

**The Renegotiation of PPP Contracts:  
An overview of its recent evolution in  
Latin America**

**Discussion Paper N° 2014-18**

Prepared for the Roundtable:  
**Public Private Partnerships for Transport Infrastructure:  
Renegotiations, how to approach them and economic  
outcomes**

27-28 October 2014,  
George Mason University, Arlington, Va, USA

**José Luis Guasch; Daniel Benitez;  
Irene Portabales; Lincoln Flor**

World Bank  
Washington D.C.  
USA

October 2014

## THE INTERNATIONAL TRANSPORT FORUM

The International Transport Forum at the OECD is an intergovernmental organisation with 54 member countries. It acts as a strategic think-tank, with the objective of helping shape the transport policy agenda on a global level and ensuring that it contributes to economic growth, environmental protection, social inclusion and the preservation of human life and well-being. The International Transport Forum organises an annual summit of Ministers along with leading representatives from industry, civil society and academia.

The International Transport Forum was created under a Declaration issued by the Council of Ministers of the ECMT (European Conference of Ministers of Transport) at its Ministerial Session in May 2006 under the legal authority of the Protocol of the ECMT, signed in Brussels on 17 October 1953, and legal instruments of the OECD.

The Members of the Forum are: Albania, Armenia, Australia, Austria, Azerbaijan, Belarus, Belgium, Bosnia-Herzegovina, Bulgaria, Canada, Chile, China, Croatia, the Czech Republic, Denmark, Estonia, Finland, France, FYROM, Georgia, Germany, Greece, Hungary, Iceland, India, Ireland, Italy, Japan, Korea, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Moldova, Montenegro, the Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Russia, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom and the United States.

The International Transport Forum's Research Centre gathers statistics and conducts co-operative research programmes addressing all modes of transport. Its findings are widely disseminated and support policymaking in Member countries as well as contributing to the annual summit.

### Discussion Papers

The International Transport Forum's Discussion Paper Series makes economic research, commissioned or carried out at its Research Centre, available to researchers and practitioners. The aim is to contribute to the understanding of the transport sector and to provide inputs to transport policy design. The Discussion Papers are not edited by the International Transport Forum and they reflect the author's opinions alone.

The Discussion Papers can be downloaded from:

[www.internationaltransportforum.org/jtrc/DiscussionPapers/jtrcpapers.html](http://www.internationaltransportforum.org/jtrc/DiscussionPapers/jtrcpapers.html)

The International Transport Forum's website is at: [www.internationaltransportforum.org](http://www.internationaltransportforum.org)

For further information on the Discussion Papers and other JTRC activities, please email: [itf.contact@oecd.org](mailto:itf.contact@oecd.org)

*This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.*

# The renegotiation of PPP contracts: an overview of its recent evolution in Latin America

## (Draft for comments)

José Luis Guasch, Daniel Benitez, Irene Portabales and Lincoln Flor<sup>1</sup>

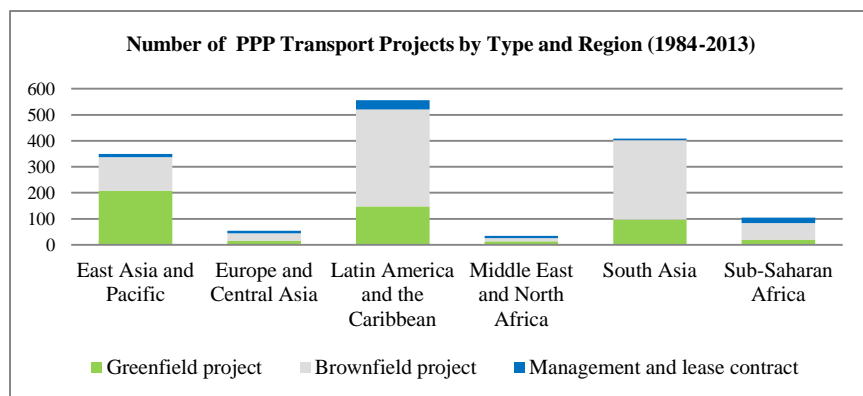
*This paper analyzes the situation, lesson learned and reflections of renegotiations in Latin America, taking in consideration the evolution of PPP contracts in the last 25 years, and how new PPP regulations will reduce an manage renegotiations. Based in experience in the last two decades, most of the countries in the region have improved their renegotiation regulations/framework in their PPP legislation, for example (Peru (2008), Chile (2010), Colombia (2011) or Mexico (2012.)) The preliminary findings show new trends in renegotiation in those contracts with more complexity where governments are providing financial or credit enhancement, such as sharing risk or co-financing.*

Keywords: Renegotiation, PPP, Latin America, Concession Contracts, Procurement, Incomplete Contracts, Economic Regulation, co-financing and value for money.

### I. Introduction

Over the last 25 years more than 6000<sup>2</sup> public private partnerships (PPP) contracts have been signed in developing countries around the world, this number and the trends suggest that private participation in infrastructure has become a good option to develop infrastructure and provide public services, as well as, to support the economic growth, improve quality of life and contribute to poverty reduction.

Transport sector concentrates 25 percent of the total PPP contracts of the developing world. Three regions and countries lead this process: Latin America (Brazil), South Asia (India) and East Asia and Pacific (China). Large economies with high economic growth rates. About 78 percent of the total investment



commitments in projects in the transport sector in the developing world in 2012 were concentrated in Brazil and India. These 3 regions concentrate almost 90% of the PPP transport projects in the world in the last 30 years.

Figure: Number of PPP transport projects by type and region (1984-

2013). Source: Own elaboration with PPI Database data.

<sup>1</sup> This paper was written for the Roundtable on Public Private Partnerships for Transport Infrastructure: Renegotiations, how to approach them and economic outcomes (Washington DC, October 27-28, 2014).

<sup>2</sup> Consulted on the 24th of September 2014, World Bank and PPIAF, PPI Project Database (<http://ppi.worldbank.org>) has data recorded from 6224 projects in 3 key sectors (transport, energy, water and sewage)

By contract type, brownfield projects are predominant in transport PPP projects although the amount of these has had a fluctuating behavior associated with economic cycles, while the number of greenfield project has remained relatively constant the last twenty years. In general, brownfield projects are usually easier to implement than greenfield projects, which are more risky, complex and have more uncertainty in particular in traffic forecasting, in this context we should expect a greater proportion or incidence of contract renegotiations associated to greenfield projects. As well as, the low number of management contract can suggest an important infrastructure gap in developing countries that has been tried to reduce mainly by build-operate-transfer (BOT) PPP projects.

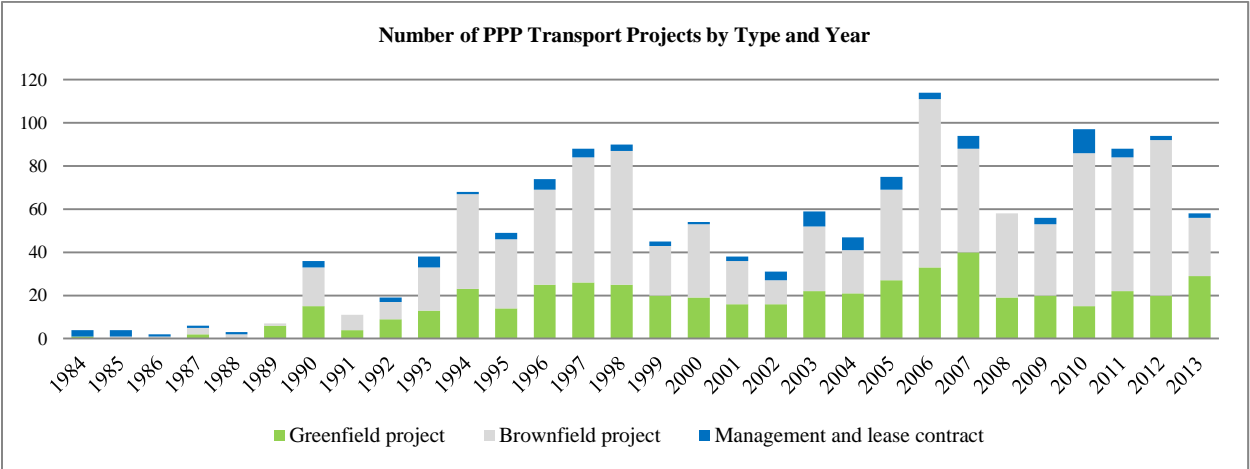


Figure: Number of PPP transport projects by type and year. Source: Own elaboration with PPI Database data.

A big legacy of PPP contracts in Latin America (LCR) along the last 25 years is a large number of renegotiations. For example in road PPPs, Colombia between 1993-2010 (Bitran et al, 2012 and Guasch, 2014) showed seven times the number of renegotiation in Chile or Peru, part of them associated to additional investments in infrastructure that were not included in the original PPP contract, suggesting poor project preparation studies critical to assess the real dimension/scope of the infrastructure projects. In addition, additional payment commitments increased the fiscal impact and affected the value for money of the PPP project (Bitran et al, 2012).

In this context, a deficient effort in project preparation studies by the government (risk allocation, minimum requirements, selection criteria and PPP procurement procedures) and lack of effective contract monitoring can lead to potential contract renegotiation from both parties-public and private. As well as, political reasons to accelerate the implementation of PPP projects with limited or lack of project preparation and proper filters (for example, feasibility studies and proper evaluations by experts) can motivate consecutive renegotiations to accommodate the continuity of the PPP contract and the implementation of the contract commitments<sup>3</sup>. There is no official data on PPP contract renegotiations.

<sup>3</sup> For example, in 2005 3 PPP roads (Interoceanic 2, 3 and 4) were awarded in Peru without cost-benefit analysis. The governments approved avoid this important step. In 2006, a third amendment was signed to allow the financial close of the projects. As well as, in 2009 and 2010, based in the global financial crisis, the government decided to avoid or relax the cost-benefit analysis and reduce the filters (value for money analysis was postponed during these years) and the deadlines during PPP project preparation, for a selected group of candidate projects.

However, between 1980-2000 (Guash, 2004) 55% of the PPP contracts in transport infrastructure in Latin America were renegotiated with and fairly quickly after the signature of contract (3.1 years).

Important lessons learned in PPP renegotiations in Latin American countries were accumulated and motivated Latin American countries to introduce key changes in the PPP legislation in countries with PPP experience (Peru, 2008 and Chile, 2010) and recently Colombia (2011) and Mexico (2012). The new regulations set up a freeze for renegotiations for the first 3 or more years, clarifies risk allocation, compensations, rate of return, and states that any contract modification cannot alter the risk allocation matrix etc.

Even under a context of renegotiation, the PPP programs have proven quite effective on average to bring about the desired benefits and reduced the infrastructure gap that most countries face. While the benefits have been quite significant, they could have been even higher had the program and project been better designed and implemented. There have been issues and problems most related to the post contract award management of projects

While the ex-post contract award management of PPP projects is indeed critical for securing the expected benefits of PPP project, it has in general not been an important priority for governments or treated lightly or as a sort of residual to be taken care somehow. It is indeed surprising when noting that most PPP contracts have durations of 15-30 years or for PPP in social sector, which can involve more complexity, for example PPP in the health sector, where set up based on the level of service and its monitoring is a big challenge. Issues do and will come up, and often not well specified or detailed in contract, in particular in dynamic markets where cost structure is changing aligned to the main drivers (high prices of commodities) or the demands has increased over the expectations. All that creates opportunities for abuse and opportunism, and rise the likelihood of conflicts among the two parties quite significantly. The conflicts appear at all levels, i) Contract based, and ii) Beyond the contract through renegotiation.

To some extent, disputes and differences in interpreting the contract are to be expected and are part of the business as usual-but only those contract based and not on renegotiation (contract/risk modifications). Yet the incidence of both has been and is a concern particularly that of renegotiations. Renegotiations on average have been by and large the critical problem facing PPP. Given its implications on value for money and the legitimation of PPP over traditional procurement, there is a need to be prepared and to diffuse, pre-empt and address the issue.

The PPP contract, processes and institutionality are the key determinants along with the contractual integrity are the focus and impinge on the likelihood of securing those benefits and avoiding conflicts. If the key contractual clauses are not well written (or risks are not well allocated) the benefits will be reduced and the incidence of conflicts significantly increased. If the oversight/fiscalization and regulation is not properly set up, again the benefits will be reduced and the conflicts increased. If the conflict resolution mechanisms is not predicable, transparent enough, again interest and benefits likely decline

As is reported here a very significant number of PPP have been renegotiated shortly after the contracts have been signed. These renegotiations occur frequently in a short period of time after financial close (or even before). The problem is especially acute in some sectors, notably transport and the supply of water

and sanitation. Most of renegotiations are initiated by private sector operators, and to a lesser extent by the Government. Thus it is indeed critical to understand the issue, its causes and how best to address so as that PPP programs can generate its expected benefits. This is the challenge of this paper, which analyzes and evaluates the renegotiations paradigm during the last 25 years.

**II. Definitions: What is renegotiation?**

A renegotiation of PPP contracts involves a change in the original contractual terms and conditions, as opposed to an adjustment in the payments (or tariffs) that takes place under a mechanism defined in the contract. Renegotiations are mainly:

Renegotiation is when:	Examples
i) a change in the risk matrix assignment and / or in the conditions of the contract, or	<ul style="list-style-type: none"> <li>• Reduce the level of services (airports, from IATA A to B).</li> <li>• Defer or advance investments for several years.</li> <li>• Extension of the contract term.</li> <li>• Reduction guarantees (financial bonds)</li> <li>• Increase the guarantee of the government (to pay lenders).</li> <li>• Delays in the reduction of tariffs (tolls).</li> <li>• Reduce the thresholds of the economic equilibrium of the contract, etc.</li> </ul>
ii) a change in project scope (if this was not regulated in the contract).	<ul style="list-style-type: none"> <li>• Government requests new investments.</li> <li>• Reduction of fees for the government.</li> <li>• Ovoid bankruptcy of the operator.</li> <li>• Changes on the contract scope, etc.</li> </ul>
Renegotiation is not when:	<ul style="list-style-type: none"> <li>• Tariffs are adjusted with a formula set it in the contract or indexed by inflation.</li> <li>• Triggers are activated and eventual investments become mandatory.</li> <li>• Payments to operator if they are regulated in the contract, etc.</li> </ul>

The challenge in “good” renegotiations is to improve the value for all parties, including users of the services. But accounting for possible fiscal consequences of the contract modification

Renegotiation requests are often linked to aggressive bids, and have become quite widespread. The rationale for an aggressive bid is that it is presented at the auction time, with the intention of winning the award/the PPP contract, and then renegotiate better conditions. If there is only one valid bid, under the weak institution, and the negotiation position of the government is also weak, in general will try solving the PPP contract and accepting the renegotiation conditions<sup>44</sup>. An aggressive bid is defined when the

---

<sup>44</sup> If the government doesn’t accept the renegotiation conditions, the PPP project has to be rebid, under a new procurement process, with no guarantee of more competition. In political terms, the whole PPP program can be affected. For example: the container terminal of Paita, Peru in 2009. Only one valid bid was received in March and the contract signed in September. One year later, the contract was amended regarding the guarantees to the government.

present value of revenues (R) is insufficient to cover the present value of costs (C) of the PPP project and generate the expected return on capital investment:

$$R = (P - C)Q - T - D < rK$$

Where:

R: Revenues

T: Taxes

P: Unitary price

D: Depreciation

C: Unitary cost

rK: Rate of Return of CAPEX

Q: Quantity

Renegotiations can occur at any time after the PPP contract is signed. The problem is particularly acute in some sectors, particularly transport and water supply and sanitation. Most renegotiations are initiated by private sector operators, but there are also initiated on a lesser scale by the government.

Usually the results of renegotiations are: improvement of the terms of the operator and / or investors, reduction of efficiency, reduction of quality for users and adverse fiscal impact, including increases in direct and contingent liabilities.

### III. Renegotiations typology

Regarding to the initiator of the renegotiation, renegotiations can be classified in: initiated by the government, initiated by the operator or concessioner, by both or ambiguous. When initiated by the government, the reason usually is because of change of priorities, change of government party or that the government cannot fulfill its contractual obligation, although politically opportunistic reasons also exist (in some cases, governments can offer anticipate investments or to increase investment or to decrease tariffs to increase popularity, prior to elections etc.). On the other hand, when initiated by the private sector, renegotiations are due quite often to opportunistic reasons, seeking for maximizing the net present value of the PPP contract (more revenues, less costs or/and less risks), but also to shocks (domestic or external) that significantly unbalance the financial equilibrium.

	Both Government and Operator	Government	Operator
All sectors	13%	26%	61%
Water and Sanitation	10%	24%	66%
Transport	16%	27%	57%

*Fuente: Guasch (2004, updated 2014), Concesión y renegociar las concesiones de Infraestructuras hacerlo bien -- Análisis de renegociar las concesiones en América Latina y el Caribe, mediados de la década de 1980 a 2010.*

### IV. Why Renegotiation is an important issue? Implications

The concerns about the incidence of renegotiations are based in that they:

- Eliminate the competitive effect of the auction including transparency: questioning the credibility of the model/program

- Asymmetric information and lack of negotiation skills of public sector to renegotiate the contract.
- Distortion in public tender, in that the most likely winner is not the most efficient operator but the most expert/qualified in renegotiations.
- Decreases the benefits/advantages of PPP and the welfare of users, and usually it has a fiscal impact by increasing liabilities to the government.
- While some can be efficient, many of them are opportunistic.

Not surprisingly there are fewer renegotiations when the initial contracts were awarded through a process of bilateral negotiations, in contrast to public procurement tenders, but this "not be interpreted as an endorsement of bilateral negotiations". The reason being that through bilateral negotiations, in the absence of competition, much better contractual terms are secured, diminishing significantly the incentives to renegotiate.

The typology of costs associated with disputes, conflicts and renegotiations are:

- Time and financial resources: to address and resolve the conflict.
- Social and Political: Since conflicts tend to be highly visible and have great coverage of the media, leading to disenchantment of citizens, the PPP model tends to lose credibility and public support, and the government can be weakened.
- Financial/Fiscal: Often the results of the negotiation have a fiscal cost to the government.
- Economic and Social: Users tend to be adversely affected by the results of conflicts, particularly renegotiations (in terms of reduced access, higher or lower prices and delays in service quality)

On average, these costs are quantified as 3-15% of the investment, the impact and uncertainty of the results of the conflict resolution can be quantified as adding 2-4 points percentages of capital cost of the project.

## **V. Evidence.**

### **i. Overall Incidence of Renegotiated Contracts in Latin America and Caribbe.**

Since 1990 to 2013 more than 1,700 PPP projects have reached financial closure distributed along 29 Latin American countries, one country (Brazil) concentrate 41 percent of the total PPP contracts.

As the projects become more complex usually an increase on the government's support is needed. In Latin America, from 2000 to 2007 an urged increase on the government support to PPP projects occurred, including transport infrastructure followed by a sharp decline after the global financial crisis.



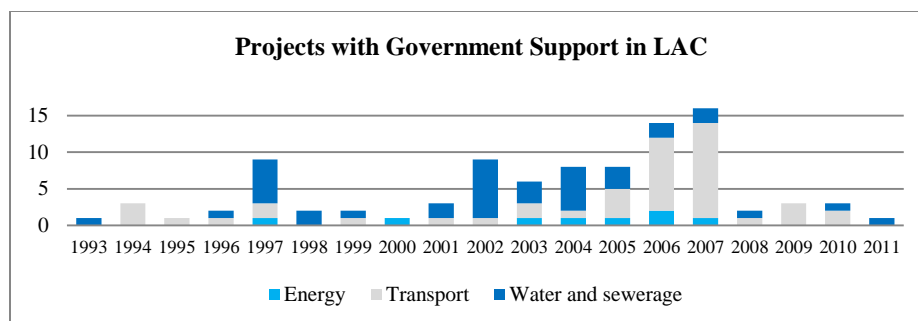


Figure: Projects with government support. Source: Own elaboration with PPI Database data.

The increase in the complexity of PPP projects might suggest more renegotiation incidence; but on the other hand, the countries with PPP experience have improved their renegotiation regulations in their PPP legislation, which intends to reduce incentives and manage renegotiations with better structure and oversight.

As shown in Table below the incidence of renegotiation continues to be significantly large, averaging 68% overall and 78% in transport infrastructure, and also are done relatively quick after contract award, about one year after (between 1980 and 2000, was 3.1 years, Guasch, 2004). The sectors most affected continue to be transport and water and sanitation. Yet social sector PPP are picking up.

Sectors	Percentage of Renegotiated PPP	Average Time to Renegotiation
All Sectors	68%	1.0 years
Electricity	41 %	1.7 years
Transport	78%	0.9 years
Water	87%	0.8 years
Social Sectors	39%	1.2 years
Other Sectors	35%	1 year

Source: Guasch (2004, updated 2014)

*Cancelled PPP Projects.* Regarding cancelled project the evidence is also telling. The number of cancelled contracts in Latin America is low, but increasing, about 5 percent of total PPP projects granted as shown in Table below. This rate is slightly higher the average of developing countries (4.3%)<sup>5</sup>. When it is contrasted with the number of renegotiated contracts, it strongly hints to the difficulty of governments to commit to a policy of no renegotiations. One would expect that number to be significantly large, particularly at the begging of programs, where the Governments could signal, by rejecting the request, to a credible policy of no renegotiations. Yet governments when confronted to renegotiations can have the option to deny the request and leave the decision to abandon or not the concession to the private operator. Yet that seldom happen, and for a number of reasons that we detail below, governments find it easier to allow the renegotiation of contracts (Harris and Pratat, 2009). And that leads to a vicious circle, since private operator understand the difficulties of government to uphold them to the initial, bid contract.

Figure: PPP contracts cancelled 1984-2013 (no divestitures). Source: Own elaboration with PPI Database data.

<sup>5</sup> For the same period, low income countries show a PPP cancellation rate of 7.16%.

Infrastructure LCR: Total Number of PPP Projects	Cancelled	Percentage of Projects
<b>1713</b>	<b>85</b>	<b>4.96 %</b>
By sector	By sector	By sector
Transport	39	7.01%
Energy	19	2.46%
Water and Sanitation	22	8.56%
Telecom	5	3.91%

Figure: PPP contracts cancelled 1984-2013 in LCR (no divestitures). Source: Own elaboration with PPI Database data

## ii. Specific Examples in Latin America: Renegotiations in Chile, Colombia and Peru.

Here we show the evidence of renegotiations in three Latin American countries, Chile, Colombia and Peru for the period 1993 to 2010. It shows a significant incidence of renegotiations of PPP contracts, a significant incidence of renegotiations of the same contract, and substantial fiscal costs of the outcomes of renegotiations

	Chile	Colombia	Peru
Total road concessions	21	25	19
Mean initial value of contract (constant USD Dec 2009, million)	246	263	166
Mean initial term (years)	25.2	16.7	22.1
Mean concession length (km)	114	195	383
Mean concession years elapsed	12.5	9.0	4.6
Renegotiated road concessions	18	21	11
Total number of renegotiations	60	430	53
Mean number of renegotiations per concession	3.3	20.5	4.8
Mean time of first renegotiation (years)	2.7	1.0	1.4
Mean fiscal cost of renegotiations (constant USD Dec 2009, million)	47.2	266.8	28.9
Mean fiscal costs / initial value (percentage)	17.4	282.8	13.4
Mean added term (years)	0.9	6.3	0.8
Mean added length (km)	0	54.6	0
Number of renegotiations / concessions year elapsed	0.2	1.9	0.9

Figure: Summary of sample statistics by country, 1993-2010. Source: Bitran et al 2012

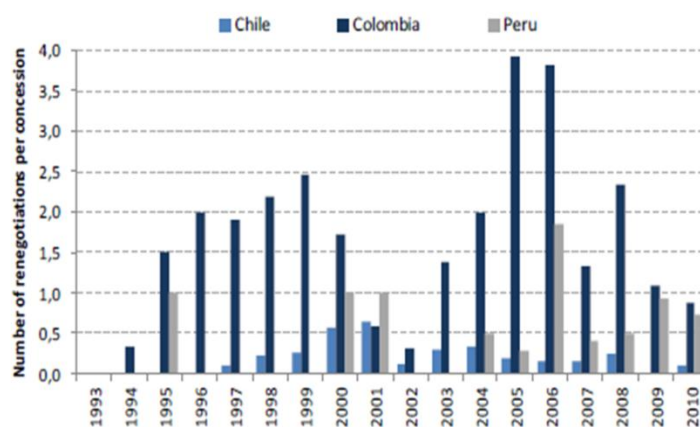


Figure: Number of concession renegotiations per year in each country. Source: Bitran et al 2012.

		Chile	Colombia	Peru
<b>Total</b>		60	403	44
<b>How</b>	Bilateral Agreement	83%	98%	100%
	Arbitration	17%	2%	0%
	Government-led	84%	40%	64%
	Firm-led	12%	20%	23%
	Jointly-led	4%	40%	13%
<b>When</b>	During construction	53%	51%	62%
	After construction	47%	49%	38%
<b>What for</b>	Complementary works	69%	39%	17%
	Change conditions	22%	55%	83%
	Both	9%	1%	0%
	Add new stretches	0%	5%	0%
<b>Paid when</b>	Present fiscal transfer	66%	42%	14%
	Deferred fiscal funds	55%	6%	0%
	Other costs realized later	36%	28%	39%
	No cost	14%	24%	47%
<b>Types of cost</b>	Fiscal transfer	66%	48%	20%
	Increase concession term	12%	12%	14%
	Higher toll tariffs	24%	1%	0%
	Other type of payment	16%	0%	0%
	Without direct cost	15%	45%	77%

Figure: Characteristics of contract changes, 1993-2010. Source: Bitran et al 2012.

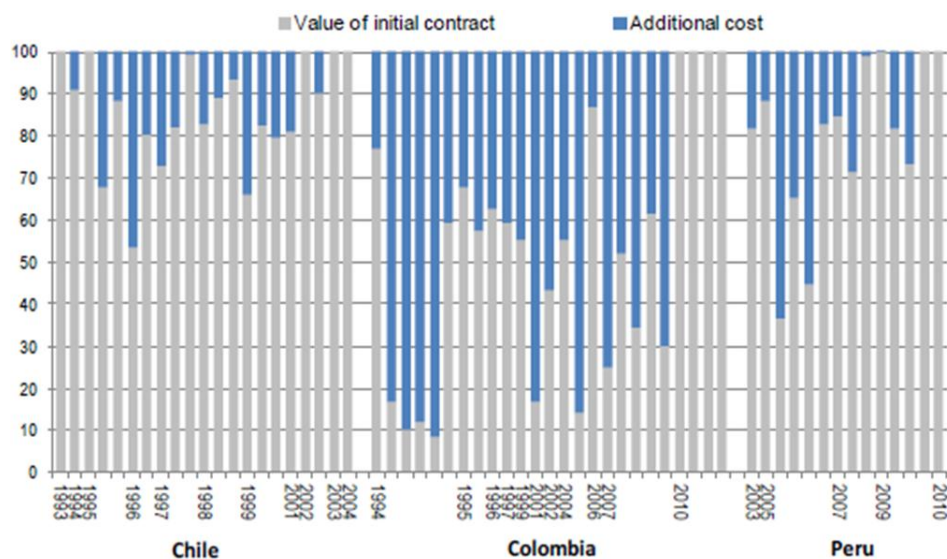
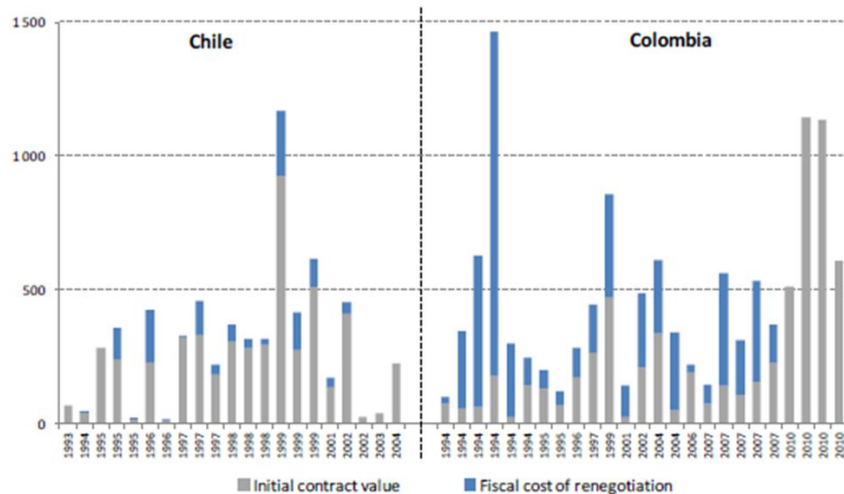


Figure: Additional cost versus initial contract value (%). Source: Bitran et al 2012.



Note: The x-axis indicates the year in which the concession contract was initially signed.

Figure: The fiscal costs of renegotiations in Chile and Colombia (Constant prices in millions USD December 2009). Source: Bitran et al 2012.

### iii. Other cases outside the region

That high incidence of renegotiations is not privy to the LAC Region. It also happened outside the Region, Cases in point are the experiences of India, and Portugal, among others.

#### i) India Renegotiations

India launched in the mid to late 2000s an aggressive program of PPP particularly in the road sector, awarding over 300 highway PPP. Many of them with the support of the Viability Gap Fund, often awarded under the criteria of minimum subsidy requested. As of 2014, more than half of those projects are in distress with the private operators requesting renegotiation of the contract. Apparently a significant number of those renegotiations demands originate from aggressive bids. The Government of India has been evaluating the situation and preparing a response for this systemic problem but in a selective and case by case basis.

#### ii) Portugal Renegotiations Case Study (Source UTAP 2014)

##### “Troika” agreement – PPP reforms implemented, 2011-2012

All PPP projects to be developed were paralyzed, affecting several sectors were paralyzed, 2011-2012. The Ministry of Finance (MoF) and the International Monetary Fund assessed the PPP legal and institutional framework in a new PPP framework law and UTAP created (June 2012). MoF updated and enhanced its reporting instruments on PPP and concessions. Ernst & Young was hired for the assessment of the PPP renegotiations.

<b>Strategic position of the States message to private partners</b>	<ul style="list-style-type: none"> <li>• The road model is not sustainable for the public partners (EP) party.</li> <li>• Renegotiation will provide more rational contracts and remuneration schemes.</li> <li>• Overall reduction of public payments through reduction in IRR, CAPEX and OPEX</li> <li>• No debt renegotiation is undertaken: any debt renegotiation would increase financial costs of contracts.</li> <li>• Financial institution would increase financial costs of: only transitory ADSCR reduction from 1,25 to 1,05.</li> </ul>
<b>January 2013, formal launch of negotiations to 1,05</b>	<p>Renegotiations of 16 contracts in order to reduce State gross payments. The main strategic lines:</p> <ul style="list-style-type: none"> <li>• Paralyzing investments in course and reduction of contract scope (subconcessions)</li> <li>• Rationalization of engineering standards according to international/EU standards</li> <li>• Suppression of automatic payments for future CAPEX</li> <li>• Reduction of the shareholder's IRR</li> </ul> <p>Additionally, toll revenue related measures</p>
<b>Negotiation outcome measures IR</b>	<p>Target for 2013: 300 million (IRRCAPEX).</p> <p>Overarching negotiation objective: reach sustained savings throughout the projects standards</p> <p>7 preliminary agreements reached throughout 2013:</p> <ul style="list-style-type: none"> <li>• 2,5 Billion euros, contract life cycle forecast</li> <li>• 231 Million EUR in 2013</li> </ul> <p>Amended contracts did not entry into force in 2013, pending financial institutions and Court of Auditors approval.</p>
<b>Negotiation outcome institutions and Court of Auditors a</b>	<p>Forecasted savings of 6.600 million euros (-22%):</p> <ul style="list-style-type: none"> <li>• State concessions (9) = 2.800 Million euros (-17%)</li> <li>• EP subconcessions (7) = 3.800 Million euros (-25%)</li> </ul> <p>Negotiation status (September 2014):</p> <ul style="list-style-type: none"> <li>• 5 contracts approved by financial institutions</li> <li>• 6 agreements pending financial institutions approval</li> <li>• 5 contracts still under negotiation</li> </ul> <p>Once approved, contracts are to be send to Court of Auditors</p>

## VI. Evolution. 2005 – 2013

Overall indicators show as of 2013 an increase in the average of renegotiations relative of the levels in 2004, a significant increase on average in the number of renegotiations per concession/PPP and a decrease in the incidence of renegotiation in selected countries that have implemented measures to address the issue.

### **Drivers of Renegotiations Requests**

- The renegotiations requests can have multiple causes, external and/or internal. For example, in the first case, in regulated markets, where no prices can be adjusted, significant changes in economic circumstances frequently lead to renegotiation requests, either by the operator or the Government (even if the risk allocation is established in the contract)
- Occasionally, economic conditions change unexpectedly because of the macroeconomic conditions beyond of the control of the parties (e.g. financial crises worldwide, the fluctuations of currencies, election where the new administration can change the regulation and affect the operator rights, etc.).
- Most commonly, demands for the renegotiation relate to bidding errors, lack of decision during the procurement process, aggressive offers, and poorly written contracts.
- One of the main causes of the renegotiation is opportunistic behavior by operators and governments (governments may decide to modify the contract in benefit of users acting unilaterally to capture "excess profits" in electoral votes, or changing priorities after elections to anticipate investments). As well as the opportunity of governments to bypass the due process to secure additional financing and authorization (by parliament) expand investments
- The inability of Governments to credibly commit to a policy of no renegotiations and abuse of the exception for renegotiation.
- Operators believe the circumstances to confer a considerable influence on the host Government to grant them additional benefits through the renegotiation and weak contract monitoring.

### **VII. Measures that have been taken to tackle this issue.**

A number of countries have taken decisions to address the issue with mixed success

Mexico, New Law and Regulations and Process; Peru, Review to the Law and Regulations; Chile, New Law and Regulations and Conflict Resolution Framework; Colombia, New Law and Regulations and Institutionality and Process; Portugal, Platform for renegotiations; India, Normative package to guide the process

More specifically, measures that have been taken are for example:

- Use and implementation of "delivery unit" to high level.
- Use and implementation of requirements of resolution unit (licenses, permits, rights-of-way, evaluations specific-environmental archaeological.
- Greater role of the PPP Unit in the control/regulation of the contract (Peru, Colombia).
- Disuse of clause of financial equilibrium (Chile and Peru).
- Platforms of renegotiations and process led by the Ministries of Finance (Chile and Peru).
- Platform for efficient land expropriation and securing of rights of way
- Use of regulatory accounting (Peru and Chile).

- Transparency of the renegotiation process. Disclosure of information since the request, analysis, negotiations and final amendment- web information. Greater use of LPVR as the award criteria to mitigate demand risk (Chile en Colombia).
- Control of aggressive bids by larger performance bonds (Uruguay).
- A Freeze period for renegotiations (Colombia and Peru)
- A statement in the law or regulations that the risk matrix cannot be altered (Mexico).
- Use and composition of panels of experts (aggressive betting, renegotiation, arbitration, regulation).
- 

### **VIII. Platform for Addressing Renegotiations**

The principles behind the platform are as follows,

- Preserve the value for money of the PPP project/contract.
- Inviolability of the Contractual/Bid Offer. When confronted with requests for renegotiation, the sacred character of the original contract/bid must be respected. And the operator should be held responsible for its offer.
- The financial equation of the winning offer should always be the reference point, and if the contract would be modified in the case of the renegotiation or adjustment, the outcome should be an impact of zero net present value of the benefits and risks, and without changing the allocation matrix. Compensations to the other party have to be considered to insure any extraordinary benefit.
- Renegotiation must not be used to correct errors in the basis for tender or excessively risky or aggressive bids.

Some reflections to be adopted to attack the problem of renegotiation are the following:

- The contract should stipulate the renegotiations approach, criteria and process.
- Increase the political costs of accepting renegotiations demands, by implementing a Transparency Framework-Use of Web, publish the requests, decisions and arguments, and using the media to inform on request and decisions and rational.
- Establish a reputation of not being well disposed to renegotiate by cancelling PPP/concessions processes.
- Establish a freeze period for renegotiations; say no renegotiations will be considered for three to five year after contract award. Only few exceptions can be accepted.
- Establish clear jurisdiction over the decision to renegotiate, at high level, such as Interministerial Committee lead by Minister of Finance.
- Establish in the contract the right to evaluate and reject aggressive and reckless bids, defining the criteria and standards, including submission of financial model for those bids or additional guarantees (financial bonds).
- Use panel of experts to evaluate: i) aggressive bids, ii) renegotiations request, ii) and conflict resolution.

- Matrix of risks with detailed risks identification and allocation-establishing that modifications of the contract must not alter the risk allocation.
- Clarification and wording of key contractual clauses and bidding documents.
- Platform for efficient land expropriation and for the securing of rights of way (Mexico and Chile are good practices).
- Contingent financing over time, not all at the beginning (viability gap funding)
- Establish guidelines for levels of compensation.
- Request a mandatory bidding process for additional infrastructure and the interest rate for PPP financing (Chile is the best practice)
- Establish transparent framework of conflict resolution (panel of experts and arbitration).
- Impose appropriate (biting) level of performance bonds: for example, at least 15% of the investment.
- Use appropriately the selection of competitive factors (such as the award criteria) to increase the costs – make more expensive the exit. When possible use as award criteria (for some sectors) the least present value of revenue, as it is quite robust to mitigate renegotiation requests (automatically extending the duration of the contract if economic conditions become adverse, Chile and Colombia are best practices).
- Establish that if the contract is modified, the net present value of the modifications must be zero, and preserve value for money.

## References

*Bitran Eduardo & Villena Marcelo (2012) Benefits and Costs in Public Private Partnership: Transport Infrastructure Projects in Latin America. Facultad de Ingeniería y Ciencias, Universidad Adolfo Ibañez.*

*Bitran E., Nieto-Parra S. and Robledo J. (2012) “Opening the black box of contract renegotiations: An analysis of road concessions in Chile, Colombia and Peru” Draft Renegotiations in Chile, Peru and Colombia, Mimeo.*

*Guasch, J. L., J.J. Laffont and S. Straub (2007) “Concessions of Infrastructure in Latin America: Government-led Renegotiation”, Journal of Applied Econometrics 22, p 1267-1264.*

*Guasch, J. L., J.J. Laffont and S. Straub (2006) “Renegotiation of Concession Contracts: A theoretical approach”, Review of Industrial Organization 29: 55-73*

*Guasch J.L., J-J Laffont and S. Straub (2005) Infrastructure concessions in Latin America: government-led renegotiations, World Bank Policy research Working Paper 3749.*

*Guasch, J.L. (2004) “Granting and Renegotiating Concession Contracts: Doing it right”, World Bank Publications*

*Guasch, J. L., J.J. Laffont and S. Straub (2003) “Renegotiation of Concession Contracts In Latin America”, Policy Research Working Paper 3011, The World Bank, April.*

*Harris, Clive, John Hodges, Michael Schur, and Padmesh Shukla (2003) Project Infrastructure a review of Canceled Private Projects., World Bank, Note Number 252.*



*Harris, Clive and Pratap Kumar (2009), What drives private sector exit from infrastructure? Gridlines. Note 46. PPIAF.*

*Huamaní Sandro and Vargas Tito (2011) Renegociaciones no eficientes a partir del diseño del contrato y la licitación en las concesiones en transporte. Revista de Regulación en Infraestructura de Transporte. Number 7.OSITRAN.*

*Laffont Jean-Jacques and Tirole Jean (1993) "A theory of Incentives in Procurement and Regulation", The MIT Press, Cambridge*

*Mc Affee Preston and John Mc Millan (1986) "Bidding for Contracts: A Principal Agent Analysis", The RAND Journal of Economics, Vol. 17. Issue 3, Autumn, 326-338*

*Montesinos Jorge and Saavedra Eduardo (2011) Algunos alcances en torno a la institucionalidad y renegociación de concesiones en la infraestructura de transporte de uso público en Perú, Revista de Regulación en Infraestructura de Transporte. Number 7.OSITRAN.*

*OECD Development Center (2012). "Latin American Economic Outlook". Paris: OECD Development Center.*

*Tirole, Jean (2007) "Bounded rationality and incomplete contracts", May (accessed at <http://citeseerx.ist.psu.edu> on October 6, 2012)*

*UTAP, (2014), Renegotiations of PPP Concessions in Portugal, Power Point Presentation.*

## **Annex 1**

### **Main renegotiation drivers:**

- Adjustments of macroeconomic shocks.
- Changes in Governments or in their priorities.
- Securing additional investments or projects without going through due diligence.
- Governments can not fulfill their contract commitments.
- Financial close is not possible or expensive.
- Take advantage of the lack of credible commitment to no-renegotiation.
- Abuse of financial equilibrium principle when stated in contract.
- Causality and the levels of remuneration of the foreseen and unforeseen events.
- Mistakes during procurement and poor contract management.
- Perceive corruption opportunities.
- Fear of government officials of being accused of corruption leads to a non deterrent of aggressive bets / disqualification of opportunistic deals.
- Poor regulation and the lack of regulatory accounting.
- Political cycle (elections) can incentive anticipate investments.
- Misaligned institutions and jurisdiction of the decisions.
- Lack of transparent framework and processes.
- Poorly key studies, designed risk matrix and risk allocation.
- Inefficient and improper acquisition of land and/or right to via and related topics.
- Issues related to unforeseen events, assignment of cause causation and levels of compensation poorly treated in contract.
- Changes in the scope of the project.
- Poor estimates of traffic/demand levels in viability studies and changes in the traffic structure.