

## Chapter 3

### **The renegotiation of public private partnership contracts: An overview of the recent evolution in Latin America**

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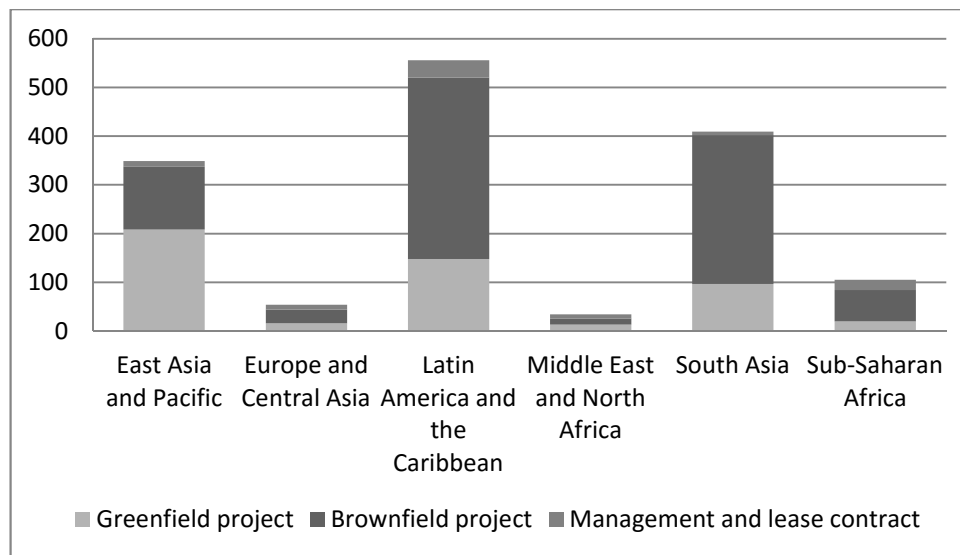
Daniel Benitez, Irene Portabales and Lincoln Flor, World Bank

*This chapter analyses the experience of renegotiations in Latin America: the lessons learned, reflections made and their high incidence, based on the evolution of PPP contracts over the last 25 years.*

*The chapter also shows how countries, via new PPP laws, regulations, norms and specific platforms, can reduce the incidence and the incentives to renegotiate contracts. Based on experience over the last two decades, many countries in the region have improved renegotiation practices and regulations/frameworks through their PPP legislation and associated regulations, e.g. Peru (2008), Chile (2010), Colombia (2011) and Mexico (2012.) The preliminary findings show advances in the implementation of platforms to address renegotiations and new trends in the renegotiations of contracts, particularly in complex projects and where governments are providing financial or credit enhancement, such as sharing risk or co-financing.*

Over the last 25 years, more than 6 000<sup>1</sup> public-private partnership (PPP) projects have reached financial closure in developing countries. This number, the benefits secured and the trends of the PPPs suggest that private participation in infrastructure has become a good, viable option to complement public investment for the development of infrastructure and the provision of public services. As well as supporting economic growth, improving quality of life and contributing to poverty reduction, it provides an alternative for financing infrastructure.

Figure 3.1. Number of PPP transport projects in developing countries by type and region (1984-2013)

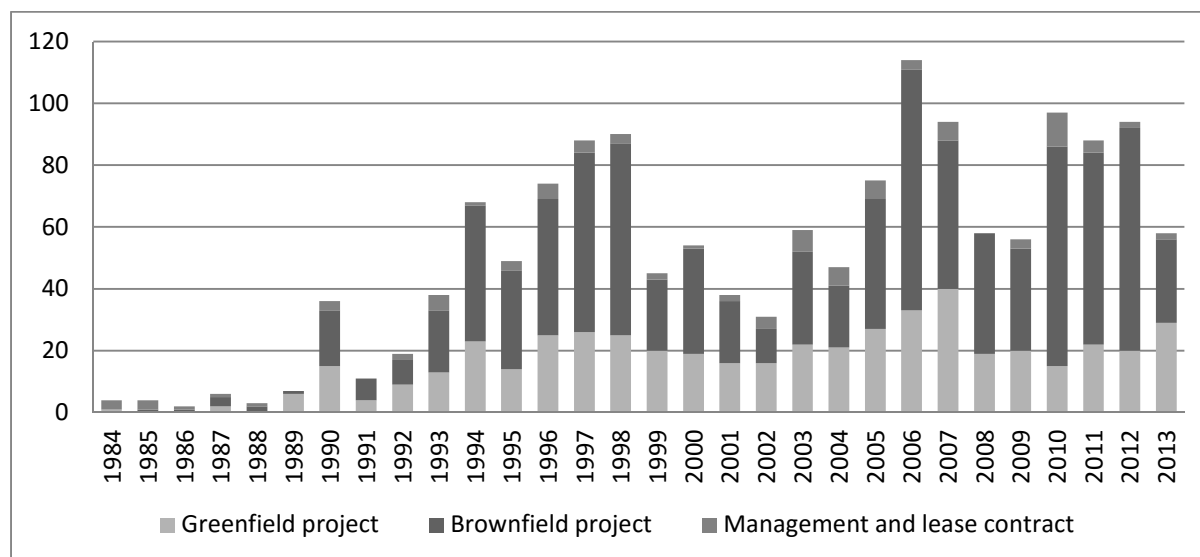


Source: Based on PPI Database data, World Bank.

The transport sector comprises 25% 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 the Pacific (China) – all large emerging economies with high economic growth rates. Almost 90% of worldwide PPP transport projects have been concentrated in these three regions over the last 30 years. In the developing world, in 2013, about 78% of the total investment commitments in projects in the transport sector were concentrated in Brazil and India.

By contract type, brownfield projects are predominant in transport PPP projects, although the number of these has fluctuated according to economic cycles. The number of greenfield projects has remained relatively constant over the last twenty years. In general, brownfield projects are usually easier to implement than greenfield projects, which are more risky, complex and uncertain, in particular in traffic forecasting. In this context we should expect a greater proportion of potential contract renegotiations associated with greenfield projects. The low number of management contracts suggests the importance of the infrastructure gap that developing countries have tried to reduce mainly through a high number of Build-Operate-Transfer (BOT) PPP projects.

Figure 3.2. Number of PPP transport projects by type and year in developing countries



Source: Based on PPI Database data, World Bank.

A big legacy and a significant concern concerning PPP contracts in Latin America (LCR) over the last 25 years is the high number of renegotiations. Overall in the transport sector, over 75% of contracts are renegotiated, and in some countries the incidence of repeated renegotiations of the same project is astonishing. For example, between 1993-2010, Colombia showed seven times more renegotiations for road PPPs than in Chile or Peru (Bitran *et al.*, 2012 and Guasch, 2014), partly associated with additional investment in infrastructure that was not included in the original PPP contract. This suggests poor project preparation studies – critical to assess the real dimension/scope of the infrastructure projects – poor contract management and significant consented opportunism and abuse. Furthermore, as outcomes of the negotiation process, additional payment commitments increased the fiscal impact and considerably reduced the value for money of the PPP project, estimated on the basis of the original contract (Bitran *et al.*, 2012).

In this context, a poor project preparation study by the government (scope of the project, level of investment, improper and ambiguous 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. Political reasons to accelerate the implementation of PPP projects with limited or lack of project preparation and proper filters (for example, without feasibility studies and proper evaluations by experts) can lead to consecutive renegotiations to accommodate the continuity of the PPP contract and the implementation of the contract commitments<sup>2</sup>. There is no reliable systemic data collected on PPP contract renegotiations. The most complete study is by Guasch (2004 [updated in 2014]) which shows that, between 1980-2002, 78% of the PPP contracts in transport infrastructure in Latin America were renegotiated fairly quickly after the signature of the contract (3.1 years).

Important lessons learned in PPP renegotiations in Latin American countries were collected, and motivated them 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 established a freeze on renegotiations for the first three or more years, clarify risk allocation,

compensations and rate of return, and state that no contract modification can alter the risk allocation matrix, etc. Renegotiations also occur in other countries with extensive PPP experience, such as France, the USA or the United Kingdom.

Table 3.1. Percentage of renegotiated contracts by region and sector

Region / country	Sector	% of renegotiated contracts	Source
Latin America and Caribbean	Total	68%	Guasch 2004 (2012)
	Electricity	41%	
	Transport	78%	
	Water	92%	
US	Highways	40%	Engel Fischer & Galetovic 2011
France	Highways	50%	Atthias and Saussier 2007
	Parking	73%	Beuve <i>et al.</i> 2013
UK	All sectors	55%	NAO 2001

Source: Estache, Antonio and Stéphane Saussier, "Public-Private Partnerships and Efficiency: A Short Assessment", CESifo DICE Report 12 (3), 2014, 08-13.

Even under a context of renegotiation, the PPP programmes have proved quite effective on average to bring about the desired benefits and reduce the infrastructure gap that most countries face. While the benefits have been quite significant, they could have been even higher had the programme and project been better designed and implemented. There have been issues and problems mostly 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 projects, it has in general not been an important priority for governments, or treated lightly, or as a sort of residual to be taken care of. It is indeed surprising when noting that most PPP contracts have durations of 15-30 years, or for PPPs in the social sector which can involve more complexity; for example, in the health sector, where fixing the level of service and monitoring is a great challenge for governments. Issues do and will come up, and they are often not well specified or detailed in the contract, in particular in dynamic markets where changing cost structure is aligned to the main drivers (for example, the high prices of commodities) or demand has increased above expectations or levels of service. This all creates opportunities for abuse and opportunism, and significantly raises the likelihood of conflicts among the two parties. 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 considered business-as-usual, but this applies only to those which are contract-based and not under renegotiation (contract/risk modifications). Yet the incidence of both has been and is a concern, particularly that of renegotiation. Renegotiations have been, by and large, the critical problem facing PPPs. Given its implications on value for money and the legitimization of PPPs over traditional procurement, there is a need to be prepared and to diffuse, pre-empt and address the issue.

The PPP contract, processes and institutionalism are the key determinants, along with contractual integrity, that impact on the likelihood of securing 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/fiscalisation and regulation is not properly set up, again the benefits will be reduced and conflicts increased. If the conflict resolution mechanisms are not predictable and transparent enough, interest and benefits will likely decline.

As reported here, a very significant number of PPPs 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 renegotiations are initiated by private-sector operators and, to a lesser extent, by government. Thus it is indeed critical to understand the issue, its causes and how best to address them so that PPP programmes can generate the expected benefits. This is the challenge of this study, which analyses and evaluates the renegotiations paradigm over the last 25 years.

### 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. Those contractual changes as described below in Table 3.2.

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

Renegotiation requests are often linked to aggressive bids, which have become quite widespread. The rationale for an aggressive bid is that it is presented at the time of auction, with the intention of being awarded the contract and later, away from competitive conditions, renegotiating better terms with the government bilaterally. If there is only one valid bid, under weak institutions, the negotiating position of the government is undermined and, in general, it will try negotiating the PPP contract and accepting part or all of the renegotiation conditions<sup>3</sup>. An aggressive bid is defined when the present value of revenues (R) is insufficient to cover the present value of costs at the time of the bid, including taxes and depreciation of the PPP project, thus generating losses on the 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	

Table 3.2. Definition of renegotiation and examples

Renegotiation occurs when:	Examples
i) there is 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) there is 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>• Avoid bankruptcy of the operator.</li> <li>• Changes in contract scope, etc.</li> </ul>
<b>Renegotiation does not occur when:</b>	<ul style="list-style-type: none"> <li>• Tariffs are adjusted with a formula set in the contract or indexed by inflation or other index.</li> <li>• Triggers are activated and eventual investments become mandatory.</li> <li>• Payments to operator if they are regulated in the contract, etc.</li> <li>• Correction of errors in the contract, which do not create obligations, commitments or contingencies (typos, contradictions that affect the implementation of the PPP contract, etc.).</li> </ul>

Under a legal framework without restrictions, renegotiations can occur at any time after the PPP contract is signed. 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. Some have benefited the users, but they are a very small proportion of the renegotiated contracts.

### Renegotiations typology

Renegotiation initiations can be classified as being initiated by government, by the operator or concessioner, by both or ambiguous. When initiated by the government, the reason usually is because of a change in priorities, a change of government party or that the government cannot fulfil its contractual obligation. Politically opportunistic reasons may also exist (in some cases, government wants to anticipate or expand investments, or delay the increase or decrease in tariffs to augment popularity prior to elections, etc.). On the other hand, when initiated by the private sector, renegotiations are due quite often to opportunistic reasons – seeking to maximise the present net value of the PPP contract (more revenue, fewer costs or investments and/or less risks), but also protecting against shocks (domestic or external) that significantly unbalance the financial equilibrium.

Table 3.3. **Renegotiation classifications:**  
**Initiated by the government, the operator or concessioner, by both or ambiguous**

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

Source: 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 1980-2010.*

### Why renegotiation is an important issue: implications

The concerns about the incidence of renegotiations are biased in that:

- They eliminate the competitive effect of the auction including transparency, questioning the credibility of the model/programme.
- They lead to asymmetric information and lack of negotiation skills of the public sector and lack of competitive pressures to renegotiate the contract.
- They create distortion in public tenders, in that the most likely winner is not the most efficient operator but the most expert/qualified in renegotiation.
- They decrease the benefits/advantages of PPPs and the welfare of users, usually with a fiscal impact by increasing liabilities to the government.
- While some can be efficient, many of them are opportunistic.

In the case of unsolicited bids, when the only available bid is presented by the proponent, some PPP legislation allows governments to negotiate the contract conditions. Even this is not a formal renegotiation; the same challenges are present. Other PPP legal frameworks regulate a negotiation period after the contract is awarded, where under threshold the parties will agree on specific topics.

Some renegotiations are the consequence of dispute resolution decisions, where the government or the operator has to pay the other party or when there are reductions in costs or risks. 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 extensive coverage by the media, leading to public discontent, 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 to 4 percentage points onto the capital cost of the project.

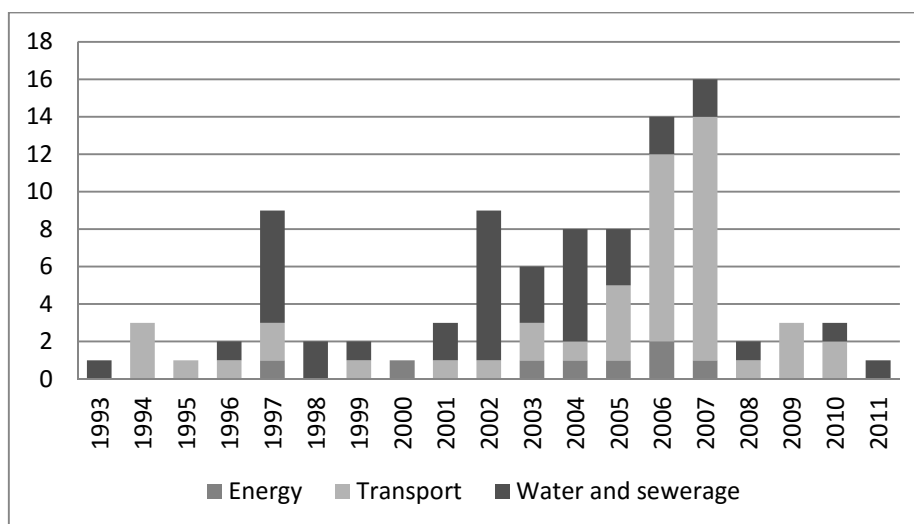
## Evidence

### Overall incidence of renegotiated contracts in Latin America and the Caribbean

From 1990 to 2013, more than 1 700 PPP projects reached financial closure in Latin American countries, 41% of the total PPP contracts being concentrated in one country (Brazil).

As the projects become more complex, an increase in government support is usually needed. In Latin America between 2000 and 2007, a surge in government support for PPP projects occurred, including transport infrastructure, followed by a sharp decline after the global financial crisis.

Figure 3.3. **Projects with government support**



Source: Based on PPI Database data, World Bank.

The increase in the complexity of PPP projects might suggest more incidence of renegotiation 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 the table below, the incidence of renegotiation continues to be significantly high, averaging 68% overall and 78% in transport infrastructure, and is achieved relatively soon after the award of the contract, on average, one year later [3.1 years between 1980 and 2000 (Guasch, 2004)]. The most common sectors continue to be transport, water and sanitation; although social sector PPPs are gaining ground.



Table 3.4. Percentage of renegotiated PPPs and average time to renegotiation

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

### *Cancel or renegotiate contracts*

Governments with weak institutions face a crucial trade-off between the cancellation and renegotiation of a PPP contract to avoid, for example, a potential bankruptcy. The number of cancelled contracts in Latin America is low but has increased in the last 30 years, about 5% of total PPP projects granted, as shown in Table 3.5 below. This rate is slightly higher than the average for developing countries (4.3%)<sup>4</sup>. When contrasted with the number of renegotiated contracts, it strongly hints to the difficulty of governments to commit to a policy of no-renegotiation and assume the political consequences of cancellations of PPP projects. One would expect that number to be significantly large, particularly at the beginning of a programme, where government could signal a credible policy of no renegotiations by rejecting the request. Yet, when confronted with renegotiation, governments can opt to deny the request and leave the decision to the private operator regarding whether or not to abandon the concession. Yet that seldom happens and, for a number of reasons that we detail below, governments find it easier to allow the renegotiation of contracts (Harris and Pratat, 2009). This becomes a vicious circle, since private operators understand the difficulties of governments to manage the PPP programme; their inability to cancel contracts and reject renegotiation requests, and the political consequences.

Table 3.5. PPP contracts cancelled 1984-2013 in LCR (no divestitures)

Infrastructure LCR: Total number of PPP projects	Cancelled	Percentage of projects
1 713	85	4.96 %
By sector	By sector	By sector
Transport	39	7.01%
Energy	19	2.46%
Water and Sanitation	22	8.56%
Telecom	5	3.91%

Source: Based on PPI Database data, World Bank.

### *Specific examples in Latin America: Renegotiations in Chile, Colombia and Peru*

Table 3.6 and Figure 3.4 show the evidence of renegotiations in three Latin American countries – Chile, Colombia and Peru – for the period 1993 to 2010. They show a significant incidence of both

renegotiations of PPP road contracts and renegotiations of the same contract, and the substantial fiscal costs of the outcomes of renegotiations. Colombia shows an important fiscal impact, in particular between 2005 and 2006.

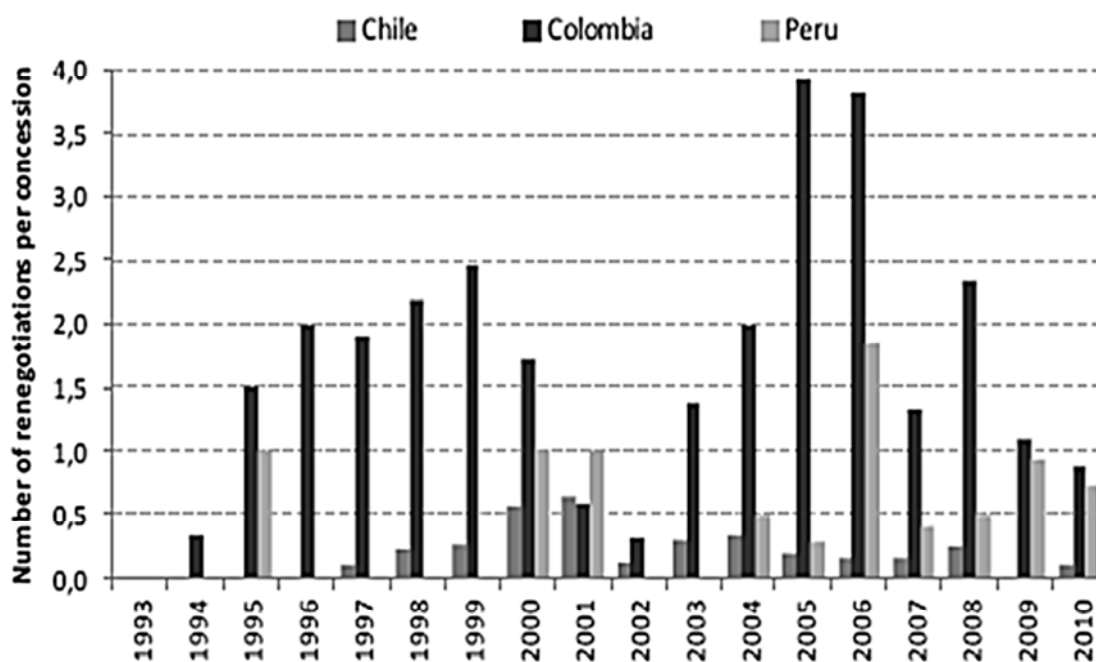
Table 3.6. Summary of sample statistics by country: 1993-2010

	Chile	Colombia	Peru
Total road concessions	21	25	15
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	403	44
Mean number of renegotiations per concession	3.3	19.2	4.6
Mean time of first renegotiation (years)	2.7	1.0	1.4
Mean fiscal cost of renegotiations (constant USD Dec 2009, million)*	54.8	262.5	28.9
Mean fiscal costs / initial value (percentage)	20.3	278.5	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	1.8	0.9

Source: Bitran et al., 2012.

\*Over the life of the contracts, across all renegotiations.

Figure 3.4. Number of concession renegotiations per year in each country



Source: Bitran et al., 2012.

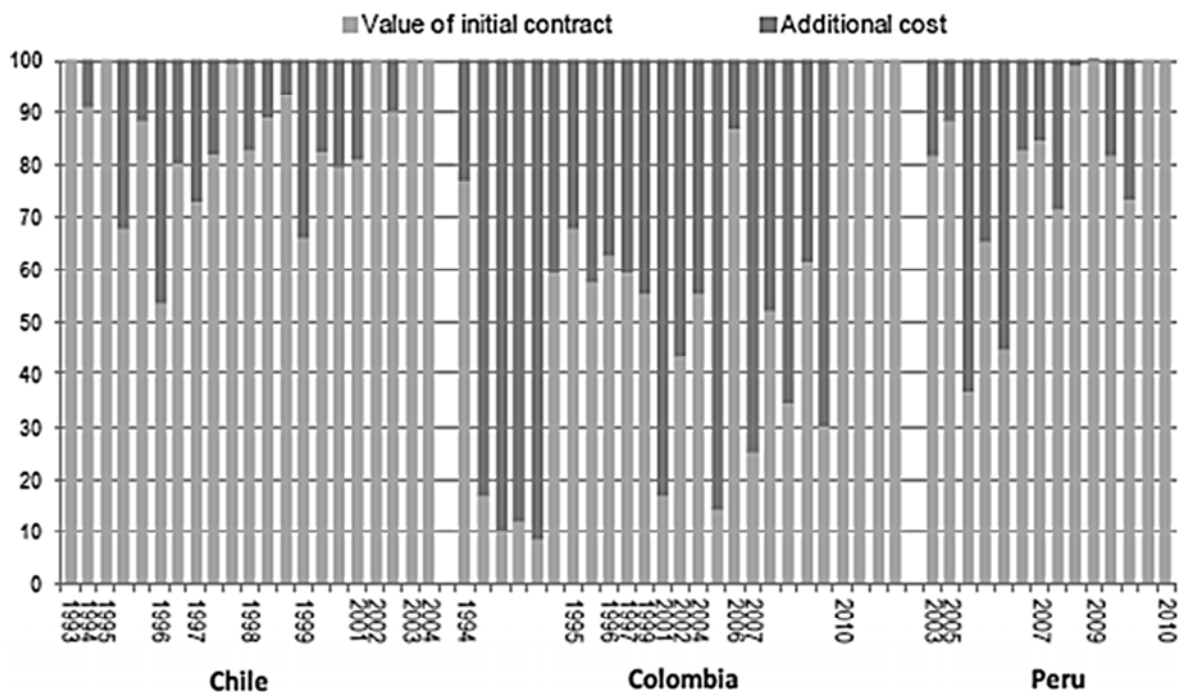
The trends in PPP road contract renegotiations in Chile, Colombia and Peru (see Table 3.7) show the government leadership motivating renegotiations, most of them during the construction stage, which suggests poor project preparation regarding the scope and condition of the infrastructure, and with important fiscal costs.

Table 3.7. **Characteristics of contract changes: 1993-2010**

		Chile	Colombia	Peru
<b>Total</b>		<b>60</b>	<b>403</b>	
<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 realised 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%

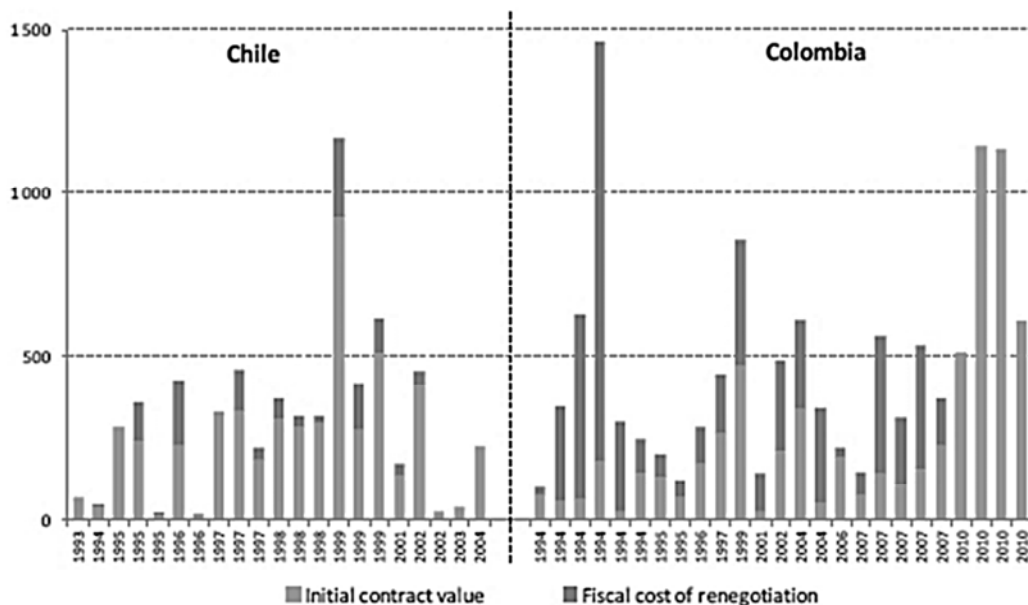
Source: Bitran et al., 2012.

Figure 3.5. Additional cost versus initial contract value (%)



Source: Bitran et al., 2012.

Figure 3.6. The fiscal costs of renegotiations in Chile and Colombia (Constant prices in million USD, December 2009)



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

Source: Bitran et al., 2012.

### *Other cases outside the region*

This high incidence of renegotiations is not confined to the LAC Region. Other cases in point are the experiences of India, Portugal and Korea<sup>5</sup>, among others.

#### *i. India*

India launched in the late 2000s an aggressive programme of PPPs, particularly in the road sector, awarding over 300 highway PPPs; many of them with the support of the Viability Gap Fund, often awarded under the criteria of requested minimum subsidy. As of 2014, more than half of those projects are encountering problems, with the private operators requesting renegotiation of the contract. Apparently, a significant number of those renegotiation demands originate from aggressive bids. The Government of India has been evaluating the situation and prepared a response for this systemic problem, but on a selective and case-by-case basis. Overall, its approach has been to reject most of the requests.

#### *ii. Portugal – Case Study<sup>6</sup>*

##### *“Troika” Agreement – PPP reforms implemented, 2011-12*

All PPP projects to be developed were paralysed, affecting several sectors during 2011-12. The Ministry of Finance (MoF) and the International Monetary Fund (IMF) assessed the PPP legal and institutional framework under a new PPP framework law and UTAP (Unidade Técnica de Acompanhamento de Projetos) was created (June 2012). MoF updated and enhanced its reporting instruments on PPPs and concessions. Ernst & Young were hired for the assessment of the PPP renegotiations.

Table 3.8. **Portugal renegotiations case study**

<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 (sub concessions)</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</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>

## Evolution 2005-2013

Overall indicators show, as of 2013, an increase in the average of renegotiations compared with 2004 levels, 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 renegotiation requests*

Renegotiation requests can have multiple causes, external and/or internal. Some examples associated mainly with external drivers are:

- Significant changes in economic circumstances. In regulated markets where no prices can be adjusted unilaterally by the private operator, this frequently leads 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 – due to macroeconomic conditions beyond the control of the parties (e.g. financial crises worldwide, currency fluctuations) – break the bankability of the project and induce renegotiation requests.
- Unforeseen natural events or disasters that require emergency interventions or investment.

Among the most common internal drivers for demands for renegotiation are:

- Elections where the new administration can change the regulation and contract terms and affect operator rights, etc.
- New user demands over and above the original level of services (in particular in the first generation for roads and airports).
- Bidding errors, aggressive offers and poorly-written contracts and ambiguous risk allocation;
- Breach of contractual obligation by government (the land expropriation process can be lengthy and not be available in time), lack of bankability of the project (misperceived risks) and lack of preparatory studies (which increase construction risk).
- Opportunistic behaviour by operators and governments (governments may decide to modify the contract for the benefit of users acting unilaterally to capture electoral votes, or a newly-elected government may change priorities to modify or expand investments after the elections).
- The opportunity of governments to bypass fiscal controls to secure additional financing and avoid authorisation (by parliament) for additional investments.
- The inability of governments to credibly commit to a policy of no-renegotiation leads to the abuse of renegotiation requests.
- The operator's perceived leverage to influence the host government to grant them additional benefits through renegotiation and weak contract monitoring.

## Platform for addressing renegotiations and measures taken to tackle this issue

A number of countries have taken measures to address the renegotiations issue with mixed success, mainly as the result of not implementing a coherent and comprehensive renegotiation platform, along the lines shown below.

Here are some of the normative measures implemented by some countries.

Table 3.9. **Measures taken in some countries to address the renegotiations issue**

<b>Mexico</b>	<b>New law and regulations and procedures</b>
<b>Peru</b>	Review to the Law and Regulations
<b>Chile</b>	New Law and Regulations and Conflict Resolution Framework
<b>Colombia</b>	New Law and Regulations and Institutional and Process
<b>Portugal</b>	Platform for renegotiations
<b>India</b>	Normative package to guide the renegotiation process

Addressing renegotiations in Latin America (and elsewhere) will continue to be a great challenge where a solid legal and institutional structure can help to mitigate requests and better regulate the renegotiation process, but more specific measures are needed. Countries ought to adopt a Renegotiation Platform. Elements of that platform are indicated below and some of them have already been adopted by certain countries:

- The contract should stipulate the renegotiations approach, criteria and process.
- Increase the political cost of accepting renegotiation demands, by implementing a Transparency Framework; use of the Internet, publishing requests, decisions and arguments, and using the media to provide information on requests, decisions and rationale.
- Establish a reputation of not being well-disposed to renegotiate by cancelling PPP/concessions processes, particularly from requests driven by aggressive bids.
- Use and implementation of a high-level "delivery unit" to resolve deadlocks in the preparation of projects/contracts.
- Use and implementation of a resolution/problem unit (licences, permits, rights-of-way, evaluations, specifically environmental, archaeological, etc.).
- Establish a freeze period for renegotiations; for example, no renegotiations will be considered for a three- to five-year period after award of the contract. Only a few exceptions could be accepted (Peru and Colombia).
- Establish clear jurisdiction over the decision to renegotiate, at a high level, such as the Interministerial Committee headed by the Minister of Finance (Chile and Peru).
- Establish in the contract the right to evaluate and reject aggressive and reckless bids, defining the criteria and standards, including submission of a financial model for those bids or additional guarantees (financial bonds).
- Establish a transparent framework for conflict resolution (panel of experts and arbitration). Using proper panels of experts (whose composition to be based on technical profiles and



selected at random from a pool of experts) to address issues such as aggressive bidding, renegotiation requests, arbitration, regulation-resetting tariff structure.

- Establishing a matrix of risks with detailed risk identification and allocation setting so that modifications of the contract must not alter the risk allocation. A legal statement or regulation that the risk matrix cannot be altered (Mexico).
- Establish that if the contract is modified, the net present value of the modifications must be zero, and preserve value for money.
- Impose an appropriate (biting) level of performance bonds: for example, at least 15% of the investment (Uruguay).
- Clarification and wording of key contractual clauses and binding documents.
- Putting in place a platform for efficient land expropriation and for the securing of rights of way (Mexico and Chile).
- Structure financial support by government (certain and contingent) over time, not all at the beginning (i.e. viability gap funding).
- Establish guidelines for levels of compensation.
- Symmetry on effects and compensation of unilateral actions taken by government.
- Request a mandatory bidding process for an additional infrastructure request (either by government or by the operator) and the interest rate for PPP financing (Chile).
- Use appropriately the selection of competitive factors (such as the award criteria) to increase the costs – render exit more expensive. 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).
- A greater role of the regulator and PPP unit in the design and regulation of the contract (Peru, Colombia).
- Abandonment of clause on financial equilibrium (Chile and Peru).
- Platforms on renegotiations and processes led by the Ministry of Finance (Chile and Peru).
- Use of regulatory accounting (Peru and Chile).
- Transparency of the renegotiation process. Disclosure of information since the request, analysis, negotiations, final amendment and web information. Greater use of LPVR as the award criteria to mitigate demand risk (Chile and Colombia).

### **Some reflections on PPP renegotiation**

Finally, we provide some reflections on the issue of renegotiations of PPPs. There are indeed valid reasons to renegotiate PPP contracts and some incidence is to be expected for various reasons, such as incompleteness of the contract, the long duration of the contract/project, the likelihood of unforeseen events with significant economic/financial impacts, the likelihood of changes in priorities by succeeding governments and so on. Yet the observed high incidence of renegotiations is of serious concern and a source for criticism and questioning of the effectiveness of PPP programmes. It indicates an abuse of the instrument and its use for opportunistic reasons rather than well-founded contractual ones. The benefits

of PPP programmes have been extensively proven over the 25 years of PPP experience in Latin America (Guasch, 2004; 2012). Yet to sustain the programmes and secure the expected benefits, the issue of renegotiations (whose outcomes generally reduce the original benefits of the contract) needs to be addressed and is the major weakness of PPP programmes.

As presented here, key principles to guide country initiatives when addressing renegotiations are as follows:

- When governments are confronted with requests for renegotiation, the sacred character of the original contract/bid must be respected to preserve the value-for-money of the original contract, and the contractual or bid offer must not be breached.
- The operator should be held responsible for its offer and risks accepted in the contract.
- The financial equation of the winning offer should always be the reference point, and if the contract is to be modified, the outcome should have an impact of zero net present value of the benefits, and the contract modifications should not change the original risk allocation matrix.
- Renegotiation must not be used to correct errors in the bid or excessively risky or aggressive bids.

## Notes

1. Consulted on 24 September 2014, World Bank and PPIAF, PPI Project Database (<http://ppi.worldbank.org>) has data recorded from 6 224 projects in three key sectors (transport, energy, water and sewage).
2. For example, in 2005 three PPP roads (Interoceanic 2, 3 and 4) were awarded in Peru without cost-benefit analysis. The government's approval circumvented this important step. In 2006, a third amendment was signed to allow the financial close of the projects. In 2009 and 2010, influenced by the global financial crisis, the government decided to side-step the cost-benefit analysis and reduce the filters (value-for-money analysis was postponed during those years) and the deadlines during PPP project preparation, for a selected group of candidate projects.
3. If only one valid bid was received, and the winning bidder did not want to sign the contract, unless there is a commitment to renegotiate later this behaviour can be assimilated with an aggressive bid. If institutions are weak and cancellation for the PPP process can affect the PPP programme or have political consequences, this context can induce more aggressive bids. Even in the case where a contract is signed or the government decides to reject the renegotiation conditions, the contract has to be cancelled and the PPP project has to be rebid, under a new procurement process. Political promises to develop infrastructure and deliver services will affect the credibility of the government, and there is no guarantee of more competition under a new PPP process. In political terms, the whole PPP programme can be affected or delayed.
4. For the same period, low-income countries show a PPP cancellation rate of 7.16%.
5. In Korea, there are currently over 168 projects (in the construction or operation phases) which have been renegotiated (*source*: KDI PIMAC, 2012).
6. *Source*: Unidade Técnica de Acompanhamento de Projetos (UTAP), 2014.

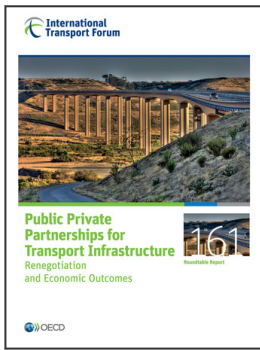
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