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Public-private partnerships (PPPs): Proposed updates to the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects (revised chapter IV)

Note by the Secretariat

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A. General provisions of the PPP contract

1. The "PPP contract" (sometimes referred to as "concession contract", see "Introduction and background information on PPPs", para. …) between the contracting authority and the private partner is the central contractual document in a PPP or an infrastructure project. The PPP contract defines the scope and purpose of the project as well as the rights and obligations of the parties; it provides details on the execution of the project and sets forth the conditions for the operation of the infrastructure or the delivery of the relevant services. In concession PPPs, the contract will also cover the conditions under which the private partner will deliver the public service and receive payment from users and the public authority. In non-concession PPPs, the contract will ensure that the infrastructure is built, or the service is rendered in exchange for the payment by the public authority of the remuneration agreed. PPP contracts may consist of a single document or of various separate agreements (such as facilities management agreements, equipment agreements, direct agreements with the lenders, subcontracting agreements), concluded between the contracting authority and the private partner or any related entities involved in the project. Legislative provisions may offer guidelines for avoiding inconsistencies between various contractual documents, such as public policy principles and interpretation rules. This section discusses the relationship between the PPP contract and the local or domestic regulation on PPPs. It also discusses procedures and formalities for the conclusion and entry into force of the PPP contract.

1. Legislative approaches

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

3. Legislative provisions on certain essential elements of the PPP contract may serve the purpose of establishing a general framework for the allocation of rights and obligations between the parties, to give effect to the risk allocation on the basis of which the project was designed (see chapter II, "Project planning and preparation", para. …). Legislative provisions may be intended to ensure consistency in the treatment of certain contractual issues and to provide guidance to the public authorities involved in the negotiation of PPP contracts at different levels of government (national, provincial or local). Such guidance may be particularly useful for contracting authorities lacking experience in the negotiation of PPP contracts. Lastly, legislation may sometimes be required to provide the contracting authority with the power to agree on certain types of provisions.

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

2. The law governing the PPP contract

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

6. The law governing the PPP contract includes the rules contained in laws and regulations of the host country related directly to PPPs, where specific legislation on the matter exists. In some countries the PPP contract may be subject to administrative law, while in others it may be governed by private law (see chap. VII, "Other relevant areas of law", paras. 24–27). The governing law also includes legal rules of other fields of law that apply to the various issues that arise during the execution of an infrastructure project (see generally chap. VII, "Other relevant areas of law", sect. B). Some of those rules may be of an administrative or other public law nature and their application in the host country may be mandatory, such as those dealing with environmental protection measures and health and labour standards. Some domestic laws expressly identify the matters that are subject to rules of mandatory application. However, various issues arising out of the PPP contract or the operation of the facility may not be the subject of mandatory rules of a public law nature. This is typically the case for most contractual issues arising under the PPP contract (for example, formation, validity and breach of contract, including liability and compensation for breach of contract and wrongful termination).

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

8. For purposes of clarity, it may be useful to provide information to potential investors concerning those statutory and regulatory texts which are directly applicable to the execution of PPPs and, as appropriate, those whose application has been repealed by the legislature. However, as it would not be possible to list exhaustively in the law all the statutes or regulations of direct or subsidiary relevance for PPPs, such a list might best be provided in a non-legislative document, such as a promotional brochure prepared by the PPP unit when such PPP unit exists (see chap. I, "General legal and institutional framework", para. …) or by the agency in charge of promoting investment. The relevant regulation might also be provided to bidders at the time of the issuance of the request for proposals (see chap. III, "Selection of the private partner", para. 60).

3. Conclusion of the PPP contract

9. For projects as complex as infrastructure projects, it is not unusual for several months to elapse between contract award and the finalization and signing of all contractual documents (see chap. III, "Selection of the private partner", paras. 83

and 84). The quality of the feasibility and other studies conducted during the planning phase, as well as the existence of detailed and adequate contract templates and guidelines (see chap. II, "Project planning and preparation", paras. …) will be crucial to facilitating closing and reducing unnecessary delay. However, firm and final commitments by the lenders and other capital providers cannot reasonably be expected to be available prior to the final award of the PPP contract, and the parties will still need to take into account the terms and conditions of financing when finalizing the PPP contract. Additional time may also be needed to accomplish certain formalities that are often prescribed by law, such as approval of the PPP contract by a higher authority. The entry into force of the PPP contract or of certain categories of PPP contract is in some countries subject to an act of parliament or even the adoption of special legislation. It is often the case in the concession-PPP related to the provision of a public service. Given the cost entailed by delay in the implementation of the PPP contract, it is advisable to find ways of expediting the final negotiations in order to avoid unnecessary delay in the conclusion of the PPP contract.

10. The parties may reduce that risk of delay by establishing at the planning stage a timetable setting forth important steps and benchmarks such as mandatory procedures of approval by the public authority side (see chap. II, "Project planning and preparation", para. …). During the final stage itself, several factors have been found to delay negotiations, such as inexperience of the parties, poor coordination between different public authorities, uncertainty as to the extent of governmental support and difficulties in establishing security arrangements acceptable to the lenders. The Government may make a significant contribution by providing adequate guidance to negotiators acting on behalf of the contracting authority in the country. In that respect, the role of a PPP unit or similar coordination agency is of paramount importance to keep the negotiation process on track and facilitate a swift way forward (see chap. I, "General legal and institutional framework", para. …). The clearer the understanding of the parties as to the provisions to be included in the PPP contract, the greater the chances that the negotiation of the PPP contract will be conducted successfully. Conversely, where important issues remain open after the contract award and little guidance is provided to the negotiators as to the substance of the PPP contract, there may be considerable risk of costly and protracted negotiations as well as of justified complaints that the selection process was not sufficiently transparent and competitive.

11. Various international organizations, such as the World Bank[1] or the International Federation of Consulting Engineers,[2] provided advice on PPP contract negotiation or compiled standard clauses or template contracts for PPP projects that can be used as a starting point in the drafting of the contract or some elements of it. Those templates are widely accepted and used around the world and they are updated regularly by the institutions. Moreover, guidance is provided as to their meaning and interpretation, which ensure uniformity and reduce the risk accordingly.

12. The procedures for conclusion and entry into force of the PPP contract should also be reviewed with a view to expediting matters and avoiding the adverse consequences of delays in the project's timetable. In some countries the power to bind the contracting authority or the Government, as appropriate, is delegated in the relevant legislation to designated officials, so that the entry into force of the PPP contract occurs upon signature or upon the completion of certain formalities, such as publication in the official gazette. In countries where such a procedure would not be feasible or where final approvals by another entity may still be required, it would be desirable to consider streamlining the approval procedures. Where such procedures are perceived as arbitrary or cumbersome, the Government may be requested to provide sufficient guarantees to the private partner and the lenders against such risk (see chap. II, "Project planning and preparation", paras. 45–50). In some countries where approval requirements exist, contracting authorities have sometimes been

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

[2] See on the FIDIC website, the dedicated page on international construction projects standards forms of contracts: http://fidic.org/bookshop/about-bookshop/which-fidic-contract-should-i-use.

authorized to compensate the selected bidder for costs incurred during the selection process and in preparations for the project, should final approval be withheld for reasons not attributable to the selected bidder.

B. Corporate structure of the private partner

13. Certain requirements concerning the corporate structure of the private partner are often found in domestic legislation and are elaborated upon by detailed provisions in PPP contracts. They typically deal with issues such as the establishment of the private partner as a legal entity, its capital, scope of activities, statutes and by-laws. In most cases, the selected bidders establish a project company as an independent legal entity with its own juridical personality, often referred to as "special purpose vehicle" or "special purpose entity" which then becomes the private partner under the PPP contract. A project company established as an independent legal entity is the vehicle typically used for raising financing under the project finance modality (see "Introduction and background information on PPPs", para. 54). A separate project company facilitates coordination in the execution of the project and provides a mechanism for protecting the interests of the project and of the parent company of the private partner, which may not necessarily coincide with the individual interests of all project promoters. This aspect may be crucial where members of the project consortium undertake to provide significant portions of the services or supplies required by the project.

14. The project company is usually required to be established within a reasonably short period after the award of the contract. Since a substantial part of the liabilities and obligations of the private partner, including long-term ones (PPP contract, loan and security agreements and construction contracts), are usually agreed upon at an early stage, the project may benefit from being independently represented at the time those instruments are negotiated. Some countries where foreign investment is subject to specific rules and case by case approval by the competent authorities have found it useful to merge the requirements for investment registration and PPP project authorization into a single procedure in order to save time and costs.

15. Entities providing public services are often required to be established as legal entities under the laws of the host country. This requirement reflects the legislature's interest to ensure, *inter alia*, that public service providers comply with domestic accounting and publicity provisions (such as publication of financial statements or requirements to make public certain corporate acts). However, this emphasizes the need for the host country to have adequate company laws in place (see chap. VII, "Other relevant areas of law", paras. 30–33). The ease with which the project company can be established, with due regard to reasonable requirements deemed to be of public interest, may help to avoid unnecessary delay in the implementation of the project.

16. Another important issue concerns the equity investment required for the establishment of the project company. The contracting authority has a legitimate interest in seeking an equity level that ensures a sound financial basis for the project company and guarantees its capability to meet its obligations. However, as the total investment needed, as well as the ideal proportion of debt and equity capital, vary from project to project, it may be undesirable to require in legislation a fixed sum as minimum capital for all companies carrying out PPP projects in the country. The contracting authority might instead be given more flexibility to arrive at a desirable amount of equity investment commensurate with the project's financial needs. For instance, the expected equity investment might be expressed as a desirable ratio between debt and equity in the request for proposals and might be included among the evaluation criteria for financial and commercial proposals, so as to stimulate competition among the bidders (see chap. III, "Contract award", paras. 75 and 77).

17. In any event, it is advisable to review legislative provisions or regulatory requirements relating to the organization of the private partner to ensure their

consistency with international obligations assumed by the host country. Provisions that restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service and limitations on the participation of foreign capital in terms of a maximum percentage limit on foreign share-holding or the total value of individual or aggregate foreign investment may be inconsistent with specific obligations undertaken by the signatory States of certain international agreements on economic integration or the liberalization of trade in services.

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

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

20. The contracting authority might also wish to be assured that the statutes and by-laws of the project company will adequately reflect the obligations assumed by the company in the PPP contract. For this reason, PPP contracts sometimes provide that the entry into force of changes in the statutes and by-laws of the project company is effective upon approval by the contracting authority. Where the contracting authority or another public authority participates in the project company, provisions are sometimes made to the effect that certain decisions necessitate the positive vote of the contracting authority in the meeting of the shareholders or board. In any event, it is important to weigh the public interests represented through the contracting authority against the need to afford the project company the flexibility necessary for the conduct of its business. Where it is deemed necessary to require the contracting authority's approval to proposed amendments to the statutes and by-laws of the project company, it is advisable to limit such a requirement to cases concerning provisions deemed to be of fundamental importance (for example, amount of capital, classes of shares and their privileges or liquidation procedures), which should be identified in the PPP contract.

C. The project site, assets and easements

21. Provisions relating to the site of the project are an essential part of most PPP contracts. They typically deal with issues such as title to land and project assets, acquisition of land, and easements required by the private partner to carry out works

or to operate the infrastructure. To the extent that the PPP contract contemplates transfer of public property to the private partner or the creation of a right of use regarding public property, prior legislative authority may be required. Legislation may also be needed to facilitate the acquisition of the required property or easements when the project site is not located on public property.

1. Ownership of project assets

22. As indicated earlier, PPPs may be devised in a variety of different forms, ranging from publicly owned and operated infrastructure to fully privatized projects (see “Introduction and background information on PPPs”, paras. 47–53). Irrespective of the host country’s general or sectoral policy, it is important that the ownership regime of the various assets involved be clearly defined and based on sufficient legislative authority. However, there may be no compelling need for detailed legislative provisions on this matter. In various countries it has been sufficient to provide a legislative framework outlining the matters that need to be addressed in the PPP contract.

23. In some legal systems, physical infrastructure required for the provision of public services under a concession-type PPP (see “Introduction and background information on PPPs”, paras. …), is generally regarded as public property, even where it was originally acquired or created with private funds. This would typically include any property especially acquired for the construction of the facility in addition to any property that might have been made available to the private partner by the contracting authority. However, during the life of the project the private partner may make extensive improvements or additions to the facility. It may not always be easily ascertainable under the applicable law whether or not such improvements or additions become an integral part of the public assets held in possession by the private partner or whether some of them may be separable from the public property held by the private partner and become the private partner’s private property. It is therefore advisable for the PPP contract to specify, as appropriate, which assets will be public property, and which will become the private property of the private partner.

24. The need for clarity in respect of ownership of project assets is not limited to legal systems where physical infrastructure required for the provision of public services is regarded as public property. Generally, where the contracting authority provides the land or facility required to execute the project, it is advisable for the PPP contract to specify, as appropriate, which assets will remain public property and which will become the private property of the private partner. The private partner may either receive title to such land or facilities or be granted only a leasehold interest or the right to use the land or facilities and build upon it, in particular where the land remains public property. In either case, the nature of the private partner’s rights should be clearly established, as this will directly affect the private partner’s ability to create security interests in project assets for the purpose of raising financing for the project (see paras. 54 and 55).

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

26. Differences in legislative approaches often reflect the varying role of the public and private sectors under different legal and economic systems but may also be the result of practical considerations on the part of the contracting authority. One practical reason for the contracting authority to allow the private partner to retain certain assets at the end of the project period may be the desire to lower the cost at which the service will be provided. If the project assets are likely to have a residual value for the private partner and if that value can be considered during the selection process, the contracting authority may expect the tariffs charged for the service to be lower. Indeed, if the private partner does not expect to have to cover the entire cost of the assets over the life of the project, but can recover part of it by selling them, or using them for other purposes, after the PPP contract expires, there is a possibility that the service may be provided at a lower cost than if the private partner had to amortize all its costs over the life of the project. Moreover, certain assets may require such extensive refurbishing or technological upgrading at the end of the project period that it might not be cost-effective for the contracting authority to claim them. There may also be residual liabilities or consequential costs, for instance, because of liability for environmental damage or demolition costs.

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

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

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

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

28. In the light of the above, it is useful for the law to require that the PPP contract specify, as appropriate, which assets will be public property, and which will be the private property of the private partner. The PPP contract should identify which assets the private partner is required to transfer to the contracting authority or to a new private partner upon expiry or termination of the PPP contract; which assets the contracting authority, at its option, may purchase from the private partner; and which assets the private partner may freely remove or dispose of upon expiry or termination of the PPP contract. These provisions should be complemented by contractual criteria for establishing, as appropriate, the compensation to which the private partner may be entitled in respect of assets transferred to the contracting authority or to a new private partner or purchased by the contracting authority upon expiry or termination of the PPP contract (see chap. V, “Duration, extension and termination of the PPP contract”, paras. 37–40).

2. Acquisition of land required for execution of the project

29. Where a new infrastructure facility is to be built on public land (that is, land owned by the contracting authority or another public authority) or an existing

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

30. The procedure whereby private property is compulsorily acquired by the Government against the payment of appropriate compensation to the owners, which is referred to in domestic legal systems by various technical expressions, such as "expropriation", is referred to in the present *Guide* as "compulsory acquisition". In countries where the law contemplates more than one type of procedure for compulsory acquisition, it may be desirable to authorize the competent public authorities to carry out all acquisitions required for PPPs pursuant to the most efficient of those procedures, such as the special procedures that in some countries apply for reasons of compelling public need (see chap. VII, "Other relevant areas of law", paras. 22 and 23).

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

3. Easements

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

33. The right to use another person's property for a specific purpose or to do work on it is often referred to by the word "easement". Easements usually require the consent of the owner of the property to which they pertain, unless such rights are provided by the law. Usually it is not an expeditious or cost-effective solution to leave it to the private partner to acquire easements directly from the owners of the properties

concerned. Instead, it is more frequent for those easements to be compulsorily acquired by the contracting authority simultaneously with the project site.

34. A somewhat different alternative might be for the law itself to empower public service providers to enter, pass through or do work or affix installations upon the property of third parties, as required for the construction, operation and maintenance of public infrastructure. Such an approach, which may obviate the need to acquire easements in respect of individual properties, may be used in sector-specific legislation where it is deemed possible to determine, in advance, certain minimum easements that may be needed by the private partner. For instance, a law specific to the power generation sector may lay down the conditions under which the private partner obtains a right of cabling for the purpose of placing and operating basic and distribution networks on property belonging to third parties. Such a right may be needed for several measures, such as establishing or placing underground and overhead cables, as well as establishing supporting structures and transforming and switching equipment; maintaining, repairing and removing any of those installations; establishing a safety zone along underground or overhead cables; or removing obstacles along the wires or encroaching on the safety zone. Under some legal systems, the owners may be entitled to compensation should the extent of the rights granted to the private partner be such that the use of the properties by their owners is substantially hindered.

D. Financial arrangements

35. Financial arrangements for PPP projects typically include provisions concerning the private partner's obligations to raise funds for the project, the mechanisms for disbursing and accounting for funds, the remuneration of the private partner and the types of security interests that may be established in favour of the private partner's creditors. The overall financial structure of the project, the sources of capital and lending facilities used, as well as the commercial and other risks that may arise during the operation of the project are all essential elements of the initial project design and "value for money" assessment (see chap. II, "Project planning and preparation", paras. …). All of those elements will vary significantly depending on the nature of the project and the sector concerned. Furthermore, as noted earlier, there are two broad categories of PPP projects, according to the primary form of remuneration of the private partner, namely "concession PPPs" and "non-concession PPPs" (see "Introduction and background information on PPPs", paras. …). Financial arrangements for concession-type PPPs may have little in common with non-concession-type PPPs, and even within those two categories different sectors and projects may require different financial arrangements. It is important to ensure that the laws of the host country take that diversity into account and facilitate or at least do not pose obstacles to the financial management of the project.

1. Financial obligations of the private partner

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

37. The amount of private capital contributed directly by the project company's shareholders typically represents only a portion of the total proposed investment. A far greater portion derives from loans extended to the private partner by commercial banks and international financial institutions and from the proceeds of the placement of bonds and other negotiable instruments on the capital market (see "Introduction and background information on PPPs", paras. 54–67). It is therefore important to

ensure that the law does not unnecessarily restrict the private partner's ability to enter into the financial arrangements it sees fit for the purpose of financing the infrastructure.

2. Payment sources and methods

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

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

(a) User charges

40. In concession-PPPs, tariffs or usage fees charged by the private partner may be the main (sometimes even the sole) source of revenue to recover the investment made in the project in the absence of subsidies or payments by the contracting authority (see paras. …) or the Government (see chap. II, "Project planning and preparation", paras. 30–60). The private partner will therefore seek to be able to set and maintain tariffs and fees at a level that ensures sufficient cash flow for the project. However, in some legal systems there may be limits to the private partner's freedom to establish tariffs and fees. The cost at which public services are provided is typically an element of the Governments' infrastructure policy and a matter of immediate concern for large sections of the public. Thus, the regulatory framework in many countries includes special rules to control tariffs and fees for the provision of public services. Furthermore, statutory provisions or general regulations in some legal systems establish parameters for pricing goods or services, for instance by requiring that tariffs meet certain standards of "reasonableness", "fairness" or "equity".

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

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

42. Where it is deemed necessary to include in general legislation provisions concerning the level of tariffs and user fees, those provisions should seek to achieve a balance between the interests of investors and current and future users. It is advisable that statutory criteria for determining tariffs and fees take into account, in addition to social factors the Government regards as relevant, the private partner's interest in achieving a level of cash flow that ensures the economic viability and commercial profitability of the project. Good practice in that respect call for including

the tentative tariff calculations in the feasibility studies and in the bidding documents. Furthermore, it is advisable to provide the parties with the necessary authority to negotiate appropriate arrangements, including compensation provisions, to address situations where the application of tariff control rules directly or indirectly related to the provision of public services may result in the fixing of tariffs or fees below the level required for the profitable operation of the project (see para. 133).

(ii) Tariff control methods

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

a. Rate-of-return method

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

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

b. Price-cap method

46. Under the price-cap method, a tariff formula is set for a given period (such as four or five years) taking into account future inflation and future efficiency gains

expected from the facility. Tariffs are allowed to fluctuate within the limits set by the formula. In some countries, the formula is a weighted average of various indices, in others it is a consumer price index minus a productivity factor. Where substantial new investments are required, the formula may include an additional component to cover these extra costs. The formula can apply to all services of the company or to selected groups of services only, and different formulas may be used for different groups. The periodic readjustment of the formula is, however, based on the rate-of-return type of calculations, requiring the same type of detailed information as indicated above, though on a less frequent basis.

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

c. Hybrid methods

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

(iii) Policy considerations on tariff control

49. Each of the main tariff adjustment methods discussed above has its own advantages and disadvantages and varying impact on private sector investment decisions. The legislature should bear in mind these issues when considering the appropriateness of tariff control methods to domestic circumstances. Different methods may also be used for different infrastructure sectors. Some laws indeed authorize the contracting authority to apply either a price-cap or rate-of-return method in the selection of private partners, according to the scope and nature of investments and services. In choosing a tariff control method, it is important to consider the impact of the various policy options on private sector investment decisions. Whatever mechanism is chosen, the capacity of the contracting authority or the regulatory agency to monitor adequately the performance of the private partner and to implement the adjustment method satisfactorily should be carefully considered (see also chap. I, "General legal and institutional framework", paras. 30–53). Notwithstanding the private partner's interest, the public authority should also ensure an adequate level of transparency vis-à-vis the final users in concession-PPPs. The choice of the tariff control method should be clearly set in the feasibility studies and the contracting

authority or regulatory agency should enable public access to the calculation and the decision process.

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

(b) Payments by the contracting authority

51. The function and nature of payments by the contracting authority will differ according to the type of PPP arrangement. Direct payments by the contracting authority may be the sole source of revenue for the private partner in non-concession PPPs, where the private partner does not charge the final user for the infrastructure or service (for example, when the private partner operates a publicly accessible facility). Also, where the private partner produces a commodity for further transmission or distribution by another service provider, the contracting authority may undertake to purchase that commodity wholesale at an agreed price and on agreed conditions. In concession-type PPPs, in turn, direct payments are not the primary source of funding for the project, but are often used when the private partner is not able to charge the users for the service (for example, correctional facilities or detention centres) or when the level of user demand is too uncertain or too low to be agreed on by the lenders and other entities providing financing for the project. In concession-type PPPs under which the concessionaire offers services directly to the general public, the contracting authority or other public authority may undertake to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users. In either situation, the financial situation of the contracting authority and its rating by financial institutions, if applicable, are crucial for securing financing at an adequate cost.

52. Many PPP projects may not be feasible without direct payments, be it because there is no direct market demand for the services or facilities developed outside the public sector (such as for waste collection, correctional facilities, or sewage treatment plants), because the demand may be insufficient to cover the project costs (such as bridges or tunnels in low traffic regions) or because the contracting authority is the actual customer of the private sector (such as when a government agency uses office space built and managed by the private partner, or when the private partner builds and maintains a hospital operated by the country's health and social security system). Depending on the type of project and the payment method chosen, direct payments may shift back to the contracting authority some of the project risks (for instance, demand risk) that a private partner is usually expected to assume under a PPP arrangement. Therefore, the type, amount and methods for calculating payments should be performance-based and consistent with the financial model prepared during the project assessment and at the time of the contract award (see chap. II, "Project planning and preparation", paras. …; and chap. III, "Contract award", para. …). The main examples of such arrangements are discussed briefly below.

(i) Upfront or rental payments

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

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

(ii) Capacity and usage-based payments

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

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

57. Shadow tolls (and any similar supplemental payment based on an estimate of usage) may involve a substantial expenditure for the contracting authority and require close and extensive monitoring. In countries that have used shadow tolls for the development of new road projects, payments by the contracting authority to the

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

(iii) Purchase commitments

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

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

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

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

E. Security interests

60. Security interests in personal property provide the secured creditor with essentially two kinds of rights: a property right allowing the secured creditor, in principle, to repossess the property or have a third party repossess and sell it, and a

priority right to receive payment with the proceeds from the sale of the property in the event of default by the debtor (in addition to this general economic and legal part, see chap. VII, "Other areas of law", paras. …). Security arrangements in project finance generally play a defensive or preventive role by ensuring that, in the event a third party acquires the debtor's operations (for example, by foreclosure, in bankruptcy or directly from the debtor) all proceeds resulting from the sale of those assets will go first to repayment of outstanding loans. Nevertheless, lenders would generally aim at obtaining security interests that allow them to foreclose and take possession of a project they can take over and operate either to restore its economic viability with a view to reselling at an appropriate time or to retaining the project indefinitely and collecting ongoing revenue.

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

1. Security interests in physical assets

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

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

2. Security interests in intangible assets

64. The main intangible asset in a concession-type infrastructure project is the concession itself, that is, the concessionaire's right to operate the infrastructure or to provide the relevant service and charge the public for its use of services it delivers. In most legal systems, the concession attached to the PPP contract provides its holder with the authority to control the entire project and entitles the private partner to earn the revenue generated by the project. Thus, the value of the concession exceeds the combined value of all the physical assets involved in a project. Because the private partner would usually have the right to possess and dispose of all project assets (with the possible exception of those which are owned by other parties, such as public property in the possession of the private partner), the concession would typically encompass both present and future assets of a tangible or intangible nature. The

lenders may therefore regard the concession as an essential component of the security arrangements negotiated with the private partner. A pledge of the concession itself may have various practical advantages for the private partner and the lenders, in particular in legal systems that would not otherwise allow the creation of security over all of a company's assets or which do not generally recognize non-possessory security interests (see chap. VII, "Other relevant areas of law", paras. 10–16). These advantages may include avoiding the need to create separate security interests for each project asset, allowing the private partner to continue to deal with those assets in the ordinary course of business and making it possible to pledge certain assets without transferring actual possession of the assets to the creditors. Furthermore, a pledge of the concession may entitle the lenders, in case of breach by the private partner, to avert termination of the project by taking over the concession and making arrangements for continuation of the project under another private partner. A pledge of the concession may, therefore, represent a useful complement to or, under certain circumstances, a substitute for a direct agreement between the lenders and the contracting authority concerning the lenders' step-in rights (see paras. 162–165).

65. However, in some legal systems there may be obstacles to a pledge of the concession in the absence of express legislative authorization. Under various legal systems, security interests may only be created in respect of assets that can be freely transferable by the grantor of the security. Since the right to operate the infrastructure is, in most cases, not transferable without the consent of the contracting authority (see paras. 70 and 71), in some legal systems it may not be possible for the private partner to create security interests over the concession itself. Recent legislation in some civil law jurisdictions has removed that obstacle by creating a special category of security interest, sometimes referred to by expressions such as "*hipoteca de concesión de obra pública*" or "*prenda de concesión de obra pública*" ("public works concession mortgage" or "pledge of public works concession"), which generally provides the lenders with an enforceable security interest covering all of the rights granted to the private partner under the PPP contract. However, in order to protect the public interest, the law requires the consent of the contracting authority for any measure by the lenders to enforce such a right, under conditions to be provided in an agreement between the contracting authority and the lenders. A somewhat more limited solution has been achieved in some common law jurisdictions in which a distinction has been made between the non-transferable right to carry out a certain activity under a governmental licence (that is, the "public rights" arising under the licence) and the right to claim proceeds received by the licensee (the latter's "private rights" under the licence).

3. Security interests in trade receivables

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

67. Security over trade receivables plays a central role in financing arrangements involving the placement of bonds and other negotiable instruments. Those instruments may be issued by the private partner itself, in which case the investors

purchasing the security will become its creditors, or they may be issued by a third party to whom the project receivables have been assigned through a mechanism known as "securitization". Securitization involves the creation of financial securities backed by the project's revenue stream, which is pledged to pay the principal and interest of that security. Securitization transactions usually involve the establishment of a legal entity separate from the private partner and especially dedicated to the business of securitizing assets or receivables. This legal entity is often referred to as a "special-purpose vehicle". The private partner assigns project receivables to the special-purpose vehicle, which, in turn, issues to investors interest-bearing instruments that are backed by the project receivables. The securitized bondholders thereby acquire the right to the proceeds of the private partner's transactions with its customers. The private partner collects the tariffs from the customers and transfers the funds to the special-purpose vehicle, which then transfers it to the securitized bondholders. In some countries, recent legislation has expressly recognized the private partner's authority to assign project receivables to a special-purpose vehicle, which holds and manages the receivables for the benefit of the project's creditors. With a view to protecting the bondholders against the risk of insolvency of the private partner, it may be advisable to adopt the necessary legislative measures to enable legal separation between the private partner and the special-purpose vehicle.

68. In most cases it would not be practical for the private partner to specify individually the receivables being assigned to the creditors. Assignment of receivables in project finance therefore typically takes the form of a bulk assignment of future receivables. Statutory provisions recognizing the private partner's authority to pledge the proceeds of infrastructure projects have been included in domestic legislation in various legal systems. However, there may be considerable uncertainty in various legal systems about the validity of the wholesale assignment of receivables and of future receivables. It is therefore important to ensure that domestic laws on security interests do not hinder the ability of the parties to assign trade receivables effectively in order to obtain financing for the project (see chap. VII, "Other relevant areas of law", paras. 10–16).

4. Security interests in the project company

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

F. Assignment of rights by the private partner

70. Concessions contained in PPP contracts are granted in view of the particular qualifications and reliability of the private partner and in most legal systems they are not freely transferable. Indeed, domestic laws often prohibit the assignment of rights acquired by the private partner after the contract award without the consent of the contracting authority. The purpose of these restrictions is typically to ensure the contracting authority's control over the qualifications of infrastructure operators or public service providers. Some countries also preclude such assignment before the construction of the project facility has been completed.

71. Some countries have found it useful to mention in the legislation the conditions under which approval for the transfer of a concession prior to its expiry may be granted, such as, for example, acceptance by the new private partner of all obligations under the PPP contract and evidence of the new private partner's technical and

financial capability to provide the service. General legislative provisions of this type may be supplemented by specific provisions in the PPP contract setting forth the scope of those restrictions, as well as the conditions under which the consent of the contracting authority may be granted. However, it should be noted that restrictions typically apply to the voluntary transfer of its rights by the private partner; they do not preclude the compulsory transfer of the concession to an entity appointed by the lenders, with the consent of the contracting authority, for the purpose of averting termination due to serious breach by the private partner (see also paras. …).

G. Transfer of controlling interest in the project company

72. The contracting authority may be concerned that the original members of the bidding consortium maintain their commitment to the project throughout its duration and that effective control over the project company will not be transferred to entities unknown to the contracting authority. Private partners are selected to carry out infrastructure projects at least partly on the basis of their experience and capabilities for that sort of project (see chap. III, "Contract award", paras. 38–40). Contracting authorities are therefore concerned that, if the private partner's shareholders are entirely free to transfer their investment in a given project, there will be no assurance as to who will actually be delivering the relevant services. However, in practical terms, such commitment from the private partner and the bidding consortium is only meaningful to the extent of their capacity to meet their obligations.

73. Contracting authorities may draw reassurance from the experience that the selected bidding consortium demonstrated in the pre-selection phase and from the performance guarantees provided by the parent organizations of the original consortium and its subcontractors. In practice, however, the reassurance that may result from the apparent expertise of the shareholders in the private partner should not be overemphasized. Where a separate legal entity is established to carry out the PPP, which is often the case (see para. …), the backing of the private partner's shareholders, should the project run into difficulties, may be limited to their maximum liability. Thus, restrictions on the transferability of investment, in and of themselves, may not represent sufficient protection against the risk of performance failure by the private partner. In particular, these restrictions are not a substitute for appropriate contractual remedies under the PPP contract, such as monitoring the level of service provided (see paras. …) or termination without full compensation in case of unsatisfactory performance (see chap. V, "Duration, extension and termination of the PPP contract", paras. 44 and 45).

74. In addition to the above, imposing restrictions on the transferability of shares in companies providing public services may also present some disadvantages for the contracting authority. As noted earlier (see "Introduction and background information on PPPs", paras. 54–67), there are numerous types of funding available from different investors for different risk and reward profiles. The initial investors, such as construction companies and equipment suppliers, will seek to be rewarded for the higher risks they assume, while subsequent investors may require a lesser return commensurate with the reduced risks they bear. Most of the initial investors have finite resources and need to recycle capital to be able to participate in new projects. Therefore, those investors might not be willing to tie up capital in long-term projects. At the end of the construction period, the initial investors might prefer to sell their interest on to a secondary equity provider whose required rate of return is less. Once usage is more certain, another refinancing could take place. However, if the investors' ability to invest and re-invest capital for project development is restricted by constraints on the transferability of shares in infrastructure projects, there is a risk of a higher cost of funding. In some circumstances it may not be possible to fund a project at all, as some investors whose involvement may be crucial for the implementation of the project may not be willing to participate. From a long-term perspective, the development of a market place for investment in public infrastructure

may be hindered if investors' freedom to transfer their interest in PPPs is unnecessarily constrained.

75. For the above reasons, it may be advisable for the law to limit the restrictions placed on the transfer of a controlling interest in the project company to a certain period of time (for example, a certain number of years after the conclusion of the PPP contract, or after completion of the construction phase) or to situations where such restrictions are justified by reasons of public interest. One such situation may be where the private partner is in possession of public property or where the private partner receives loans, subsidies, equity or other forms of direct governmental support. In these cases, the contracting authority's accountability for the proper use of public funds requires assurances that the funds and assets are entrusted to a solid company, to which the original investors remain committed for a reasonable period. Another situation that may justify imposing limitations on the transfer of shares of private partner companies may be where the contracting authority has an interest in preventing transfer of shares to particular investors. For example, the contracting authority may wish to control acquisition of controlling shares of public service providers to avoid the formation of oligopolies or monopolies in liberalized sectors. Or it may not be thought appropriate for a company that had defrauded one part of Government to be employed by another through a newly acquired subsidiary.

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

H. Construction works

77. Contracting authorities purchasing construction works typically act as the employer under a construction contract and retain extensive monitoring and inspection rights, including the right to review the construction project and request modifications to it, to follow closely the construction work and schedule, to inspect and formally accept the completed work and to give final authorization for the operation of the facility.

78. On the other hand, in many PPPs, instead of assuming direct responsibility for managing the details of the project, the contracting authorities may prefer to transfer that responsibility to the private partner by requiring the latter to assume full responsibility for the timely completion of the construction (see chap. II, "Project planning and preparation", paras. …). The private partner, too, will be interested in ensuring that the project is completed on time and that the cost estimate is not exceeded, and will typically negotiate fixed-price, fixed-time turnkey contracts that include guarantees of performance by the construction contractors. Therefore, in PPPs it is the private partner that for most purposes performs the role that the employer would normally play under a construction contract.

79. For these reasons, legislative provisions on the construction of facilities under the form of PPP are in some countries limited to a general definition of the private partner's obligation to perform the public works in accordance with the provisions of the PPP contract and give the contracting authority the general right to monitor the

progress of the work with a view to ensuring that it conforms to the provisions of the agreement. In those countries, more detailed provisions are then left to the PPP contract.

1. Review and approval of construction plans

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

2. Variation in the project terms

81. During construction of an infrastructure facility, it is common for situations to arise that make it necessary or advisable to alter certain aspects of the construction. The contracting authority may therefore wish to retain the right to order changes in respect of such aspects as the scope of construction, the technical characteristics of equipment or materials to be used in the work or the construction services required under the specifications. Such changes are referred to in this *Guide* as “variations”. As used in the *Guide,* the word “variation” does not include tariff adjustments or revisions made because of cost changes or currency fluctuations (see paras. …). Likewise, renegotiation of the PPP contract in cases of substantial change in conditions (see paras. …) is not regarded in the *Guide* as a variation.

82. Given the complexity of most infrastructure projects, it is not possible to exclude the need for variations in the construction specifications or other requirements of the project. However, such variations often cause delay in the execution of the project or in the delivery of the public service; they may also render the performance under the PPP contract more onerous for the private partner. Furthermore, the cost of implementing extensive variation orders may exceed the private partner’s own financial means, thus requiring substantial additional funding that may not be obtainable at an acceptable cost. It is therefore advisable for the contracting authority to consider measures to control the possible need for variation. The quality of the feasibility studies required by the contracting authority and of the specifications provided during the selection process (see chap. III, “Contract award”, paras. 61 and 64–66) play an important role in avoiding subsequent changes in the project.

83. The PPP contract should set forth the specific circumstances under which the contracting authority may order variations in respect of construction specifications and the compensation that may be due to the private partner, as appropriate, to cover the additional cost and delay entailed by implementing the variations. The PPP contract should also clarify the extent to which the private partner is obliged to implement those variations and whether the private partner may object to variations and, if so, on which grounds. According to the contractual practice of some legal systems, the private partner may be released of its obligations when the amount of additional costs entailed by the modification exceeds a set maximum limit.

84. Various contractual approaches for dealing with variations have been used in large construction contracts to establish the extent of the contractor’s obligation to implement changes and the required adjustments in the contract price or contract duration. Such solutions may also be used, mutatis mutandis, to deal with variations

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

3. Monitoring powers of the contracting authority

85. In some legal systems, public authorities purchasing construction works customarily retain the power to order the suspension or interruption of the works for reasons of public interest. However, with a view to providing some reassurance to potential investors, it may be useful to limit the possibility of such interference and to provide that no such interruption should be of a duration or extent greater than is necessary, taking into consideration circumstances that gave rise to the requirement to suspend or interrupt the work. The definition in the legislation of events characterized as reasons of public interest, such as environmental issues at a large scale or endangerment of the population located in the zone where the PPP is being built, may reassure potential investors in that regard. It may also be useful to agree on a maximum period of suspension and to provide for appropriate compensation to the private partner. Furthermore, guarantees may be provided to ensure payment of compensation or to indemnify the private partner for loss resulting from suspension of the project and restoration of the economic and financial equilibrium of the PPP contract after the suspension is lifted (see also chap. II, "Project planning and preparation", paras. 48–50).

86. In some legal systems, facilities built for use in connection with the provision of certain public services become public property once construction is finished (see para. …). In such cases, the law often requires the completed facility to be formally accepted by the contracting authority or another public authority. Such formal acceptance is typically given only after inspection of the completed facility and satisfactory conclusion of the necessary tests to ascertain that the facility is operational and meets the specifications and technical and safety requirements. Even where formal acceptance by the contracting authority is not required (for example, where the facility remains the property of the private partner), provisions concerning final inspection and approval of the construction work by the contracting authority are often required in order to ensure compliance with health, safety, building or labour regulations. The PPP contract should set out in detail the nature of the completion tests or the inspection of the completed facility; the timetable for the tests (for instance, it may be appropriate to undertake partial tests over a period, rather than a single test at the end); the consequences of failure to pass a test; and the responsibility for organizing the resources for the test and covering the corresponding costs. In some countries, it has been found useful to authorize operation of the facility on a provisional basis, pending final approval by the contracting authority, and to provide an opportunity for the private partner to rectify defects that might be found at that juncture.

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

4. Guarantee period

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

I. Operation of infrastructure

88. Once the construction phase is completed, one of the most important risks associated with a PPP, which is the failure to complete the project, ceases to exist (see para. 75, and chap. II, “Project planning and preparation”, para. …). Therefore, it is not unusual for the PPP contract to allow construction companies to leave the project at the end of the first phase (see para. …). Moreover, the variations allowed at the operational stage could be more important than at the construction stage.

89. Conditions for the operation and maintenance of the facility, as well as for quality and safety standards, are often enumerated in the law and spelled out in detail in the PPP contract. In addition, especially in the areas of electricity, water and sanitation and public transportation, the contracting authority or an independent regulatory agency may exercise an oversight function over the operation of the facility. An exhaustive discussion of legal issues relating to the conditions of operation of infrastructure facilities would exceed the scope of this *Guide*. The following paragraphs therefore contain only a brief presentation of some of the main issues.

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

1. Performance standards

91. Public service providers generally have to meet a set of technical and service standards. Such standards are in most cases too detailed to figure in legislation and may be included in implementing decrees, regulations or other instruments. Service standards are often spelled out in detail in the PPP contract. They include quality standards, such as requirements with respect to water purity and pressure; ceilings on the length of time to perform repairs; ceilings on the number of defects or complaints; timely performance of transport services; continuity in supply; and health, safety and environmental standards. Legislation should, however, impose the basic principles

that will guide the establishment of detailed standards or require compliance with international standards.

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

2. Extension of services

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

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

3. Continuity of service

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

enforcement powers to compel the private partner to resume providing service in the event of unlawful discontinuance.

96. That obligation, too, is subject to a general rule of reasonableness. Various legal systems recognize the private partner's right to fair compensation for having to deliver the service under situations of hardship (see paras. …). Moreover, in some legal systems, it is held that a public service provider may not be required to operate where its overall operation results in a loss. Where the public service as a whole, and not only one or more of its branches or territories, ceases being profitable, the private partner may have the right to direct compensation by the contracting authority or, alternatively, the right to terminate the PPP contract. However, termination typically requires the consent of the contracting authority or a judicial decision. In legal systems that allow such a solution, it is advisable to clarify in the PPP contract which extraordinary circumstances would justify the suspension of the service or even release the private partner from its obligations under the PPP contract (see paras. …; also chap. V, "Duration, extension and termination of the PPP contract", para. 34).

4. Equal treatment of customers or users

97. Entities that provide certain services to the general public are, in some jurisdictions, under a specific obligation to ensure the availability of the service under essentially the same conditions to all users and customers falling within the same category. However, differentiation based on a reasonable and objective classification of customers and users is accepted in those legal systems as long as like contemporaneous service is rendered to consumers and users engaged in like operations under like circumstances. It may thus not be inconsistent with the principle of equal treatment to charge different prices or to offer different access conditions to different categories of users (for example, domestic consumers, on the one hand, and business or industrial consumers, on the other), provided that the differentiation is based on objective criteria and corresponds to actual differences in the situation of the consumers or the conditions under which the service is provided to them. Nevertheless, where a difference in charges or other conditions of service is based on actual differences in service (such as higher charges for services provided at hours of peak consumption), it typically has to be commensurate with the amount of difference.

98. In addition to differentiation established by the private partner itself, different treatment of certain users or customers may be the result of legislative action. In many countries, the law requires that specific services must be provided at particularly favourable terms to certain categories of users and customers, such as discounted transport for schoolchildren or senior citizens, or reduced water or electricity rates for lower-income or rural users. Public service providers may recoup these service burdens or costs in several ways, including through government subsidies, through funds or other official mechanisms created to share the financial burden of these obligations among all public service providers or through internal cross-subsidies from more profitable services (see chap. II, "Project planning and preparation", paras. 42–44 and chap. VII, "Other areas of laws", paras. …).

5. Interconnection and access to infrastructure networks

99. Companies operating infrastructure networks in sectors such as railway transport, telecommunications or power or gas supply are sometimes required to allow other companies to have access to the network. That requirement may be stated in the PPP contract or in sector-specific laws or regulations. Interconnection and access requirements have been introduced in certain infrastructure sectors as a complement to reforms in the structure of a given sector; in others, they have been adopted to foster competition in sectors that remained fully or partially integrated (for a brief discussion of market structure issues, see "Introduction and background information on PPPs", paras. 21–46).

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

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

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

6. Disclosure requirements and transparency obligations

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

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

7. Enforcement powers of the private partner

105. In countries with a well-established tradition of awarding PPP contracts for the provision of public services, the private partner may have the power to establish rules designed to facilitate the provision of the service (such as instructions to users or safety rules), take reasonable measures to ensure compliance with those rules and suspend the provision of service for emergency or safety reasons. For that purpose, general legislative authority, or even case-by-case authorization from the legislature, may be required in most legal systems. The extent of powers given to the private

partner is usually defined in the PPP contract, however, and may not need to be provided in detail in legislation. It may be advisable to provide that the rules issued by the private partner become effective upon approval by the regulatory agency or the contracting authority, as appropriate. However, the right to approve operating rules proposed by the private partner should not be arbitrary and the private partner should have the right to appeal a decision to refuse approval of the proposed rules (see also chap. I, “General legal and institutional framework”, paras. 49 and 50).

106. Of particular importance is the question whether the private partner may discontinue the service because of default or non-compliance by its users notwithstanding the general obligation to ensure service continuity (see paras. … and …). Many legal systems recognize that entities providing public services may establish and enforce rules that permit cutting off services for consumers or users having failed to pay for them or seriously infringed the conditions for using them. The power to do so is often regarded as crucial in order to prevent abuse and ensure the economic viability of the service. However, given the essential nature of certain public services, that power may require legislative authority in some legal systems. Furthermore, there may be several expressed or implied limitations upon or conditions for the exercise of that power, such as special notice requirements and specific consumer remedies. Additional limitations and conditions may derive from the application of general consumer protection rules (see chap. VII, “Other relevant areas of law”, paras. 45 and 46).

J. General contractual arrangements

107. This section discusses selected contractual arrangements that typically appear in PPP contracts in various sectors and are often reflected in standard contract clauses used by domestic contracting authorities. Although essentially contractual in nature, the arrangements discussed in this section may have some important implications for the legislation of the host country, according to its particular legal system.

1. Subcontracting

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

(a) Choice of subcontractors

109. The private partner’s freedom to hire subcontractors is in some countries restricted by rules that prescribe the use of tendering and similar procedures for the award of subcontracts by public service providers. Such statutory rules have often been adopted when infrastructure facilities were primarily or exclusively operated by the Government, with little or only marginal private sector investment. The purpose of such statutory rules is to ensure economy, efficiency, integrity and transparency in the use of public funds. However, in the case of PPPs, such provisions may discourage the participation of potential investors, since the project sponsors typically include engineering and construction companies that participate in the project in the

expectation that they will be given the main contracts for the execution of the construction and other work.

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

(b) Governing law

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

112. Domestic laws specific to PPPs seldom contain provisions concerning the law governing the contracts entered into by the private partner. In fact, most countries have found no compelling reason for devising specific provisions concerning the law governing contracts between the private partner and its contractors. Accordingly, in

most countries those contracts are governed by the applicable law parties pursuant to a choice-of-law clause in their contracts or to the applicable rules of private international law. It should be noted, however, that the freedom to choose the applicable law for contracts and other legal relationships is in some legal systems subject to conditions and restrictions pursuant to rules of private international law or certain rules of public law of the host country. For instance, States parties to some regional economic integration agreements are obliged to enact harmonized provisions of private international law dealing, inter alia, with contracts between public service providers and their contractors. While rules of private international law often allow considerable freedom to choose the law governing commercial contracts, that freedom is in some countries restricted for contracts and legal relationships that are not qualified as commercial, such as, for instance, certain contracts entered into by public authorities of the host country (for example, guarantees and assurances by the Government, power purchase or fuel supply commitments by a public authority) or contracts with consumers. The choice of foreign law in contracts between the private partner and its subcontractors should not release them from the obligation to comply with the country's mandatory laws governing the construction or operation of the facility (such as environment, labour, safety or security laws and regulations).

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

2. Liability with respect to users and third parties

114. Defective construction or operation of an infrastructure facility may result in the death of or personal injury to employees of the private partner, users of the facility or other third parties or in damage to their property. The issues concerning damages to be paid to third parties in such cases are complex and may be governed not by rules of the law applicable to the PPP contract governing contractual liability, but rather by applicable legal rules governing extra-contractual liability, which are often mandatory. Also, in some legal systems, there are special mandatory rules governing the extra-contractual liability of public authorities to which the contracting authority may be subject, in particular when the PPP belongs to the public services domain. Moreover, the PPP contract cannot limit the liability of the private partner or the contracting authority to compensate third parties who are not parties to the PPP contract. It is therefore advisable for the contracting authority and the private partner to provide for the internal allocation of risks between them as regards damages to be paid to third parties due to death, personal injury or damage to their property, to the extent that this allocation is not governed by mandatory rules. It is also advisable for the parties to provide for insurance against such risks (see paras. 128 and129).

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

against third parties under the applicable law, it may be advisable for the PPP contract to provide that the contracting authority should be protected and indemnified in respect of compensation claims brought by third parties who sustain injury or damage to their property resulting from the construction or operation of the infrastructure facility.

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

3. Performance guarantees and insurance

117. The obligations of the private partner are usually complemented by the provision of some form of guarantee of performance in the event of breach and insurance coverage against a number of risks linked with the construction (see paras. …) and operation phase (see paras. …). The law in some countries generally requires that adequate performance guarantees be provided by the private partner and refer the matter to the PPP contract for further details. In other countries, the law contains more detailed provisions, for instance requiring the offer of a certain type of guarantee up to a stated percentage of the basic investment.

(a) Types, functions and nature of performance guarantees

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

119. As regards their nature, performance guarantees may be generally divided into independent guarantees and accessory guarantees. A guarantee is said to be “independent” if the guarantor’s obligation is independent from the private partner’s obligations under the PPP contract. Under an independent guarantee (often called a first-demand guarantee) or a stand-by letter of credit, the guarantor or issuer is obligated to make payment on demand by the beneficiary and the latter is entitled to recover under the instrument if it presents the document or documents stipulated in the terms of the guarantee or stand-by letter of credit. Such a document might be simply a statement by the beneficiary that the contractor has failed to perform. The guarantor or issuer is not entitled to withhold payment on the ground that there has in fact been no failure to perform under the main contract; however, under the law applicable to the instrument, payment may in very exceptional and narrowly defined circumstances be refused or restrained (for example, when the claim by the beneficiary is manifestly fraudulent). In contrast, a guarantee is accessory when the obligation of the guarantor involves more than the mere examination of a documentary demand for payment in that the guarantor may have to evaluate evidence

of liability of the contractor for failure to perform under the works contract. The nature of the link may vary under different guarantees and may include the need to prove the contractor's liability in arbitral proceedings. By their nature, performance bonds have an accessory character to the underlying contract.

(b) Advantages and disadvantages of various types of perform/guarantee

120. From the perspective of the contracting authority, monetary performance guarantees may be particularly useful in covering additional costs that may be incurred by the contracting authority because of delay or breach by the private partner. Monetary performance guarantees may also serve as an instrument to put pressure on the private partner to complete construction in time and to perform its other obligations in accordance with the requirements of the PPP contract. However, the amount of those guarantees is typically only a fraction of the economic value of the obligation guaranteed and is usually not sufficient to cover the cost of engaging a third party to perform instead of the private partner or its contractors.

121. From the perspective of the contracting authority, a first-demand guarantee has the advantage of assuring prompt recovery of funds under the guarantee, without evidence of failure to perform by the contractor or of the extent of the beneficiary's loss. Furthermore, guarantors furnishing monetary performance guarantees, in particular banks, prefer first-demand guarantees, as the conditions are clear as to when their liability to pay accrues. The guarantors will thus not be involved in disputes between the contracting authority and the private partner as to whether or not there has been a failure to perform under the PPP contract. Another advantage for a bank issuing a first-demand guarantee is the possibility of quick and efficient recovery of the sums paid under such a guarantee by direct access to the private partner's assets.

122. A disadvantage to the contracting authority of a first-demand guarantee or a stand-by letter of credit is that those instruments may increase the overall project costs, since the private partner is usually obliged to obtain and set aside large counter-guarantees in favour of the institutions issuing the first-demand guarantee or the stand-by letter of credit. Also, a private partner that furnishes such a guarantee may wish to take out insurance against the risk of recovery by the contracting authority under the guarantee or the stand-by letter of credit when there has been in fact no failure to perform by the private partner and the cost of that insurance is included in the project cost. The private partner may further include in the project cost the potential costs of any action it may need to institute against the contracting authority to obtain the repayment of the sum improperly claimed.

123. A disadvantage to the private partner of a first-demand guarantee or a stand-by letter of credit is that, if there is recovery by the contracting authority when there has been no failure to perform by the private partner, the latter may suffer immediate loss if the guarantor or the issuer of the letter of credit reimburses itself from the assets of the private partner after payment to the contracting authority. The private partner may also experience difficulties and delays in recovering from the contracting authority the sum improperly claimed.

124. The terms of an accessory guarantee usually require the beneficiary to prove the failure of the contractor to perform and the extent of the loss suffered by the beneficiary. Furthermore, the defences available to the debtor if it is sued for a failure to perform are also available to the guarantor. Accordingly, there is a risk that the contracting authority may face a protracted dispute when it makes a claim under the bond. In practice, this risk may be reduced, for instance, if the submission of claims under the terms of the bond is subject to a procedure such as that provided in article 7 (j)(i) of the Uniform Rules on Contract Bonds, drawn up by the International Chamber of Commerce.[4] Article 7 (j)(i) of the Uniform Rules provides that notwithstanding any dispute or difference between the principal and the beneficiary in relation to the performance of the contract or any contractual obligation, a default for the purposes of

[4] The text of the Uniform Rules on Contract Bonds is reproduced in document A/CN.9/459/Add.1.

payment of a claim under a contract bond shall be deemed to be established upon issue of a certificate of default by a third party (who may without limitation be an independent architect or engineer or referee) if the bond so provides and the service of such a certificate or a certified copy thereof upon the guarantor. Where such a procedure is adopted, the contracting authority may be entitled to obtain payment under the contract bond even though its entitlement to that payment is disputed by the private partner.

125. As a reflection of the lesser risk borne by the guarantor, the monetary limit of liability of the guarantor may be considerably higher than under a first-demand guarantee, thus covering a larger percentage of work under the PPP contract. A performance bond may also be advantageous if the contracting authority cannot conveniently arrange for the rectification of faults or completion of construction itself and requires the assistance of a third party to arrange for rectification or completion. Where, however, the construction involves the use of a technology known only to the private partner, rectification or completion by a third person may not be feasible and a performance bond may not have the last-mentioned advantage over a monetary performance guarantee. For the private partner, accessory guarantees have the advantage of preserving the private partner's borrowing power, since accessory guarantees, unlike first-demand guarantees and stand-by letters of credit, do not affect the private partner's line of credit with the lenders.

126. It follows from the above considerations that different types of guarantee may be useful in connection with the various obligations assumed by the private partner. While it is useful to require the private partner to provide adequate guarantees of performance, it is advisable to leave it to the parties to determine the extent to which guarantees are needed and which guarantees should be provided in respect of the various obligations assumed by the private partner, rather than requiring in the law only one form of guarantee to the exclusion of others. It should be noted that the project company itself will require a series of performance guarantees to be provided by its contractors (see paras. 109–110) and that additional guarantees to the benefit of the contracting authority usually increase the overall cost and complexity of a project. In some countries, practical guidance provided to domestic contracting authorities advises them to consider carefully whether and under what circumstances such guarantees are required, which specific risks or loss they should cover, and which type of guarantee is best suited in each case. The ability of the project company to raise finance for the project may be jeopardized by bond requirements set at an excessive level.

(c) Duration of guarantees

127. One particular problem of PPPs concerns the duration of the guarantee. The contracting authority may have an interest in obtaining guarantees of performance that remain valid during the entire life of the project, covering both the construction and the operational phase. However, given the long duration of infrastructure projects and the difficulty in evaluating the various risks that may arise, it may be problematic for the guarantor to issue a performance bond for the whole duration of the project or to procure reinsurance for its obligations under the performance bond. In practice, this problem is compounded by stipulations that the non-renewal of a performance bond constitutes a reason for a call on the bond, so that merely allowing the project company to provide bonds for shorter periods may not be a satisfactory solution. One possible solution, used in some countries, is to require separate bonds for the construction and the operation phase, thus allowing for better assessment of risks and reinsurance prospects. Such a system may be enhanced by defining in precise terms the risk to be covered during the operation period, thus allowing for a better assessment of risks and a reduction of the total amount of the bond. Another possibility to be considered by the contracting authority may be to require the provision of performance guarantees during specific crucial periods, rather than for the entire duration of the project. For instance, a bond might be required during the construction phase and last for an appropriate period beyond completion, so as to cover possible latent defects. Such a bond might then be replaced by a performance

bond for a certain number of years of operation, as appropriate in order for the project company to demonstrate its capability to operate the facility in accordance with the required standards. If the project company's performance proves to be satisfactory, the bond requirement might be waived for the remainder of the operation phase, up to a certain period before the end of the PPP contract term, when the project company might be required to place another bond to guarantee its obligations in connection with the handing over of assets and other measures for the orderly wind-up of the project, as appropriate (see chap. V, "Duration, extension and termination of the PPP contract", paras. 50–62).

(d) Insurance arrangements

128. Insurance arrangements made in connection with PPPs typically vary according to the phase to which they apply, with certain types of insurance only being purchased during a particular project phase. Some forms of insurance, such as business interruption insurance, may be purchased by the private partner in its own interest, while other forms of insurance may be a requirement under the laws of the host country. Forms of insurance often required by law include insurance coverage against damage to the facility, third-party liability insurance, workers' compensation insurance and pollution and environmental damage insurance.

129. Mandatory insurance policies under the laws of the host country often need to be obtained from a local insurance company or from another institution admitted to operate in the country, which in some cases may pose several practical difficulties. In some countries, the type of coverage usually offered may be more limited than the standard coverage available on the international market, in which case the private partner may remain exposed to various perils that may exceed its self-insurance capacity. That risk is particularly serious in connection with environmental damage insurance. Further difficulties may arise in some countries because of limitations on the ability of local insurers to reinsure the risks on the international insurance and reinsurance markets. Therefore, the project company may often need to procure additional insurance outside the country, thus adding to the overall cost of financing the project.

4. Changes in conditions

130. PPPs normally last for a long period of time, during which many circumstances relevant to the project may change. The impact of many changes may be automatically covered in the PPP contract, either through financial arrangements such as a tariff structure that includes an indexation clause (see paras. 43–50), or by the assumption by either party, expressly or by exclusion, of certain risks (for example, if the price of fuel or electricity supply is not taken into account in the indexation mechanisms, then the risk of higher than expected prices is absorbed by the private partner). However, it may not be feasible to include some changes in an automatic adjustment mechanism, or the parties may prefer to exclude the possibility of automatic adjustment. From a legislative perspective, two particular categories deserve special attention: legislative or regulatory changes and unexpected changes in economic conditions.

(a) Legislative and regulatory changes

131. Given the long duration of PPPs, the private partner may face additional costs in meeting its obligations under the PPP contract because of future, unforeseen changes in legislation applying to its activities. In extreme cases, legislation could even make it financially or physically impossible for the private partner to carry on with the project. For the purpose of considering the appropriate solution for dealing with legislative changes, it may be useful to distinguish between legislative changes having a particular incidence on PPPs or on one specific project, on the one hand, and general legislative changes affecting other economic activities also, and not only infrastructure operation, on the other.

132. All business organizations, in the private and public sectors alike, are subject to changes in law and generally must deal with the consequences that such changes may have for business, including the impact of changes on the price of or demand for their products. Possible examples might include changes in the structure of capital allowances that apply to entire classes of assets, whether owned by the public or private sector and whether related to infrastructure projects or not; regulations that affect the health and safety of construction workers on all construction projects, not just infrastructure projects; and changes in the regulations on the disposal of hazardous substances. General changes in law may be regarded as an ordinary business risk rather than a risk specific to the private partner's activities and it may be difficult for the Government to undertake to protect infrastructure operators from the economic and financial consequences of changes in legislation that affect other business organizations equally. This is particularly true when the PPP is undertaken by a local authority not under the direct oversight of the central government, which retains the power to regulate the sector concerned. Thus, there may not be a prima facie reason why the private partner should not bear the consequences of general legislative risks, including the risk of costs arising from changes in law applying to the whole business sector.

133. Nevertheless, it is important to take into account possible limitations in the private partner's capacity to respond to or absorb cost increases that result from general legislative changes. Infrastructure operators are often subject to service standards and tariff control mechanisms that make it difficult for them to respond to changes in the law in the same manner as other private companies (by increasing tariffs or by reducing services, for example). Where tariff control mechanisms are provided in the PPP contract, the private partner will seek to obtain assurances from the contracting authority and the regulatory agency, as appropriate, that it will be allowed to recover the additional costs entailed by changes in legislation by means of tariff increases. Where such an assurance cannot be given, it is advisable to empower the contracting authority to negotiate with the private partner the compensation to which the private partner may be entitled in the event that tariff control measures do not allow for full recovery of the additional costs generated by general legislative changes. Including such economic and financial scenario in the preparation documents issued at the planning stage (see chap. II, "Project planning and preparation", paras. …) and in the contract document is advisable.

134. A different situation arises when the private partner faces increased costs as a result of specific legislative changes that target the particular project, a class of similar projects or PPPs in general. Such changes cannot be regarded as an ordinary business risk and may significantly alter the economic and financial assumptions based on which the PPP contract was negotiated. Thus, the contracting authority often agrees to bear the additional cost resulting from specific legislation that targets the particular project, a class of similar projects or PPPs in general. For example, in highways projects, legislation aimed at a specific road project or road operating company, or at that class of privately operated road projects, might result in a tariff adjustment under the relevant provisions in the PPP contract. When the PPP involves foreign investment, the private partner may also be able to invoke the dispute settlement mechanisms of any applicable treaty on promotion or protection of investment (see chap. VII, "Other areas of Law", para. …).

(b) Changes in economic conditions

135. Some legal systems have rules that allow a revision of the terms of the PPP contract following changes in the economic or financial conditions that, without preventing the performance of a party's contractual obligations, render the performance of those obligations financially hazardous compared to what was originally foreseen at the time they were entered into. In some legal systems, the possibility of a revision of the terms of the agreement is generally implied in all Government contracts or is expressly provided for in the relevant legislation. At the

same time, it is important to ensure that such general legal theories would not lead to open ended liabilities for the contracting authorities.

(i) The circumstances leading to renegotiation of the contract

136. The financial and economic considerations for the private partner's investment are negotiated in the light of assumptions based on the circumstances prevailing at the time of the negotiations and the reasonable expectations of the parties as to how those circumstances will evolve during the life of the project. To a certain extent, projections of economic and financial parameters and sometimes even a certain margin of risk will normally be included in the economic and financial scenario contained in the bidding documents issued by the contracting authority and in the assumption of the financial proposals submitted by the bidders (see chap. III, "Contract award", para. 68). However, certain events may occur that the parties could not reasonably have anticipated when the PPP contract was negotiated and that, had they been taken into account, would have resulted in a different risk allocation or consideration for the private partner's investment. Given the long duration of infrastructure projects, it is important to devise mechanisms to deal with the financial and economic impact of such events. Revision rules have been applied in a number of countries and have been found useful to help parties find equitable solutions for ensuring the continued economic and financial viability of infrastructure projects, thus averting a disruptive failure of performance by the private partner. However, revision rules may also have some disadvantages, in particular from the perspective of the Government.

137. As with general legislative changes, changes in economic conditions are risks to which most business organizations are exposed without having recourse to a general guarantee of the Government that would protect them against the economic and financial effects of those changes. An unqualified obligation of the contracting authority to compensate the private partner for changes of economic conditions may result in a reversion to the public sector of a substantial portion of the commercial risks originally allocated to the private partner and represent an open-ended financial liability. Furthermore, it should be noted that the proposed tariff level and the essential elements of risk allocation are important, if not decisive, factors in the selection of the private partner (see chap. II, "Project planning and preparation", paras. …). An excessively generous recourse to renegotiation of the project may lead to unrealistically low proposals being submitted during the selection procedure in the expectation of tariff increases once the project has been awarded. Thus, the contracting authority may have an interest in establishing reasonable limits for statutory or contractual provisions authorizing revisions of the PPP contract following changes in economic conditions.

138. It may be desirable to provide in the PPP contract that a change in circumstances that justifies a revision of the PPP contract must have been beyond the control of the private partner and of such a nature that the private partner could not reasonably be expected to have taken it into account at the time the PPP contract was negotiated or to have avoided or overcome its consequences. For example, a toll road operator holding an exclusive concession might not be expected to take into account and assume the risk of traffic shortfalls brought about by the subsequent opening of an alternative toll-free road by an entity other than the contracting authority. However, the private partner would normally be expected to consider the possibility of reasonable labour cost increases over the life of the project. Thus, under normal circumstances, the fact that wages turned out to be higher than expected would not be sufficient reason for revising the PPP contract.

139. It may also be desirable to provide in the PPP contract that a request for revision of the PPP contract requires that the alleged changes of economic and financial conditions amount to a certain minimum value in proportion to the total project cost or the private partner's revenue. Such a threshold rule might be useful in order to avoid cumbersome adjustment negotiations for small changes until the changes have accumulated to comprise a significant figure. In some countries, there are rules that

establish a ceiling for the cumulative amount of periodic revisions of the PPP contract. The purpose of such rules is to avoid the misuse of the change mechanism as a means for achieving an overall financial balance that bears no relation to the one contemplated in the original PPP contract. From the perspective of the private partner and the lenders, however, such limitations may represent exposure to considerable risk in the event, for instance, of dramatic cost increases resulting from an extraordinarily radical change of circumstances. Therefore, both the desirability of introducing a ceiling and the appropriate amount of such ceiling need to be carefully considered.

(ii) The range of the admitted contract modifications

140. Contracting authorities should have the possibility to provide for modifications to a PPP contract within some reasonable limits. The best way for the parties to do so is to draft specific review or option clauses providing, for instance, clear mechanisms for price adjustment or indexation (see above, paras. …), or determining precisely the scope for other adaptations of the contract that become necessary because of technical difficulties that appear during operation of the facilities, such as any extraordinary maintenance interventions that might become necessary in order to ensure continuation of a public service (see below, paras. …).

141. In addition to changes covered by a contractually agreed variation, indexation or adjustment mechanism, contracting authorities can also face external circumstances not originally foreseen at the time they awarded the PPP contract. It may be advisable to allow for contract amendments and modifications to ensure the continued economic and practical sustainability of a PPP contract where performance under the existing contract becomes significantly more onerous due to events or development that the contracting authority could not have predicted despite reasonably diligent preparation of the initial award, considering the nature and characteristics of the specific project and good practices in the relevant field. At the same time, however, there should be limits to the parties' rights to amend the contract to avoid situations where a modification would produce a fundamental alteration in the nature of the overall contract. This could be the case, for instance if the parties were to replace the works to be executed or the services to be provided by something different or fundamentally change the type of PPP arrangement (i.e. from a concession-type PPP to a risk-sharing arrangement entailing substantial direct payments by the contracting authority).

142. The reasons for avoiding broad amendments to the contract is to uphold transparency, integrity and economy in the award and management of PPP contracts. Indeed, at least hypothetically, the outcome of the contract award procedures could have been different, had the amended terms been known or anticipated at the time of bidding so that perhaps another bidder might have submitted a more advantageous proposal leading to overall better value for money for the contract authority, than the proposal actually selected. As a matter of principle, the law should require a new contract award procedure in the case of material changes to the initial contract, in particular to the scope and content of the rights and obligations of the parties, in particular a shift in the risk allocation originally contemplated.

143. Nevertheless, modifications of the PPP contract resulting in a minor change of the contract value up to a certain level value should still be possible without the need to carry out a new contract award procedure. To that effect and in order to ensure legal certainty, the law could provide for maximum thresholds above which modifications of the PPP contract should only be possible under certain exceptional cases. One such case might be modifications that may become necessary to accommodate requests from a contracting authority with regard to environmental, security or other requirements set forth in legislation that might evolve over time.

144. For PPP contracts it is recommended that, any increase in value not requiring a new award procedure should not be higher than 50 per cent of the value of the original concession. Where several successive modifications are made, that limitation should

apply to the value of each modification. Apart from those exceptional situations, any modification above the threshold set in the law should require rebidding of the contract.

5. Exempting impediments

145. During the life of an infrastructure project, events may occur that impede the performance by a party of its contractual obligations. The events causing such an impediment are typically outside either party's control and may be of a physical nature, such as a natural disaster, or may be the result of human action, such as war, riots or terrorist attacks. Many legal systems generally recognize that a party that fails to perform a contractual obligation because of the occurrence of certain types of event may be exempted from the consequences of any such failure to perform. This concept, sometime called "force majeure", has a long existence and a clear definition, which bears important consequences for the parties to the PPP contract.

(a) Definition of exempting impediments

146. Exempting impediments are twofold: they typically include occurrences beyond the control of a party that cause the party to be unable to perform its obligation and that the party has been unable to overcome by the exercise of due diligence. Common examples include the following: natural disasters (such as cyclones, floods, droughts, earthquakes, storms, fires or lightning); war (whether declared or not) or other military activity, including riots and civil disturbance; failure or sabotage of facilities, acts of terrorism, criminal damage or the threat of such acts; radioactive or chemical contamination or ionizing radiation; effects of the natural elements, including geological conditions that cannot be foreseen and resisted; and employees' strikes of exceptional importance.

147. Some laws make only a general reference to exempting impediments, whereas other laws contain extensive lists of circumstances that excuse the parties from performance under the PPP contract. The latter technique may serve the purpose of ensuring a consistent treatment of the matter for all projects developed under the relevant legislation, thus avoiding situations where one private partner obtains a more favourable allocation of risks than that provided in other PPP contracts. However, it is important to consider the possible disadvantages of setting forth in statutory or regulatory provisions a list of events that are to be considered exempting impediments for all cases. There is a risk that the list might be incomplete, leaving out important impediments. Furthermore, certain natural disasters, such as storms, cyclones and floods, may be normal conditions at a particular time of the year at the project site. As such, those natural disasters may represent risks that any public service provider acting in the region would be expected to assume.

148. Another aspect that may need to be carefully considered is whether and to what extent certain acts of public authorities other than the contracting authority may constitute exempting impediments. The private partner may be required to secure a licence or other official approval for the performance of its certain obligations. The PPP contract might thus provide that, if the licence or approval is refused, or if it is granted but later withdrawn because of the private partner's own failure to meet the relevant criteria for the issuance of the licence or approval, the private partner cannot rely on the refusal as an exempting impediment. However, if the licence or approval is refused or withdrawn for extraneous or improper motives, it would be equitable to provide that the private partner may rely on the refusal as an exempting impediment. A further possibility of impediment might be an interruption of the project brought about by a public authority or organ of government other than the contracting authority, for instance, because of changes in governmental plans and policies that require the interruption or major revision of the project that substantially affect the original design. In such situations, it may be important to consider the institutional relationship between the contracting authority and the public authority that brings about the impediment as well as their degree of independence from one another. An event classified as an exempting impediment may in some cases amount to an outright

breach of the PPP contract by the contracting authority, depending on whether the contracting authority could reasonably control or influence the acts of the other public authority.

(b) Consequences for the parties

149. During the construction phase, the occurrence of exempting impediments usually justifies an extension of the time allowed for the completion of the facility. In that connection, it is important to consider the implications of any such extension for the overall duration of the project, in particular where the construction phase is taken into account for calculating the total PPP contract period. Delays in the completion of the facility reduce the operational period and may adversely affect the global revenue estimates of the private partner and the lenders. It may therefore be advisable to consider the circumstances that justify extension of the PPP contract period so as to take into account possible extensions that occur during the construction phase. Lastly, it is advisable to provide that, if the event in question is of a permanent nature, the parties may have the option to terminate the PPP contract (see also chap. V, "Duration, extension and termination of the PPP contract", para. 34).

150. Another important question is whether the private partner will be entitled to compensation for loss of revenue or property damage that results from the occurrence of exempting impediments. The answer to that question is given by the risk allocation provided in the PPP contract. Except for cases in which the Government provides some form of direct support, PPPs are typically undertaken at the private partner's own risk, including the risk of losses that may result from natural disasters and other exempting impediments, against which the private partner is usually required to procure adequate insurance coverage. Thus, some laws expressly exclude any form of compensation to the private partner in the event of loss or damage that results from the occurrence of exempting impediments. It does not necessarily follow, however, that an event qualified as an exempting impediment may not, at the same time, justify a revision of the terms of the PPP contract so as to restore its economic and financial balance (see also paras. 135–144).

151. However, a different type of risk allocation is sometimes contemplated for projects involving the construction of facilities that are permanently owned by the contracting authority or facilities that are required to be transferred to the contracting authority at the end of the project period. In some countries, the contracting authority is authorized to make arrangements for assisting the private partner to repair or rebuild infrastructure facilities damaged by natural disasters or similar occurrences defined in the PPP contract, provided that the possibility of such assistance was contemplated in the request for proposals. Sometimes the contracting authority is authorized to agree to pay compensation to the private partner in case of an interruption of the work for more than a certain number of days up to a maximum time limit, if the interruption is caused by an event for which the private partner is not responsible.

152. Should the private partner become unable to perform because of any such impediment and should the parties fail to achieve an acceptable revision of the contract, some national laws authorize the private partner to terminate the PPP contract, without prejudice to the compensation that might be due under the circumstances (see chap. V, "Duration, extension and termination of the PPP contract", para. 34).

153. Statutory and contractual provisions on exempting impediments also need to be considered in the light of other rules governing the provision of the service concerned. The law in some legal systems requires public service providers to make every effort to continue providing the service despite the occurrence of circumstances defined as contractual impediments (see paras. 95 and 96). In those cases, it is advisable to consider the extent to which such an obligation may reasonably be imposed on the private partner and what compensation may be due for the additional costs and hardship faced by it.

154. In addition to the mechanisms described below, some of the risks (armed conflicts and civil riots notably) can be covered in part by international financial institutions, such as the World Bank, through the Multilateral Investment Guarantee Agency (MIGA), provided that the country is eligible for MIGA coverage and that the otherwise applicable conditions are met (see “Introduction and background information on PPPs”, para. …).

6. Breach and remedies

155. Generally, there is a wide range of remedies that the parties may agree on to deal with the consequences of breach, culminating with termination of the PPP contract. The following paragraphs set out general considerations on breach and remedies by either party (see paras. 156 and 157). They consider the legislative implication of certain types of remedy intended to rectify the causes of breach and preserve the continuity of the project, in particular the intervention of the contracting authority (see paras. 158–161) or the substitution of the private partner (see paras. 162–165). The ultimate remedy of terminating the PPP contract and the consequences that may result from termination are discussed elsewhere in the *Guide* (see chap. V, “Duration, extension and termination of the PPP contract”, sects. D and E).

(a) General considerations

156. The remedies for breach by the private partner typically include those that are customary in construction or long-term service contracts such as forfeiture of guarantees, contractual penalties and liquidated damages.[5] In most cases, such remedies are typically contractual in nature and do not give rise to significant legislative considerations. Nevertheless, it is important to establish adequate procedures for ascertaining failures and giving opportunities for rectifying such failures. In some countries, the imposition of contractual penalties requires findings of official inspections and other procedural steps, including review by senior officials of the contracting authority prior to the imposition of more serious sanctions. Those procedures may be complemented by provisions distinguishing between defects that can be rectified and those that cannot, and by setting down the corresponding procedures and remedies. It is usually advisable to require the private partner to be given notice requiring it to remedy the breach within a reasonable period. It may also be advisable to contemplate the payment of penalties or liquidated damages by the private partner in the event of non-performance of essential obligations and to clarify that no penalties apply in case of breach of secondary or ancillary obligations for which other remedies may be obtained under national law. Furthermore, a performance monitoring system that imposes penalties or liquidated damages may be complemented by a scheme of bonuses payable to the private partner for performance over and above agreed terms.

157. While the contracting authority may protect itself against the consequences of breach by the private partner through a variety of judicially enforceable contractual arrangements, the remedies available to the private partner in case of breach by the contracting authority may be subject to a number of limitations under the applicable law. Important limitations may derive from national or international regulations that recognize the immunity of public authorities from judicial suit and enforcement measures. Depending on the legal nature of the contracting authority or of other public authorities that assume obligations vis-à-vis the private partner, the latter may be deprived of the possibility of enforcing measures of execution to secure the fulfilment of obligations entered into by those public entities (see also chap. VI, “Settlement of disputes”, paras. 33–35). This situation makes it important to provide mechanisms to protect the private partner against the consequences of breach by the contracting authority, for example by means of governmental guarantees covering specific events

[5] For a discussion of remedies used in construction contracts for complex industrial works, see the UNCITRAL Legal Guide on Drawing Up Contracts for the Construction of Industrial Works, chap. XVIII, “Delay, defects and other failures to perform”.

of breach or guarantees provided by third parties, such as multilateral lending institutions (see also chap. II, "Project planning and preparation", paras. 61–71).

(b) Step-in rights for the contracting authority

158. Some national laws expressly authorize the contracting authority to take over temporarily the operation of the facility, normally in case of failure to perform by the private partner, in particular where the contracting authority has a statutory duty to ensure the effective delivery at all times of the service concerned. In some legal systems, such a prerogative is inherent in most government contracts and may be presumed to exist even without being expressly mentioned in legislation or in the PPP contract.

159. It should be noted that the contracting authority's right to intervene, its "step-in right", is an extreme measure. Private investors may fear that the contracting authority may use it, or threaten to use it, in order to impose its own desires about the way in which the service is provided, or even to get control of the project assets. It is therefore advisable to define as clearly as possible the circumstances in which step-in rights can be exercised. It is important to limit the contracting authority's right to intervene to cases of serious failure of services and not to mere cases of dissatisfaction with the private partner's performance. It may be useful to clarify in the law that the contracting authority's intervention in the project is temporary and is intended to remedy a specific, urgent problem that the private partner has failed to remedy. The private partner should resume responsibility for service delivery once the emergency situation has been remedied.

160. The contracting authority's ability to step in may be limited in that it may be difficult immediately to identify and engage a subcontractor to carry out the actions that the contracting authority is stepping in to do. Furthermore, frequent interventions carry a risk of the reversion to the contracting authority of risks that have been transferred in the PPP contract to the private partner. The private partner should not rely on the contracting authority to step in to deal with a particular risk instead of handling it itself, as required by the PPP contract.

161. It is advisable to clarify in the PPP contract which party bears the cost of an intervention by the contracting authority. In most cases, the private partner should bear the costs incurred by the contracting authority when the intervention is caused by a performance failure attributable to the private partner's own fault. In some cases, to prevent disputes about liability and about the appropriate level of costs, the agreement may authorize the contracting authority to take steps to remedy the problem itself and then charge the actual cost of having done so (including its own administrative costs) to the private partner. However, when such intervention takes place following the occurrence of an exempting impediment (see paras. 131–139), the parties might agree on a different solution, depending on how that particular risk has been allocated in the PPP contract.

(c) Step-in rights for the lenders

162. During the life of the project situations may arise where, because of breach by the private partner or the occurrence of an extraordinary event outside the private partner's control, it may nevertheless be in the interest of the parties to avert termination of the project by allowing the project to continue under the responsibility of a different private partner. The lenders, whose main security is the revenue generated by the project, are particularly concerned about the risk of interruption or termination of the project prior to repayment of the loans. In the event of breach impediment affecting the private partner, the lenders will be interested in ensuring that the work will not be left incomplete and that the PPP contract will remain profitable. The contracting authority, too, may be interested in allowing the project to be carried out by a new private partner, as an alternative for having to take it over and continue it under its own responsibility.

163. Clauses allowing the lenders to select, with the consent of the contracting authority, a new private partner to perform under the existing PPP contract have been included in a number of recent agreements for large infrastructure projects. Such clauses are typically supplemented by a direct agreement between the contracting authority and the lenders who are providing finance to the private partner. The main purpose of such a direct agreement is to allow the lenders to avert termination by the contracting authority when the private partner is in breach by substituting a private partner that will continue to perform under the PPP contract in place of the private partner in breach. Unlike the contracting authority's right to intervene, which relates to a specific, temporary and urgent failure of the service, lenders' step-in rights are for cases where the private partner's failure to provide the service is recurrent or can reasonably be regarded as irremediable. In the experience of countries that have recently made use of such direct agreements, it has been found that the ability to head off termination and provide an alternative private partner gives the lenders additional security against breach by the private partner. At the same time, it gives the contracting authority an opportunity to avoid the disruption entailed by terminating the PPP contract, thus maintaining continuity of service.

164. However, in some countries, the implementation of such clauses may face difficulties in the absence of legislative authorization. The private partner's inability to carry out its obligations is usually a ground for the contracting authority to take over the operation of the facility or terminate the agreement (see chap. V, "Duration, extension and termination of the PPP contract", paras. 15–23). For the purpose of selecting a new private partner to succeed the private partner in breach, the contracting authority often needs to follow the same procedures that applied to the selection of the original private partner and it might not be possible for the contracting authority to agree in consultation with the lenders on engaging a new private partner that has not been selected pursuant to those procedures. On the other hand, even where the contracting authority is authorized to negotiate with a new private partner under emergency conditions, a new PPP contract might need to be entered into with the new private partner and there may be limitations on its ability to assume the obligations of its predecessor.

165. Therefore, it may be useful for the law to acknowledge the contracting authority's right to enter into agreements with the lenders providing for the appointment, with the consent of the contracting authority, of a new private partner to perform under the existing PPP contract, when the private partner seriously fails to deliver the service required under the PPP contract or following the occurrence of other specified events that could justify the termination of the PPP contract. The agreement between the contracting authority and the lenders should, inter alia, specify the following: the circumstances in which the lenders are permitted to substitute a new private partner; the procedures for the substitution of the private partner; the grounds for refusal by the contracting authority of a proposed substitute; and the obligations of the lenders to maintain the service at the same standards and on the same terms as required by the PPP contract.

III. Contents and implementation of the PPP contract

Model provision 33. Contents and implementation of the PPP contract

The PPP contract shall provide for such matters as the parties deem appropriate,[37] such as:

(a) The nature and scope of works to be performed and services to be provided by the private partner (see chap. IV, para. 1);

(b) The conditions for provision of those services and the extent of exclusivity, if any, of the private partner's rights under the PPP contract;

(c) The assistance that the contracting authority may provide to the private partner in obtaining licences and permits to the extent necessary for the implementation of the infrastructure project;

(d) Any requirements relating to the establishment and minimum capital of a legal entity incorporated in accordance with model provision 30 (see model provision 30);

(e) The ownership of assets related to the project and the obligations of the parties, as appropriate, concerning the acquisition of the project site and any necessary easements, in accordance with model provisions 31 to 33 (see model provisions 31–33);

(f) The remuneration of the private partner, whether consisting of tariffs or fees for the use of the facility or the provision of services; the methods and formulas for the establishment or adjustment of any such tariffs or fees; and payments, if any, that may be made by the contracting authority or other public authority;

(g) Procedures for the review and approval of engineering designs, construction plans and specifications by the contracting authority, and the procedures for testing and final inspection, approval and acceptance of the infrastructure facility;

(h) The extent of the private partner's obligations to ensure, as appropriate, the modification of the service so as to meet the actual demand for the service, its continuity and its provision under essentially the same conditions for all users (see model provision 38);

(i) The contracting authority's or other public authority's right to monitor the works to be performed and services to be provided by the private partner and the conditions and extent to which the contracting authority or a regulatory agency may order variations in respect of the works and conditions of service or take such other reasonable actions as they may find appropriate to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements;

(j) The extent of the private partner's obligation to provide the contracting authority or a regulatory agency, as appropriate, with reports and other information on its operations;

[37] Enacting States may wish to note that the inclusion in the PPP contract of provisions dealing with some of the matters listed in this model provision is mandatory pursuant to other model provisions.

(k) Mechanisms to deal with additional costs and other consequences that might result from any order issued by the contracting authority or another public authority in connection with subparagraphs (h) and (i) above, including any compensation to which the private partner might be entitled;

(l) Any rights of the contracting authority to review and approve major contracts to be entered into by the private partner, in particular with the private partner's own shareholders or other affiliated persons;

(m) Guarantees of performance to be provided and insurance policies to be maintained by the private partner in connection with the implementation of the infrastructure project;

(n) Remedies available in the event of default of either party;

(o) The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the PPP contract owing to circumstances beyond its reasonable control;

(p) The duration of the PPP contract and the rights and obligations of the parties upon its expiry or termination;

(q) The manner for calculating compensation pursuant to model provision 47;

(r) The governing law and the mechanisms for the settlement of disputes that may arise between the contracting authority and the private partner (model provisions 29 and 49);

(s) The rights and obligations of the parties with respect to confidential information (see model provision 24).

Model provision 34. Governing law

The PPP contract is governed by the law of [*the enacting State*] unless otherwise provided in the PPP contract.[38]

Model provision 35. Corporate structure of the private partner

The contracting authority may require that the successful bidder establish a legal entity incorporated under the laws of [*the enacting State*], provided that a statement to that effect was made in the pre-selection documents or in the request for proposals, as appropriate. Any requirement relating to the minimum capital of such a legal entity and the procedures for obtaining the approval of the contracting authority to its statute and by-laws and significant changes therein shall be set forth in the PPP contract consistent with the terms of the request for proposals.

[38] Legal systems provide varying answers to the question as to whether the parties to a PPP contract may choose as the governing law of the contract a law other than the laws of the host country. Furthermore, as discussed in the *Legislative Guide* (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. 5–8), in some countries the PPP contract may be subject to administrative law, while in others the PPP contract may be governed by private law (see also chap. VII, "Other relevant areas of law", paras. 24–27). The governing law also includes legal rules of other fields of law that apply to the various issues that arise during the implementation of an infrastructure project (see generally chap. VII, "Other relevant areas of law", sect. B).

Model provision 36. Ownership of assets[39]

The PPP contract shall specify, as appropriate, which assets are or shall be public property and which assets are or shall be the private partner's own property private partner. The PPP contract shall in particular identify which assets belong to the following categories:

(a) Assets, if any, that the private partner is required to return or transfer to the contracting authority or to another entity indicated by the contracting authority in accordance with the terms of the PPP contract;

(b) Assets, if any, that the contracting authority, at its option, may purchase from the private partner; and

(c) Assets, if any, that the private partner may retain or dispose of upon expiry or termination of the PPP contract.

Model provision 37. Acquisition of rights related to the project site

1. The contracting authority or other public authority under the terms of the law and the PPP contract shall make available to the private partner or, as appropriate, shall assist the private partner in obtaining such rights related to the project site, including title thereto, as may be necessary for the implementation of the project.

2. Any compulsory acquisition of land that may be required for the implementation of the project shall be carried out in accordance with [*the enacting State indicates the provisions of its laws that govern compulsory acquisition of private property by public authorities for reasons of public interest*].

Model provision 38. Easements[40]

Variant A

1. The contracting authority or other public authority under the terms of the law and the PPP contract shall make available to the private partner or, as appropriate, shall assist the private partner to enjoy the right to enter upon, transit through or do work or fix installations upon property of third parties, as appropriate and required for the implementation of the project in accordance with [*the enacting State indicates the provisions of its laws that govern easements and other similar rights enjoyed by public utility companies and infrastructure operators under its laws*].

[39] Private sector participation in infrastructure projects may be devised in a variety of different forms, ranging from publicly owned and operated infrastructure to fully privatized projects (see "Introduction and background information on PPPs", paras. 47–53). Those general policy options typically determine the legislative approach for ownership of project-related assets. Irrespective of the host country's general or sectoral policy, the ownership regime of the various assets involved should be clearly defined and based on sufficient legislative authority. Clarity in this respect is important, as it will directly affect the private partner's ability to create security interests in project assets for the purpose of raising financing for the project. Consistent with the flexible approach taken by various legal systems, the model provision does not contemplate an unqualified transfer of all assets to the contracting authority but allows a distinction between assets that must be transferred to the contracting authority, assets that may be purchased by the contracting authority, at its option, and assets that remain the private property of the private partner, upon expiry or termination of the PPP contract or at any other time.

[40] The right to transit on or through adjacent property for project-related purposes or to do work on such property may be acquired by the private partner directly or may be compulsorily acquired by a public authority simultaneously with the project site. A somewhat different alternative, which is reflected in variant B, might be for the law itself to empower public service providers to

Variant B

1. The private partner shall have the right to enter upon, transit through or do work or fix installations upon property of third parties, as appropriate and required for the implementation of the project in accordance with [*the enacting State indicates the provisions of its laws that govern easements and other similar rights enjoyed by public utility companies and infrastructure operators under its laws*].

2. Any easements that may be required for the implementation of the project shall be created in accordance with [*the enacting State indicates the provisions of its laws that govern the creation of easements for reasons of public interest*].

Model provision 39. Financial arrangements

1. Where the private partner operates a facility used by the public or provides a service to the public under the PPP contract, the private partner shall have the right to charge, receive or collect tariffs or fees for the use of the facility or its services in accordance with the PPP contract. The PPP contract shall provide for methods and formulas for the establishment and adjustment of those tariffs or fees [*in accordance with the rules established by the competent regulatory agency*].[41]

2. The contracting authority shall have the power to agree to make direct payments to the private partner as a substitute for, or in addition to, tariffs or fees for the use of the facility or its services under the preceding paragraph.

3. Where the private partner operates a facility used by the public or provides a service to the contracting authority or other public body, the private partner shall have the right to the rental, usage fees or other payments set forth in the contract for the actual use or availability of the facility or service in accordance with the PPP contract. The PPP contract shall provide for methods and formulas for the establishment and adjustment of those payments.

Model provision 40. Security interests

1. Subject to any restriction that may be contained in the PPP contract,[42] the private partner has the right to create security interests over any of its assets, rights or interests, including those relating to the infrastructure project, as required to secure any financing needed for the project, including, in particular, the following:

(a) Security over movable or immovable property owned by the private partner or its interests in project assets;

(b) A pledge of the proceeds of, and receivables owed to the private partner for, the use of the facility or the services it provides.

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enter, pass through or do work or fix installations upon the property of third parties, as required for the construction, operation and maintenance of public infrastructure.

[41] Tolls, fees, prices or other charges accruing to the private partner, which are referred to in the *Legislative Guide* as "tariffs", may be the main (sometimes even the sole) source of revenue to recover the investment made in the project in the absence of subsidies or payments by the contracting authority or other public authorities (see chap. II, "Project planning and preparation, paras. 30–60). The cost at which public services are provided is typically an element of the Government's infrastructure policy and a matter of immediate concern for large sections of the public. Thus, the regulatory framework for the provision of public services in many countries includes special tariff-control rules. Furthermore, statutory provisions or general rules of law in some legal systems establish parameters for pricing goods or services, for instance by requiring that charges meet certain standards of "reasonableness", "fairness" or "equity".

[42] These restrictions may, in particular, concern the enforcement of the rights or interests relating to assets of the infrastructure project.

2. The shareholders of the private partner shall have the right to pledge or create any other security interest in their shares in the private partner.

3. No security under paragraph 1 may be created over public property or other property, assets or rights needed for the provision of a public service, where the creation of such security is prohibited by the law of [*the enacting State*].

Model provision 41. Assignment of the PPP contract

Except as otherwise provided in model provision 35, the rights and obligations of the private partner under the PPP contract may not be assigned to third parties without the consent of the contracting authority. The PPP contract shall set forth the conditions under which the contracting authority shall give its consent to an assignment of the rights and obligations of the private partner under the PPP contract, including the acceptance by the new private partner of all obligations thereunder and evidence of the new private partner's technical and financial capability as necessary for providing the service.

Model provision 42. Transfer of controlling interest[43] in the private partner

Except as otherwise provided in the PPP contract, a controlling interest in the private partner may not be transferred to third parties without the consent of the contracting authority. The PPP contract shall set forth the conditions under which consent of the contracting authority shall be given.

Model provision 43. Operation of infrastructure

1. The PPP contract shall set forth, as appropriate, the extent of the private partner's obligations to ensure:

(a) The modification of the service so as to meet the demand for the service;

(b) The continuity of the service;

(c) The provision of the service under essentially the same conditions for all users;

(d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the private partner.

2. The private partner shall have the right to issue and enforce rules governing the use of the facility, subject to the approval of the contracting authority or a regulatory body.

[43] The notion of "controlling interest" generally refers to the power to appoint the management of a corporation and influence or determine its business. Different criteria may be used in various legal systems or even in different bodies of law within the same legal system, ranging from formal criteria attributing a controlling interest to the ownership of a certain amount (typically more than 50 per cent) of the total combined voting power of all classes of stock of a corporation to more complex criteria that take into account the actual management structure of a corporation. Enacting States that do not have a statutory definition of "controlling interest" may need to define the term in regulations issued to implement the model provision.

Model provision 44. Compensation for specific changes in legislation

The PPP contract shall set forth the extent to which the private partner is entitled to compensation in the event that the cost of the private partner's performance of the PPP contract has substantially increased or that the value that the private partner receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of changes in legislation or regulations specifically applicable to the infrastructure facility or the services it provides.

Model provision 45. Revision of the PPP contract

1. Without prejudice to model provision 44, the PPP contract shall further set forth the extent to which the private partner is entitled to a revision of the PPP contract with a view to providing compensation in the event that the cost of the private partner's performance of the PPP contract has substantially increased or that the value that the private partner receives for such performance has substantially diminished, as compared with the costs and the value of performance originally foreseen, as a result of:

(a) Changes in economic or financial conditions; or

(b) Changes in legislation or regulations not specifically applicable to the infrastructure facility or the services it provides;

provided that the economic, financial, legislative or regulatory changes:

(a) Occur after the conclusion of the contract;

(b) Are beyond the control of the private partner; and

(c) Are of such a nature that the private partner could not reasonably be expected to have taken them into account at the time the PPP contract was negotiated or to have avoided or overcome their consequences.

2. The PPP contract shall establish procedures for revising the terms of the PPP contract following the occurrence of any such changes.

3. The contracting authority shall require the approval of [*the enacting State indicates the public body or entity*] for any amendments to the PPP contract:

(a) That exceeds [*the enacting State indicates the percentage*] of the value of the original contract; or

(b) That provides for additional works or services to be provided by the private partner that were not included in the initial contract but have since become necessary and for the performance of which it would not be in the public interest to select another private partner:

(i) Because of economic or technical reasons such as requirements of interchangeability or interoperability with existing equipment, services or installations procured under the initial contract; and

(ii) Because the selection of another private partner would cause significant inconvenience or substantial duplication of costs for the contracting authority.

4. The contracting authority may not accept, and the [*the enacting State indicates the public body or entity*] may not approve any amendment or modification to the PPP contract that would render the contract materially different in character from the one initially concluded. A modification shall be considered to be substantial where one or more of the following conditions is met:

(a) The modification introduces conditions which, had they been part of the initial contract award procedure, would have allowed for the admission of bidders other than those initially selected or for the acceptance of a proposal other than that originally accepted or would have attracted additional participants in the contract award procedure;

(b) The modification changes the economic balance of the contract in favour of the private partner in a manner which was not provided for in the initial contract;

(c) The modification extends the scope of the contract considerably;

(d) Where a new private partner replaces the one to which the contracting authority had initially awarded the contract in other cases than those provided for under Model Provision 47.

Model provision 46. Takeover of an infrastructure project by the contracting authority

Under the circumstances set forth in the PPP contract, the contracting authority has the right to temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service in the event of serious failure by the private partner to perform its obligations and to rectify the breach within a reasonable period of time after having been given notice by the contracting authority to do so.

Model provision 47. Substitution of the private partner

The contracting authority may agree with the entities extending financing for an infrastructure project and the private partner to provide for the substitution of the private partner by a new entity or person appointed to perform under the existing PPP contract upon serious breach by the private partner or other events that could otherwise justify the termination of the PPP contract or other similar circumstances.[44]

[44] The substitution of the private partner by another entity, proposed by the lenders and accepted by the contracting authority under the terms agreed by them, is intended to give the parties an opportunity to avert the disruptive consequences of termination of the PPP contract (see, chap. IV, "PPP implementation: legal framework and PPP contract", paras. 147–150). The parties may wish first to resort to other practical measures, possibly in a successive fashion, such as temporary takeover of the project by the lenders or by a temporary administrator appointed by them, or enforcement of the lenders' security over the shares of the private partner company by selling those shares to a third party acceptable to the contracting authority.