effect on an agreed commencement date, or when the parties and the adjudicator (or adjudicators if a panel) each have signed the agreement, whichever date is the latest.

26. As is the case with dispute review boards, dispute adjudication boards can be permanent or, in the interest of containing cost, be appointed on an ad hoc basis, as the need arises. The parties select the adjudicator or panel of three adjudicators. In the case of a panel, each party will nominate one adjudicator for the approval of the other party, and after consulting these two adjudicators, the parties will agree upon the third adjudicator who will act as the chairperson of the dispute adjudication board. When selecting the adjudicator, the parties rely on several factors. These normally include the adjudicator's representations on the adjudicator's experience in the work in which the contractor is to carry out under the contract, the adjudicator's experience in the interpretation of contract documentation, and the adjudicator's fluency of the language for communications stated in the PPP contract. The appointment of the adjudicator is personal and the adjudicator usually has to warrant and agree to be impartial and independent, and is obliged to disclose any fact or circumstance which might appear inconsistent with his/her impartiality and independence to the parties.

27. Parties to the dispute adjudication agreement can challenge the appointment of the adjudicator for lack of independence notwithstanding any disclosure made or not made by the adjudicator. The party challenging the appointment may refer the alleged lack of independence to an appointed institution provided for in the PPP contract, or if considered necessary or prudent, refer the matter to an independent professional person or body to review and assess the challenge. If the person or body is of the opinion that the adjudicator is no longer independent pursuant to the dispute adjudication agreement, the said adjudicator should be removed and the appointed institution should without delay appoint a new adjudicator. Costs for such a challenge are usually shared between the parties.

28. An adjudicator is furthermore subject to several general obligations. Typical obligations include the adjudicator having no interest financial or otherwise in the project, not previously having been employed as a consultant or otherwise by either party, having disclosed any previous involvement professionally or personally with the project or employer, among other obligations that may be agreed between parties and provided for in the dispute adjudication agreement. In some cases, parties can also agree to waive certain obligations, for example, not previously employed as a consultant or otherwise by either party, if such information was disclosed in writing to the other party.

29. Similarly, parties are themselves subject to general obligations under the dispute adjudication agreement as well. These obligations can include terms

stating that either party will not request advice from or consultation with the adjudicator regarding the PPP contract, otherwise than in the normal course of the dispute adjudication board's activities under the PPP contract and the dispute adjudication agreement, or when both parties jointly agree to refer a matter to the dispute adjudication board pursuant to the PPP contract. Furthermore, parties usually undertake to each other that the adjudicator will not be appointed as an arbitrator in any arbitration under the PPP contract, be called as a witness to give evidence for any arbitration under the PPP contract, nor be liable for any claims or anything done or omitted in the discharge or purported discharge of the adjudicator's functions, unless the act or omission is shown to be in bad faith. Parties also normally hold the adjudicator harmless against and from claims where the adjudicator is relieved from liability, and usually agree to jointly and severally indemnify the adjudicator. If the adjudicator is required to make a site visit and attend a hearing, the referring party will also be required to provide appropriate security for a sum equivalent to the reasonable expenses to be incurred by the adjudicator.

30. Remuneration of the adjudicator can be set out in the dispute adjudication agreement too. Normally, the dispute adjudication agreement will state the currency for the adjudicator's remuneration, the retainer fee, the daily fee, payment for reasonable expenses including necessary travel, and any applicable taxes. The retainer fees and daily fees are provided in detail and parties can agree to have these fees fixed for a specific period. Parties are also required to make payment promptly and adjudicators are expected to submit invoices with sufficient description of activities performed. The dispute adjudication agreement also allows parties to arrange how payment of the adjudicator should be made. If parties cannot agree on the sum of the adjudicator, the appointing entity or official named in the project will decide, and if the adjudicator is not paid within a specific time after submitting a valid invoice, the adjudicator may elect to suspend his/her services without notice or resign his/her appointment by giving a valid notice.

31. The adjudicators of the dispute adjudication board are also required to follow specific procedural rules set out in the dispute adjudication agreement. These procedural rules state what the dispute adjudication board is required to do at site visits such as timing, agenda and regularity; it is further required to become and remain acquainted with the progress of the project and of any actual potential problems or claims. Furthermore, these rules also detail what the parties are expected to do during a hearing or claim, including furnishing to the dispute adjudication board one copy of all documents that the dispute adjudication board may request, copying the other party in all communications between the dispute adjudication board, and if the board comprises three persons, to send copies of requested documents to all three persons.

32. The procedural rules also state how the hearing on disputes will be conducted and how ambiguity and errors of fact or principle arising from the dispute adjudication board should be treated. For instance, if there are errors of fact or principle and if the adjudicators of the dispute adjudication board agree that the decision contained errors of fact or principle within a stipulated period, the dispute adjudication board must advise the parties of the error and issue an addendum to its decision in writing. In the case of an ambiguity, a similar procedure applies. If either party believes that the decision contains an ambiguity, that party may seek clarification from the dispute adjudication board, and within a stipulated period of receiving such a request, the dispute adjudication board should respond with a copy to the other party. If the dispute adjudication board believes that the decision did contain an error or ambiguity, it may correct its decision by issuing an addendum to its original decision.

33. The powers of the dispute adjudication board are provided in the procedural rules. Normally, the dispute adjudication board is allowed to adopt an inquisitorial procedure, refuse admission to hearings or audience at hearings to any persons other than representatives of either party, and to proceed in the absence of any party who the dispute adjudication board is satisfied received notice of the hearing. However, it should be noted that such powers could be limited depending on the agreement made between the parties. Other powers of the dispute adjudication board include but are not limited to establishing the procedure to be applied in deciding a dispute, deciding on the dispute adjudication board's jurisdiction and scope of any dispute referred to it, among other powers as may be agreed between parties.

34. During any hearing concerning the merits of any arguments advanced by the parties, the dispute adjudication board should not express any opinions. The dispute adjudication board should also convene in private after a hearing in order to have discussions and prepare its decision and should endeavour to reach a unanimous decision. If this is not possible, a decision should be made by a majority of the adjudicators who may require the minority adjudicator to prepare a written report which is usually appended to the board's decision. Lastly, in a panel of three adjudicators, an absent adjudicator may not prevent the other two adjudicators from making a decision unless the parties do not agree to this arrangement, and if the absent adjudicator is the chairman and he/she instructs the other adjudicators to not make a decision.

35. Parties are able to terminate the adjudicator through various mechanisms, such as by providing the notice of termination to the adjudicator in accordance with the dispute adjudication agreement, or if the adjudicator fails to comply with the dispute adjudication agreement. In these termination situations, both parties must agree to the termination for it to be valid. An adjudicator may also terminate his

participation in the dispute adjudication board if either party fails to comply with the dispute adjudication agreement. However, if the adjudicator does not comply with any of the obligations described in the dispute adjudication agreement, the said adjudicator will not be entitled to any fees or expenses and may be required to reimburse parties for any fees and expenses received for proceedings or decisions that are rendered void or ineffective by the adjudicator's failure to comply. In the event of any dispute or claim arising from the breach, termination or invalidity of the dispute adjudication agreement, parties can agree to settle such disputes or claims by institutional arbitration. Arrangements on the appointment of the arbitration institution, the arbitrator, or the rules of arbitration can be agreed beforehand by parties in the dispute resolution agreement.

36. The role of the dispute adjudication board is not limited only to disputes referred to it through the formal dispute adjudication board mechanism. A dispute adjudication board can also assist to resolve issues jointly referred by the parties. The parties can request the dispute adjudication board to assist and/or informally discuss and attempt to resolve any disagreement that may have arisen between the parties during the performance of the PPP contract. Informal assistance can take place during meetings, site visits, or otherwise, as long as both parties are present at the meeting unless otherwise agreed. However, parties are not bound to act upon any advice given during such informal meetings, and the dispute adjudication board is not bound to any future dispute resolution process and decision by any views given during the informal assistance process.

37. PPP contracts that use dispute adjudication boards as the preferred form of dispute resolution will normally state that the decision of a dispute resolution board to be final and binding in nature. In some PPP contracts, there are provisions for the right by either party to lodge a notice of dissatisfaction or similar notice within a given period. Upon the lapse of the given period, this decision by the dispute adjudication board will become final and binding. If such notice of dissatisfaction has been given, then parties are required to attempt to settle the dispute amicably; if they fail to settle the dispute amicably, they can commence arbitration to resolve it. However, the arbitration proceedings can commence on the last day of the given period for a party to lodge a notice of dissatisfaction even if no attempt to settle the dispute amicable was made.

(f) Arbitration

38. Arbitration has been used increasingly for settling disputes arising under PPPs. In some legal systems, the law mandates the use of arbitration for disputes arising from public contracts, including PPPs. Arbitration is typically used both for the settlement of disputes that arise during the construction or operation of the infrastructure facility and for the settlement of disputes related to the expiry or

termination of the PPP contract. Arbitration is preferred, and in many cases required, by private investors and lenders since arbitral proceedings may be structured by the parties so as to be less formal than judicial proceedings and better suited to the needs of the parties and to the specific features of the disputes likely to arise under the PPP contract. The parties can choose as arbitrators persons who have expert knowledge of the particular type of project. They may choose the place where the arbitral proceedings are to be conducted. They can also choose the language or languages to be used in the arbitral proceedings. Arbitral proceedings may be less disruptive of business relations between the parties than judicial proceedings. Furthermore, the enforcement of arbitral awards in countries other than the country in which the award was rendered is facilitated by the wide acceptance of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958. The possibility of keeping the arbitration proceedings confidential – as opposed to judicial proceedings which are by nature generally accessible to the public – was an additional reason commonly invoked in the past to justify the parties' choice arbitration in commercial disputes.

39. With regard, in particular, to infrastructure projects involving foreign investors, it may be noted that a framework for the settlement of disputes between the contracting authority and foreign companies participating in a project consortium may be provided through adherence to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.[7] The Convention, which has thus far been adhered to by 154 States, established the International Centre for the Settlement of Investment Disputes (ICSID). ICSID is an autonomous international organization with close links to the World Bank. ICSID provides facilities for the mediation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries. Recourse to ICSID mediation and arbitration is voluntary. However, once the parties to a contract or dispute have consented to arbitration under the ICSID Convention, neither can withdraw its consent unilaterally. All ICSID members, whether or not parties to the dispute, are required by the Convention to recognize and enforce ICSID arbitral awards. The consent of the parties to ICSID arbitration may be given with regard to an existing dispute or with respect to a defined class of future disputes. The consent of the parties need not, however, be expressed in relation to a specific project; a host country might in its legislation on the promotion of investment offer to submit disputes arising out of certain classes of investment to the jurisdiction of ICSID and the investor might give its consent by accepting the offer in writing. The UNCITRAL Arbitration Rules are often used in investment arbitration as well. In recent years, however, there has been a growing trend towards transparency on investor-State dispute settlement, which is encouraged by the UNCITRAL Rules on Transparency in Treaty-based investor-State Arbitration (the

[7] United Nations *Treaty Series*, vol. 575, No. 8359.

"Rules on Transparency"),[8] adopted in 2013 and the United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (New York, 2014) (the "Mauritius Convention on Transparency").[9]

40. Bilateral investment treaties (BITs) may also provide a framework for the settlement of disputes between the contracting authority and foreign companies concerning the subject matter covered by BIT. In these treaties, the host State typically extends to investors that qualify as nationals of the other signatory State various assurances and guarantees (see chap. VII, "Other relevant areas of law", paras. 4–6) and expresses its consent to arbitration, for instance, by referral to ICSID or to an arbitral tribunal applying the UNCITRAL Arbitration Rules.[10]

(i) Sovereign immunity

41. The legislator may wish to review its laws on sovereign immunity and, to the extent considered advisable, clarify in which areas contracting authorities may or may not plead sovereign immunity. When arbitration is allowed and agreed upon between the parties to the PPP contract, the implementation of an agreement to arbitrate may be frustrated or hindered if the contracting authority is able to plead sovereign immunity, either as a bar to the commencement of arbitral proceedings or as a defence against recognition and enforcement of the award. Sometimes the law on this matter is not clear, which may raise concerns with the interested parties (for instance, the private partner, project promoters and lenders) that an agreement to arbitrate might not be effective. In order to address such possible concerns, it is advisable to review the law on this topic and to indicate the extent to which the contracting authority may raise a plea of sovereign immunity.

42. In addition, a contracting authority against which an award has been issued may raise a plea of immunity from execution against public property. There is a diversity of approaches to the question of sovereign immunity from execution. For example, under some national laws immunity does not cover governmental entities when engaged in commercial activities. In other national laws a link is required

[8] See footnote 6 in this chapter.

[9] Adopted by the General Assembly in its resolution 69/116 of 10 December 2014. Entered into force on 18 October 2017, United Nations No. 54749 (for the status and official text of the Mauritius Convention on Transparency, see www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2014Transparency_Convention.html).

[10] The official text of the UNCITRAL Arbitration Rules, as revised in 2010, is reproduced in *Official Records of the General Assembly, Forty-third Session, Supplement No. 17* (A/43/17), annex I (*Yearbook of the United Nations Commission on International Trade Law*, vol. XLI, 2010, part one, chap. I, sect. A, annex I (United Nations publication, Sales No. E.13.V.8)). The UNCITRAL Arbitration Rules, as revised in 2010, have also been reproduced in booklet form (United Nations, New York, 2011). Accompanying the Rules is a model arbitration clause, which reads: "Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules." The use of the UNCITRAL Arbitration Rules was recommended by the General Assembly in its resolution 65/22 of 6 December 2010.

between the property to be attached and the claim in that, for example, immunity cannot be pleaded in respect of funds allocated for economic or commercial activity governed by private law upon which the claim is based or that immunity cannot be pleaded with respect to assets set aside by the State to pursue its commercial activities. In some countries, it is considered that it is for the Government to prove that the assets to be attached are in non commercial use.

43. In some contracts involving entities that might plea sovereign immunity, clauses have been included to the effect that the Government waives its right to plead sovereign immunity. Such a consent or waiver might be contained in the PPP contract or an international agreement; it may be limited to recognizing that certain property is used or intended to be used for commercial purposes. Such written clauses may be necessary inasmuch as it is not clear whether the conclusion of an arbitration agreement and participation in arbitral proceedings by the governmental entity constitutes an implied waiver of sovereign immunity from execution.

(ii) Effectiveness of the arbitration agreement and enforceability of the award

44. The effectiveness of an agreement to arbitrate depends on the legislative regime of the seat of the arbitral tribunal. If the legislative regime for arbitration in that country is seen as unsatisfactory, for instance, because it is found to pose unreasonable restrictions on party autonomy, a party might wish to agree on a place of arbitration outside the host country. It is therefore important for the host country to ensure that the domestic legislative regime for arbitration resolves the principal procedural issues in a manner appropriate for international arbitration cases. Such a regime is contained in the UNCITRAL Model Law on International Commercial Arbitration ("the Model Arbitration Law").[11] If the arbitration takes place outside the host country or if an award rendered in the host country would need to be enforced abroad, the effectiveness of the arbitration agreement would also depend on legislation governing the recognition and enforcement of arbitral awards. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (see para. 13), inter alia, deals with the recognition of an arbitration agreement and the grounds on which the court may refuse to recognize or enforce an award. The Convention is generally regarded as providing an acceptable and

[11] The official text of the Model Arbitration Law, as originally adopted in 1985, is reproduced in *Official Records of the General Assembly, Fortieth Session, Supplement No. 17* (A/40/17), annex I (*Yearbook of the United Nations Commission on International Trade Law*, vol. XVI, 1985, part three, annex I (United Nations publication, Sales No. E.87.V.4)). The official text of the revised articles of the Model Arbitration Law, as adopted in 2006, is reproduced in *Official Records of the General Assembly, Forty-third Session, Supplement No. 17* (A/43/17), annex I. The consolidated text of the Model Arbitration Law has also been reproduced in booklet form (United Nations publication, Sales No. E.08.V.4). The General Assembly, in its resolution 40/72 of 11 December 1985, recommended that all States give due consideration to the Model Law on International Commercial Arbitration, in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice. The General Assembly reiterated that recommendation in its resolution 61/33 of 4 December 2006.

balanced regime for the recognition and enforcement of arbitral awards. The fact that the host country is a party to the Convention is likely to be seen as a crucial element in assessing the legal certainty of binding commitments and of the reliability of arbitration as a method for solving disputes by arbitration with parties from the country. It would also facilitate the enforcement abroad of an arbitral award rendered in the host country.

(g) Judicial proceedings

45. As indicated earlier, there are legal systems where the settlement of disputes arising out of agreements related to the provision of public services is a matter of the exclusive competence of the domestic judiciary or administrative courts. In some countries, governmental agencies lack the power to agree to arbitration, except under specific circumstances (see paras. 7–9), while in other legal systems the parties have the freedom to choose between judicial and arbitral proceedings.

46. Where it is possible for the parties to choose between judicial and arbitral proceedings, the contracting authority may see reasons for leaving any dispute to be resolved by the courts of the host country. Those courts are familiar with the law of the country, which often includes legislation specifically concerned with the PPP contract. Furthermore, the contracting authority or other governmental agencies involved in the dispute may prefer local courts because of the familiarity with the court procedures and the language of the proceedings. Although not all countries may dispose of judges trained or experienced in the types of technical disputes that arise in PPP projects, some countries have specialized courts that deal with complex commercial or public contracts, and their rules on civil or administrative procedure may enable judges to obtain expert advice where needed. It may also be considered that, to the extent PPP contracts involve issues of public policy and the protection of public interest, State courts are in a better position to give them proper effect.

47. However, such a view by the contracting authority may not be shared by prospective investors, financiers and other private parties. These parties may consider that arbitration is preferable to judicial proceedings because arbitration, being to a larger degree subject to the agreement of the parties than judicial proceedings, allows the parties to tailor the proceedings to their particular needs. Furthermore, in view of the highly technical and complex issues involved in infrastructure projects, the parties may have an interest in having their disputes settled by arbitrators selected for their particular knowledge and experience. Private investors, in particular foreign ones, may also be reluctant to submit to the jurisdiction of domestic courts functioning under rules unfamiliar to them. In some countries it has been found that allowing the parties to choose the dispute settlement mechanism helped to attract foreign investment for the development of its infrastructure.

48. In considering whether any dispute should be resolved in judicial proceedings or whether an arbitration agreement should be entered into, where such choice is permitted under the applicable law, factors typically taken into account by the parties include, for example, their confidence that the courts competent to decide a dispute will be unbiased and that the dispute will be resolved without inordinate delay. The efficiency of the national judicial system and the availability of forms of judicial relief that are adequate to disputes that might arise under the PPP contract are additional factors to be taken into account. The parties will also need to consider which dispute settlement body would be best placed to handle technical questions in the area where the disputes may arise under the PPP contract.

C. Disputes between project promoters and between the private partner and its lenders, contractors and suppliers

49. Domestic laws generally recognize that in commercial transactions, in particular international ones, the parties are free to agree on the forum that will settle in a binding decision any dispute that may arise between them. In international transactions, arbitration has become the preferred method, whether or not it is preceded by, or combined with, mediation. Contracts between the private partner and lenders, contractors and suppliers in connection with infrastructure projects, are generally considered as commercial agreements. Accordingly, the parties to those contracts are usually free to choose their preferred dispute settlement method, which in most cases includes arbitration. Lenders, however, although in most cases favouring arbitration for the settlement of disputes arising out of the PPP contract (and increasingly also for disputes between different lenders), often prefer judicial proceedings for the settlement of disputes between them and the private partner arising out of loan agreements. Where arbitration is the preferred method, the parties will typically wish to be able to select the place of arbitration and to determine whether or not any arbitration case should be administered by an arbitral institution. Host countries wishing to establish a hospitable legal climate for PPPs would be well advised to review their laws with respect to such commercial contracts so as to eliminate any uncertainty regarding the freedom of the parties to agree to dispute settlement mechanisms of their choice.

D. Disputes involving customers or users of the infrastructure facility

50. Depending on the type of project, the private partner may provide goods or services to various different persons and entities, such as, for example, government

owned utility companies that purchase electricity or water from the private partner so as to resell it to the ultimate users; commercial companies, such as airlines or shipping lines contracting for the use of the airport or port; or individuals paying for the use of a toll road. The considerations and policies regarding the settlement of disputes arising out of those legal relationships may vary according to who the parties are, the conditions under which the services are provided and the applicable regulatory regime.

51. In addition to particular requirements set forth in specific legislation, when individuals are the end-users of the service provided by the private partner, special rules on consumer protection may also apply (for consumer protection laws, see also chap. VII, "Other relevant areas of law", paras. 50 and 51). Accordingly, in some countries, public service providers are required by law to establish special simplified and efficient mechanisms for handling claims brought by their customers. Such special regulation is typically limited to certain industrial sectors and applies to purchases of goods or services by customers. Statutory requirements for the establishment of such dispute settlement mechanisms may apply generally to claims brought by any of the private partner's customers or may be limited to customers who are individual persons acting in their non commercial capacity. The private partner's obligation may be limited to the establishment of a mechanism for receiving and dealing with complaints by individual consumers. Such mechanisms may include a special facility or department set up within the project company for receiving and handling claims expeditiously, for instance by making available to the customers standard online claim forms or toll free telephone numbers for voicing grievances. If the matter is not satisfactorily resolved, the customer may have the right to file a complaint with a regulatory agency, if any, which in some countries may have the authority to issue a binding decision on the matter. Such mechanisms are often optional for the consumer and typically do not preclude resort by the aggrieved persons to courts.

52. If the customers are utility companies (such as a power distribution company) or commercial enterprises (for instance, a large factory purchasing power directly from an independent producer) who freely choose the services provided by the private partner and negotiate the terms of their contracts, the parties would typically settle any disputes by methods usual in trade contracts, including arbitration. Accordingly, there may not be a need for addressing the settlement of these disputes in legislation relating to PPPs. However, where the private partner's customers are government owned entities, their ability to agree on dispute settlement methods may be limited by rules of administrative law governing the settlement of disputes involving governmental entities. For countries that wish to allow the use of non judicial methods, including arbitration, for the settlement of disputes between the private partner and its government-owned customers, it is important to remove possible legal obstacles and to provide a clear authorization for those entities to agree on dispute settlement methods (see paras. 7–9).

VII. Other relevant areas of law

A. General remarks

1. The stage of development of the relevant laws of the host country, the stability of its legal system and the adequacy of remedies available to private parties are essential elements of the overall legal framework for PPPs. By reviewing and, as appropriate, improving its laws in those areas of immediate relevance for PPPs, the host country will make an important contribution to securing an enabling climate for private sector investment in public infrastructure and services. Greater legal certainty and a favourable legal framework will translate into a better assessment of country risks by lenders and investors. This will have a positive influence on the cost of mobilizing private capital and reduce the need for governmental support or guarantees (see chap. II, "Project planning and preparation", paras. 56–86).

2. When properly prepared and planned, PPPs can impact positively the economic and social development of a country and play an important role in its infrastructure strategy (for a discussion of general principles guiding a country's PPP strategy, see chap. I, "General legal and institutional framework", paras. 2–20). PPPs may also allow the States to achieve many of the Sustainable Development Goals (see chap. I, "General legal and institutional framework", para. 3). However, the considerable dimension of PPP projects and the significant funding that they require may have a major impact on the economic, social and environmental framework of the host country. Such impact translates into changes in the laws that a country might wish to carefully consider. In that respect, section B points out a few selected aspects of the laws of the host country that, without necessarily dealing directly with PPPs, may have an impact on their implementation (see paras. 3–60). Section C indicates the possible relevance of a few major international agreements for the implementation of PPPs in the host country (see paras. 61–65).

B. Other relevant areas of law

3. In addition to issues pertaining to legislation directed specifically towards PPPs, an enabling legal framework also requires supportive provisions in other areas of legislation. Private investment in infrastructure and services will be encouraged

by the existence of legislation that promotes and protects private investment in economic activities. The following paragraphs pinpoint only a few selected aspects of other fields of law that may have an impact on the implementation of infrastructure projects. The existence of adequate legal provisions in those other fields may facilitate a number of transactions necessary to carry out infrastructure projects and help to reduce the perceived legal risk of investment in the host country.

1. *Promotion and protection of investment*

4. One matter of particular concern for the project promoters and lenders is the degree of protection afforded to investment in the host country. Foreign investors in the host country will require assurances that they will be protected from nationalization or dispossession without legal recourse and appropriate compensation in accordance with the rules in force in the host country and with international law standards. Project promoters will also be concerned about their ability, inter alia, to bring to the country without unreasonable restriction the qualified personnel required to work with the project, to import needed goods and equipment, to gain access to foreign exchange as needed and to transfer abroad or repatriate their profits or sums needed to repay loans that the company has entered into for the purpose of the PPP project. In addition to specific guarantees that may be provided by the Government (see chap. II, "Project planning and preparation", paras. 71–76), legislation on promotion and protection of investment may play an important role in connection with PPPs. For countries that already have adequate investment protection legislation, it may be useful to consider expressly extending the protection provided in such legislation to PPP projects. Countries wishing to develop a consistent and efficient policy aiming at promoting and protecting investments can find useful inspiration in the core principles for investment policymaking contained in the Investment Policy Framework adopted by the United Nations Conference on Trade and Development (UNCTAD).[1]

5. An increasing number of countries have entered into bilateral investment agreements that aim at facilitating and protecting the flow of investment between the contracting parties. Investment protection agreements usually contain provisions concerning the admission and treatment of foreign investment; transfer of capital between the contracting parties (payment of dividends abroad or repatriation of investment, for example); availability of foreign exchange for transfer or repatriation of proceeds of investment; protection from expropriation and nationalization; and settlement of investment disputes outside of the host country

[1] The UNCTAD Investment Policy Framework for Sustainable Development (UNCTAD/WEB/DIAE/PCB/2015/3) and its "Principles for investment policy making" are available on the following address: http://investmentpolicyhub.unctad.org/ipfsd.

(see chap. VI, "Settlement of disputes" paras. 38–40). The existence of such an agreement between the host country and the originating country or countries of the project sponsors may play an important role in their decision to invest in the host country. In addition, depending on its terms, such an agreement may reduce the need for assurances or guarantees by the Government geared to individual infrastructure projects. The guide of UNCTAD on Investment Policy Framework (see para. 4) is also consistent with such an approach: it contains recommendations on how to define and implement a strategy in the highly complex and fragmented web of treaties at the multilateral level.

6. Moreover, in a number of countries rules aimed at facilitating and protecting the flow of investment (which also include areas such as immigration legislation, import control and foreign exchange rules) are contained in legislation that might not necessarily be based on a bilateral or multilateral treaty.

2. Laws related to property

7. It is desirable for the property laws of the host country to reflect acceptable international standards, contain adequate provisions on the ownership and use of land and buildings, as well as movable and intangible property, and ensure the private partner's ability to purchase, sell, transfer and license the use of property, as appropriate. Constitutional provisions upholding property rights have been found to be important factors in attracting and fostering private investment in many countries.

8. Where the private partner owns the land on which the facility is built, it is important that the ownership or the right of use of the land can be clearly and unequivocally established through adequate registration and publicity procedures. The private partner and lenders will need clear proof that ownership or usage rights of the land will not be subject to dispute. They will therefore be reluctant to commit funds to the project if the laws of the host country do not provide adequate means for ascertaining ownership or long-time usage of the land.

9. In some countries, the property rights granted to the private partner, if any, may be restricted by the laws applicable to public property, which is particularly the case if the PPP project is developed on land that is owned by the State or by any public authority. In practice laws relating to public property would typically prevent the private partner from using the land for an extraneous purpose, such as subletting part of the land to third parties to generate additional income. Where such a special regime exists, the PPP contract would provide the private partner with the right to use the land for the duration of the contract, subject to the private partner complying with the legal assignment of the land to its specific public use, as identified in the PPP contract (see chap. IV, "PPP implementation: legal framework and PPP contract", para. 24).

10. It is also necessary to provide effective mechanisms for the enforcement of the property and possessory rights granted to the private partner against violation by third parties. Enforcement should also extend to easements and rights of way that may be needed by the private partner for providing and maintaining the relevant service (such as placing of poles and cables on private property to ensure the distribution of electricity) (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 32–34).

3. *Security interests*

11. As indicated earlier (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 60–69), security arrangements in PPP projects may be complex and consist of a variety of forms of security, including fixed security over physical assets of the private partner (for example, mortgages or charges), pledges of shares of the private partner and assignment of intangible assets (receivables) of the project. While the loan agreements are usually subject to the governing law chosen by the parties, the laws of the host country will in most cases determine the type of security that can be enforced against assets located in the host country and the remedies available.

12. Differences in the type of security or limitations in the remedies available under the laws of the host country may be a cause of concern to potential lenders. It is therefore important to ensure that domestic laws provide adequate legal protection to secured creditors and do not hinder the ability of the parties to establish appropriate security arrangements. Because of the significant differences between legal systems regarding the law of security interests, the *Guide* does not discuss in detail the technicalities of the requisite legislation and the following paragraphs provide only a general outline of the main elements of a modern regime for secured transactions.

13. In some legal systems, security interests can be created in virtually all kinds of assets, including intellectual property, whereas in other systems security interests can only be created in a limited category of assets, such as land and buildings. In some countries, security interests can be created over assets that do not yet exist (future assets) and security may be taken over all of a company's assets, while allowing the company to continue to deal with those assets in the ordinary course of business. Some legal systems provide for a non-possessory security interest, so that security can be taken over assets without taking actual possession of the assets; in other systems, as regards those assets which are not subject to a title registration system, security may only be taken by physical possession or constructive possession. Under some systems, enforcement of the security interest can be undertaken without court involvement, whereas in other systems it may only be enforced through court procedures. Some countries provide

enforcement remedies that not only include sale of the asset, but also enable the secured lender to operate the asset either by taking possession or appointing a receiver; in other countries, judicial sale may be the primary enforcement mechanism. Under some systems, certain types of security will rank ahead of preferential creditors, whereas in others the preferential creditors rank ahead of all types of security. In some countries, creation of a security interest is cost-efficient, with minimal fees and duties payable, whereas in other countries it can be costly. In some countries, the value of the amount of security taken may be unlimited, while in others the value of security cannot be excessive in comparison with the debt owed. Some legal systems impose obligations on the secured lender on enforcement of the security, such as the obligation to take steps ensuring that assets will be sold at fair market value.

14. Basic legal protection may include provisions ensuring that fixed security (such as a mortgage) is a registrable interest and that, once such security is registered in the register of title or other public register, any purchaser of the property to which the security attaches should take the property subject to such security. This may be difficult, since in many countries no specialized registers of title exist. Furthermore, security should be enforceable against third parties, which may require that they have the nature of a property right and not a mere obligation, and should entitle the person receiving security to a sale, in enforcement proceedings, of the assets taken as security.

15. Another important aspect concerns the flexibility given to the parties to define the assets that are given as security. In some legal systems, broad freedom is given to the parties in the definition of assets that may be given as security. In some legal systems, it is possible to create security that covers all the assets of an enterprise, making it possible to sell the enterprise as a going concern, which may enable an enterprise in financial difficulties to be rescued while increasing the recovery of the secured creditor. Other legal systems, however, allow only the creation of security that attaches to specific assets and do not recognize security covering the entirety of the debtor's assets. There may also be limitations on the debtor's ability to trade in goods given as security. The existence of limitations and restrictions of this type makes it difficult or even impossible for the debtor to create security over generically described assets or over assets traded in the ordinary course of its business.

16. Given the long-term nature of PPPs, the parties may wish to be able to define the assets that are given as security specifically or generally. They may also wish such security to cover present or future assets and assets that might change during the life of the security. It may be desirable to review existing provisions on security interests with a view to including provisions enabling the parties to agree on suitable security arrangements.

17. Various international intergovernmental bodies, including UNCITRAL, have elaborated instruments that can be used as models for the development or modernization of legislation on security interests. Notably, the UNCITRAL Model Law on Secured Transactions[2] provides a transparent, comprehensive and modern legislative framework of secured financing that can meet the needs of the operators active in PPPs, as described above (see paras. 11–15). The United Nations Convention on the Assignment of Receivables in International Trade[3] is also a useful tool to remove obstacles to cross-borders transactions that are fundamental for the financing of PPP projects. Another set of international instruments relevant for international security interests is the Cape Town Convention on International Interests in Mobile Equipment[4] and the subsequent Protocols related to Aircraft,[5] Rail,[6] Space,[7] and Mining, Agricultural and Construction Equipment[8] elaborated under the aegis of the International Institute for the Unification of Private Law (Unidroit), which provides for secure and readily enforceable rights, notably an electronic international register, over moveable assets that could be included into PPPs transaction.

4. *Intellectual property law*

18. PPPs frequently involve the use of new or advanced technologies protected under patents or similar intellectual property rights. They may also involve the formulation and submission of original or innovative solutions, which may constitute the proponent's proprietary information under copyright protection. Therefore, private investors, national and foreign, bringing new or advanced technology into the host country or developing original solutions will need to be assured that their intellectual property rights will be protected and that they will be able to enforce those rights against infringements, which may require the enactment of criminal law provisions designed to combat infringements of intellectual property rights. Such protection should be guaranteed through all phases of a PPP project, beginning with the contract award procedure, when bidders provide the contracting authority with confidential information in their bidding documents (see chap. III, "Contract award",

[2] UNCITRAL Model Law on Secured Transactions (2016), available at https://uncitral.un.org/en/texts/securityinterests/modellaw/secured_transactions.

[3] The United Nations Convention on the Assignment of Receivables in International Trade (New York, 2001), available at https://uncitral.un.org/en/texts/securityinterests/conventions/receivables.

[4] Convention on International Interests in Mobile Equipment (The Cape Town Convention on International Interests in Mobile Equipment) (Cape Town, 2001).

[5] Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Cape Town, 2001).

[6] Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock (Luxembourg, 2007).

[7] Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets (Berlin, 2012).

[8] Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Mining, Agriculture and Construction Equipment (Pretoria, 2019).

para. 132), and continuing through the construction and operational phases, when the private partner may use proprietary know-how or technology and will need assurances about the protection of its intellectual property rights.

19. A legal framework for the protection of intellectual property may be provided by adherence to international agreements regarding the protection and registration of intellectual property rights. It would be desirable to strengthen the protection of intellectual property rights in line with such instruments as the Paris Convention for the Protection of Industrial Property of 1883.[9] The Convention applies to industrial property in the widest sense, including inventions, marks, industrial designs, utility models, trade names, geographical indications and the repression of unfair competition. The Convention provides that, as regards the protection of industrial property, each contracting State must grant national treatment. It also provides for the right of priority in the case of patents, marks and industrial designs and establishes a few common rules that all the contracting States must follow in relation to patents, marks, industrial designs, trade names, indications of source, unfair competition and national administrations. A framework for further international patent protection is provided under the Patent Cooperation Treaty of 1970, which makes it possible to seek patent protection for an invention simultaneously in each of a large number of countries by filing an international patent application. In some countries, international standards are supplemented by legislation aimed at affording legal protection to new technological developments, such as legislation that protects intellectual property rights in computer software and computer hardware design. Furthermore, the Patent Law Treaty[10] aims at the harmonization of formal procedures in respect of national and regional patent applications and patents.

20. Other important instruments providing international protection of industrial property rights are the Madrid Agreement Concerning the International Registration of Marks of 1891,[11] the Protocol Relating to the Madrid Agreement of 1989 and the Common Regulations under the Madrid Agreement and the Protocol Relating thereto of 1998. The Madrid Agreement provides for the international registration of marks (both trademarks and service marks) at the International Bureau of the World Intellectual Property Organization (WIPO). International registration of marks under the Madrid Agreement has effect in several countries, potentially in all the contracting States (except the country of origin). Furthermore, the Trademark Law Treaty of 1994 simplifies and harmonizes procedures for the application for registration of trademarks, changes after registration and renewal.

[9] As revised in Brussels on 14 December 1900, in Washington, D.C., on 2 June 1911, in The Hague on 6 November 1925, in London on 2 June 1934, in Lisbon on 31 October 1958 and in Stockholm on 14 July 1967 and as amended on 2 October 1979.

[10] Patent Law Treaty (PLT) (Geneva, 1 June 2000).

[11] As revised in Brussels on 14 December 1900, in Washington, D.C., on 2 June 1911, in The Hague on 6 November 1925, in London on 2 June 1934, in Nice on 15 June 1957 and in Stockholm on 14 July 1967.

21. In the area of industrial designs, the Hague Agreement Concerning the International Deposit of Industrial Designs of 1925[12] provides for the international deposit of industrial designs at the International Bureau of WIPO. The international deposit has, in each of the contracting States designated by the applicant, the same effect as if all the formalities required by the domestic law for the grant of protection had been complied with by the applicant and as if all administrative acts required to that end had been accomplished by the office of that country.

22. The most comprehensive multilateral agreement on intellectual property to date is the Agreement on Trade Related Aspects of Intellectual Property Rights (the "TRIPS Agreement"), which was negotiated under the auspices of the World Trade Organization (WTO) and came into effect on 1 January 1995. The areas of intellectual property that it covers are copyright and related rights (that is, the rights of performers, producers of sound recordings and broadcasting organizations); trademarks, including service marks; geographical indications, including appellations of origin; industrial designs; patents, including the protection of new varieties of plants; the layout designs of integrated circuits; and undisclosed information, including trade secrets and test data. In respect of each of the main areas of intellectual property covered by it, the TRIPS Agreement sets out the minimum standards of protection to be provided by each contracting party by requiring, first, compliance with the substantive obligations, inter alia, of the Paris Convention in its most recent version. The main substantive provisions of the Paris Convention are incorporated by reference and thus become obligations under the TRIPS Agreement. The TRIPS Agreement also adds a substantial number of additional obligations on matters where the pre-existing conventions on intellectual property are silent or were seen as being inadequate. In addition, the Agreement lays down certain general principles applicable to all procedures for the enforcement of intellectual property rights. Furthermore, the TRIPS Agreement contains provisions on civil and administrative procedures and remedies, provisional measures, special requirements related to border measures and criminal procedures, which specify, in a certain amount of detail, the procedures and remedies that must be available so that intellectual property rights can effectively be enforced by their holders.

5. Rules and procedures on compulsory acquisition of private property

23. Where the Government assumes responsibility for providing the land required for the implementation of the project, that land may be either purchased from its owners or, if necessary, compulsorily acquired against the payment of adequate

[12] With the Additional Act of Monaco of 1961, the Complementary Act of Stockholm of 1967 as amended on 28 September 1979 and the Regulations Under the Hague Agreement Concerning the International Deposit of Industrial Designs of 1998.

compensation by procedures sometimes referred to as "compulsory acquisition" or "expropriation" (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 29–31). Many countries have legislation governing compulsory acquisition of private property and that legislation would probably apply to the compulsory acquisition of property required for PPP projects.

24. Compulsory acquisition may be carried out in judicial or administrative proceedings or may be effected by an ad hoc legislative act. In most cases, the proceedings involve both administrative and judicial phases, which may be lengthy and complex. The Government may thus wish to consider reviewing existing rules on compulsory acquisition for reasons of public interest to ensure their adequacy to the needs of large infrastructure projects that are regarded as national or domestic priorities and believed to bring benefit to both the population and the economy. Such a review should, inter alia, ascertain whether the applicable rules allow quick and cost-effective procedures, while affording adequate protection to the rights of the owners. To the extent permitted by law and in the frame of the social and environmental impact study which would have been conducted at the project inception phase (see chap. II, "Project planning and preparation", paras. 17–20), it is important to enable the Government to take possession of the property without unnecessary delay, so as to avoid increased project costs.

6. Public contracts[13]

25. In many legal systems, the provision of public services may be governed by a body of law known as "administrative law", which regulates a wide range of governmental functions. Such systems operate under the principle that the Government can exercise its powers and functions either by means of an administrative act or an administrative contract. It is also generally understood that, alternatively, the Government may enter into a private contract, subject to the law governing private commercial contracts. The differences between the two types of contract may be significant.

26. Under the concept of the administrative contract, the freedom and autonomy enjoyed by the parties to a private contract are subordinate to the public interest. In some legal systems, the Government has the right to modify the scope and terms of administrative contracts or even terminate them for reasons of public interest, usually subject to compensation for loss sustained by the private partner (see chap. V, "Duration, extension and termination of the PPP contract", paras. 29, 30 and

[13] The reader may wish to note that in most countries, regardless of their legal tradition, PPP contracts are subject to specific tendering proceedings, sometimes inspired by procurement laws. For reference to laws on procurement, including standards prepared by UNCITRAL, such as the UNCITRAL Model Law on Public Procurement (2011), see chap. III, "Contract award".

54). Additional rights might include extensive monitoring and inspection rights, as well as the right to impose sanctions on the private partner for failure to perform. This is often balanced by the requirement that other changes may be made to the contract as may be necessary to restore the original financial equilibrium between the parties and to preserve the contract's general value for the private partner (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 135–144). In some legal systems, disputes arising out of government contracts are subject to the exclusive jurisdiction of special tribunals dealing solely with administrative matters, which in some countries are separate from the judicial system or form a distinct judicial system (see chap. VI, "Settlement of disputes", paras. 45–48).

27. In other systems of law, it is frequently held that the rule of law is best maintained by subjecting the Government to ordinary private law. It is generally recognized that the administration cannot by contract fetter the exercise of its sovereign functions. It cannot hamper its future executive authority in the performance of those governmental functions which affect the public interest. Under the doctrine of sovereign acts, which is upheld in some common law jurisdictions, the Government as contractor is excused from the performance of its contracts if the Government as sovereign enacts laws, regulations or orders in the public interest that prevent that performance. Thus, the law may permit a public authority to interfere with vested contractual rights. Usually such action is limited so that the changes cannot be of such magnitude that the other party could not fairly adapt to them. In those circumstances, the private party is ordinarily entitled to some sort of compensation or equitable adjustment. In anticipation of such possibilities, in some countries a standard "changes" clause is included in a governmental contract that enables the Government to alter the terms on a unilateral basis or that provides for changes as a result of an intervening sovereign act.

28. Special prerogatives for governmental agencies are justified in those legal systems by reasons of public interest. It is however recognized that special governmental prerogatives, in particular the power to alter the terms of contracts unilaterally, may, if improperly used, adversely affect the vested rights of government contractors. For this reason, countries with a well-established tradition of PPPs have developed a series of control mechanisms and remedies to protect government contractors against arbitrary or improper acts by public authorities, such as access to impartial dispute settlement bodies and full compensation schemes for governmental wrongdoing. Where protection of this nature is not afforded, rules of law providing public authorities with special prerogatives may be regarded by potential investors as an imponderable risk, which may discourage them from investing in particular jurisdictions. For this reason, some countries have reviewed their legislation on government contracts so as to provide the degree of protection needed to foster private investment and remove those provisions which gave rise to concern about the long-term contractual stability required for infrastructure projects.

Additional clarity and comfort may be achieved by providing the bidders with all the necessary information related to the rules on government contract and administrative law at the bidding stage, in order to ensure the bidder's understanding of special prerogatives that governmental agencies may use (see chap. III, "Contract award", paras. 14 and 76).

7. Private contracts

29. The laws governing private contracts play an important role in connection with contracts entered into by the private partner with subcontractors, suppliers and other private parties. The domestic law on private contracts should provide adequate solutions to the needs of the contracting parties, including flexibility in devising the contracts needed for the construction and operation of the infrastructure facility. Apart from some essential elements of adequate contract law, such as general recognition of party autonomy, judicial enforceability of contract obligations and adequate remedies for breach of contract, the laws of the host country may create a favourable environment for PPPs by facilitating contractual arrangements likely to be used in those projects. An adequate set of rules of private international law is also important, given the likelihood that contracts entered into by the private partner will include some international elements.

30. Where new infrastructure is to be built, the private partner may need to import large quantities of supplies and equipment. Greater legal certainty for such transactions will be ensured if the laws of the host country contain provisions specially adapted to international sales contracts. A particularly suitable legal framework may be provided by adherence to the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)[14] or other international instruments dealing with specific contracts, such as the Unidroit Convention on International Financial Leasing (Ottawa, 1988),[15] drawn up by Unidroit.

8. Company law

31. In most projects involving the development of a new PPP project, the project promoters will establish the project company as a separate legal entity in the host country (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 13–20). It is recognized that the project company may take various forms in different countries, which may not necessarily entail a corporation. As in most cases it is a corporate form that is selected, it is particularly important for the host

[14] *Official Records of the United Nations Conference on Contracts for the International Sale of Goods, Vienna, 10 March–11 April 1980* (United Nations publication, Sales No. E.82.V.5), part I.

[15] *Acts and Proceedings of the Diplomatic Conference for the adoption of the draft Unidroit Conventions on International Factoring and International Financial Leasing, Ottawa, 9–28 May 1988*, vol. I.

country to have adequate company laws with modern provisions on essential matters such as establishment procedures, corporate governance, issuance of shares and their sale or transfer, accounting and financial statements and protection of minority shareholders. Furthermore, the recognition of the investors' ability to establish separate entities to serve as special-purpose vehicles for raising financing and disbursing funds may facilitate the closing of project finance transactions (see chap. IV, "PPP implementation: legal framework and PPP contract", para. 67).

32. Although various corporate forms may be used, a common characteristic is that the private partner entity's owners (or shareholders) will require that their liability be limited to the value of their shares in the company's capital. If it is intended that the project company will offer shares to the public, limited liability will be necessary, as the prospective investors will usually only purchase those shares for their investment value and will not be closely involved in the operation of the project company. It is therefore important that the laws of the host country provide adequately for the limitation of liability of shareholders. Furthermore, adequate provisions governing the issuance of bonds, debentures or other securities by commercial companies will enable the private partner to obtain funds from investors on the security market, thus facilitating the financing of certain projects.

33. Legislation should establish the responsibilities of directors and administrators of the project company, including the basis for criminal responsibility. It can also set out provisions for the protection of third parties affected by any breach of corporate responsibility. Modern company laws often contain specific provisions regulating the conduct of managers so as to prevent conflicts of interest. Provisions of this type require that managers act in good faith in the best interest of the company and do not use their position to foster their own or any other person's financial interests to the detriment of the company. Provisions intended to curb conflicts of interest in corporate management may be particularly relevant in connection with infrastructure projects, where the private partner may wish to engage its own shareholders, at some stage of the project, to perform work or provide services in connection with it (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 109 and 110).

34. It is important for the law to regulate adequately the decision-making process both for meetings of the shareholders and meetings of management organs of the company (the board of directors or supervisory board, for example). Protection of shareholders' rights and, in particular, protection for minority shareholders from abuse by controlling or majority shareholders are important elements of modern company laws. Mechanisms for the settlement of disputes among shareholders are also critical. It is useful to recognize the right of the shareholders to regulate a number of additional matters concerning the management of the private partner

through agreements among themselves or through management contracts with the directors of the private partner.

9. Tax law and cross-borders tax issues

35. In addition to possible tax incentives that may be available in the host country or that may be specially granted to PPPs in general or to listed projects (see chap. II, “Project planning and preparation”, paras. 77–80), the general taxation regime of the host country plays a significant role in the investment decisions of private companies. Beyond an assessment of the impact of taxation in the project cost and the expected margin of profit, private investors consider questions such as the overall transparency of the domestic taxation system, the degree of discretion exercised by taxation authorities, the clarity of guidelines and instructions issued to taxpayers and the objectivity of criteria used to calculate tax liabilities. This may be a complex matter, in particular in those countries where the authority to establish or increase taxes or to enforce tax legislation has been decentralized.

36. PPP projects, which are typically financed through loans from commercial or international development banks or through sponsors equity finance, require a predictable cash flow. For that reason, it is crucial for all potential tax implications to be readily assessable throughout the life of the project. Unanticipated changes in the taxes that reduce that cash flow can have serious consequences for the project. In some countries, the Government is authorized to enter into agreements with the investors for the purpose of guaranteeing that the cash flow of the project will not be adversely affected by unexpected increases in taxation. Such arrangements are sometimes referred to as “tax stabilization agreements”. However, the Government may be restrained, by constitutional law or for political reasons, from providing this type of guarantee, in which case the parties may agree on compensation or contractual revision mechanisms for dealing with cost increases due to tax changes (see also chap. IV, “PPP implementation: legal framework and PPP contract”, paras. 131–134).

37. The international aspect of PPPs, where very often PPPs are concluded with foreign investors, also bears important consequences in terms of taxation, depending on the tax system in place in the host country and in the country of origin. Most national tax regimes fall into one of three general categories. One approach is worldwide taxation with credits, in which all income earned anywhere is taxed in the home country and double taxation is avoided through the use of a foreign tax credit system; home country taxes are reduced by the amount of foreign taxes already paid. If this approach is used by an investor’s home country, the investor’s tax liability can be no less than it would be at home. Under a second taxation approach, the foreign income that has already been subject to foreign tax is exempt from taxation by the home country of the investor. Thirdly, under a territorial

approach, foreign income is exempt from home country taxation altogether. Investors in home countries that use the latter two systems of taxation would benefit from tax holidays and lower tax rates in the host country, but such tax relief would offer no incentive to an investor located in a tax haven.

38. The parties involved in the project may have different concerns over potential tax liability. Investors are usually concerned about the taxation of profits earned in the host country, taxation on payments made to contractors, suppliers, investors and lenders, and tax treatment of any capital gains (or losses) when the private partner is wound up. Investors may find that payments used to reduce taxes under their home country regime (such as payments for interest on borrowed funds, investigation costs, bidding costs and foreign exchange losses) may not be available in the host country, or vice versa. Similarly, the project company in the host country may be treated for tax purposes as a different type of entity in the home country. In projects where the assets become public property, this may preclude deductions for depreciation under the laws of the home country.

39. One particular problem of PPP projects involving foreign investment is the possibility that foreign companies participating in a project consortium may be exposed to double taxation, that is, taxation of profits, royalties and interests in their own home countries as well as in the host country. The timing of tax payments and requirements to pay withholding taxes can also pose problems. A number of countries have entered into bilateral agreements often based on the OECD Model Tax Convention on Income and Capital[16] to eliminate or at least reduce the negative effects of double taxation and the existence of such agreements between the host country and the home countries of the project sponsors often plays a role in their tax considerations.

40. Ultimately, it is the cumulative effect of all taxes combined that needs to be taken into consideration. For example, there may be taxes imposed by more than one level of taxing authority; in addition to taxation by the national Government, the private partner may also face municipal or provincial taxes. There may also be certain levies other than income taxes, which often are due and payable before the private partner has earned any revenues. These include sales taxes, sometimes referred to as "turnover taxes", value-added taxes, property taxes, stamp duties and import duties. Sometimes special provisions can be made to offer partial or full relief from these payments as well, in the frame of investment incentive programmes.

[16] The reader is advised to consult the Model Tax Convention on Income and Capital prepared by the Organisation for Economic Co-operation and Development (OECD) which is updated on a regular basis by the institution to take into account the new developments in tax law and in practice on double taxation issues (http://www.oecd.org/tax/treaties/).

10. Customs clearance and duties

41. Governments often provide tax and customs benefits to the private partner to support a PPP project (see Chap. II, "Project planning and preparation", paras. 77–80). Such benefits typically lower the level of taxes and import duties that the private partner will be subject to. Apart from the policy decision to grant (or not) such benefits, it is advisable for the Government to ensure that the customs legislation allows the importation of goods necessary to the construction and the operation of the project. It is also important to ensure that customs offices have the necessary resources to make the verifications and clear the goods without unnecessary delay. Mechanisms to that effect are provided, for instance, in the Trade Facilitation Agreement[17] adopted by the World Trade Organization in 2013, which aim at expediting the movement, release and clearance of goods, including goods in transit, but sets out measures for effective cooperation between customs and other appropriate authorities on trade facilitation and customs compliance issues.

11. Accounting rules and practices

42. The *Guide* discussed in chapter II the budgetary options available to the public authorities to record the cost of government support given to PPPs (see chap. II, "Project planning and preparation", para. 60). The assessment of the private partner financial situation is equally important in the context of PPPs. In several countries, companies are required by law to follow internationally acceptable standard accounting practices and retain the services of professional accountants or accounting auditors. Among the reasons for this is that the adoption of standard accounting practices is a measure taken to achieve uniformity in the valuation of businesses. In connection with the selection of the private partner, the use of standard accounting practices may also facilitate the task of evaluating the financial standing of bidders in order to determine whether they meet the pre-selection criteria required by the contracting authority (see chap. III, "Contract award", para. 39). Standard accounting practices are also essential for carrying out audits of the profits of companies, which may be required for the application of tariff structures and the monitoring of the private partner's performance by the regulatory body (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 43–50).

43. Special accounting rules for infrastructure operators have also been introduced in some countries to take into account the particular revenue profile of infrastructure projects. Projects involving the construction of infrastructure facilities, in

[17] Agreement on Trade Facilitation Ministerial Decisions WT/MIN(13)36, 7 December 2013. It entered into force on 22 February 2017. Full text is available on the WTO website: https://www.wto.org/index.htm.

particular roads and other transportation facilities, are typically characterized by a relatively short investment period, with high financial cost and no revenue stream, followed by a longer period with increasing revenue and decreasing financial cost and, under normal circumstances, stable operating costs. Accordingly, if traditional accounting rules were applied, the particular financial structure of such projects would need to be recorded in the project company's accounts as a period of continuous negative results followed by a long period of net profit. This would not only have negative consequences, for instance, for the project company's credit rating during the construction phase, but might also result in a disproportionate tax debt during the operational phase of the project. In order to avoid such a distortion, some countries have adopted special accounting rules for companies undertaking infrastructure projects that take into account the fact that the financial results of PPP projects may only become positive on a medium-term basis. Those special rules typically authorize infrastructure developers to defer part of the financial cost accrued during the deficit phase to the subsequent financial years, in accordance with financial schedules provided in the project agreement. However, the special accounting rules are typically without prejudice to other regulations that may prohibit the distribution of dividends during financial years closed with negative results.

12. Budget appropriation and accounting rules

44. Proper planning and preparation are necessary conditions for the success of PPP projects. The potential fiscal impact of the project and its budget implication for the contracting authority or the government, as appropriate, should be carefully considered during the planning and preparation stages (see chap. II, "Project planning and preparation", paras. 15 and 16). Government support and other contingent liabilities that the project may trigger throughout the duration of the PPP contract would need to comply with the budget rules. In particular, the contracting authority would need to ensure that adequate budget appropriation is made for payments due to the private partner and allotted in such a way so as to permit payments in the timeframe agreed between the parties.

45. Indeed, in most countries, budget appropriation is a yearly process which does not automatically foresee contingent liabilities that may be due unexpectedly under a PPP contract. Moreover, appropriation would often require the authorization of the legislative body or any other authority in charge of public means management. It might prove difficult for the contracting authority or the Government to request authorization for appropriation within the timeframe contractually negotiated. In practice, various mechanisms can be put in place to ensure that liabilities are paid timely. For example, the establishment of a contingent liability fund may allow for the payments to the private partner without having to request for specific

authorization. Such fund would need, however, to operate under strict rules and be transparent enough to justify the payments made.

46. PPPs have been increasingly used to supplement the lack of public funding and to offset the liabilities incurred in PPP projects from the Government balance sheet. This practice may have a damaging impact on the budget of contracting authorities and other public bodies, for instance, where contingent liabilities materialize into obligations to pay compensation or make other disbursements to the private partner (see chap. II, "Project planning and preparation", paras. 58–60). In order to prevent this risky use of PPPs, it is recommended that all the liabilities assumed by the contracting authority, whether direct or contingent, be recorded and made known to the public. In addition, the Government may wish to empower the central entity coordinating PPPs at the national level with the mission of gathering all the financial information related to current PPP projects and to assess the cumulative amount of commitments (see chap. II, "Project planning and preparation", paras. 46 and 47).

13. Environmental protection and PPPs

47. Environmental protection encompasses a wide variety of issues, ranging from handling of wastes and hazardous substances to relocation of persons displaced by large land-use projects. Public authorities are making increasing use of PPPs to develop the facilities that are needed to meet their environmental protection and sustainable development goals (such as water and waste treatment facilities and systems, or "clean" energy generators). This has to be balanced with the social and environmental concerns that those type of large-scale projects raise (see chap. II, "Project planning and preparation" paras. 17–20). For years now, it is widely recognized that environmental protection is a critical prerequisite to sustainable development, as enshrined in the United Nations Sustainable Development Goals (see chap. I, "General legal and institutional framework", paras. 3–4). Environmental protection legislation is likely to have a direct impact on the implementation of PPP projects at various levels. Therefore, the legislative provisions related to the management of environmental risks will often require prior authorization for the exercise of a number of business activities, which may be particularly stringent for some types of infrastructure (for instance, waste treatment, waste collection, power transmission, roads and railways). Environmental legislative framework will also aim at controlling any negative impact of projects on environment and population, such impacts being the most frequent causes of disputes and project delay. It can set forth different obligations: carrying out social and environmental studies, leading to a commitment to implement risk mitigation measures or an action plan for resettlement allowing for compensation and support measures for the displaced population or population whose means of subsistence have suffered a negative impact from the project.

48. It is therefore advisable to include in legislation measures that make obligations arising from environmental laws transparent. It is important to ensure the highest possible degree of clarity in provisions concerning the tests that may be applied by the environmental authorities, the documentary and other requirements to be met by the applicants, the conditions under which licences are to be issued and the circumstances that justify the denial or withdrawal of a licence. Particularly important are provisions that guarantee the applicant's access to expeditious appeals procedures and judicial recourse, as appropriate. It may also be advisable to ascertain to the extent possible, prior to the final award of the contract, whether the conditions for obtaining the required environmental licences are met. In some countries, special public authorities or advocacy groups may have the right to institute legal proceedings to seek to prevent environmental damage, which may include the right to seek the withdrawal of a licence deemed to be inconsistent with applicable environmental standards. In some of those countries, it has been found useful to involve representatives of the public in the proceedings that lead to the issuance of environmental licences (see also chap. II, "Project planning and preparation", paras. 19 and 20). The legislation may also establish the range of penalties that may be imposed and specify the parties that may be held responsible for the damage.

49. Adhering to treaties relating to the protection of the environment may help to strengthen the international regime of environmental protection. A large number of international instruments have been developed in the past decades to establish common international standards. These include the following: Agenda 21[18] and the Rio Declaration on Environment and Development,[19] adopted by the United Nations Conference on Environment and Development in 1992; the World Charter for Nature (General Assembly resolution 37/7, annex); the Basel Convention on the Control of Transboundary Movement of Hazardous Wastes and Their Disposal of 1989; the Convention on Environmental Impact Assessment in a Transboundary Context of 1991;[20] and the Convention on the Protection and Use of Transboundary Watercourses and International Lakes of 1992.[21] Likewise, the development of Climate Finance, in the wake of the entry into force of the Paris Agreement, in 2016,[22] is considered as a way to meet the goals set up by each country in terms of mitigating global warming. In that respect, most financial institutions active in climate finance would apply the Performance Standards of

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[18] *Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3–14 June 1992* (United Nations publication, Sales No. E.93.I.8 and corrigenda), vol. I: *Resolutions adopted by the Conference*, resolution 1, annex II.

[19] Ibid., annex I.

[20] United Nations, *Treaty Series*, vol. 1989, No. I-34028.

[21] Ibid., vol. 1936, No. I-33207.

[22] Paris Agreement, 12 December 2015 (No. 54113). The Paris Agreement was adopted at the twenty-first session of the Conference of the Parties to the United Nations Framework Convention on Climate Change held in Paris from 30 November to 13 December 2015. It is published on the website of the Treaty section of the United Nations https://treaties.un.org/Pages/showDetails.aspx?objid=0800000280458f37&clang=_fr.

the International Finance Corporation[23] or the "Equator Principles"[24] to identify and manage the social and environmental impacts of projects that they are considering financing. Failure by a recipient country to meet the standards would trigger a request for the preparation of a corrective action plan and could ultimately lead to the cessation of funding by the financial institution.

14. Consumer protection laws

50. The growing focus on public interest witnessed in PPPs bears consequences on the importance of the assessment of the consumer protection laws in the host country (see chap. I, "General legal and institutional framework" para. 6). A number of countries have special rules of law on consumer protection. Consumer protection laws vary greatly from country to country, both in the way they are organized and in their substance. Nevertheless, consumer protection laws often include provisions such as favourable time limits for asserting claims and enforcing contractual rights; special rules for the interpretation of contracts whose terms are not usually negotiated with the consumer (sometimes referred to as "adhesion contracts"); extended warranties in favour of consumers; special termination rights; access to simplified dispute settlement instances (see also chap. VI, "Settlement of disputes", paras. 50–52); or other protective measures. The United Nations Guidelines for Consumer Protection (UNGCP),[25] first adopted in 1985 under the aegis of the Economic and Social Council of the United Nations, and then revised through a consultation process driven by UNCTAD, can be a useful inspiration for countries looking for improving their legal framework on consumer protection. In particular, guideline 76 on Energy and guideline 77 on Public utilities, are relevant with PPPs projects development.

51. From the private partner's perspective, it is important to consider whether the host country's laws on consumer protection may limit or hinder its ability to enforce, for instance, its right to obtain payment for the services provided, to adjust prices or to discontinue services to customers who breach essential terms of their contracts or violate essential conditions for the provision of the services. This is particularly relevant in the context of "concession-PPP" where the private partner

[23] For International Finance Corporation Standards, see chap. IV, "PPP implementation: legal framework and PPP contract", para. 91.

[24] Equator Principles, June 2013. The Equator Principles is a risk management framework, adopted by financial institutions, for determining, assessing and managing environmental and social risk in projects. It applies to all industry sectors and to four financial products: 1) Project Finance Advisory Services; 2) Project Finance; 3) Project-Related Corporate Loans; and 4) Bridge Loans. For more information, see: https://equator-principles.com/about/.

[25] The Resolution is available on the following page: http://unctad.org/meetings/en/SessionalDocuments/ares70d186_en.pdf and on the UNCTAD dedicated page: http://unctad.org/en/Pages/DITC/CompetitionLaw/UN-Guidelines-on-Consumer-Protection.aspx.

charges a fee to the end user in addition to the payment received from the public authority (see "Introduction and background information on PPPs", para. 15).

15. Insolvency law

52. The insolvency of an infrastructure operator or public service provider raises a number of issues that have led some countries to establish special rules to deal with such situations, including rules that enable the contracting authority to take the measures required to ensure the continuity of the project (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 158–161). The continuity in the provision of the service may be achieved by means of a legal framework that allows for the rescue of enterprises facing financial difficulties, such as reorganization and similar proceedings. In the event that bankruptcy proceedings become inevitable, the secured lenders will be specially concerned about provisions concerning secured claims, in particular as to whether secured creditors may foreclose on the security despite the opening of bankruptcy proceedings, whether secured creditors are given priority for payments made with the proceeds of the security and how claims of secured creditors are ranked. As noted earlier, a substantial portion of the private partner's debt takes the form of "senior" loans, with the lenders requiring precedence of payment over payment of the subordinated debt of the private partner (see "Introduction and background information on PPPs", para. 60). The extent to which the lenders will be able to enforce such subordination arrangements will depend on the rules and provisions of the laws of the country that govern the ranking of creditors in insolvency proceedings. The legal recognition of party autonomy on the establishment of contractual subordination of different classes of loans may facilitate the financing of infrastructure projects.

53. Among the issues that the legislation should address are the following: the question of the ranking of creditors; the relationship between the insolvency administrator and creditors; legal mechanisms for reorganization of the insolvent debtor; special rules designed to ensure the continuity of the public service in case of insolvency of the private partner; and provisions on avoidance of transactions entered into by the debtor shortly before the opening of the insolvency proceedings. The UNCITRAL Legislative Guide on Insolvency[26] and its explanatory texts[27] are useful tools for the modernization of a country's insolvency regime.

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[26] UNCITRAL Legislative Guide on Insolvency Law (2004), UNCITRAL Legislative Guide on Insolvency Law, Part Three: Treatment of enterprise groups in insolvency (2010) and UNCITRAL Legislative Guide on Insolvency Law, Part Four: Directors' obligations in the period approaching insolvency (2013) (all available at: https://uncitral.un.org/en/texts/insolvency).

[27] UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation (2009) and UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective, UNCITRAL Model Law on Cross-Border Insolvency (1997) with Guide to Enactment and Interpretation (2013), both available at: https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border_insolvency.

54. In large infrastructure projects, the insolvency of the project company is likely to involve creditors from more than one country or affect assets located in more than one country. It may therefore be desirable for the host country to have provisions in place that facilitate judicial cooperation, court access for foreign insolvency administrators and recognition of foreign insolvency proceedings. A suitable model that may be used by countries wishing to adopt legislation for that purpose is provided in the UNCITRAL Model Law on Cross-Border Insolvency and its Guide to Enactment and Interpretation,[28] supplemented by the UNCITRAL Model Law on the Recognition and Enforcement of Insolvency-related Judgements and its guide to enactment.[29]

16. Anti-corruption measures

55. The investment and business environment in the host country may also be enhanced by measures to fight corruption in the administration of government contracts. It is particularly important for the host country to take effective and concrete action to combat bribery and related illicit practices, in particular to pursue effective enforcement of existing laws prohibiting bribery.

56. The enactment of laws that incorporate international agreements and standards on integrity in the conduct of public business may represent a significant step in that direction. In that respect, the only legally binding universal anti-corruption instrument is the United Nations Convention against Corruption (see chap. I, "General legal and institutional framework", para. 4), which requires countries to establish criminal and other offences to cover a wide range of acts of corruption, notably bribery, if these are not already crimes under domestic law. Other important instruments include the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions of 1997, which was negotiated under the auspices of the Organization for Economic Cooperation and Development.[30]

57. Furthermore, it is important that the rules covering the functioning of contracting authorities and the monitoring of public contracts ensure the required

[28] The official text of the UNCITRAL Model Law on Cross-Border Insolvency is reproduced in *Official Records of the General Assembly, Fifty-second Session, Supplement No. 17* (A/52/17), Annex I (*Yearbook of the United Nations Commission on International Trade Law*, vol. XXVIII, 1997, part three, Annex I (United Nations publication, Sales No. E.96.V.6)). The UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation have also been reproduced in booklet form (United Nations publication, Sales No. E.14.V.2). The use of the Model Law was recommended by the General Assembly in its resolution 52/158 of 15 December 1997.

[29] The official text of the UNCITRAL Model Law on the Recognition and Enforcement of Insolvency-related Judgements and its guide to enactment (2018) is reproduced in *Official Records of the General Assembly, Seventy-third Session, Supplement No. 17* (A/73/17), Annex III. The use of the Model Law was recommended by the General Assembly in its resolution 73/200 of 20 December 2018.

[30] http://www.oecd.org/corruption/oecdantibriberyconvention.htm.

degree of transparency and integrity, permitting notably the publication of contract opportunities and awarded contracts, but also of the performance evaluation reports. Licenses and permits regulation may also be included in the list of information to be disclosed. Where such rules do not exist, appropriate legislation and regulations should be developed and adopted. Simplicity and consistency, coupled with the elimination of unnecessary procedures that prolong the administrative procedures or make them cumbersome, are additional elements to be taken into consideration in this context.

17. Labour laws and standards

58. Workers and employees are at the heart of the design, construction and operation of an infrastructure, and are of course of paramount importance for the success of PPPs. The international aspect of PPPs does not imply that the local laws and standards applicable to labour rights may be ignored. These, in turn, should also meet the basic international standards, not only because most countries have assumed international obligations through their participation in the work of organizations such as the International Labour Organization (ILO), the specialized agency of the United Nations in the sector of social justice and labour conditions. Foreign investors would also have an interest in compliance with international standards, as they may be exposed to lawsuits in their jurisdictions of origin, if they are found to invest in businesses that violate internationally recognized labour standards. Another common issue in concession-PPPs are complaints that the employment conditions of the project workers are less favourable when employed by the private partner as compared to previously employed by a public authority. The insertion of fair wages clauses and fair labour conditions in the PPP contract may ensure a protection of workers' rights. Such clauses would specify the minimum conditions of work and other mandatory standards that the private partner shall include in its labour contracts with the workers. ILO Convention No. 94 concerning Labour Clauses in Public Contracts, which entered into force on 20 September 1952, aims at preventing companies bidding for public contracts from cutting labour costs and offering less favourable conditions to workers. It requires Governments having ratified the convention to include fair wages clauses in government contracts, including PPP contracts.

18. Stakeholders engagement in PPPs

59. Consultations with communities affected by a PPP project helps to ensure the project's sustainability by stimulating a discussion on ways to limit the project's negative social and environmental impact, such as forced displacement, modification or destruction of the environment or any other measure necessary for the construction of the project (see also, chap. II, "Project planning and preparation", para. 20). Such consultations can also serve to improve design by, for example,

identifying better ways to facilitate access for the disabled, or improve affordability of services. Communities living on or across the site where the project is envisaged are key stakeholders who need to be consulted. It is especially the case for indigenous peoples, as it has been recognized in some international instruments (for example, the International Labour Organization's Indigenous and Tribal Peoples Convention[31]). The consultation process can be conducted in various ways, depending on the existing legal framework in the country, but it often includes the realization of impact studies, the diffusion of such studies and other relevant information about the project, the organization of dialogues with the affected communities and securing their prior consent, as appropriate.

60. There are useful industry standards protecting community engagement in the preparation and implementation of projects.[32] Nevertheless, it is also advisable for domestic legislators and policymakers to consider adopting rules on the consultation process, if they do not yet exist, to facilitate the organization and supervision of the consultation process (for example, through ombudsman or review boards). An effective consultation process should follow well-established principles. For example, engagement with affected communities should begin as early as possible in the elaboration of the project, be based on thorough disclosure, be free of external influence, and it should be documented. It should also be tailored to the affected communities and the project, for example by using the language used by the affected community.

C. International agreements

61. In addition to the internal legislation of the host country, PPPs may be affected by international agreements entered into by the host country. The implications of certain international agreements is discussed briefly below, in addition to other international agreements mentioned throughout the *Guide*.

1. Membership in international financial institutions

62. Membership in multilateral financial institutions such as the World Bank, the International Development Association, the International Finance Corporation, the Multilateral Investment Guarantee Agency and the regional development banks is necessary to create a favourable climate for PPPs. Firstly, the host country's membership in those institutions is typically a requirement in order for projects

[31] ILO Convention No. 169 on Indigenous and Tribal Peoples, art. 17, imposes an obligation on States to undertake prior consultation of indigenous populations in infrastructure decisions affecting their lands and, in some specific cases, seek their prior, informed and free consent.

[32] Equator Principles, Principle 5, refers to "stakeholder engagement".

in the host country to receive financing and guarantees provided by those institutions. Secondly, the rules on financing and guarantee instruments provided by those institutions typically contain a variety of terms and conditions of direct relevance for the terms of the project agreement and the loan agreements negotiated by the private partner (for example, a clause of negative pledge of public assets and provision of counter-guarantees in favour of the multilateral financial institution). Lastly, multilateral financial institutions usually follow a number of policy objectives whose implementation they seek to ensure in connection with projects supported by them (such as adherence to internationally acceptable environmental standards, long-term sustainability of the project beyond the initial concession period and transparency and integrity in the selection of the private partner and the disbursement of their loans).

2. General agreements on trade facilitation and promotion

63. A number of multilateral agreements have been negotiated to promote free trade at the global level. The most notable of those agreements have been negotiated under the auspices of the General Agreement on Tariffs and Trade and later WTO. Those agreements may contain general provisions on trade promotion and facilitation of trade in goods (such as a most-favoured-nation clause or prohibition of the use of quantitative restrictions and other discriminatory trade barriers) and on the promotion of fair trade practices (such as prohibition of dumping and limitations on the use of subsidies). Some specific agreements are aimed at the removal of barriers for the provision of services by foreigners in the contracting States or promoting transparency and eliminating discrimination of suppliers in public procurement. Those agreements may be relevant for national legislation on PPPs that contemplates restrictions on the participation of foreign companies in infrastructure projects or establishes preferences for national entities or for the procurement of supplies on the local market.

3. International agreements on specific industries

64. In the context of the negotiations on basic telecommunications concluded as part of the General Agreement on Trade in Services (GATS), a number of States members of WTO representing most of the world market for telecommunication services have made specific commitments to facilitate trade in telecommunication services. It should be noted that all WTO member States (even those which have not made specific telecommunication commitments) are bound by the general GATS rules on services, including specific requirements dealing with most-favoured-nation treatment, transparency, regulation, monopolies and business practices. The WTO telecommunication agreement adds sector- and country-specific commitments to the overall GATS agreement. Typical commitments cover the opening of various segments of the market, including voice telephony, data

transmission and enhanced services, to competition and foreign investment. Legislators of current or prospective WTO member States should thus ensure that the country's telecommunication laws are consistent with the GATS agreement and their specific telecommunication commitments.

65. Another important sector-specific agreement at the international level is the Energy Charter Treaty, concluded in Lisbon on 17 December 1994 and in force since 16 April 1998, which has been enacted to promote long-term cooperation in the energy field. The Treaty provides for various commercial measures, such as the development of open and competitive markets for energy materials and products and the facilitation of transit and access to and transfer of energy technology. Furthermore, the Treaty aims at avoiding market distortions and barriers to economic activity in the energy sector and promotes the opening of capital markets to encourage the flow of capital in order to finance trade in materials and products. The Treaty also contains regulations about investment promotion and protection: equitable conditions for investors, monetary transfers related to investments, compensation for losses due to war, civil disturbance or other similar events and compensation for expropriation.

Index

In this index, Roman numerals refer to chapters and Arabic numerals to paragraphs. For instance, "III, 67" refers to chapter III, "Contract award", paragraph 67. The symbol "___" replaces the wording of the main entry to avoid repeating the same wording in the sub-entries.

ISBN 978-92-1-130399-5

V.19-10872