

THE PUBLIC-PRIVATE
PARTNERSHIP
LAW REVIEW

FIFTH EDITION

Editors

Bruno Werneck and Mário Saadi

THE LAWREVIEWS

THE PUBLIC-PRIVATE
PARTNERSHIP LAW
REVIEW

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Editors

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PREFACE

We are very pleased to present the fifth edition of *The Public-Private Partnership Law Review*. Notwithstanding the number of chapters in various publications in The Law Reviews series on topics involving public-private partnerships (PPPs) and private finance initiatives (in areas such as projects and construction, real estate, mergers, transfers of concessionaires' corporate control, special purpose vehicles and government procurement), we identified the need for a deeper understanding of the specific issues related to this topic in different countries.

In 2014, Brazil marked the 10th year of the publication of its first Public-Private Partnership Law (Federal Law No. 11,079/2004). Our experience with this law is still developing, especially in comparison with other countries where discussions on PPP models and the need to attract private investment in large projects dates from the 1980s and 1990s.

This is the case for countries such as the United Kingdom and the United States. PPPs have been used in the United States across a wide range of sectors in various forms for more than 30 years. From 1986 to 2012, approximately 700 PPP projects reached financial closure. The United Kingdom is widely known as one of the pioneers of the PPP model; Margaret Thatcher's governments in the 1980s embarked on an extensive privatisation programme of publicly owned utilities, including telecoms, gas, electricity, water and waste, airports, and railways. The Private Finance Initiative was launched in the United Kingdom in 1992, aiming to boost design-build-finance-operate projects.

In certain developing countries, PPP laws are more recent than the Brazilian PPP law. Argentina was the first country in Latin America to enact a PPP Law (Decree No. 1,299/2000, ratified by Law No. 25,414/2000). The Argentinian PPP Law was designed to promote private investment in public infrastructure projects that could not be afforded exclusively by the state, especially in the areas of health, education, justice, transportation, construction of airport facilities, highways and investments in local security. In Mozambique, Law No. 15/2011 and Decree No. 16/2012 govern the Public-Private Partnerships Law and other related PPP regulations, which establish procedures for contracting, implementing and monitoring PPP projects. In Paraguay, a regulation establishing the PPP regime has been enacted (Law No. 5,102) to promote public infrastructure and the expansion and improvement of services provided by the state; this law has been in force since late 2013.

In view of the foregoing, we hope a comparative study covering practical aspects and different perspectives regarding PPP issues will become an important tool for the strengthening of this model worldwide. We are certain this study will bring about a better dissemination of best practices implemented by private professionals and government authorities working on PPP projects around the world.

With respect to Brazil, the experience evidenced abroad may lead to the strengthening of this model. One specific feature of the PPP law in Brazil, for instance, is state guarantees. This

feature permits that the obligation of the public party to pay a concessionaire be guaranteed by, among other mechanisms authorised by law: a pledge of revenues; creation or use of special funds; purchase of a guarantee from insurance companies that are not under public control; guarantees by international organisations or financial institutions not controlled by any government authority; or guarantees by guarantor funds or state-owned companies created especially for that purpose.

The state guarantee pursuant to PPP agreements is an important innovation in administrative agreements in Brazil; it assures payment obligations by the public partner and serves as a guarantee in the event of lawsuits and claims against the government. This tool is one of the main factors distinguishing the legal regimen of PPP agreements from ordinary administrative agreements or concessions – one that is viewed as crucial for the success of PPPs, especially from a private investor's standpoint.

Nevertheless, the difficulty in implementing state guarantees on PPP projects has been one of the main issues in the execution of new PPP projects in the country. This is made worse by the history of government default in administrative contracts.

In other jurisdictions, however, state guarantees are not a rule. Unlike PPP projects in developing countries, government solvency has not historically been a serious consideration in other jurisdictions. That is the case in countries such as Australia, France, Ireland, Japan, the United Kingdom and the United States.

We expect that the consolidation of PPPs and the strengthening of the government in Brazil may lead to a similar model, enabling private investments in areas where the country lacks the most.

Brazil must adopt cutting-edge models for awarding PPP agreements. The winner is usually chosen based solely on the price criterion (offering of lower prices or highest offers), which sometimes leads to projects lacking advanced or tailor-made solutions. Despite the legal provisions on the role of technical evaluation of offers, they are becoming less relevant. However, some ongoing discussions regarding amendments to the Brazilian procurement legislation and new criteria, which are based on the international experience, could (fortunately) be approved.

We highlighted some discussions regarding the amendment to the Federal Procurement Law (Federal Law No. 8,666/1993), which is expected to expedite public procurement in Brazil. One of the main innovations proposed in this debate is the competitive dialogue, a type of bid in which the authority engages with bidders to discuss and develop one or more solutions for the tendered project. After the conclusion of the dialogue phase, the authority will establish a term for the submission of bids.

Competitive dialogue is a reality in many jurisdictions (e.g., Australia, Belgium, China, France, Ireland, Japan and the United Kingdom). In Japan, for example, some projects are procured through the competitive dialogue process. This process may be adopted if a relevant authority is unable to prepare a proper service requirement, in which case it proposes a dialogue with multiple bidders simultaneously to learn more about the specific service it seeks to implement. As another example, in France a dialogue will be conducted with each bidder to define solutions on the basis of the functional programme. At the end of the dialogue period, the procuring authority will invite the candidates to submit a tender based on the considered solutions. After analysis of the tenders, a partnership contract will be awarded to the bidder with the best price in accordance with the criteria established in the contract notice or in the tender procedure. We hope the importance of this tool is recognised in Brazil and reflected in our legislation.

Further, the Investment Partnerships Programme, as established in Federal Law No. 13,334/2016, is a legal plan regarding infrastructure development in the country, providing conditions for the attraction of investments in infrastructure projects and creating environments for greater integration between public and private sectors.

The PPI is comprised of two relevant bodies within the federal government: the PPI Board and the PPI Secretariat. The first one evaluates and recommends to the President the projects that should be part of the PPI, as well as decides on subjects concerning the execution of partnership contracts and privatisations. The second one is a taskforce that acts in support of the Ministries and Regulatory Agencies to execute the PPI's activities. These entities, together with other bodies and controlling agencies, are expected to act in an articulated manner as to ensure stability, legal certainty, predictability and effectiveness of the investment policies.

With regard to the plans of the president-elect for infrastructure investments in Brazil, the responsible governmental team has already confirmed the continuity of the PPI, linked to the presidency and preserving the members of its current technical team. In addition, the new government team endorses the development of a programme by PPI to support public-private partnerships of states and municipalities, which would mainly cover sanitation and public lighting sectors. Given the lack of operational, technical and economic-financial ability of municipalities to manage such programmes, the federal government is expected to act closely with local entities to boost projects in priority areas.

In the fifth edition of this book, our contributors were drawn from the most renowned firms working in the PPP field in their jurisdictions. We would like to thank all of them for their support in producing *The Public-Private Partnership Law Review*, and in helping with the collective construction of a broad study on the main aspects of PPP projects.

We strongly believe that PPPs are an important tool for generating investments (and development) in infrastructure projects and creating efficiency not only in infrastructure, but also in the provision of public services, such as education and health, as well as public lighting services and prisons. PPPs are also an important means of combating corruption, which is common in the old and inefficient model of direct state procurement of projects.

We hope you enjoy this fifth edition of *The Public-Private Partnership Law Review* and we sincerely hope that this book will consolidate a comprehensive international guide to the anatomy of PPPs. We also look forward to hearing your thoughts on this edition, and particularly your comments and suggestions for improving future editions of this work.

Bruno Werneck and Mário Saadi

Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados

São Paulo

March 2019

MEXICO

Alejandro Rojas V and Fernando Castillo V¹

I OVERVIEW

Mexico is a federal republic composed of 32 states and several municipalities within each state. As such, federal and local statutes apply to public-private partnerships (PPPs).

The development of PPPs in Mexico began in 2004 under the scheme known as projects for the provision of services (PPS), although the enactment of the Law on Public-Private Partnerships (the PPP Law) and its Regulations occurred until 2012. In Mexico, however, different types of public-private investment schemes have been used since the early 1990s to implement infrastructure projects, such as concessions, financed public works and investment projects with deferred expenditure registration. These schemes served as direct precedents of PPPs as understood at the time of writing.

PPPs constitute a long-term contractual relationship between the public and private sectors for the provision of services to the public sector or the end user, in which the private developer provides, partially or totally, the infrastructure required for such services and, generally, the public entity pays a monetary consideration to the private developer. PPPs have been used for government policy reasons to increase social welfare, offer more and better infrastructure and foster investment in the country.

Since the enactment of the PPP Law in 2012, there have been more than a hundred public biddings for the implementation of projects through the PPP model focused on the following sectors: health, transportation, telecommunications, social and hydraulic infrastructure. Also, the energy and environmental sectors have shown an increasing participation in PPPs.

To ensure transparency and access to information, the federal government created two websites known as CompraNet and Mexico Projects Hub. CompraNet is a digital platform that provides public information on projects, bidding processes, procurements, leases, public works and other related services; while Mexico Projects Hub contains updated detailed information of the most relevant energy and infrastructure projects that require private investment. The Hub is part of the Mexican government's initiative to create an investor-relations office to link investment projects with domestic and foreign potential investors, encouraging long-term financing for infrastructure.

In the following years, the PPP agenda in Mexico may increase, particularly in the transportation and telecommunications sectors, since the new administration for

¹ Alejandro Rojas V is a partner and Fernando Castillo V is an associate at Nader, Hayaux & Goebel. The authors would like to thank Benjamín Torrero G for his assistance in preparing this chapter.

2018 to 2024 has shown particular interest in developing railways, highways, airports, as well as an extensive telecommunications network project to provide internet access and digital services across the country.²

II THE YEAR IN REVIEW

In 2018, different entities and agencies of the federal government awarded approximately 13 projects structured under the PPP Law across a wide range of sectors, including health, transportation and telecommunications. The main reason for the increase in the number of PPP projects compared to previous years was the clear objective to promote private investment in critical public infrastructure projects that could not be afforded on an exclusive basis by the Mexican government.

In the telecommunications sector, the shared network project (Red Compartida) reached financial closing. This project offers wholesale telecommunications services across the country as a result of the telecommunications reform, which seeks to create greater competition, as well as increase telecommunications coverage by offering access to its infrastructure and capacity as a service. Further, the federal government opened the tender process for the trunk network project (Red Troncal), attracting investment opportunities to domestic and international operators and investors. This project consists of a PPP contract for the design, installation, operation and maintenance of an optical fibre backbone to improve telephone and mobile data services, aiming to reduce the tariffs charged to customers. The decision for the award of this project is scheduled for February 2019.³

In the health sector, two of the most important PPPs developed by the Institute of Social Security and Services for State Workers reached financial closing in 2018 with the National Bank for Public Works and Services (Banobras) and other financial institutions. It is expected that completion of the new hospitals occurs as scheduled in the contract and the operation phase will start on the second semester of 2020.

Finally, the first self-financed PPP project was awarded in 2018 to design, build, develop and operate an aquarium in the city of Mazatlán, Sinaloa. Although the federal government allocated public resources through the National Infrastructure Fund (Fonadin) and the Ministry of Tourism, most of the funds for the construction of the facilities shall be contributed by the private developer. Under the self-financed PPP scheme, the private developer assumed the 'demand risk' and will receive revenues exclusively through the tariffs charged to the users of the aquarium. Financial closing is expected this year, although construction started in December 2018.

2 For more information on the projects agenda please refer to the following link: https://www.finanzaspublicas.hacienda.gob.mx/work/models/PPEF2019/paquete/politica_hacendaria/CGPE_2019.pdf.

3 For more information about the trunk network project please refer to the following link: https://www.proyectosmexico.gob.mx/proyecto_inversion/602-telecomm-red-troncal/#popme.

III GENERAL FRAMEWORK

i Types of public-private partnership

There are different structures to develop PPP projects in general, including the following:

- a concessions, in which the private sector – concessionaire – builds and operates the project owned by the public sector and the investment is recovered through the fees or tariffs paid by the project's end users;
- b financed public works, in which the private developer invests in a project, and once it is constructed and operating, the public entity repays the total investment;
- c joint ventures, involving particular risk-sharing models; and
- d PPP contracts (*stricto sensu*), which regulatory framework consists of the PPP Law and its Regulations. It is relevant to mention that for projects that are not regulated by the PPP Law, there is a specific legal framework for each infrastructure sector (i.e., oil and gas, power or special economic zones).

Regarding PPP contracts in particular, the PPP Law and its Regulations set forth a classification related to the funding used for the project:

- a pure PPP projects – completely funded with public resources, either:
 - provided in the annual federal budget; or
 - resources different from budgetary funds, including those granted by Fonadin;
- b combined PPP projects – using both public funds and any other source of funding; and
- c self-financed PPP projects – funded exclusively with private funds, other non-financial resources or with the cash flow generated by the project itself.

In the last year, a couple of PPP projects have been structured for the first time through the self-financed PPP model for the development and construction of water and energy facilities (i.e., Mazatlán Aquarium). As previously explained, the private developers will not receive any payment from the public contracting parties; rather, they will repay the financing and recover their investment entirely through the cash flow obtained by operating the project.

ii The authorities

The process of structuring, bidding and entering into a PPP contract is subject to the control of the public entity acting as contracting party in the relevant jurisdiction. As mentioned before, PPP matters are subject to federal and local statutes; therefore, the contracting party could be any federal, state or municipal authority developing a PPP project, whether state-owned companies, agencies, public trusts or any other governmental entity.

At the federal level, the PPP Law applies to federal public agencies and entities, federal public entities regulated by federal laws with autonomy derived from the Constitution, federal public trusts not considered state-owned entities, and any other governmental entities (state or municipal) that allocate federal resources to PPP projects.

The Ministry of Finance and Public Credit is one of the principal authorities for PPPs in Mexico. It has jurisdiction to interpret the PPP Law for administrative purposes and to enact complex rules to prepare viability studies required to structure a PPP. Another relevant authority for PPPs is the Inter-Ministerial Commission on Public Expense, Financing and Disincorporation, which approves those projects previously analysed and authorised by the Ministry of Finance and Public Credit to be developed under the PPP scheme and that have complied with the regulatory requirements provided for in the PPP Law and its Regulations.

Once the Inter-Ministerial Commission's authorisation has been granted, the projects are submitted to the budget and Public Account Commission of the House of Representatives (in Congress) for the authorisation of the allocation of budgetary federal funds.

The Ministry of Public Affairs also plays an important role in PPPs as it is in charge of state-owned property, valuations and investigation of public officials' responsibilities. The PPP Law also provides for the Ministry of Public Affairs' responsibility to provide information related to PPP projects and the bidding processes through Compranet, including the supervision of the project and the enforcement of the PPP contract.

The Ministry of Environment and Natural Resources also participates by authorising the environmental impact assessments for PPP projects, intended to protect the environment, as well as to preserve and restore the ecosystems for the purpose of avoiding or minimising the adverse effects on the environment of works and activities caused by the development of the projects.

Other authorities at the federal, state and municipal levels may also be involved in the implementation of PPPs, for instance, to grant the specific permits, licences or authorisations required to develop the project (i.e., land-use licences, water supply and wastewater discharge permits, civil protection and municipal operating licences, among others).

iii General requirements for PPP contracts

A public entity interested in developing a PPP must first complete a structuring phase for the project according to the following considerations:

- a* if the PPP project involves budgetary funds provided in the annual federal budget, the public entity must prepare and obtain:
 - the viability studies of the project;
 - the registry in the Investment Portfolio of the Ministry of Finance and Public Credit;
 - the authorisation of the Inter-Ministerial Commission on Public Expense, Financing and Disincorporation; and
 - the authorisation of the budget and Public Account Commission of the House of Representatives;⁴
- b* if the PPP project involves federal resources different from budgetary funds, the public entity must prepare and obtain:
 - the viability studies of the project; and
 - the registry in the Investments Portfolio of the Ministry of Finance and Public Credit; and
- c* if the PPP project involves other non-budgetary funds or other non-financial resources (such as self-financed PPPs), the public entity must only prepare the viability studies for the project.

Moreover, the viability studies that the PPP Law provides for must include the:

- a* general description of the project;
- b* necessary goods and assets (including real property) for developing the project;
- c* necessary permits, licences and authorisations for developing the project;
- d* social, legal, economic, financial and environmental feasibility; and

⁴ See the previous section for information about the authorities involved in the structuring of PPPs.

- e* financial analysis on the convenience of developing the project through the PPP scheme compared to other models of project financing.⁵

IV BIDDING AND AWARD PROCEDURE

i Expressions of interest

After the project is structured and approved by the corresponding authorities, the public entity publishes a tender notice or call inviting the private sector to participate in a bidding process. The tender notice shall be published in the contracting entity's website, in the Official Federal Gazette, in CompraNet and in a newspaper of major distribution. The PPP Law establishes that PPPs are subject to transparent and publicly available bidding processes.

Along with the tender notice, the contracting entity publishes bidding rules containing, among others, the:

- a* identity of the contracting entity;
- b* requirements for the participants to prepare and submit their proposals;
- c* term for the services to be provided;
- d* characteristics and technical aspects for the construction of infrastructure works and services to be provided;
- e* PPP contract model containing the rights and obligations of the parties and the distribution of risks;
- f* guarantees that participants must deliver; and
- g* ancillary documents that participants must submit together with their proposals.

After the tender notice and bidding rules are published, the contracting entity grants a period for Q&A with the participants (the PPP procedure shall have at least one Q&A meeting to clarify doubts and concerns that participants may have). Once that period is concluded, participants prepare and submit their technical and economic proposals. At the end of the bidding process, the project is awarded to the bidder that offered the best terms in price, quality, financing, opportunity and other circumstances as determined by the contracting party in the bidding rules.

Any person is allowed to attend the events of the bidding process as a public observer. Likewise, the bidding process shall have a social witness to verify that the procedures follow the principles of legality, free participation and competition, objectivity, impartiality, transparency and publicity.

ii Requests for proposals and unsolicited proposals

Any individual or entity that fulfils the requirements established in the bidding rules is allowed to participate in the bidding process, whether individually or as a consortium. The term for the submission of proposals is at least 20 business days after the last Q&A meeting or event as provided for in the bidding process calendar. Bidders must submit a technical and an economic proposal for the project in separate and sealed envelopes, which are opened in a public session for evaluation.

⁵ Article 14 of the PPP Law and Articles 21 to 31 of its Regulations provide for the preparation and submission of the viability studies for a PPP project.

The technical proposals shall contain, among others, technical aspects to carry out the project, including the development of the infrastructure and the provision of the services referred to in the bidding rules, as well as the commitment to create a special purpose vehicle (SPV) to develop the project. On the other hand, the economic proposals shall contain, among others, the minimum financial requirements, the project's financial model, investment amounts committed for the project and the price of the services to be provided.

Additionally, the PPP Law sets forth terms and conditions for the submission of unsolicited proposals by private sector entities interested in implementing a PPP project. An unsolicited proposal begins with the request for an expression of interest by the private sector to the public entity; the public entity shall respond within 30 business days whether it is interested or not in developing the project. Once the private sector obtains a favourable expression of interest from the public entity, it must prepare the unsolicited proposal with the following documentation: the viability studies including the description and characteristics of the project; legal, technical, economic and financial feasibility of the project as a PPP; essential elements of the PPP contract; and financial requirements and estimated investments.

Furthermore, public entities can ask for proposals of PPP projects they are willing to accept, specifying the sectors, subsectors, geographical matters, type of projects, estimated goals, relationship between the proposal and the purposes described in the National Development Plan, as well as the expected benefits. Interested parties take into consideration this information to prepare more accurate unsolicited proposals that could be admitted for public bidding.

The public entity receiving an unsolicited proposal has three months to conclude the analysis and evaluation of the proposal. This term may be extended for an additional three-month period if the complexity of the project requires so. In addition, the public entity may as well transfer the proposal to other authorities or invite federal, state or municipal entities to participate in the project, if applicable.

After the analysis and evaluation period, the public entity issues an opinion on the feasibility of the unsolicited proposal. If the proposal is considered feasible, the public entity has the right to call for a bidding process inviting private sector participants, which is conducted under the general rules of bidding procedure as provided for in the PPP Law. Still, if the promoting party that submitted the unsolicited proposal is the only participant in the bidding, the PPP contract may be directly awarded if it fulfils the corresponding requirements.

The promoting party of an unsolicited proposal is entitled to obtain an incentive in the evaluation of its offer during the bidding process, which shall be no greater than 10 per cent of the evaluation method over other bidders. It also has the obligation to convey the necessary information, documents and studies to the public entity to ensure fairness in the bidding. If the promoting party does not win the bidding, it has the right to receive the amounts expended to carry out the studies for the unsolicited proposal.

iii Evaluation and grant

When evaluating the technical and economic proposals submitted by the bidders, the public entity is required to verify their compliance with all the requirements set forth in the bidding rules and the integration of every element contained in each proposal.

The PPP Law emphasises the importance of the objectiveness in the evaluation of the proposals, so that no participant is favoured over the others. For such purposes, the public entity may use an evaluation matrix that could consist of percentage points, cost-benefit

criteria, point-rated criteria or any other quantifiable method that allows an objective and impartial evaluation. This evaluation criteria shall be clearly determined in the bidding rules so that every participant knows the method that the public entity will use to award the contract.

The public entity must evaluate the technical proposals of each bidder and, only if these proposals fulfil the necessary requirements provided for in the bidding rules, it continues with the evaluation of the economic proposals. The bidding rules provide for cases in which a proposal is considered insolvent, being the most common in the following cases: if the proposal is incomplete or its evaluation is impossible; if the proposal fails to comply with legal, technical or economic provisions contained in the bidding rules; and if the provided information is misleading or false.

After the evaluation of proposals, the public entity awards the PPP contract to the bidder whose proposal is considered solvent for fulfilling all legal, technical and economic requirements, in accordance with the evaluation criteria detailed in the bidding rules. If two or more proposals are considered solvent, the contract is awarded to the proposal that provides the best economic conditions for Mexico; and if two or more proposals are still in equal conditions, then the contract is awarded to the proposal that considers the greater generation of national employment, as well as the use of national or regional goods and services.

To support the public entity's decision, it must issue a detailed opinion explaining the analysis of the proposals, the reasons for their admitting or discarding, a comparison between them, and the elements by which the winning proposal is considered to offer the best conditions for the project. The award is then notified to all participants in a public meeting and published in the entity's website and in CompraNet.

V THE CONTRACT

i Payment

One of the main elements that the PPP contract model includes is the form of payment to the private party for the infrastructure and services provided during the project. Participants in the bidding process put special attention to the rules regarding consideration and payment procedure to prepare and submit their proposals.

The payment mechanism depends on the specific nature of every project and the allocation of risks established in the contract. A variety of payment models have been implemented in Mexico; however, the typical form of remuneration in projects awarded in the last couple of years consists of monthly payments that are subject to deductions or withholdings depending on performance indicators set forth in the contract, to ensure that the services are being rendered effectively according to the agreed upon technical specifications. Under the self-financed PPP scheme, the payment method includes solely the collection of fees by the private party from the end users of the infrastructure (e.g., highway tolls, energy and water tariffs). For instance, in the aforementioned trunk network project (Red Troncal), one of the largest projects tendered in 2018, the PPP contract model provided for continuous revenues in favour of the private party received from tariffs paid by the customers of the trunk network.

ii State guarantees

In general, federal PPPs do not offer state guarantees to secure payment by the public entity to the private developer. Approval of the required funds for the project and their provision in the annual federal budget as multi-annual expenditure commitments may suffice to prove the government's solvency to comply with its payment obligations under the PPP contract.

Nonetheless, some guarantees to the private party could be contractually based, such as assuring a minimum level of revenue or usage of the project's infrastructure. For instance, if the revenues generated by the project fall below the amount set forth in the PPP contract, the public entity may be responsible for the difference and this type of contractual provision is frequently used to enhance the bankability of the project.

On the other hand, sub-national PPPs must include mechanisms to guarantee payment obligations undertaken by state and municipal public entities in PPP contracts in order to be successful. Financial institutions are reluctant to finance state or municipal PPPs if they fail to provide an alternative source of payment different from the state or municipality budget allocation authorised for the project. Usually these guarantees include the creation of special funds with federal contributions that states and municipalities are entitled to receive from the federal government or the pledge of revenues collected from local taxes. Thus, the type of guarantees will depend on the availability of funds by the relevant state or municipality.

iii Distribution of risk

Risk evaluation and allocation represents a key factor for the project's success. Project risks analysis is based on a due diligence process intended to ensure that all necessary information about the project is available, the identification of project risks and the distribution of such risks to the appropriate parties that can bear them efficiently through provisions in the PPP contract.

The main risks to be considered and shared among the parties depend widely on the specific nature of each project, but the most common risks that are constantly considered in the structuring of a PPP project in Mexico are:

- a* commercial risks: those inherent in the project itself, on the industry or market in which it operates (e.g., commercial viability, construction, revenue, operating and environmental risks);
- b* macro-economic risks: not directly related to the project, but to external economic conditions of the country or region;
- c* regulatory and political risks: relating to the effects of government action or political events, such as changes in law, war or civil disturbance, etc;
- d* financial risks: attempting against the funding of the project (including capital and debt requirements); and
- e* *force majeure*: unpredictable events that do not allow the ordinary course and development of the project;

Considering the above, the usual measures adopted to prevent and mitigate project risks include the following:

- a* Contract provisions: the PPP Law provides that the contract must contain among its provisions the efficient distribution of risks between the public and private parties, which must be properly balanced and, in any case, the contracting entities cannot guarantee any payment or indemnity for risks that are not established in the contract, the PPP Law or its Regulations.

- b* SPV: the SPV or project company is the entity responsible for hiring financing for the project, entering into the necessary agreements (i.e., EPC and O&M) and being held liable in the case of default.
- c* Insurance: the PPP Law also provides that the private party must hire insurance to cover, at least, the risks that the infrastructure, end users, assets and goods are exposed to during the term of the contract.
- d* Guarantees: the private party must grant guarantees for completion, operation and performance level of the services as established in the bidding rules; and guarantees in favour of third parties by the nature of the SPV itself and with respect to the project.
- e* Financial terms: lenders are usually willing to bear limited risk provided that they are adequately compensated through interest rates or other financial terms and conditions on the project loan.

iv Adjustment and revision

Any adjustment to the PPP contract may be formalised in an amendment agreement and, when applicable, the necessary authorisations for the project shall be also modified. However, in emergency cases or when the security of the end users is at risk, the public entity may request the private developer to carry out the corresponding actions and changes in the operation of the project without entering into the relevant amendment agreement.

The adjustment of the PPP contract may only have the following objectives:

- a* to improve infrastructure features, which may include additional works;
- b* to increase the services or their performance level;
- c* to deal with aspects related to environmental protection, as well as to the preservation and conservation of natural resources;
- d* to adjust the project in case of unpredictable events during the structuring, award or development of the project; and
- e* to restore the economic balance of the project.

To restore the economic balance of the project, the private party has the right to request the amendment of the PPP contract if an act of authority caused a substantial increase in the developer's obligations or substantial reduction in the benefits. A substantial variation generally means any change that is long-lasting and puts the financial viability of the project at risk. However, specific requirements have to be met depending on the causes and effects of the adjustment to the parties' obligations.

v Ownership of underlying assets

The responsibility to acquire the necessary assets for the development of the project may rest with the public entity or with the private developer, as established in the bidding rules and agreed upon in the PPP contract. The acquisition may be achieved through conventional means (observing civil law property transfer rules) or through taking or expropriation proceedings. Nonetheless, in Mexico, the public entity generally has ownership and control of the underlying assets, since the projects are mostly implemented over state-owned real property. In such cases, a concession or permit is sufficient to authorise the developer to use, exploit and operate the assets provided that, upon termination of the contract, the underlying assets of the project's infrastructure and the ones that were essential to provide the services will

remain under the public entity's ownership and control, subject to the state-owned property regime. The public entity is also entitled to acquire from the private developer the remaining assets that are not strictly necessary for the project.

vi Early termination

The public entity has the right to terminate the PPP contract before the specified term for reasons of public interest or if the need for the contracted services or infrastructure no longer exists, and if the performance of the contract would cause an injury or damage to the state. The early termination decision must be accompanied by an opinion issued by the public entity stating the reasons for the termination.

If the contract is terminated for causes that are proven different to the private party's fault, developers are entitled to receive a termination payment in the form of reimbursement of the expenses and investments that could not be recovered and have not been fully redeemed. The termination payment also covers the financial obligations assumed by the private developer in the project's financing.

The PPP Law provides that the contract shall address termination causes for the public entity default, for the private party default, for extended *force majeure* events and for convenience of the public entity as explained herein.

VI FINANCE

In Mexico, PPPs are financed through a combination of equity and project finance-based debt, either public or private. The PPP Law requires that an SPV is formed by the sponsor upon the award of a contract. This structure requires the private sector sponsor to fund the project (at least partially) with equity. Public funds are also usually allocated to PPP projects mainly from Fonadin, the government agency responsible for coordinating the financing and development of infrastructure. The debt-to-equity ratio depends on the particular circumstances of each project, such as the participants' desired leverage, borrowing costs and risks involved in the project.

Most common lenders include commercial banks, multilateral agencies and development banks. From the public sector, the main players in project finance transactions in Mexico are Fonadin and Banobras and, when publicly financed, the projects must meet additional legal requirements to ensure the proper repayment of debt in favour of lenders.

Whether by equity or debt (public or private), foreign entities are frequently involved in the financing of projects in cross-border transactions. Most of these transactions are funded in foreign currency and, in such cases, participants have to deal with exchange risks. Project sponsors engage in hedging or swap instruments to reduce the project's sensitivity to changes in the foreign exchange rate. On the other hand, project sponsors may recur to local currency loans in Mexico if the market can offer the amount and term of financing to eliminate any long-term currency risk.

VII RECENT DECISIONS

Although there is no jurisprudence related to PPPs in Mexico yet, and there have not been relevant administrative or judicial procedures in the past years, in 2017, the Supreme Court upheld, in an *amparo* procedure, Article 130 of the PPP Law, providing for sanctions to individuals and entities that are in default of their obligations under PPP contracts for reasons

attributable to the private party and that may, therefore, cause serious damage to the public entity. Other similar judicial decisions have been made regarding early termination rights and termination payments. These rulings strengthen the application of the PPP Law as they seek a balanced protection of the parties' interests and the principles of the bidding process to award PPP projects.

VIII OUTLOOK

Mexico represents an opportunity for the promotion of PPP projects since they have been a fundamental mechanism in developing economies to increase the offer of infrastructure and public services, involving public and private funding with the participation of the private sector in the development of projects where the private sector has better knowledge and experience. As of 2016, 41 new federal PPP projects have been structured and developed in Mexico; of those 41 projects, 18 are in the structuring and pre-investment phase; six in the bidding phase; and 17 in the development and operation phase. These projects are focused on the transportation, health, telecommunications, social and hydraulic infrastructure.

In 2018, the two main telecommunications projects were key factors in PPP development: the trunk network project (Red Troncal) and the shared network project (Red Compartida). The energy sector has also proven to be one of the biggest opportunity areas for PPPs since the enactment of the energy reform, allowing the private sector to actively participate in the previously monopolised sector controlled by PEMEX and CFE.

In addition, the new administration led by President Andres Manuel Lopez Obrador has announced an ambitious agenda in infrastructure, mainly focused on the south and southeast regions of the country, which are the most marginalised in terms of public services. This agenda includes the development of new railways, highways, ports and refineries that could benefit from the PPP model. Besides, to prevent a reduction in foreign investment, it is essential that the federal government turns to PPPs as a viable option for structuring and developing new infrastructure projects that are much needed in the country, gaining investors' confidence and promoting the participation of the private sector in Mexico's economic growth.

Moreover, the federal government recently announced a new treaty with Canada to rehabilitate and modernise the existing hydroelectric facilities in Mexico, a project that could bring new opportunities in the future and, more importantly, that shows the intention to pursue clean energy projects that are certainly achievable with the current energy legislation.

For the upcoming year, PPPs will become fundamental for the accomplishment of the goals established in the federal budget for 2019. If a safe environment for national and foreign investment is assured, PPPs can expect to grow in the following years with some expected changes to provide more transparent and objective mechanisms in public biddings, as well as to properly manage public funds in the implementation of PPPs. Therefore, 2019 may represent an unprecedented change for the current situation of PPPs. Special attention should be put to the upcoming reforms to the PPP Law and its Regulations, as well as to the entering administration's intention to pursue PPP projects.

ABOUT THE AUTHORS

ALEJANDRO ROJAS V

Nader, Hayaux y Goebel, SC

Alejandro Rojas V specialises in projects and project finance, structured finance, financing of public entities, real estate finance and investment, and mergers and acquisitions. Alejandro's projects practice focuses on project finance and public-private partnerships, including the Mexican PPS model, energy and infrastructure projects. Alejandro advised both the state of Mexico and the state of Sonora on the structuring, bidding and implementation of the first PPS state projects. He has since continued to be involved in major PPS projects including hospitals, roads, water treatment plants, energy and gas.

Alejandro has strong international experience. He regularly advises multinational clients, particularly major hotel, tourism and leisure groups, on real estate investments and development in Mexico, as well as in forming bidding consortiums and other aspects of infrastructure and energy projects in Mexico. He also advises financial institutions participating in tourism, energy and infrastructure.

Alejandro has been recognised by *Chambers Latin America* as an innovative and skilful lawyer for complex transactions. Alejandro worked in the International Law Firm Mayer Brown LLP in New York. He obtained his LLM from the University of Columbia, School of Law and passed the New York Bar Exam. Alejandro graduated as an attorney from the Instituto Tecnológico Autónomo de México with honours.

FERNANDO CASTILLO V

Nader, Hayaux y Goebel, SC

Fernando Castillo V specialises in the areas of project finance, energy and infrastructure, real estate finance and investment, with significant expertise in public-private partnerships and renewable energy projects. He advises national and global lenders, sponsors, investors, contractors and government entities in connection with the structuring, development and financing of infrastructure projects in Mexico and Latin America, as well as with related corporate matters, including joint ventures and mergers and acquisitions.

Fernando represents clients in a wide range of sectors, such as power, oil and gas, water, toll roads, railroads, hospitals and other infrastructure projects. He is continuously involved in high-profile transactions that encompass the formation of consortium arrangements for public biddings, the organisation of Mexican project companies (SPV) and the negotiation of complex contractual structures (PPP agreements, credit facilities, security agreements, trusts, asset securitisation agreements, EPC and O&M contracts, among other project documents).

Fernando also has substantial experience in real estate transactions, in particular relating to business, commercial, industrial and residential developments, advising clients on financial investment vehicles for the real estate sector.

Fernando received an LLM from the University of Chicago Law School (2017), having graduated with honours as an attorney from the Escuela Libre de Derecho (2013), where he was president of the Law Students Association (2012–2013).

NADER, HAYAUX Y GOEBEL, SC

Paseo de los Tamarindos 400 B, 7th Floor

Bosques de las Lomas, Cuajimalpa

Mexico City 05120

Mexico

Tel: +52 55 4170 3000

Fax: +52 55 2167 3099

arojas@nhg.com.mx

fcastillo@nhg.com.mx

www.nhg.mx



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