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PPP CONTRACT RENEGOTIATION

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KEY CHALLENGES FOR CONTRACT RENEGOTIATION

What is contract renegotiation?

"Modification of contract not foreseen (legal and economic) at the time of execution."

Events which leads to contract renegotiation

Renegotiation is:

- A change in the risk matrix or conditions of the contract
- A change in project scope (which is not contemplated in the contract)

Usually triggered by:

- Additions or changes in the scope of the Project
- Shortfalls in demand/revenues
- Financing Issues
- Rent seeking opportunities
- Political opportunities
- Aggressive bids
- For Land and Rights Acquisition Issues
- Lower than expected revenue
- Higher than expected costs

Drivers of Renegotiation Request

Initiated by Government

- Change of priorities or change of government
- Unable to fulfill contractual obligation (land acquisition)
- Lack of preparation studies
- Politically realities

Initiated by Private Party

- Maximizing of the NPV of the PPP contract (more revenues, less costs or investments, or/and less risks)
- Against shocks (domestic or external) that significantly unbalance the financial equilibrium
- Bidding errors, aggressive offers

Events which should not lead to Renegotiation

- Tariffs adjustment in accordance with a formula set it in the contract.
- Triggers are activated, and investments become mandatory.
- Payments to concessionaire if they are regulated in the contract.
- Variation in accordance with its terms.

Implication of Contract Renegotiation

Reduces transparency that existed during competitive bidding, which may also be controversial in terms of public perception.

May reduces the overall economic benefits of PPP arrangements by changing the tendered and agreed risk allocation.

If renegotiations are frequent, the credibility of PPP is questioned.

Decreases the benefits/advantages of PPP and the welfare of users, and usually it has a fiscal impact by increasing liabilities to the government.

Implication of Contract Renegotiation

Competitors may also challenge the renegotiated changes on the basis of competition or procurement laws, which can also have implications for future tender processes.

A renegotiation may highlight broader issues and set a precedent for other similar projects (i.e., other project companies in similar projects might demand the same changes).

Distortion in public tender, in that the most likely winner is not the most efficient operator but the most expert/qualified in renegotiations.

Renegotiation is not Recommended

Events that are foreseeable.

Events that would affect the project company in its ordinary course of business.

Materialization of a risk allocated to the project company or invalid assumptions made in its pricing or the scope of work required in relation to those risks.

Renegotiation is not Recommended

Any failure of the project company to secure financing for the project.

Any distress arising directly or indirectly from the performance, action or inaction of the project company.

Renegotiation must include evidence that the project distress is material and likely to result in default under the concession agreement in future should it continue.

Principles for Renegotiation

Improve the value for all parties including users of the project, but accounting for possible fiscal consequences of the renegotiation.

The main character of the original contract must be retained.

The NPV of the modifications must be zero, and preserve value for money.

Must not be used to correct errors in the basis for tender or excessively risky or aggressive bids.

Factors to be considered for Renegotiation Legislation/ Policy

The contract should stipulate the renegotiations approach, criteria and process.

Establish a freeze period for renegotiations (i.e., no renegotiations for 3 to 5 year after award).

The cost of renegotiating should be less than the financial outcome of doing nothing.

Use panel of experts to evaluate: (i) aggressive bids, (ii) renegotiations request, (iii) and conflict resolution.

Factors to be considered for Renegotiation Legislation/ Policy

Establish in the contract the right to evaluate and reject aggressive and reckless bids, defining the criteria and standards

Policy for minimal renegotiation.

Ensure compliance with the regulatory framework in relation to a renegotiation.

Consider the associated private partners' roles (including the lenders' role) in a renegotiation.

Finance Ministry Recommendation

Renegotiated concession agreement should have direct cost implications for the government that are less than the financial outcomes of doing nothing.

Decision for renegotiation should be based on full disclosure of long-term costs, risks and potential benefits.

Comparison with the financial position for the government at the time of signing the concession agreement and at the time prior to renegotiation.

Conclusion

Renegotiation has to balance the interest of the people, government and private party

Should be allowed only in exceptional situations

Policy for renegotiation should be enacted and procedure in the conract

Proper risk allocation and detailed project study/preparation should be pre-condition of PPP projects

Contract management should be emphasised

SAFEGUARDS TO MITIGATE THE UNCERTAINTIES OF LONG TERM CONTRACTS

Mitigation Measures

- **Secure long-term efficiency**
- **Good implementation and compliance**

How to achieve long term efficiency, compliance and implementation

Delinking private players from unquantifiable and contingent risks.

Involve private sector early in the project and consider the feedback of the private sector.

Detailed project management mechanism should be established for PPP project.

Contracts should contain clauses providing for renegotiation only in the case of well-defined triggers.

How to achieve long term efficiency, compliance and implementation

Significant fee for any renegotiation request. Fee to be reimbursed if the renegotiation is favorable decided.

Proper regulatory accounting of all assets and liabilities should also be in place to avoid any ambiguity about the regulatory treatment and allocation of costs, investments, asset base, revenues, transactions with related parties, management fees, and operational and financial variables.

An appropriate regulatory framework and agency should be in place prior to the award of the concession, with sufficient autonomy and implementation capacity to ensure high quality enforcement and deter political opportunism.

Quickly organized concession programs should be avoided.

How to achieve long term efficiency, compliance and implementation

Detailed analysis of seemingly aggressive bids should be required before a concession is awarded.

Contracts should be structured to avoid ambiguity in:

- the treatment of assets (ownership, disposal, maintenance, turnover),
- the evaluation of investments (right side, let side of balance sheet),
- KPIs,
- adjustment of tariff (CPI, traffic, etc),
- termination rights, and
- disputes resolution.

Conclusion

- Proper Risk Allocation
- Detailed Study of the Project
- Analysis of aggressive bid
- Contract Monitoring
- Speedy Dispute Resolution Mechanism

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THANK YOU

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