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Public-private partnerships (PPPs): Proposed updates to the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects (revised chapters I and II)

Note by the Secretariat

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I. General legal and institutional framework

A. General remarks

1. PPPs are one of the options that Governments may use to develop infrastructure or procure facilities or systems required for the provision of public services or for use by a public entity. An appropriate legal framework is needed to attract private investment to those projects that the Government considers worthwhile to implement as PPP. Both countries considering the adoption of new laws, and countries where such a legal framework already exists should ensure that the relevant laws and regulations are drafted clearly, comply with fundamental principles of good governance and sustainable development, and are comprehensive yet sufficiently flexible to respond to the country's infrastructure development goals and policies and to keep pace with the technology and market developments in various infrastructure sectors. This chapter deals with some general issues that domestic legislators should consider when setting up or reviewing the legal framework for PPPs in order to achieve these objectives. Section B (paras. 2–28) discusses the guiding principles and options for a legal framework for PPPs; section C (paras. 29–36) deals with the scope of authority to carry out projects as PPPs; and section D (paras. 37–60) offers an overview of institutional and procedural arrangements for the regulation of infrastructure sectors.

B. Guiding principles and options for legal framework for PPPs

2. This section considers general guiding principles that should inspire the legal framework for PPPs. It further points out the possible implications that the constitutional law of the host country may have for the implementation of some of these projects. Lastly, this section deals briefly with available options regarding the level and type of instrument that a country may need to enact and their scope of application.

1. General guiding principles for a legal framework for PPPs

3. The Sustainable Development Goals express the commitment of United Nations member States, inter alia, to "develop quality, reliable, sustainable and resilient infrastructure, including regional and transborder infrastructure, to support economic development and human well-being, with a focus on affordable and equitable access for all."[1] The legal framework for PPPs is one of the policy tools that a country may use to carry out its strategy for the development of public infrastructure and services, and should be formulated and implemented in a manner that is consistent with the country's strategy and conducive to achieving its goals.

4. Therefore, when considering the enactment of laws and regulations to enable PPPs or in reviewing the adequacy of the existing legal framework, domestic legislators and regulators may wish to take into account some internationally recognized principles of good governance and sustainable development. The United Nations General Assembly, for instance, has recognized "the importance of fair, stable and predictable legal frameworks for generating inclusive, sustainable and equitable development, economic growth and employment, generating investment and facilitating entrepreneurship".[2] Similarly, in article 5, paragraph 1, of the nearly

[1] *Transforming our world: the 2030 Agenda for Sustainable Development* (United Nations General Assembly Resolution 70/1, of 25 September 2015), Goal 9.1.

[2] "We recognize the importance of fair, stable and predictable legal frameworks for generating inclusive, sustainable and equitable development, economic growth and employment, generating investment and facilitating entrepreneurship, and in this regard we commend the work of the United Nations Commission on International Trade Law in modernizing and harmonizing international trade law." (Declaration of the High-level Meeting of the General Assembly on the Rule of Law at the National and International Levels, General Assembly resolution 67/1 of 24 September 2012).

universally adopted United Nations Convention against Corruption,[3] the States Parties undertake to "develop and implement or maintain effective, coordinated anti-corruption policies that promote the participation of society and reflect the principles of the rule of law, proper management of public affairs and public property, integrity, transparency and accountability". These and other principles more specifically aimed at deriving most benefit of PPPs, which have inspired legislative actions in various countries, are discussed briefly in the following paragraphs.

(a) Public interest

5. As PPPs are a tool for the implementation of a country's strategies and policies for developing infrastructure and public services, the PPP legal framework must promote and protect the public interest. In the context of PPPs, public interest refers, on the one hand, to the interests of the Government as provider and regulator of infrastructure and public services, and, on the other hand, as purchaser, user and possibly owner or operator of the facilities or systems developed under the PPP, or party to the PPP contract. Each of these perspectives needs adequate consideration by the legislator. While the *Guide* focuses on the role of the contracting authority as party to the PPP contract (which is extensively discussed, in particular, in chap. IV, "PPP implementation: legal framework and PPP contract" and chap. V, "Duration, extension and termination of the PPP contract"), it also pays attention to the role of Government as infrastructure and public services regulator (see, in particular, this chapter, paras. 37–60 and chap. IV, "PPP implementation: legal framework and PPP contract", paras. …) as well as manager and trustee of public property and resources (see, in particular, chap. III, "Contract award").

6. Public interest in the context of PPPs also refers, on the other hand, to the interests of the country's citizens and companies as users of the infrastructure, as consumers and users of the services or goods it generates or as ultimate beneficiaries of the public services which are provided with the support of the facilities or systems developed under the PPP. From this perspective, the legislative framework for PPPs must take into account, and be coordinated with, the specific regulatory regime for the particular infrastructure or service sector (see, in particular, this chapter, paras. 37–60; and chap. IV, "PPP implementation: legal framework and PPP contract", paras. …), and also general rules on consumer protection (see chap. VII, "Other relevant areas of law").

(b) Transparency

7. A transparent legal framework is characterized by clear and readily accessible rules and by efficient procedures for their application. Transparent rules and administrative procedures create predictability, enabling the private sector to estimate the costs and risks of an investment and thus to offer the most advantageous terms. Transparent rules and administrative procedures may also foster openness through provisions requiring the publication of administrative decisions, including, when appropriate, an obligation to state the grounds on which they are based and to disclose other information of public relevance. They also help to guard against arbitrary or improper actions or decisions by the contracting authority or its officials and thus help to promote confidence in a country's PPP programme.

8. Transparent rules and procedures offer a framework for the exercise of discretion in the implementation of PPP projects. Transparent rules and procedures limit the exercise of discretion, where appropriate, allowing it to be monitored and, where necessary, challenged. Transparent rules and administrative procedures are a key element of promoting accountability for actions or decisions taken by Government, thus supporting integrity and public confidence. A transparent set of rules and administrative procedures governing the planning and implementation of

[3] The Convention was adopted by the United Nations General Assembly resolution 58/4 of 31 October 2003 and entered into force on 14 December 2005.

PPP projects will facilitate the evaluation of a country's PPP programme and individual projects against their desired outcomes.

9. Transparency of rules and administrative procedures is needed throughout the life cycle of PPP projects, from planning and project development to the operation of the infrastructure and the delivery of services to citizens. A transparent legal framework for PPPs may mandate, for instance, the publication of key decisions on project implementation, including the justification for choosing a PPP in the concrete case (see chap. II, "Project planning and preparation", para. 3). Transparency is particularly important for the award of PPP contracts, for which the *Guide* stresses five key aspects: the public disclosure of the legal framework; the publication of project opportunities; the prior determination and publication of the key terms of the contract against which offers are to be assessed; the visible conduct of the process according to the prescribed rules and procedures; and the existence of a system to monitor that the applicable rules are being followed and to enforce them if necessary (see chap. III, "Contract award", paras. 138–239). Transparency during the operation of the infrastructure may also entail the disclosure to the public by the contracting authority or the regulatory agency of targeted information concerning the private partner, such as financial statements or performance reporting documents (see para. 15 and para. 49; see also chap. IV, "PPP implementation: legal framework and PPP contract", para. 103–104).

(c) Fairness, stability and predictability

10. Closely related to the principle of transparency is the requirement of a fair, stable and predictable legal framework for PPPs. Laws and regulations are the tools with which Governments regulate and ensure the provision of public services to their citizens. At the same time, they provide the means for public service providers and their customers to protect their rights. A fair legal framework takes into account the various (and sometimes conflicting) interests of the Government, the public service providers and their customers and seeks to achieve an equitable balance between them. The private sector's business considerations, the users' right to adequate services (both in terms of quality and price), the Government's responsibility for ensuring the continuous provision of essential services and its role in promoting national infrastructure development are but a few of the interests that deserve appropriate recognition in the law.

11. A stable legal framework is particularly important for PPPs in view of the typically long duration of infrastructure projects. The private partners need to be able to forecast and evaluate risks and possible changes in the life of the project in order to mobilize the resources needed and take the necessary steps to mitigate the consequences of anticipated risks. The contracting authority and the public, too, should be able to rely on continuity of services and the conditions under which they are provided. Of course, the legal framework for PPPs must be capable of adaptation to meet changing needs (see para. 28). However, unjustified, untimely or arbitrary changes of laws and regulations destabilize performance by the private partner, undermine the mutual trust basis needed for a successful PPP and ultimately jeopardize the Government's infrastructure and public service development goals and policies.

12. A stable legal framework for PPPs would contribute to enhancing the predictability of administrative or judicial decisions concerning the award and implementation of PPP projects. This would have positive effects for all parties involved. The private partner, for instance, would be able to plan and manage the project more efficiently if it were able to rely on a predictable outcome of various administrative procedures that are required during project implementation (construction and zoning permits, technical inspections or regulatory decisions). The contracting authority might itself be subject to the consequences of decisions by other authorities and would benefit likewise from a predictable process. The public, too, would find comfort in a system in which it could anticipate, for instance, that decisions concerning conditions for the provision of the public service, where this

was the object of a PPP, would follow a predictable pattern, in accordance with the applicable laws and regulations, rather than being made out of extraneous considerations. Sound and clear rules are as much a condition to ensure predictability, as are the efficiency of the administrative procedures and the qualification and training of those responsible for enforcing the legal framework.

(d) Proper management, integrity and accountability

13. Depending on the type of project or the nature of the relevant facility or system, a PPP could involve the management of public property, the disbursement of public funds or both. Therefore, it is essential that the applicable laws and regulations set forth appropriate safeguards to prevent mismanagement, misappropriation or other forms of improper management of public property or funds. Most provisions to this effect may be found in laws and regulations that govern public property or administrative procedures, budgetary and accounting controls as well as criminal laws (see chap. VII, “Other relevant areas of the law”, paras. …). In any event, given the magnitude of some PPP projects, the Government should satisfy itself that the relevant administrative and criminal laws will extend to PPPs, and those PPPs will not be misused to escape applicable controls. As regards specific laws on PPPs or on infrastructure sectors in which PPPs may be entered into, it is important to ensure that provisions on PPP planning, contract award, contract content and the operation of the infrastructure facility or system will promote best practices in property management of public property and funds and will not contain loopholes that encourage improper conduct.

14. Closely linked to the need to avoid mismanagement of public property or funds is the requirement of ensuring integrity in the award and performance of PPP contracts. Here, too, it would normally be for other bodies of law to set forth the substantive rules to uphold integrity in the form of criminal provisions, administrative law standards and codes of conduct. A central concern in order to promote integrity is the need to prevent conflicts of interest throughout the main stages of PPPs: from planning through bidding all the way to the winding up of a project. The magnitude of many PPP projects, their typically long duration, and the need for constant interaction between Government officials, agents of the contracting authority and employees or agents of the private partner may encourage, and create innumerable opportunities for, bribery, extortion or other corrupt practices. It is imperative to ensure that officials of the contracting authority will not benefit directly or indirectly from the project or their dealings with the private partner. The private partner, too, should not exercise improper influence on any official involved in project design, selection, implementation or regulation. Appropriate safeguards should be provided during project design (see chap. II, “Project planning and preparation”, para. 49), contract award (see chap. III, “Contract award”, paras. …) and operation (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. …). Beyond economic and financial damage, corrupt practices in PPPs may have serious negative consequences for the public at large, in particular where the PPP involves the provision of a public service or the management of an infrastructure used by the public. Indeed, corrupt practices often result in improper lenience towards lowered safety, security or quality standards, which may be the cause of accidents or other hazards likely to cause damage to property or to endanger the health or lives of citizens.

15. An effective system to uphold integrity must be enforced through an effective accountability system. Here, too, the essential mechanisms are expected to be found in other areas of the law, in particular penal and administrative laws and rules governing the investigation and trial of criminal cases (see chap. VII, “Other relevant areas of the law”, paras. …). Laws and regulations specific to PPPs can contribute to accountability by setting forth appropriate disclosure and reporting requirements, as well as the possibility for the contracting authority or other relevant Government body to audit the accounts or otherwise reasonably request relevant information from the

private partner (see chap. IV, “PPP implementation: legal framework and PPP contract” paras. …).

(e) Economy and efficiency

16. The legal and regulatory framework, including the budget and appropriation processes, should set the conditions necessary to ensure that PPP projects offer economy and efficiency throughout their life cycle (see chap. VII, “Other relevant areas of law”, paras. …. Prior to embarking on the selection of a project partner, the contracting authority should be required to conduct a rigorous planning and feasibility assessment, examining, in particular, the extent to which a PPP optimizes the use of resources to achieve the intended impact of the project concerned (or a “value for money” test). PPP projects should only move forward if those tests demonstrate, for instance: (a) that the project offers an optimal relationship between the cost, time and other resources, and the quality of the subject matter of the project; (b) that, if structured as a PPP, the project is expected to deliver the required level of services at a lower level of cost, time and other resources, without reducing the quality of those services than would otherwise have been the case; and (c) that a PPP will deliver a better-than-required level of services or achieve a better return on investment in the project for the cost, time and other resources than would otherwise have been the case (see chap. II, “Project planning and preparation” paras. 6–14).

(f) Long-term sustainability

17. Important objectives of a country’s infrastructure development policy include ensuring the long-term provision of public services, continuously improving the quality of infrastructure, and achieving economic, environmental and social sustainability. PPPs are one of the tools that a country may use to implement its policy, and therefore the laws and regulations dealing specifically with PPPs should help to promote those objectives. Proper planning and preparation are indispensable to ensure the sustainability of infrastructure projects, in particular when carried out as PPPs. Positive steps, from a general policy perspective, include the formulation of a master plan for infrastructure development, including public services, and the establishment of priority sectors, projects or types of project based on socioeconomic considerations, financial implications, effects on sustainable development, and other relevant factors.

18. Proper planning and preparation of individual projects requires careful choice of project type, based on financial and other capacity of the contracting authority (i.e. whether public procurement and operation or any particular type of PPP). Unrealistic assumptions about the advantages or costs of a PPP model are likely to nullify the expectations of infrastructure development through PPPs, and should be avoided as much as possible through careful planning and project assessment at the early stages (see chap. II, “Project planning and preparation”, paras. …). Indeed, poor planning or ill-conceived rules or procedures may lead to inadequate contractual or regulatory arrangements for the operation and maintenance of public infrastructure, severely limit efficiency in all sectors of infrastructure, reduce service quality and increase costs for the Government or users (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. …). From a legislative perspective, it is important to ensure that the host country has the institutional capacity to undertake the various tasks entrusted to public authorities authorized to enter into PPPs throughout their phases of implementation (see chap. II, “Project planning and preparation”, paras. 44–45). One way by which a Government can ascertain the readiness of its institutions to handle PPP projects is to conduct an assessment of its public investment capabilities including a review of institutions and procedures responsible for national and sectoral planning, investment budgeting, project appraisal and selection, and managing and monitoring of project implementation. The efficiency of a country’s overall institutional and administrative resources is essential to ensure the sustainability of PPP projects, and a country may wish to consider using

appropriate tools reflecting best practices to assess their suitability for ensuring sustainable management of PPP projects.[4]

(g) Competition

19. Another measure to enhance the long-term sustainability of PPPs within the context of a national infrastructure policy is to achieve a correct balance between competitive and monopolistic infrastructure operation and provision of public services. Competition may reduce overall costs and provide more backup facilities for essential services. In certain sectors, competition has also helped to increase the productivity of infrastructure investment, to enhance responsiveness to the needs of the customers and to obtain better quality for public services, thus improving the business environment in all sectors of the economy (see also chap. VII, "Other relevant areas of law", paras. …).

20. For laws and regulations directly related to PPPs, competition has two dimensions. On the one hand, the scope for competition in the sector or activity concerned is one of the elements that the contracting authority should be required to examine at the project planning stage (see chap. II, "Project planning and preparation", paras. 19–20). The contracting authority's assessment should serve as a basis for determining whether or not the private partner should have an exclusive right to operate the infrastructure or to provide the relevant services under the PPP, or whether the sector or market could benefit from competition (see "Introduction and background information on PPPs", paras. 28–32). On the other hand, competition is usually one of the structural elements of public procurement systems, and aims at maximizing economy (or "value for money") for the public sector. Competition for PPP contracts in the form of a rigorous contest among potential investors and private entities for the opportunity to be awarded the PPP contract can reduce overall costs and other resource demands, increase the productivity of infrastructure investment, enhance responsiveness to the needs of the customers and thus obtain better quality of public services. Competition has the potential both to improve value for money in PPPs and to increase the likelihood of achieving the intended outcome of the project concerned. Competition is also one of the principles that should guide domestic public procurement systems pursuant to article 9, paragraph 1, of the United Nations Convention against Corruption. The *Guide* therefore strongly recommends the use of competitive procedures for the award of PPP contracts (see chap. III, "Contract award", paras. 17–19). Promoting potential investors' and private entity participation in PPPs is a key prerequisite for competition for PPP contracts. The procurement procedures recommended in the *Guide* recognize, however, that in the context of complex infrastructure projects, competition is most effective by limiting the number of participants. Two reasons justify this apparent paradox: first, the technical, commercial and financial complexity of most PPP projects would make it excessively cumbersome, time and resource consuming for the contracting authority to have to examine a potentially large number of proposals; second, the high costs of participating in the procedure discourage private entities from participating unless they assess their chances of winning the ultimate contract as reasonable. Consequently the procurement procedures recommended in the *Guide* start with a process to identify a limited number of high-quality potential partners (see chap. III, "Contract award", paras. 34–50).

2. Constitutional law and PPPs

21. The constitutional law of a number of countries refers to the duty of the State to ensure the provision of public services. Some of them list the infrastructure and service sectors that come under the responsibility of the State, while in others the task of identifying those sectors is delegated to the legislator. Some national constitutions reserve the provision of certain public services exclusively to the State or to specially

[4] The International Monetary Fund, for instance, has developed a Public Investment Management Assessment (PIMA) to help countries evaluate the strength of the public investment management practices (see http://www.imf.org/external/np/fad/publicinvestment/#5).

created public entities. Other constitutions, however, authorize the State to engage private entities for the development and operation of infrastructure and the provision of public services. In some countries, there are limitations to the participation of foreigners in certain sectors or requirements that the State should participate in the capital of the companies providing public services.

22. For countries wishing to use PPPs to develop public infrastructure and services, it is important to ascertain whether existing constitutional rules impose possible restrictions to their implementation. In some countries, uncertainties regarding the legal basis for PPPs may delay or even impede their implementation. Concerns that PPPs might contravene constitutional rules on State monopolies or on the provision of public services have caused judicial disputes, with negative impact on the implementation of PPP projects.

23. It is further important to consider constitutional rules relating to the ownership of land or infrastructure facilities. The constitutional law of some countries contains limitations to private ownership of land and certain means of production. In other countries, private property is recognized, but the constitution declares all or certain types of infrastructure to be State property. Restrictions of this nature can be an obstacle to the execution of projects that entail private operation, or private operation and ownership, of the relevant infrastructure (see further chap. IV, "PPP implementation: legal framework and PPP contract", paras. ...).

3. General and sector-specific legislation

24. The law plays a central role in promoting confidence in PPPs. The legal framework for PPPs will generally comprise a primary law or set of laws, secondary regulations or decrees, internal rules, and guidance, drawing on the policy choices made by the legislator and the Government. The law typically embodies a political commitment, provides specific legal rights and may represent an important guarantee of stability of the legal and regulatory regime by setting forth the general rules under which those projects are awarded and implemented. Laws governing the award and implementation of PPP projects, including sector-specific legislation, are typically supplemented, and should be coordinated with laws and regulations on various other matters, including international obligations of the country on taxation or investment protection (see chap. VII, "Other relevant areas of the law", paras. …).

25. As a matter of constitutional law or legislative practice, some countries may need to adopt specific legislation in respect of individual projects. In other countries with a well-established tradition of awarding concessions to the private sector for the provision of public services, the Government is authorized by general legislation to award to the private sector any activity carried out by the public sector having an economic value that makes such activity capable of being exploited by private entities. General legislation of this type creates a framework for providing a uniform treatment to issues that are common to PPP in different infrastructure sectors.

26. However, by its very nature, general legislation is normally not suitable to address all the particular requirements of different sectors. Even in countries that have adopted general legislation addressing cross-sectoral issues, it has been found that supplementary sector-specific legislation allows the legislator to formulate rules that take into account the market structure in each sector (see "Introduction and background information on PPPs", paras. 33–45). It should be noted that in many countries sector-specific legislation was adopted at a time when a significant portion or even the entirety of the national infrastructure consisted of State monopolies. For countries interested in promoting private sector investment in infrastructure it is advisable to review existing sector-specific legislation so as to ascertain its suitability for PPPs. Countries that consider the adoption of a general law on PPPs may wish to use this opportunity to review and amend, as appropriate, existing sector-specific laws in order to ensure their consistency with the general PPP law, or otherwise clearly indicate which text prevails in case of conflict (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. …).

27. Sector-specific legislation may further play an important role in establishing a framework for the regulation of individual infrastructure sectors (see below, paras. 37–60). Legislative guidance is particularly useful in countries at the initial stages of setting up or developing national regulatory capacities. Such legislation represents a useful assurance that the regulators do not have unlimited discretion in the exercise of their functions, but are bound by the parameters provided by the law. However, it is generally advisable to avoid rigid or excessively detailed legislative provisions dealing with contractual aspects of the implementation of PPPs, which in most cases would not be adequate to their long-term nature (see further chap. IV, "PPP implementation: legal framework and PPP contract", paras. …; and chap. V, "Duration, extension and termination of the PPP contract", paras. …).

28. Many countries have used legislation to establish the general principles for the organization of infrastructure sectors and the basic policy, institutional and regulatory framework. However, the law may not be the best instrument to set detailed technical and financial requirements. Many countries have preferred to enact regulations setting forth more detailed rules to implement the general provisions of domestic laws on PPPs. Regulations are found to be easier to adapt to a change in environment, whether the change results from the transition to market-based rules or from external developments, such as new technologies or changing economic or market conditions. As stressed earlier in the *Guide* (see above, para. 11), stability of the legal framework is essential to promote confidence in a country's PPP policy. Countries that choose to limit the enabling legislation to general principles and to use regulations for detail matters should avoid too frequent changes of regulations or inconsistencies between regulations and the laws on which they are based, as these are common sources of uncertainty and disputes in PPPs (see further chap. IV, "PPP implementation: legal framework and PPP contract", paras. ...). Whatever the instrument used, clarity and predictability are of the essence.

C. Scope of authority to enter into PPPs

29. The implementation of PPPs may require the enactment of special legislation or regulations expressly authorizing the State to entrust the development of infrastructure or the provision of public services to private entities. The existence of express legislative authorization may be an important measure to foster the confidence of potential investors, national or foreign, in a national policy to promote private sector investment in infrastructure through PPPs.

1. Authorized agencies and relevant fields of activity

30. In some legal systems, the Government's responsibility for the development of infrastructure or the provision of public services may not be delegated without prior legislative authorization. For those countries that wish to develop public infrastructure or services through PPPs, it is particularly important to state clearly in the law the authority to entrust entities other than public authorities of the host country with the right to provide certain public services. Such a general provision may be particularly important in those countries where public services are governmental monopolies or where it is envisaged to engage private entities to provide certain services that used to be available to the public free of charge (see further chap. IV, "PPP implementation: legal framework and PPP contract", paras. …).

31. Where general legislation is adopted, it is also advisable to identify clearly the public authorities or levels of government competent to award infrastructure projects and to act as contracting authorities. In order to avoid unnecessary delay, it is particularly advisable to have rules in place that make it possible to ascertain the persons or offices that have the authority to enter into commitments on behalf of the contracting authority (and, as appropriate, of other public authorities) at different stages of negotiation and to sign the PPP contract. It is useful to consider the extent of powers that may be needed by authorities other than the central Government to carry out projects falling within their purview. For projects involving offices or

agencies at different levels of government (for example, national, provincial or local), where it is not possible to identify in advance all the relevant offices and agencies involved, other measures may be needed to ensure appropriate coordination among them (see chap. II, "Project planning and preparation", paras. 44–53).

32. For purposes of clarity, it is advisable to identify in such general legislation those sectors in which PPP contracts may be awarded. Alternatively, where this is not deemed feasible or desirable, the law might identify those activities, which may not be the object of a PPP contract (for example, activities related to national defence or security).

2. Purpose and scope of PPPs

33. It may be useful for the law to define the nature and purpose of projects for which PPPs may be entered into in the country. One possible approach may be to define the various categories of projects according to the extent of the rights and obligations assumed by the private partner (for example, "build-operate-transfer", "build-own-operate", "built-transfer-operate" and "build-transfer"). However, given the wide variety of schemes that may come into play in connection with private investment in infrastructure (see "Introduction and background information on PPPs", paras. 23–24), this approach is not advisable. As an alternative, the law could generally provide that PPPs may be entered into for the development of any or specific types or public infrastructure or services. The law could clarify that PPPs may involve the direct provision of services to the public by the private partner pursuant to a concession issued by the competent authority, or the management and operation of an infrastructure used by the contracting authority or other Government body for the provision of public services or to house its own activities. The law could further clarify that the private partner's remuneration may take the form of a right to charge a price for the use of the facility or premises or for the service or goods it generates, or of other payment or remuneration agreed to by the parties. Lastly, it may be useful for the law to further clarify that PPPs may be used for the construction and operation of a new infrastructure facility or system or for maintenance, repair, refurbishment, modernization, expansion and operation of existing infrastructure facilities and systems, or only for the management and delivery of a public service.

34. Another important issue concerns the nature of the rights vested in the private partner, in particular whether the right to provide the service is exclusive or whether the private partner will face competition from other infrastructure facilities or service providers. Exclusivity may concern the right to provide a service in a particular geographical region (for example, a communal water distribution company) or embrace the whole territory of the country (for example, a national railway company); it may relate to the right to supply one particular type of goods or services to one particular customer (for example, a power generator being the exclusive regional supplier to a power transmitter and distributor) or to a limited group of customers (for example, a national long-distance telephone carrier providing connections to local telephone companies).

35. The decision whether or not to grant exclusivity rights to a certain project or category of projects should be taken in the light of the host country's policy for the sector concerned. As discussed earlier, the scope for competition varies considerably in different infrastructure sectors. While certain sectors, or segments thereof, have the characteristics of natural monopolies, in which case open competition is usually not an economically viable alternative, other infrastructure sectors have been successfully opened to free competition (see "Introduction and background information on PPPs", paras. 28–32).

36. It is desirable therefore to deal with the issue of exclusivity in a flexible manner. Rather than excluding or prescribing exclusive PPPs, it may be preferable for the law to authorize the granting of exclusive rights when it is deemed to be in the public interest, such as in cases where the exclusivity is justified for ensuring the technical or economic viability of the project. The contracting authority should state the reasons

for granting exclusivity in the assessment and studies that it is required to make prior to starting the procedure to select the private partner (see chap. II, "Project planning and preparation", paras. 19–20). Sector-specific laws may also regulate the issue of exclusivity in a manner suitable for each particular sector.

D. Authority to regulate infrastructure services

37. PPP projects that involve the direct provision or services or goods to the public by the private partner ("concession PPPs") often relate to sectors or activities that are subject to special regulation. The applicable regulatory regime may consist of substantive rules, procedures, instruments and institutions. That framework represents an important instrument to implement the governmental policy for the sector concerned (see "Introduction and background information on PPPs", paras. 25–26). Depending on the institutional structure of the country concerned and on the allocation of powers between different levels of government, provincial or local legislation may govern some infrastructure sectors, in full or concurrently with national legislation.

38. Regulation of infrastructure services involves a wide range of general and sector-specific issues, which may vary considerably according to the social, political, legal and economic reality of each host country. While occasionally discussing some of the main regulatory issues that are encountered in a similar context in different sectors (see, for instance, chap. IV, "PPP implementation: legal framework and PPP contract", paras. … and …), the *Guide* is not intended to exhaust the legal or policy issues arising out of the regulation of various infrastructure sectors. The term "regulatory agencies" refers to the institutional mechanisms required to implement and monitor the rules governing the activities of infrastructure operators. Because the rules applicable to infrastructure operation often allow for a degree of discretion, a body is required to interpret and apply them, monitor compliance, impose sanctions and settle disputes arising out of the implementation of the rules. The specific regulatory tasks and the amount of discretion they involve will be determined by the rules in question, which can vary widely.

39. The *Guide* assumes that a country that chooses to authorize PPPs in any of those sectors has satisfied itself that it has in place the proper institutional and bureaucratic structures and human resources necessary for the implementation of PPPs. Nevertheless, as a contribution to domestic legislatures considering the need for, and desirability of, establishing regulatory agencies for monitoring the provision of public services, this section discusses some of the main institutional and procedural issues that may arise in that connection. The discussion contained in this section is illustrative of different options that have been used in domestic legislative measures to set up a regulatory framework for PPPs, but the *Guide* does not thereby advocate the establishment of any particular model or administrative structure. Practical information and technical advice may be obtained from international financial institutions that carry out programmes to assist their member countries in setting up an adequate regulatory framework (such as the World Bank and the regional development banks).

1. Sectoral competence and mandate of regulatory agencies

40. Regulatory responsibilities may be organized on a sectoral or cross-sectoral basis. Countries that have opted for a sectoral approach have in many cases decided to place closely linked sectors or segments thereof under the same regulatory structure (for example, a common regulatory agency for power and gas or for airports and airlines). Other countries have organized regulation on a cross-sectoral basis, in some cases with one regulatory entity for all infrastructure sectors and in others with one entity for utilities (water, power, gas, telecommunications) and one for transport. In some countries the competence of regulatory agencies might also extend to several sectors within a given region.

41. Regulatory agencies whose competence is limited to a particular sector usually foster the development of technical, sector-specific expertise. Sector-specific regulation may facilitate the development of rules and practices that are tailored to the needs of the sector concerned. However, the decision between sector-specific and cross-sectoral regulation depends in part on the country's regulatory capacity. Countries with limited expertise and experience in infrastructure regulation may find it preferable to reduce the number of independent structures and try to achieve economies of scale.

42. The law setting up a regulatory mechanism often stipulates a number of general objectives that should guide the actions of regulatory agencies, such as the promotion of competition, the protection of users' interests, the satisfaction of demand, the efficiency of the sector or the public service providers, their financial viability, the safeguarding of the public interest or of public service obligations and the protection of investors' rights. Having one or two overriding objectives helps clarify the mandate of regulatory agencies and establish priorities among sometimes conflicting objectives. A clear mandate may also increase a regulatory agency's autonomy and credibility.

2. Institutional mechanisms

43. The range of institutional mechanisms for the regulation of infrastructure sectors varies greatly. While there are countries that entrust regulatory functions to organs of the Government (for example, the concerned ministries or departments), other countries have preferred to establish autonomous regulatory agencies, separate from the Government. Some countries have decided to subject certain infrastructure sectors to autonomous and independent regulation while leaving others under ministerial regulation. Sometimes, powers may also be shared between an autonomous regulatory agency and the Government, as is often the case with respect to licensing. From a legislative perspective, it is important to devise institutional arrangements for the regulatory functions that ensure to the regulatory agency an adequate level of efficiency, taking into account the political, legal and administrative tradition of the country.

44. The efficiency of the regulatory regime is in most cases a function of the objectiveness with which regulatory decisions are taken. This, in turn, requires that regulatory agencies should be able to take decisions without interference or inappropriate pressures from infrastructure operators and public service providers. To that effect, legislative provisions in several countries require the independence of the regulatory decision-making process. In order to achieve the desired level of independence it is advisable to separate the regulatory functions from operational ones by removing any regulatory functions that may still be vested with the public service providers and entrust them to a legally and functionally independent entity. Regulatory independence is supplemented by provisions to prevent conflicts of interest, such as prohibitions for staff of the regulatory agency to hold mandates, accept gifts, enter into contracts or have any other relationship (directly or through family members or other intermediaries) with regulated companies, their parents or affiliates.

45. This leads to a related issue, namely, the need to minimize the risk of decisions being made or influenced by a body that is also the owner of enterprises operating in the regulated sector or a body acting on political rather than technical grounds. In some countries it was felt necessary to provide the regulatory agency with a certain degree of autonomy vis-à-vis the political organs of government. Independence and autonomy should not be considered solely on the basis of the institutional position of the regulatory function, but also on the basis of its functional autonomy (i.e. the availability of sufficient financial and human resources to discharge their responsibilities adequately).

3. Powers of regulatory agencies

46. Regulatory agencies may have decision-making powers, advisory powers or purely consultative powers or a combination of these different levels of powers depending on the subject matter. In some countries, regulatory agencies were initially given limited powers, which were expanded later as the agencies established a track record of independence and professionalism. The legislation often specifies which powers are vested with the Government and which with a regulatory agency. Clarity in this respect is important to avoid unnecessary conflicts and confusion. Investors, as well as consumers and other interested parties, should know to whom to turn with various requests, applications or complaints.

47. Selection of public service providers, for example, is in many countries a process involving the Government as well as the regulatory agency. If the decision to award a project involves broad judgment of a political rather than technical nature, which may often be the case in the context of infrastructure privatization, final responsibility often rests with the Government. If, however, the award criteria are more technical, as may be the case with a liberal licensing regime for power generation or telecommunication services, many countries entrust the decision to an independent regulatory agency. In other cases, the Government may have to ask the regulatory agency's opinion prior to awarding a contract. On the other hand, some countries exclude direct involvement of regulatory agencies in the award process on the basis that it could affect the way they later regulate the provision of the service concerned.

48. The jurisdiction of regulatory agencies normally extends to all enterprises operating in the sectors they regulate, with no distinction between private and public enterprises. The use of some regulatory powers or instruments may be limited by law to the dominant public service providers in the sector. A regulatory agency may, for example, have price policing powers only vis-à-vis the incumbent or dominant public service provider, while new entrants may be allowed to set prices freely.

49. The matters on which regulatory agencies have to make decisions range from normative responsibilities (for example, rules on contract award and conditions for certification of equipment) to the actual award of contracts; the approval of contracts or decisions proposed by the regulated entities (for example, a schedule or contract on network access); the definition and monitoring of an obligation to provide certain services; the oversight over public service providers (in particular compliance with licence conditions, norms and performance targets); the disclosure to the public, for sake of transparency, of targeted financial information related to the private partner (for example, its shareholding structure or the base-case financial model used on the project); price setting or adjustments; vetting of subsidies, exemptions or other advantages that could distort competition in the sector; sanctions; and dispute settlement.

4. Composition, staff and budget of regulatory agencies

50. When setting up a regulatory agency, a few countries have opted for an agency comprised of a single officer, whereas most others have preferred a regulatory commission. A commission may provide greater safeguards against undue influence or lobbying and may limit the risk of rash regulatory decisions. A one-person regulatory agency, on the other hand, may be able to reach decisions faster and may be held more accountable. To improve the management of the decision-making process in a regulatory commission, the number of members is often kept small (typically three or five members). Even numbers are often avoided to prevent a deadlock, though the chairman could have a casting vote.

51. To increase the regulatory agency's autonomy, different institutions may be involved in the nomination process. In some countries regulatory agencies are appointed by the head of State based on a list submitted by parliament; in others the executive branch of the Government appoints the regulatory agency but subject to confirmation by parliament or upon nominations submitted by parliament, user

associations or other bodies. Minimum professional qualifications are often required of the officials of the regulatory agencies, as well as the absence of conflicts of interest that might disqualify them from the function. Terms of office of members of regulatory boards may be staggered in order to prevent total turnover and appointment of all members by the same administration; staggering also promotes continuity in regulatory decision-making. Terms of office are often for a fixed term, may be non-renewable and may be terminated before the expiry of the term for limited reasons only (such as criminal conviction, mental incapacitation, gross negligence or dereliction of duty). Regulatory agencies are often faced with experienced lawyers, accountants and other experts working for the regulated industry and need to be able to acquire the same level of expertise, skills and professionalism, either in-house or by hiring outside advisers as needed.

52. Stable funding sources are critical in order for the regulatory agency to function adequately. In many countries, the budget of the regulatory agency is funded by fees and other levies on the regulated industry. Fees may be set as a percentage of the turnover of the public service providers or be levied for the award of licences, contracts or other authorizations. In some countries, the agency’s budget is complemented as needed by budget transfers provided in the annual finance law. However, this may create an element of uncertainty that may reduce the agency’s autonomy.

5. Regulatory process and procedures

53. The regulatory framework typically includes procedural rules governing the way the institutions in charge of the various regulatory functions have to exercise their powers. The credibility of the regulatory process requires transparency and objectivity, irrespective of whether regulatory authority is exercised by a government department or minister or by an autonomous regulatory agency. Rules and procedures should be objective and clear so as to ensure fairness, impartiality and timely action by the regulatory agency. For purposes of transparency, the law should require that they be made public. Regulatory decisions should state the reasons on which they are based and should be made accessible to interested parties, through publication or other appropriate means.

54. Transparency may be further enhanced, as required by some laws, by the publication by the regulatory agency of an annual report on the sector, including, for example, the decisions taken during the exercise, the disputes that have arisen and the way they were settled. Such an annual report may also include the accounts of the regulatory agency and an audit thereof by an independent auditor. Legislation in many countries further requires that this annual report be submitted to a committee of parliament.

55. Regulatory decisions may have an impact on the interests of diverse groups, including the concerned public service provider, its current or potential competitors and business or non-business users. In many countries, the regulatory process includes consultation procedures for major decisions or recommendations. In some countries, that consultation takes the form of public hearings, in others of consultation papers on which comments from interested groups are solicited. Some countries have also established consultative bodies comprised of users and other concerned parties and require that their opinion be sought before major decisions and recommendations are made. To enhance transparency, comments, recommendations or opinions resulting from the consultation process may have to be published or made publicly available.

6. Recourse against decisions of the regulatory agency

56. Another important element of the host country’s regulatory regime are the mechanisms whereby public service providers may request a review of regulatory decisions. As with the whole regulatory process, a high degree of transparency and credibility is essential. To be credible, the review should be entrusted to an entity that

is independent from the regulatory agency taking the original decision, from the political authorities of the host country and from the public service providers.

57. Review of decisions of regulatory agencies is often in the jurisdiction of courts, but in some legal systems recourse against decisions by regulatory agencies is in the exclusive jurisdiction of special tribunals dealing solely with administrative matters, which in some countries are separate from the judicial system. If there are concerns over the review process (for example, as regards possible delays or the capacity of courts to make evaluations of the complex economic issues involved in regulatory decisions) review functions may be entrusted to another body, at least in the first instance, before a final recourse to courts or administrative tribunals. In some countries, requests for review are considered by a high-level cross-sectoral independent oversight body. There are also countries where requests for review are heard by a panel composed of persons holding specified judicial and academic functions. As to the grounds on which a request for review may be based, in many cases there are limits, in particular as to the right of the appellate body to substitute its own discretionary assessment of facts for the assessment of the body whose decision is being reviewed.

7. Settlement of disputes between public service providers

58. Disputes may arise between competing private partners (for example, two operators of cellular telephony systems) or between private partners providing services in different segments of the same infrastructure sector. Such disputes may involve allegations of unfair trade practices (for example, price dumping), uncompetitive practices inconsistent with the country's infrastructure policy (see "Introduction and background information on PPPs", paras. 25–31) or violation of specific duties of public service providers (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. …). In many countries, legislative provisions have been found necessary in order to establish an appropriate framework for the settlement of these disputes.

59. Firstly, the various parties may not have contractual arrangements with one another that could provide for an appropriate dispute settlement mechanism. Even where it would be possible to establish a contractual mechanism, the host country may have an interest that disputes involving certain issues (for example, conditions of access to a given infrastructure network) be settled by a specific body in order to ensure consistency in the application of the relevant rules. Furthermore, certain disputes between public service providers may involve issues that, under the laws of the host country, are not considered able to be settled through arbitration.

60. Domestic laws often establish administrative procedures for handling disputes between public service providers. Typically, public service providers may file complaints with the regulatory agency or with another governmental agency responsible for the application of the rules alleged to have been violated (for example, a governmental body in charge of enforcing competition laws and regulations), which in some countries has the authority to issue a binding decision on the matter. Such mechanisms, even where mandatory, do not necessarily preclude resort by the aggrieved persons to courts, although in some legal systems the courts may only have the power to control the legality of the decision (for example, observance of due process) but not its merits.

General provisions

Model provision 1. PPP Guiding Principles

Option 1

WHEREAS the [*Government*] [*Parliament*] of [...] wishes to enable the use of public-private partnerships in infrastructure development and the provision of associated services to the public;

WHEREAS, for those purposes, the [*Government*] [*Parliament*] considers it desirable to regulate public-private partnerships so as to enhance transparency, fairness, stability and predictability; promote proper management, integrity; competition and economy; and ensure long-term sustainability;

[*Other objectives that the enacting State might wish to state*];

Be it therefore enacted as follows:

Option 2

This law establishes the procedures for the approval, award and implementation of public-private partnership projects, in accordance with the principles of transparency, fairness, stability, proper management, integrity, completion, economy, and long-term sustainability.

Model provision 2. Definitions

For the purposes of this law:

(a) Public-private partnership (PPP) means an agreement between a contracting authority and a private entity for the implementation of an infrastructure project, against payments by the contracting authority or the users of facility;

(b) "Infrastructure facility" means physical facilities and systems that directly or indirectly provide services to the general public;

(c) "Infrastructure project" means the design, construction, development and operation of new infrastructure facilities or the rehabilitation, modernization, expansion or operation of existing infrastructure facilities;

(d) "Contracting authority" means the public authority that has the power to enter into a PPP contract [*under the provisions of this law*];[1]

(e) "Private Partner" means the private entity retained by the contracting authority to carry out a project under a PPP contract;

(f) "PPP contract" means the mutually binding agreement or agreements between the contracting authority and the private partner that set forth the terms and conditions for the implementation of a PPP;

(g) "Bidder" or "bidders" means persons, including groups thereof, that participate in selection proceedings for the award of the PPP contract;[2]

(h) "Unsolicited proposal" means any proposal relating to the implementation of an infrastructure project that is not submitted in response to a

[1] It should be noted that this definition relates only to the power to enter into PPP contracts. Depending on the regulatory regime of the enacting State, a separate body, referred to as "regulatory agency" in subpara. (i), may have responsibility for issuing rules and regulations governing the provision of the relevant service.

[2] The term "bidder" or "bidders" encompasses, according to the context, both persons that have sought an invitation to take part in preselection proceedings or persons that have submitted a proposal in response to a contracting authority's request for proposals.

request or solicitation issued by the contracting authority within the context of a selection procedure;

(i) "Regulatory agency" means a public authority that is entrusted with the power to issue and enforce rules and regulations governing the infrastructure facility or the provision of the relevant services.[3]

Model provision 3. Authority to enter into PPP contracts

The following public authorities have the power to enter into PPP contracts[4] for the implementation of infrastructure projects falling within their respective spheres of competence: [*the enacting State lists the relevant public authorities of the host country that may enter into PPP contracts by way of an exhaustive or indicative list of public authorities, a list of types or categories of public authority or a combination thereof*].[5]

Model provision 4. Eligible infrastructure sectors

PPP contracts may be entered into by the relevant authorities in the following sectors: [*the enacting State indicates the relevant sectors by way of an exhaustive or indicative list*].[6]

[3] The composition, structure and functions of such a regulatory agency may need to be addressed in special legislation (see paras. …).

[4] It is advisable to establish institutional mechanisms to coordinate the activities of the public authorities responsible for issuing the approvals, licences, permits or authorizations required for the implementation of PPP in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned (see chap. II, "Project planning and preparation", paras. …). In addition, for countries that contemplate providing specific forms of government support to infrastructure projects, it may be useful for the relevant law, such as legislation or a regulation governing the activities of entities authorized to offer government support, to identify clearly which entities have the power to provide such support and what kind of support may be provided (see chap. II, "Project planning and preparation", paras. …).

[5] Enacting States may generally have two options for completing this model provision. One alternative may be to provide a list of authorities empowered to enter into PPP contracts, either in the model provision or in a schedule to be attached thereto. Another alternative might be for the enacting State to indicate the levels of government that have the power to enter into those contracts, without naming relevant public authorities. In a federal State, for example, such an enabling clause might refer to "the Union, the states [or provinces] and the municipalities". In any event, it is advisable for enacting States that wish to include an exhaustive list of authorities to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.

[6] It is advisable for enacting States that wish to include an exhaustive list of sectors to consider mechanisms allowing for revisions of such a list as the need arises. One possibility to that end might be to include the list in a schedule to the law or in regulations that may be issued thereunder.

II. Project planning and preparation

A. General remarks

1. PPPs are one of the means that Governments use to develop infrastructure or systems needed to provide a public service or support the functions of a Government entity. When properly designed and implemented, PPPs can create opportunities for reducing the commitment of public funds and other resources for infrastructure development or the provision of public services. They also make it possible to transfer to the private sector a number of risks that the private sector may be able to control or mitigate in more efficient or economical terms than the Government.

2. The extent to which those expected benefits would actually materialize depends on various factors. They include the adequacy and stability of the overall legal and regulatory framework (see chap. I, “General legal and institutional framework”, paras. 10–12), the selection of a qualified private partner (see chap. III, “Contract award”, paras. 6–9), the technical and commercial feasibility of the project, the soundness of the contractual arrangements and their fitness during the entire life of the project (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. …). While some of the factors that compose this equation may be outside the control of the parties, an essential prerequisite for the success of a PPP is a comprehensive, rigorous and professionally conducted planning and preparation phase that tests the projects assumptions and anticipates risks and contingencies throughout the entire life cycle of a PPP.

3. As discussed in section B, the legal framework for PPPs should therefore require, and provide the mechanisms for, a mandatory review of the project’s assumptions in order for the competent authorities to assess accurately whether a PPP is the adequate option for developing the infrastructure or service concerned, as compared to direct procurement, financing and management by the Government (paras. 5–22). These preliminary studies should also analyse the main risks encountered in PPPs, including common contractual solutions for risk allocation, and the degree of flexibility that will be needed to allocate project risks efficiently (see section C, paras. 23–45). Section D, paras. 46–55, discusses institutional and administrative aspects of project preparation and coordination. Section E (paras. 56–86) sets out policy considerations that the Government may wish to take into account when considering the level of direct governmental support that may be provided to infrastructure projects, such as the degree of public interest in the execution of any given project and the need to avoid the assumption by the Government of open-ended or excessive contingent liabilities. Lastly, sections F (paras. 87–98) and G (paras. 99–101) outline guarantees and support measures that may be provided by export credit agencies and investment promotion agencies.

4. Other chapters of this *Guide* deal with related aspects of the host Government’s legal regime that are of relevance to the credit and risk analysis of a project. The reader is referred in particular to chapters IV, “PPP implementation: legal framework and PPP contract”; V, “Duration, extension and termination of the PPP contract”; VI, “Settlement of disputes”; and VII, “Other relevant areas of law”.

B. Project assessment and options

5. One important measure to ensure the successful implementation of PPPs is to require the relevant public authority to conduct a preliminary assessment of the project’s feasibility, including economic and financial aspects, such as expected economic advantages of the project, estimated cost and potential revenue anticipated from the operation of the infrastructure facility, as well as the economic, social and environmental impact of the project. The studies prepared by the contracting authority should, in particular, identify clearly the expected output of the project, provide sufficient justification for the investment, propose a modality for private sector

participation and describe a particular solution to the output requirement. These studies, when properly conducted, should not only serve to substantiate the policy choices made as regards the type of PPP project and the structure of the contract awards procedures. Indeed, a thorough project assessment and planning phase should consider the entire life cycle of a PPP project and provide a basis for crucial decisions on contract design and contract management (including mechanisms for contract monitoring and adjustment).

1. Economy and efficiency ("value for money") assessment

6. One of the main objectives of any system for the award of public contracts, and a central concern of the UNCITRAL Model Law on Public Procurement, for instance, is to maximize economy and efficiency. The Guide to Enactment of the Model Law explains, in this connection, that "economy" (which is often termed "value for money" or "best value"), means an optimal relationship between the price paid and other factors, including the quality of the subject matter of the procurement, and presupposes that the public purchaser's needs are in fact met. "Efficiency" in procurement means that the relationship between the transaction costs and administrative time of each procurement procedure and its value are proportionate. "Efficiency" also includes the notion that the costs of the procurement system as a whole are also proportionate to the value of all procurement conducted through that system.

7. Economy and efficiency are central concerns in all PPP projects. Some of them may fall under the scope of general public procurement law, in particular those where the contracting authority undertakes to make direct payments to the private partner. Other types of PPP projects, however, do not involve the disbursement of public funds to pay the project partner, and the role of the contracting authority as an overall project manager may be quite different from the role of Government in traditional public procurement. This means that the notions of economy and efficiency (or "value for money") in PPPs have a broader meaning than in a narrow public procurement context.

8. Indeed, in the context of PPPs, rather than focusing mainly on the price paid for works or services performed by the private partner, the Government needs to be able to demonstrate that carrying out the project as a PPP is not only more economical, but also a more efficient option than, for example, through public procurement of works or services or through public operation of the infrastructure or service system. Poorly conceived or ill-designed PPP projects may lead to project failure, public service disruption, cost overruns or fears of undue profit making by the private sector at the cost of the public interest. With a view to ensuring transparency and good governance, the contracting authority needs to show that carrying out the project as a PPP offers the best "value for money". Therefore, the law should require a thorough assessment of the project's economy and efficiency ("value for money") as a mandatory step in the approval process of any proposed project, and as a condition precedent in order for the contracting authority to proceed with preparations for the selection of the project partner.

9. Generally, the test should include a quantitative and qualitative analysis of the costs, benefits and quality of the project that conclusively shows that carrying out the project as a PPP is the best available option. A PPP project should be considered to offer "value for money" only if operating the project as a PPP would result in a better quality delivered at lower cost than using any other method or arrangement to carry out the project or deliver a comparable outcome. It may even be useful to repeat the test after the bidding process in order to ensure a full consistency in the calculation method and in the results (see chap. III, "Contract award", paras. …).

10. The contracting authority may use various tools to conduct a value for money assessment. A common and widely used tool is the so-called "public sector comparator". This test consists of an estimate of the hypothetical cost of a public sector project throughout its life cycle if were to be carried out by the Government.

The public sector comparator uses the proposed output specification and the proposed risk allocation as a basis to compare the PPP option with a hypothetical model of the project costs if it were to be carried out under the most efficient modality for project delivery through the public sector offering the same level and quality of service expected of the private sector, and taking into account the life cycle risks of the project. The starting point is typically the best estimate of the capital cost and lifetime operations and maintenance cost of implementing the project if delivered by the public sector.

11. The methodology for conducting a “value for money” test and the exact matrix of factors to be taken into account may vary according to the nature of the project, and it may evolve over time. Where a central approving authority, coordinating or advising body exists (see section D, paras. …), the host country might consider setting up dedicated structures to review periodically or systematically the methodology used and set appropriate parameters therefor. It should be noted, however, that the usefulness and accuracy of a value for money assessment depends on the availability and reliability of public sector comparators, which may be limited in countries with little experience in PPPs or in advanced Government accounting and management practices, as may be the case in some developing countries. Moreover, an accurate “value for money” analysis might be beyond the capacity of some public authorities, as there might be insufficient or incomplete data to undertake the assessment. Furthermore, the efficiency of the Government entity to be used as a public sector comparator would have a significant bearing on the project costs, and the contracting authority may not have the expertise to factor public sector performance adequately as part of a comparative analysis. These potential limitations underscore the importance of ensuring that the contracting authority or other bodies in charge of planning for PPPs have the required human and technical resources needed to conduct this assessment. The Government will also be well advised the keep abreast with current international standards and guidance for an adequate value for money assessment.[1]

12. The need for an accurate and realistic confirmation of the project’s business case is even more important in view of the financing structure of most PPP projects. In the past, debt financing for infrastructure development was obtained on the basis of credit support from project sponsors, multilateral and national export credit agencies, Governments and other third parties. Those traditional sources have not been able to meet the growing needs for infrastructure capital. Indeed, PPP projects have been increasingly funded on a project finance basis.

13. Project finance, as a method of financing, seeks to establish the creditworthiness of the private partner on a “stand alone” basis, even before construction has begun or any revenues have been generated, and to borrow on the basis of that credit. Commentators have observed that project finance may hold the key to unlocking the vast pools of capital theoretically available in the capital markets for investment in infrastructure. However, project finance has distinctive and demanding characteristics from a financial point of view. Principal among these is that, in a project finance structure, financing parties must rely mainly upon the private partner’s assets and cash flows for repayment. If the project fails they will have no recourse, or only limited recourse, to the financial resources of a sponsor company or other third party

[1] To support Governments in early stage identification and selection of projects suitable to be delivered on a PPP basis, the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) designed the PPP qualitative value-for-money toolkit, which is an online instrument allowing governments and public authorities to undertake the right PPP project selection, based on value for money. The toolkit is available at the following address: https://ppp.unescap.org/. See also World Bank. 2017. *Public-Private Partnerships: Reference Guide Version 3*, Section 3.2.4 Assessing Value for Money of the PPP. World Bank, Washington, D.C. © World Bank; World Bank Institute; Public-Private Infrastructure Advisory Facility. 2013. *Value-for-Money Analysis-Practices and Challenges: How Governments Choose When to Use PPP to Deliver Public Infrastructure and Services*. World Bank, Washington, D.C. © World Bank.

for repayment (see also "Introduction and background information on PPPs", paras. 57 and 58).

14. The financial methodology of project financing requires a precise projection of the capital costs, revenues and projected costs, expenses, taxes and liabilities of the project. In order to predict these numbers precisely and with certainty and to create a financial model for the project, it is typically necessary to project the "base case" amounts of revenues, costs and expenses of the private partner over a long period – often 20 years or more – in order to determine the amounts of debt and equity the project can support. Central to this analysis is the identification and quantification of risks. For this reason, the identification, assessment, allocation and mitigation of risks is at the heart of project financing from a financial point of view. Indeed, risk allocation is at the core of every PPP, and a thorough understanding of the risk allocation arrangements is a precondition to drafting the PPP contract. The appropriate application of risk allocation principles is what determines whether a given PPP project will be capable of attracting finance and will be sustainable throughout its life cycle. (A summary presentation of the most common risks in PPPs and general consideration on risk allocation is set out in section C, paras. 27–36).

2. Fiscal risk assessment

15. Another important reason for requiring an accurate and realistic confirmation of the project's business case as a condition precedent for the project to move ahead as a PPP is the need to avoid unexpected costs for the public sector ("fiscal risk"). In many countries, investment projects have been carried out as PPPs not for efficiency reasons, but to circumvent budget constraints and postpone recording the fiscal costs of providing infrastructure services. Hence, some Governments ended up carrying out projects that either could not be funded within their budgetary means, or that exposed public finances to excessive fiscal risks in the form of contingent liabilities not accurately estimated and not properly accounted for. It is therefore advisable for the contracting authority or any central unit with overall responsibility for PPP-related policy (see below, para. 47) to assess at this early stage the potential fiscal costs and risks arising from a proposed PPP project, where this assessment was not already an integral party of the mandatory "value for money" test (see paras. 6–14). A thorough fiscal risk assessment should consider a wide variety of factors likely to affect the overall financial balance of the project (see below, paras. 23–36), as well as the options for risk allocation through the contractually agreed rights and obligations (see below, paras. 37–45). Moreover, in order to fully estimate the expected outcomes and budgetary implications of the project throughout its life cycle, the assessment should consider at least four main variables of PPP projects:

(a) *The initiator of a project*: The impact of main fiscal indicators (i.e. deficit and debt) varies depending on the public entity ultimately responsible for the project (e.g. central, local governments, state-owned enterprises, etc.);

(b) *Who controls the asset*: The likelihood and extent of fiscal risk level varies depending on the government's ability to control the PPP-related asset – either through ownership, lease, right of use or other interest;

(c) *Who ultimately pays for the infrastructure*: The funding structure of the project (i.e. whether the government pays for the infrastructure facility or system using public funds; whether the private partner collects fees directly from users of the infrastructure facility or system; or whether there is a combination of both) is crucial to assess the project's implication on main fiscal aggregates;

(d) *Whether the Government provides additional support to the project*: Governments can fund PPP projects directly but they can also support the project in a variety of ways, including providing guarantees, equity capital, or tax and customs benefits (see below, paras. 56–86). Such an early assessment of the fiscal impact of any Government support envisaged for a PPP project will be crucial to avoid exposure to open-ended liabilities and secure a long-term commitment of public resources that promotes the sustainability of the country's infrastructure development strategy and policies.

16. Governments may use various methods and tools for conducting this assessment. The International Monetary Fund and the World Bank have developed an analytical tool to help Governments quantify the macro-fiscal implications of PPP projects. Designed to be used mostly by PPP units in ministries of finance, the PPP Fiscal Risk Assessment Model (P-FRAM) uses standard software to process project-specific and macroeconomic data and automatically generate standardized outcomes, including: (a) project cash flows; (b) fiscal tables and charts both on a cash and accrual basis; (c) debt sustainability analysis with and without the PPP project; (d) sensitivity analysis of main fiscal aggregates to changes in macroeconomic and project-specific parameters; and (e) a summary risk matrix of the project.[2]

3. Welfare and social impact assessment

17. The purpose of the "value for money" test is to permit an informed preliminary decision as to whether PPP is at all an efficient and economically justifiable alternative to other forms of project development through public procurement. Failure of a proposed project to pass the value for money test does not necessarily mean that the project as such is not feasible, but should prompt the contracting authority to consider other options that are more affordable than a PPP. Likewise, the fact that a proposed project shows value for money does not necessarily mean that the project is worthwhile pursuing as a PPP. The Government must be satisfied that the project meets its overall infrastructure and public service development needs and strategies (see chap. I "General legal and institutional framework", paras. 17 and 18), as well as the Government's broader economic and social policies, with due regard being paid to commitments undertaken to achieve its sustainable development goals.

18. Indeed, essential as it is, the value for money test emphasizes monetarily quantifiable parameters of good governance in infrastructure and public service development. In order to fully assess the benefits – but also potential risks of a PPP – the Government should consider conducting an alternative assessment of the project. Firstly, from a purely financial viewpoint, the authorities involved may wish to calculate the impact of the availability of the infrastructure concerned, the fiscal returns on the investment in addition to the cash-flow position. Secondly, as the PPPs projects are by nature of great importance for the public in terms of size and service rendered, the social impact of the project should be addressed by the public authority during the preparatory phase. Of particular importance is a consideration by the Government of the extent to which the project, whether or not carried as a PPP, is in line with relevant United Nations Sustainable Development Goals. In general, it is recommended to assess at the planning stages the sustainability of the project and its environmental, economic and social impact. From the viewpoint of good governance and transparency, it is further advisable at this stage to consider the interests of the non-commercial partners and stakeholders – possibly through an adequate consultation mechanism – in order to foster public support for the project and reduce the risk of challenges or even litigation at later stages.

4. Environmental impact assessment

19. The analysis of a project's welfare and social impact should be complemented with a thorough assessment of its environmental impact. The Rio Declaration on Environment and Development expressly calls for environmental impact assessment, as a national instrument, to be undertaken "for proposed activities that are likely to have a significant adverse impact on the environment and are subject to a decision of a competent national authority".[3] Where a project is also likely to have a "significant

[2] P-FRAM is available on the following address: http://www.imf.org/external/np/fad/publicinvestment/#5.

[3] Report of the United Nations Conference on Environment and Development (Rio de Janeiro, 3–14 June 1992) (A/CONF/151/26 (vol. I), Annex I "Rio Declaration on Environment and

adverse transboundary environmental effect", States are further called upon to "provide prior and timely notification and relevant information to potentially affected States" and to "consult with those States at an early stage and in good faith."[4] An environmental impact assessment (EIA) is a "systematic process that seeks to identify and evaluate the potential environmental consequences, impacts (and to a lesser extent the social and economic impacts also) and effects of a proposed project, such that information can be provided to decision makers and other stakeholders in order to minimize, mitigate, or eliminate altogether, any adverse potential impacts arising from the proposed development project".[5] Good governance and transparency principles in environmental matters call for an open and inclusive EIA process, through a mechanism that ensures access to information and the involvement of all potentially affected stakeholders in the decision-making process in accordance with relevant international standards.[6]

20. Carrying an EIA is essential to ensure that projects are sustainable and do not detrimentally affect people's lives or the natural environment (using mitigation measures to achieve this where necessary). The EIA should help understand the consequences or impacts of proposed projects on the environment and identify ways in which projects can be improved, for example, by minimizing negative environmental impacts. For that purpose, the EIA should examine and evaluate the impact that the proposed project is likely to have on the natural environment, local environment and local communities and set out the measures required to avoid, reduce or compensate for environmental effects after implementation of the project. Those measures should be reflected in corresponding obligations for the private partner during both the construction and the operation phase of the project (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. … and, … respectively). An increasingly important element of an EIA is an assessment of the likely obsolescence of the facilities or their technology and the need for developing an environmentally sound decommissioning plan and to integrate decommissioning measures into the PPP contract (see chap. V, "Duration, extension and termination of the PPP contract", paras. …).

5. Impact on competition

21. The contracting authority needs further to consider at the planning stages the extent to which the private partner should obtain exclusive rights for the operation of the infrastructure or provision of the relevant service, or whether the private partner might even need such exclusivity as a guarantee for the recovery of the original investment. This preliminary assessment should consider the geographic scope of the exclusivity – if any should be granted – and take into account the country's policies for the sector concerned (see "Introduction and background information on PPPs", paras. 27–45 and chap. I, "General legal and institutional framework", paras. 24–28). The issue of exclusivity will play a central role in assessing the project's financial and commercial viability and its economic and social impact. From a practical point

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Development", Principle 17.

[4] Ibid., Principle 19. In some regions, this obligation has received a treaty-based legal framework, such as through the Convention on Environmental Impact Assessment in a Transboundary Context (Espoo, Finland, 25 February 1991), negotiated under the auspices of the United Nations Economic Commission for Europe (United Nations, *Treaty Series* , vol. 1989, p. 309).

[5] United Nations Environment Programme, An Introduction to Environmental Assessment, 2015, p. 23 (http://apps.unep.org/publications/index.php?option=com_pub&task=download&file=011945_en).

[6] For instance, the Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters (Aarhus Convention), adopted at the Fourth "Environment for Europe" Ministerial Conference (Aarhus, Denmark, 25 June 1998), which was negotiated under the auspices of the United Nations Economic Commission for Europe, requires States Parties to guarantee the rights of access to information, public participation in decision-making and access to justice in environmental matters in order to contribute to the protection of the right of every person of "present and future generations" to live in an environment adequate to his or her health and well-being (United Nations, *Treaty Series* , vol. 2161, p. 447.

of view, exclusivity will be one of the central contract provisions (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. …), and it will also impact the level of Government support that the private partner may require (see section E, Government Support, (f) Protection from competition).

22. The contracting authority should consider carefully the macroeconomic impact and policy disadvantages of granting exclusive rights to the private partner as well as the overall welfare costs of eliminating competition. As private partners may have a keen interest in exclusivity, the risk of collusion and corruption in this context may be particularly high. Laws and regulations may establish appropriate parameters for granting exclusivity, and should generally require the contracting authority to provide a justification for its recommendation to grant exclusivity (on competition, see also chap. VII, "Other relevant areas of law", paras. …).

C. Project risks and risk allocation

23. The precise allocation of risks among the various parties involved is typically defined after consideration of a number of factors, including the public interest in the development of the infrastructure in question and the level of risk faced by the private partner, other investors and lenders (and the extent of their ability and readiness to absorb those risks at an acceptable cost). Adequate risk allocation is essential to reducing project costs and to ensuring the successful implementation of the project. Conversely, an inappropriate allocation of project risks may compromise the project's financial viability or hinder its efficient management, thus increasing the cost of the service.

[*Paragraphs 24–25 correspond to paras. 8–29 of chapter II, as they appear in the Legislative Guide, except for the terminology changes explained in A/CN.9/939, paras. 17–19 and 31, and other adjustments to reflect the expanded scope of the* Guide *and the deliberations at the Commission's 51st session and at the Intergovernmental Expert Group meeting (Vienna, 26–30 November 2018).*]

24. As used in this chapter, the notion of "project risks" refers to those circumstances which, in the assessment of the parties, may have a negative effect on the benefit they expect to achieve with the project. While there may be events that would represent a serious risk for most parties (for example, the physical destruction of the facility by a natural disaster), each party's risk exposure will vary according to its role in the project.

25. The expression "risk allocation" refers to the determination of which party or parties should bear the consequences of the occurrence of events identified as project risks. This is generally the subject of negotiation between the parties, although a country's regulations, policies or administrative guidance often establishes parameters for the allocation of some risks. The agreement of the parties in this respect is then translated into rights and obligations in the PPP contract. For example, if the private partner is obliged to deliver the infrastructure facility to the contracting authority with certain equipment in functioning condition, the private partner is bearing the risk that the equipment may fail to function at the agreed performance levels. The occurrence of that project risk, in turn, may have a series of consequences for the private partner, including its liability for failure to perform a contractual obligation under the PPP contract or the applicable law (for example, payment of damages to the contracting authority for delay in bringing the facility into operation); certain losses (for example, loss of revenue as a result of delay in beginning operating the facility); or additional cost (for example, cost of repair of faulty equipment or of securing replacement equipment).

26. The party bearing a given risk may take preventive measures with a view to limiting the likelihood of the risk, as well as specific measures to protect itself, in whole or in part, against the consequences of the risk. Such measures are often referred to as "risk mitigation". In the previous example, the private partner will carefully review the reliability of the equipment suppliers and the technology

proposed. The private partner may require its equipment suppliers to provide independent guarantees concerning the performance of their equipment. The supplier may also be liable to pay penalties or liquidated damages to the private partner for the consequences of failure of its equipment. In some cases, a more or less complex chain of contractual arrangements may be made to mitigate the consequences of a project risk. For instance, the private partner may combine the guarantees provided by the equipment supplier with commercial insurance covering some consequences of the interruption of its business because of equipment failure.

1. Overview of main categories of project risk

27. For purposes of illustration, the following paragraphs provide an overview of the main categories of project risks and give examples of certain contractual arrangements used for risk allocation and mitigation. For further discussion on this subject, the reader is advised to consult other sources of information, such as the *UNIDO BOT Guidelines*.[7]

(a) Project disruption caused by events outside the control of the parties

28. The parties face the risk that the project may be disrupted by unforeseen or extraordinary events outside their control, which may be of a physical nature, such as natural disasters – floods, storms or earthquakes – or the result of human action, such as war, riots or terrorist attacks. Such unforeseen or extraordinary events may cause a temporary interruption of the project execution or the operation of the facility, resulting in construction delay, loss of revenue and other losses. Severe events may cause physical damage to the facility or even destruction beyond repair (for a discussion of the legal consequences of the occurrence of such events, see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. …).

(b) Project disruption caused by adverse acts of Government (“political risk”)

29. The private partner and the lenders face the risk that the project execution may be negatively affected by acts of the contracting authority, another agency of the Government or the host country’s legislature. Such risks are often referred to as “political risks” and may be divided into three broad categories: “traditional” political risks (for example, nationalization of the private partner’s assets or imposition of new taxes that jeopardize the private partner’s prospects of debt repayment and investment recovery); “regulatory” risks (for example, introduction of more stringent standards for service delivery or opening of a sector to competition) and “quasi-commercial” risks (for example, breaches by the contracting authority or project interruptions due to changes in the contracting authority’s priorities and plans) (for a discussion of the legal consequences of the occurrence of such events, see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. …). In addition to political risks originating from the host country, some political risks may result from acts of a foreign Government, such as blockades, embargoes or boycotts imposed by the Governments of the investors’ home countries.

(c) Construction and operation risks

30. The main risks that the parties may face during the construction phase are the risks that the facility cannot be completed at all or cannot be delivered according to the agreed schedule (completion risk); that the construction cost exceeds the original estimates (construction cost overrun risk); or that the facility fails to meet performance criteria at completion (performance risk). Similarly, during the operational phase the parties may face the risk that the completed facility cannot be effectively operated or maintained to produce the expected capacity, output or efficiency (performance risk); or that the operating costs exceed the original estimates (operation cost overrun). It should be noted that construction and operation risks do not affect only the private sector. The contracting authority and the users in the host

[7] See *Introduction and background information on PPPs*, footnote 2.

country may be severely affected by an interruption in the provision of needed services. The Government, as representative of the public interest, will be generally concerned about safety risks or environmental damage caused by improper operation of the facility.

31. Some of these risks may be brought about by the private partner or its contractors or suppliers. For instance, construction cost overrun and delay in completion may be the result of inefficient construction practices, waste, insufficient budgeting or lack of coordination among contractors. Failure of the facility to meet performance criteria may also be the result of defective design, inadequacy of the technology used or faulty equipment delivered by the private partner's suppliers. During the operational phase, performance failures may be the consequence, for example, of faulty maintenance of the facility or negligent operation of mechanical equipment. Operation cost overruns may also derive from inadequate management.

32. However, some of these risks may also result from specific actions taken by the contracting authority, by other public authorities or even the host country's legislature. Performance failures or cost overruns may be the consequence of the inadequacy of the technical specifications provided by the contracting authority during the PPP contract award. Delays and cost overruns may also be brought about by actions of the contracting authority subsequent to the award of the contract (delays in obtaining approvals and permits, additional costs caused by changes in requirements due to inadequate planning, interruptions caused by inspecting agencies or delays in delivering the land on which the facility is to be built). General legislative or regulatory measures, such as more stringent safety or labour standards, may also result in higher construction or operating costs. Shortfalls in production may be caused by the non-delivery of the necessary supplies (for example, power or gas) on the part of public authorities.

(d) Commercial risks

33. "Commercial risks" relate to the possibility that the project cannot generate the expected revenue because of changes in market prices or demand for the goods or services it generates. Both of these forms of commercial risk may seriously impair the private partner's capacity to service its debt and may compromise the financial viability of the project.

34. Commercial risks vary greatly according to the sector and type of project. The risk may be regarded as minimal or moderate where the private partner has a monopoly over the service concerned or when it supplies a single client through a standing off-take agreement. However, commercial risks may be considerable in projects that depend on market-based revenues, in particular where the existence of alternative facilities or supply sources makes it difficult to establish a reliable forecast of usage or demand. This may be a serious concern, for instance, in toll road projects, since toll roads face competition from toll-free roads. Depending on the ease with which drivers may have access to toll-free roads, the toll revenues may be difficult to forecast, especially in urban areas where there may be many alternative routes and roads may be built or improved continuously. Furthermore, traffic usage has been found to be even more difficult to forecast in the case of new toll roads, especially those which are not an addition to an existing toll facility system, because there is no existing traffic to use as an actuarial basis.

(e) Exchange rate and other financial risks

35. Exchange rate risk relates to the possibility that changes in foreign exchange rates alter the exchange value of cash flows from the project. Prices and user fees charged to local users or customers will most likely be paid for in local currency, while the loan facilities and sometimes also equipment or fuel costs may be denominated in foreign currency. This risk may be considerable, since exchange rates are particularly unstable in many developing countries or countries whose economies are in transition. In addition to exchange rate fluctuations, the private partner may

face the risk that foreign exchange control or lowering reserves of foreign exchange may limit the availability in the local market of foreign currency needed by the private partner to service its debt or repay the original investment.

36. Another risk faced by the private partner concerns the possibility that interest rates may rise, forcing the project to bear additional financing costs. This risk may be significant in infrastructure projects given the usually large sums borrowed and the long duration of projects, with some loans extending over a period of several years. Loans are often given at a fixed rate of interest (for example, fixed-rate bonds) to reduce the interest rate risk. In addition, the finance package may include hedging facilities against interest rate risks, for example, by way of interest rate swaps or interest rate caps.

2. Contractual arrangements for risk allocation and mitigation

37. It follows from the above that the parties need to take into account a wide range of factors to allocate project risks effectively. For this reason, it is generally not advisable to have in place statutory provisions that limit unnecessarily the negotiators' ability to achieve a balanced allocation of project risks, as appropriate to the needs of individual projects. Nevertheless, it may be useful for the Government to provide some general guidance to officials acting on behalf of domestic contracting authorities, for instance, by formulating advisory principles on risk allocation.

38. Practical guidance provided to contracting authorities in a number of countries often refers to general principles for the allocation of project risks. One such principle is that specific risks should normally be allocated to the party best able to assess, control and manage the risk. Additional guiding principles envisage the allocation of project risks to the party with the best access to hedging instruments (that is, investment schemes to offset losses in one transaction by realizing a simultaneous gain on another) or the greatest ability to diversify the risks or to mitigate them at the lowest cost. In practice, however, risk allocation is often a factor of both policy considerations (for example, the public interest in the project or the overall exposure of the contracting authority under various projects) and the negotiating strength of the parties. Furthermore, in allocating project risks it is important to consider the financial strength of the parties to which a specific risk is allocated and their ability to bear the consequences of the risk, should it occur.

39. It is usually for the private partner and its contractors to assume ordinary risks related to the development and operation of the infrastructure. For instance, completion, cost overrun and other risks typical of the construction phase are usually allocated to the construction contractor or contractors through a turnkey construction contract, whereby the contractor assumes full responsibility for the design and construction of the facility at a fixed price, within a specified completion date and according to particular performance specifications (see chap. IV, "PPP implementation: legal framework and PPP contract", para. …). The construction contractor is typically liable to pay liquidated damages or penalties for any late completion. In addition, the contractor is also usually required to provide a guarantee of performance, such as a bank guarantee or a surety bond. Separate equipment suppliers are also usually required to provide guarantees in respect of the performance of their equipment. Guarantees of performance provided by contractors and equipment suppliers are often complemented by similar guarantees provided by the private partner to the benefit of the contracting authority. Similarly, the private partner typically mitigates its exposure to operation risks by entering into an operation and maintenance contract in which the operating company undertakes to achieve the required output and assumes the liability for the consequences of operational failures. In most cases, arrangements of this type will be an essential requirement for a successful project. The lenders, for their part, will seek protection against the consequences of those risks, by requiring the assignment of the proceeds of any bonds issued to guarantee the contractor's performance, for instance. Loan agreements typically require that the proceeds from contract bonds be deposited in an account pledged to the lenders (that is, an "escrow account"), as a safeguard against

misappropriation by the private partner or against seizure by third parties (for example, other creditors). Nevertheless, the funds paid under the bonds are regularly released to the private partner as needed to cover repair costs or operating and other expenses.

40. The contracting authority, on the other hand, will be expected to assume those risks which relate to events attributable to its own actions, such as inadequacy of technical specifications provided during the selection process or delay caused by failure to provide agreed supplies on time. The contracting authority may also be expected to bear the consequences of disruptions caused by acts of Government, for instance by agreeing to compensate the private partner for loss of revenue due to price control measures (see chap. IV, “PPP implementation: legal framework and PPP contract”, para. …). While some political risks may be mitigated by procuring insurance, such insurance, if at all available for projects in the country concerned, may not be obtainable at an acceptable cost. Thus, prospective investors and lenders may turn to the Government, for instance, to obtain assurances against expropriation or nationalization and guarantees that proper compensation will be payable in the event of such action (see para. …). Depending on their assessment of the level of risk faced in the host country, prospective investors and lenders may not be ready to pursue a project in the absence of those assurances or guarantees.

41. Most of the project risks referred to in the preceding paragraphs can, to a greater or lesser extent, be regarded as falling within the control of one party or the other. However, a wide variety of project risks result from events outside the control of the parties or are attributable to the acts of third parties and other principles of risk allocation may thus need to be considered.

42. For example, the private partner could expect that the interest rate risk, together with the inflation risk, would be passed on to the end users or customers of the facility through price increases, although this may not always be possible because of market-related circumstances or price control measures. The price structure negotiated between the private partner and the contracting authority will determine the extent to which the private partner will avoid those risks or whether it will be expected to absorb some of them (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. …).

43. Another category of risk that may be allocated under varying schemes concerns extraneous events such as war, civil disturbance, natural disasters or other events wholly outside the control of the parties. In traditional infrastructure projects carried out by the public sector, the public entity concerned usually bears the risk, for example, of destruction of the facility by natural disasters or similar events, to the extent that those risks may not be insurable. In PPP projects the Government may prefer this type of risk to be borne by the private partner. However, depending on their assessment of the particular risks faced in the host country, the private sector may not be ready to bear those risks. Therefore, in practice there is not a single solution to cover this entire category of risk and special arrangements are often made to deal with each of them. For example, the parties may agree that the occurrence of some of those events may exempt the affected party from the consequences of failure to perform under the PPP contract and there will be contractual arrangements providing solutions for some of their adverse consequences, such as contract extensions to compensate for delay resulting from events or even some form of direct payment under special circumstances (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. …). Those arrangements will be supplemented by commercial insurance purchased by the private partner, where available at an acceptable cost (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. …).

44. Special arrangements may also need to be negotiated for the allocation of commercial risks. PPP projects such as mobile telecommunication projects usually have a relatively high direct cost recovery potential and in most cases the private partner is expected to carry out the project without sharing those risks with the contracting authority and without recourse to support from the Government. In other

infrastructure PPP projects, such as power-generation projects, the private partner may revert to contractual arrangements with the contracting authority or other public authority in order to reduce its exposure to commercial risks, for example, by negotiating long-term off-take agreements that guarantee a market for the product at an agreed price. Payments may take the form of actual consumption or availability charges or combine elements of both; the applicable rates are usually subject to escalation or indexation clauses in order to protect the real value of revenues from the increased costs of operating an ageing facility (see also chap. IV, "PPP implementation: legal framework and PPP contract", paras. … and …). Lastly, there are relatively capital-intensive projects with more slowly developing cost recovery potential, such as water supply and some toll road projects, which the private sector may be reluctant to carry out without some form of risk-sharing with the contracting authority, for example, through fixed revenue assurances or agreed capacity payments regardless of actual usage (see also chap. IV, "PPP implementation: legal framework and PPP contract", paras. … and …).

45. The risk allocation eventually agreed to by the contracting authority and the private partner will be reflected in their mutual rights and obligations, as set forth in the PPP contract. The possible legislative implications of certain provisions commonly found in project agreements are discussed in other chapters of the *Guide* (see chaps. IV, "PPP implementation: legal framework and PPP contract", and V, "Duration, extension and termination of the PPP contract"). Various other agreements will also be negotiated by the parties to mitigate or reallocate the risks they assume (for example, loan agreements; construction, equipment supply, operation and maintenance contracts; direct agreement between the contracting authority and the lenders; and off-take and long-term supply agreements, where applicable).

D. Administrative coordination

46. Depending on the administrative structure of the host country, PPPs may require the involvement of several public authorities, at various levels of government. For instance, the competence to lay down regulations and rules for the activity concerned may rest in whole or in part with a public authority at a level different from the one that is responsible for providing the relevant service. It may also be that both the regulatory and the operational functions are combined in one entity, but that the authority to award government contracts is centralized in a different public authority. For projects involving foreign investment, it may also happen that certain specific competences fall within the mandate of an agency responsible for approving foreign investment proposals.

47. International experience has demonstrated the usefulness of entrusting a central unit within the host country's administration with the overall responsibility for formulating policy and providing practical guidance on PPPs. Such a central unit may also be responsible for coordinating the input of the main public authorities that interface with the private partner. It is recognized, however, that such an arrangement may not be possible in some countries, owing to their particular administrative organization. Where it is not feasible to establish such a central unit, other measures may be considered to ensure an adequate level of coordination among the various public authorities involved, as discussed in the following paragraphs.

1. Coordination of preparatory measures

48. Following the identification of the future project, and a positive evaluation of the proposed PPP as the best option for implementing it, it is for the Government to establish the project's relative priority and to assign human and other resources for its implementation. At that point, it is desirable that the contracting authority review existing statutory or regulatory requirements relating to the operation of infrastructure facilities of the type proposed with a view to identifying the main public authorities whose input will be required for the implementation of the project. It is also important at this stage to consider the measures that may be required in order for the contracting

authority and the other public authorities involved to perform the obligations they may reasonably anticipate in connection with the project. For instance, the Government may need to make advance budgeting arrangements to enable the contracting authority or other public authorities to meet financial commitments that extend over several budgetary cycles, such as long-term commitments to purchase the project's output (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. ... and …). Furthermore, a series of administrative measures may be needed to implement certain forms of support provided to the project, such as tax exemptions and customs facilitation (see below, paras. 26–56), which may require considerable time.

2. Preparations for the selection of the private partner

49. The choice of the best private partner capable of developing the project to the contracting authority's satisfaction is the central condition for the success of the project. This is why the contracting authority must turn its attention as early as possible to preparing a selection procedure appropriate to ensure that result (see chap. III, "Contract award"). As most modern laws on public procurement do, the UNCITRAL Model Procurement Law generally allows the procuring entity the flexibility to determine what will constitute value for money in each procurement and how to conduct the procurement procedure in a way that will achieve it. Specifically, the UNCITRAL Model Law on Public Procurement gives the procuring entity a broad discretion to decide what to purchase, and in determining what will be considered responsive to the procuring entity's needs (art. 10), who can participate and on what terms (arts. 9, 18 and 49) and the criteria that will be applied in selecting the winning submission (art. 11). This level of flexibility is also desirable for the selection of the private partner to carry out a PPP project.

50. Flexibility does not mean, however, that the contracting authority should be free to make those decisions at any time or alter the nature of the procedure without proper justification. To the contrary, it is already essential at the planning stage for the contracting authority to identify and study in detail the appropriate selection procedure from among those provided for in the country's general public procurement laws or any specific laws on PPPs (see chap. III, "Contract award", paras. …). Indeed the choice of the appropriate procedure will depend on a number of practical aspects that the contracting authority needs to consider in conjunction at the project preparation phase. Indeed the choice of the PPP modality (see chap. I, "General legal and institutional framework", para. 16), the ownership and maintenance arrangements envisaged for the facility (see chap. I, "General legal and institutional framework", paras. ...), the payment model (e.g. whether user fees, government payments or a combination of both) and other essential elements of project design will determine, for instance, the degree of interest of the contracting authority for the physical aspects of work and may, in turn, influence the extent to which the contracting authority wishes to control technical aspects by preparing a set of specifications, or prefers instead to allow bidders until the end to propose their own solutions to meet the expected output. Different selection processes may be available to meet the contracting authority's preferences (see chap. III, "Contract award", paras. ...).

51. The contracting authority will also need to consider important aspects of the contract award process already at this stage. The contracting authority will have to consider the need for, or desirability of, a preselection process, in light of the level of competition actually available in the market and the need for ensuring a robust and transparent selection process. The contracting authority will need to consider carefully the preselection criteria in light of both the desired output but also the nature of the PPP envisaged. The contracting authority will also need to prepare appropriate evaluation criteria to permit a ranking of proposals leading to the choice of the bidder offering the best value for money. From a practical point of view, the contracting authority will have to ensure that it will be able to avail itself of the required technical

expertise to evaluate proposals, both in technical, as well as financial and commercial aspects.

52. Another crucial step in the preparatory process is for the contracting authority to refine the risk allocation assumptions considered when doing the "value for money" test and determine the essential terms of the contract, including the non-negotiable ones, as this will constitute a central element of the selection process and one of the bases for comparing the proposals received (see chap. III, "Contract award", paras. …). The time needed for concluding the PPP contract after the selection of the private partner is often excessively long, adding to the overall project cost. The contracting authority can help shorten that time and make the final negotiations more structured and efficient by using as much as possible standards documents that, based on previous experience and practice, reflect the essential terms of the PPP (adapted, of course, to the circumstances of the project in question).

3. Arrangements for facilitating the issuance of licences and permits

53. Legislation may play a useful role in facilitating the issuance of licences and permits that may be needed in the course of a project (such as licences under foreign exchange regulations; licences for the incorporation of the private partner; authorizations for the employment of foreigners; registration and stamp duties for the use or ownership of land; import licences for equipment and supplies; construction licences; licences for the installation of cables or pipelines; licences for bringing the facility into operation; and spectrum allocation for mobile communication). The required licences or permits may fall within the competence of various organs at different levels of the administration and the time required for their issuance may be significant, in particular when the approving organs or offices were not originally involved in conceiving the project or negotiating its terms. Delays in bringing an infrastructure project into operation because of missing licences or permits for reasons not attributable to the private partner is likely to result in an increase in the cost of the project and in the price paid by the users.

54. Thus, it is advisable to conduct an early assessment of licences and permits needed for a particular project in order to avoid delay in the implementation phase. A possible measure to enhance the coordination in the issuance of licences and permits might be to entrust one organ with the authority to receive the applications for licences and permits, to transmit them to the appropriate agencies and to monitor the issuance of all licences and permits listed in the request for proposals and other licences that might be introduced by subsequent regulations. The law may also authorize the relevant agencies to issue provisional licences and permits and set forth a period beyond which those licences and permits are deemed to be granted unless they are rejected in writing.

55. However, it should be noted that the distribution of administrative authority among various levels of government (for example, local, regional and central) often reflects fundamental principles of a country's political organization. Therefore, there are instances where the central government would not be in a position to assume responsibility for the issuance of all licences and permits or to entrust one single body with such a coordinating function. In those cases, it is important to introduce measures to counter the possibility of delay that might result from such distribution of administrative authority, such as, for instance, agreements between the contracting authority and the other public authorities concerned to facilitate the procedures for a given project or other measures intended to ensure an adequate level of coordination among the various public authorities involved and to make the process of obtaining licences more transparent and efficient. Furthermore, the Government might consider providing some assurance that it will assist the private partner as much as possible in obtaining licences required by domestic law, for instance by providing information and assistance to bidders regarding the required licences, as well as the relevant procedures and conditions. From a practical point of view, in addition to coordination among various levels of government and various public authorities, there is a need to

ensure consistency in the application of criteria for the issuance of licences and for the transparency of the administrative process.

E. Government support

[*Paragraphs 56–86 correspond to paras. 30–60 of chapter II, as they appear in the Legislative Guide, except* for *the terminology changes explained in A/CN.9/939, paras. 17–19 and 31, and other adjustments to reflect the expanded scope of the* Guide *and the deliberations at the Commission's 51st session and at the Intergovernmental Expert Group meeting (Vienna, 26–30 November 2018).*]

56. The discussion in Section C shows that the parties may use various contractual arrangements to allocate and mitigate PPP project risks. Nevertheless, those arrangements may not always be sufficient to ensure the level of comfort required by private investors to participate in PPP projects. It may also be found that certain additional government support is needed to enhance the attractiveness of private investment in PPP projects in the host country.

57. Government support may take various forms. Generally, any measure taken by the Government to enhance the investment climate for PPP projects may be regarded as governmental support. From that perspective, the existence of legislation enabling the Government to award PPP contracts or the establishment of clear lines of authority for the negotiation and follow-up of PPP contracts (see chap. I, "General legal and institutional framework", paras. 29–36) may represent important measures to support the execution of infrastructure projects. As used in the *Guide*, however, the expression "government support" has a narrower connotation and refers in particular to special measures, in most cases of a financial or economic nature, that may be taken by the Government to enhance the conditions for the execution of a given project or to assist the private partner in meeting some of the project risks, above and beyond the ordinary scope of the contractual arrangements agreed to between the contracting authority and the private partner to allocate project risks. Government support measures, where available, are typically an integral part of governmental programmes to attract private investment for infrastructure projects.

1. Policy considerations relating to government support

58. In practice, a decision to support the implementation of a project is based on an assessment by the Government of the economic or social value of the project and whether that justifies additional governmental support. The Government may estimate that the private sector alone may not be able to finance certain projects at an acceptable cost. The Government may also consider that particular projects may not materialize without certain support measures that mitigate some of the project risks. Indeed, the readiness of private investors and lenders to carry out large projects in a given country is not only based on their assessment of specific project risks but is also influenced by their comfort with the investment climate in the host country, in particular in the infrastructure sector. Factors to which private investors may attach special importance include the host country's economic system and the degree of development of market structures and the degree to which the country has already succeeded with PPP projects over a period of years.

59. For the above reasons, a number of countries have adopted a flexible approach for dealing with the issue of governmental support. In some countries, this has been done by legislative provisions that tailor the level and type of support to the specific needs of individual infrastructure sectors. In other countries, this has been achieved by providing the host Government with sufficient legislative authority to extend certain types of assurance or guarantee while preserving its discretion not to make them available in all cases. However, the host Government will be interested in ensuring that the level and type of support provided to the project does not result in the assumption of open-ended liabilities. Indeed, over-commitment of public

authorities through guarantees given to a specific project may prevent them from extending guarantees in other projects of perhaps even greater public interest.

60. The efficiency of governmental support programmes for private investment in infrastructure may be enhanced by the introduction of appropriate techniques for budgeting for governmental support measures or for assessing the total cost of other forms of governmental support. For example, loan guarantees provided by public authorities usually have a cost lower than the cost of loan guarantees provided by commercial lenders. The difference (less the value of fees and interests payable by the private partner) represents a cost for the Government and a subsidy for the private partner. Therefore, a Government envisaging to offer some form of governmental support for a PPP should consider carefully their overall fiscal implications to avoid the risk of unanticipated contingent liabilities (see above, paras. 15 and 16). For instance, loan guarantees are often not recorded as expenses until such time as a claim is made. Thus, the actual amount of the subsidy granted by the Government is not recorded, which may create the incorrect impression that loan guarantees entail a lesser liability than direct subsidy payments. Similarly, the financial and economic cost of tax exemptions granted by the Government may not be apparent, which makes them less transparent than other forms of direct governmental support. For these reasons, countries that are contemplating establishing support programmes for PPP projects may need to devise special methods for estimating the budgetary cost of support measures such as tax exemptions, loans and loan guarantees provided by public authorities that take into account the expected present value of future costs or loss of revenue.

2. Forms of government support

61. The availability of direct governmental support, be it in the form of financial guarantees, public loans or revenue assurances, may be an important element in the financial structuring of the project. The following paragraphs briefly describe forms of governmental support that are sometimes authorized under domestic laws and discuss possible legislative implications they may have for the host country, without advocating the use of any of them in particular.

62. Generally, besides the administrative and budgetary measures that may be needed to ensure the fulfilment of governmental commitments throughout the duration of the project, it is advisable for the legislature to consider the possible need for an explicit legislative authorization to provide certain forms of support. Where government support is found advisable, it is important for the legislature to bear in mind the host country's obligations under international agreements on regional economic integration or trade liberalization, which may limit the ability of public authorities of the contracting States to provide support, financial or otherwise, to companies operating in their territories. Furthermore, where a Government is contemplating support for the execution of an infrastructure project, that circumstance should be made clear to all prospective bidders at an appropriate time during the selection proceedings (see chap. III, "Contract award", para. 75).

(a) Public loans and loan guarantees

63. In some cases, the law authorizes the Government to extend interest-free or low-interest loans to the private partner to lower the project's financing cost. Depending on the accounting rules to be followed, some interest-free loans provided by public agencies can be recorded as revenue in the private partner's accounts, with loan payments being treated as deductible costs for tax and accounting purposes. Moreover, subordinate loans provided by the Government may enhance the financial terms of the project by supplementing senior loans provided by commercial banks without competing with senior loans for repayment. Governmental loans may be generally available to all private partners in a given sector or they may be limited to providing temporary assistance to the private partner in the event that certain project risks materialize. The total amount of any such loan may be further limited to a fixed sum or to a percentage of the total project cost.

64. In addition to public loans, some national laws authorize the contracting authority or other agency of the host Government to provide loan guarantees for the repayment of loans taken by the private partner. Loan guarantees are intended to protect the lenders (and, in some cases, investors providing funds to the project as well) against default by the private partner. Loan guarantees do not entail an immediate disbursement of public funds and they may appear more attractive to the Government than direct loans. However, loan guarantees may represent a substantial contingent liability and the Government's exposure may be significant, especially in the event of total failure by the private partner. Indeed, the Government would in most cases find little comfort in a possible subrogation in the rights of the lenders against an insolvent private partner.

65. Thus, in addition to introducing general measures to enhance the efficiency of governmental support programmes (see para. 60), it may be advisable to consider concrete provisions to limit the Government's exposure under loan guarantees. Rules governing the provision of loan guarantees may provide a maximum ceiling, which could be expressed as a fixed sum or, if more flexibility is needed, a certain percentage of the total investment in any given project. Another measure to circumscribe the contingent liabilities of the guaranteeing agency may be to define the circumstances under which such guarantees may be extended, taking into account the types of project risk the Government may be ready to share. For instance, if the Government considers sharing only the risks of temporary disruption caused by events outside the control of the parties, the guarantees could be limited to the event that the private partner is rendered temporarily unable to service its loans owing to the occurrence of specially designated unforeseeable events outside the private partner's control. If the Government wishes to extend a greater degree of protection to the lenders, the guarantees may cover the private partner's permanent failure to repay its loans for the same reasons. In such a case, however, it is advisable not to remove the incentives for the lenders to arrange for the continuation of the project, for instance by identifying another suitable private partner or by stepping in through an agent appointed to remedy the private partner's default (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. …). The call on the governmental guarantees could thus be conditional upon the prior exhaustion of other remedies available to the lenders under the PPP contract, the loan agreements or their direct agreements with the contracting authority, if any. In any event, full loan guarantees by the Government amounting to a total protection of the lenders against the risk of default by the private partner are not a common feature of infrastructure projects carried out under the project finance modality.

(b) Equity participation

66. Another form of additional support by the Government may consist of direct or indirect equity participation in the private partner. Equity participation by the Government may help achieve a more favourable ratio between equity and debt by supplementing the equity provided by the project sponsors, in particular where other sources of equity capital, such as investment funds, cannot be tapped by the private partner. Equity investment by the Government may also be useful to satisfy legal requirements of the host country concerning the composition of locally established companies. The company laws of some jurisdictions, or special legislation on infrastructure projects, require a certain amount of participation of local investors in locally established companies. However, it may not always be possible to secure the required level of local participation on acceptable terms. Local investors may lack the interest or financial resources to invest in large infrastructure projects; they may also be averse to or lack experience in dealing with specific project risks.

67. Governmental participation may involve certain risks that the Government may wish to consider. In particular, there is a risk that such participation may be understood as an implied guarantee by the Government, so that the parties, or even third parties, may expect the Government to back the project fully or eventually even take it over at its own cost if the private partner fails. Where such an implied guarantee

is not intended, appropriate provisions should be made to clarify the limits of governmental involvement in the project.

(c) Subsidies

68. Tariff subsidies are used in some countries to supplement the private partner's revenue when the actual income of the project falls below a certain minimum level. The provision of the services in some areas where the private partner is required to operate may not be a profitable undertaking, because of low demand or high operational costs or because the private partner is required to provide the service to a certain segment of the population at low cost. Thus, the law in some countries authorizes the Government to undertake to extend subsidies to the private partner in order to make it possible to provide the services at a lower price.

69. Subsidies usually take the form of direct payments to the private partner, either lump-sum payments or payments calculated specifically to supplement the private partner's revenue. In the latter case, the Government should ensure that it has in place adequate mechanisms for verifying the accuracy of subsidy payments made to the private partner, by means, for example, of audit and financial disclosure provisions in the project agreement. An alternative to direct subsidies may be to allow the private partner to cross-subsidize less profitable activities with revenue earned in more profitable ones. This may be done by combining in the same PPP contract both profitable and less profitable activities or areas of operation, or by granting to the private partner the commercial exploitation of a separate and more profitable ancillary activity (see paras. …).

70. However, it is important for the legislature to consider practical implications and possible legal obstacles to the provision of subsidies to the private partner. For example, subsidies are found to distort free competition and the competition laws of many countries prohibit the provision of subsidies or other forms of direct financial aid that are not expressly authorized by legislation. Subsidies may also be inconsistent with the host country's international obligations under international agreements on regional economic integration or trade liberalization.

(d) Sovereign guarantees

71. In connection with PPP projects, the term "sovereign guarantees" is sometimes used to refer to any of two types of guarantee provided by the host Government. The first type includes guarantees issued by the host Government to cover the breach of obligations assumed by the contracting authority under the PPP contract. A second category includes guarantees that the private partner will not be prevented by the Government from exercising certain rights that are granted to it under the PPP contract or that derive from the laws of the country, for example, the right to repatriate profits at the end of the project. Whatever form such guarantees may take, it is important for the Government and the legislature to consider the Government's ability to assess and manage efficiently its own exposure to project risks and to determine the acceptable level of direct or contingent liabilities it can assume.

(i) Guarantees of performance by the contracting authority

72. Performance guarantees may be used where the contracting authority is a separate or autonomous legal entity that does not engage the responsibility of the Government itself. Such guarantees may be issued in the name of the Government or of a public financial institution of the host country. They may also take the form of a guarantee issued by international financial institutions that are backed by a counter-guarantee by the Government (see paras. …). Guarantees given by the Government may be useful instruments to protect the private partner from the consequences of default by the contracting authority or other public authority assuming specific obligations under the PPP contract. The most common situations in which such guarantees are used include the following:

(a) *Off-take guarantees.* Under these arrangements, the Government guarantees payment of goods and services supplied by the private partner to public entities. Payment guarantees are often used in connection with payment obligations under off-take agreements in the power-generation sector (see chap. IV, "PPP implementation: legal framework and PPP contract", para. …). Such guarantees may be of particular importance where the main or sole customer of the private partner is a government monopoly. Additional comfort is provided to the private partner and lenders when the guarantee is subscribed by an international financial institution;

(b) *Supply guarantees.* Supply guarantees may also be provided to protect the private partner from the consequences of default by public sector entities providing goods and supplies required for the operation of the facility – fuel, electricity or water, for example – or to secure payment of indemnities for which the contracting authority may become liable under the supply agreement;

(c) *General guarantees.* These are guarantees intended to protect the private partner against any form of default by the contracting authority, rather than default on specifically designated obligations. Although general performance guarantees may not be very frequent, there are cases in which the private partner and the lenders may regard them as a condition necessary for executing the project. This may be the case, for example, where the obligations undertaken by the contracting authority are not commensurate with its creditworthiness, as may happen in connection with large PPP contracts awarded by municipalities or other autonomous entities. Guarantees by the Government may be useful to ensure specific performance, for example, when the host Government undertakes to substitute for the contracting entity in the performance of certain acts (for example, delivery of an appropriate site for disposal of by-products).

73. Generally, it is important not to overestimate the adequacy of sovereign guarantees alone to protect the private partner against the consequences of default by the contracting authority. Except when their purpose is to ensure specific performance, sovereign guarantees usually have a compensatory function. Thus, they may not substitute for appropriate contractual remedies in the event of default by the contracting authority (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. …). Different types of contractual remedies, or combinations thereof, may be used to deal with various events of default, for example, liquidated damages in the event of default and price increases or contract extensions in the event of additional delay in project execution caused by acts of the contracting authority. Furthermore, in order to limit the Government's exposure and to reduce the risk of calls on the guarantee, it is advisable to consider measures to encourage the contracting authority to live up to its obligations under the PPP contract or to make efforts to control the causes of default. Such measures may include express subrogation rights of the guarantor against the contracting authority or internal control mechanisms to ensure the accountability of the contracting authority or its agents in the event, for instance, of wanton or reckless breach of its obligations under the PPP contract resulting in a call on the sovereign guarantee.

(ii) Guarantees against adverse acts of Government

74. Unlike performance guarantees, which protect the private partner against the consequences of default by the contracting authority, the guarantees considered here relate to acts of other authorities of the host country that are detrimental to the rights of the private partner or otherwise substantially affect the implementation of the PPP contract. Such guarantees are often referred to as "political risk guarantees".

75. One type of guarantee contemplated in national laws consists of foreign exchange guarantees, which usually fulfil three functions: to guarantee the convertibility of the local earnings into foreign currency, to guarantee the availability of the required foreign currency and to guarantee the transferability abroad of the converted sums. Foreign exchange guarantees are common in PPP projects involving a substantial amount of debt denominated in currencies other than the local currency,

in particular in those countries which do not have freely convertible currencies. Some laws also provide that such a guarantee may be backed by a bank guarantee issued in favour of the private partner. A foreign exchange guarantee is not normally intended to protect the private partner and the lenders against the risks of exchange rate fluctuation or market-induced devaluation, which are considered to be ordinary commercial risks. However, in practice, Governments have sometimes agreed to assist the private partner in cases where the private partner is unable to repay its debts in foreign currency owing to extreme devaluation of the local currency.

76. Another important type of guarantee may be to assure the company and its shareholders that they will not be expropriated without adequate compensation. Such a guarantee would typically extend both to confiscation of property owned by the private partner in the host country and to the nationalization of the private partner itself, that is, confiscation of shares of the private partner's capital. This type of guarantee is usually provided for in laws dealing with direct foreign investment and in bilateral investment protection treaties (see chap. VII, "Other relevant areas of law", paras. 4–6).

(e) Tax and customs benefits

77. Another method for the host Government to support the execution of PPP projects could be to grant some form of tax and customs exemption, reduction or benefit. Domestic legislation on foreign direct investment often provides special tax regimes to encourage foreign investment and in some countries it has been found useful expressly to extend such a taxation regime to foreign companies participating in PPP projects (see also chap. VII, "Other relevant areas of law", paras. 34–39).

78. Typical tax exemptions or benefits include exemption from income or profit tax or from property tax on the facility, or exemptions from income tax on interest due on loans and other financial obligations assumed by the private partner. Some laws provide that all transactions related to a PPP project will be exempted from stamp duties or similar charges. In some cases, the law establishes some preferential tax treatment or provides that the private partner will benefit from the same favourable tax treatment generally given to foreign investments. Sometimes the tax benefit takes the form of a more favourable income tax rate, combined with a decreasing level of exemption during the initial years of the project. Such exemptions and benefits are sometimes extended to the contractors engaged by the private partner, in particular foreign contractors.

79. Further taxation measures sometimes used to promote PPP projects are exemptions from withholding tax to foreign lenders providing loans to the project. Under many legal systems, any interest, commission or fee in connection with a loan or indebtedness that is borne directly or indirectly by locally established companies or is deductible against income earned locally is deemed to be local income for taxation purposes. Therefore, both local and foreign lenders to infrastructure projects may be liable to the payment of income tax in the host country, which the private partner may be required to withhold from payments to foreign lenders, as non-residents of the host country. Income tax due by the lenders in the host country is typically taken into account in the negotiations between the private partner and the lenders and may result in a higher financial cost for the project. In some countries, the competent organs are authorized to grant exemptions from withholding tax in connection with payments to non-residents that are found to be made for a purpose that promotes or enhances the economic or technological development of the host country or are otherwise deemed to be related to a purpose of public relevance.

80. Besides tax benefits or exemptions, national laws sometimes facilitate the import of equipment for the use of the private partner by means of exemption from customs duties. Such exemption typically applies to the payment of import duties on equipment, machinery, accessories, raw materials and materials imported into the country for purposes of conducting preliminary studies, designing, constructing and operating infrastructure projects. In the event that the private partner wishes to

transfer or sell the imported equipment on the domestic market, the approval of the contracting authority usually needs to be obtained and the relevant import duties, turnover tax or other taxes need to be paid in accordance with the laws of the country. Sometimes the law authorizes the Government either to grant an exemption from customs duty or to guarantee that the level of duty will not be raised to the detriment of the project.

(f) Protection from competition

81. An additional form of governmental support may consist of assurances that no competing infrastructure project will be developed for a certain period or that no agency of the Government will compete with the private partner, directly or through another private partner. Assurances of this sort serve as a guarantee that the exclusivity rights that may be granted to the private partner (see chap. I, “General legislative and institutional framework”, paras. 19–20) will not be nullified during the life of the project. Protection from competition may be regarded by the private partner and the lenders as an essential condition for participating in the development of infrastructure in the host country. Some national laws contain provisions whereby the Government undertakes not to facilitate or support the execution of a parallel project that might generate competition to the private partner. In some cases, the law contains an undertaking by the Government that it will not alter the terms of such exclusivity to the detriment of the private partner without the private partner’s consent.

82. Provisions of this type may be intended to foster the confidence of the project sponsors and the lenders that the basic assumptions under which the project was awarded will be respected. However, they may be inconsistent with the host country’s international obligations under agreements on regional economic integration and trade liberalization. Furthermore, they may limit the ability of the Government to deal with an increase in the demand for the service concerned as the public interest may require to ensure the availability of the services to various categories of user. It is therefore important to consider carefully the interests of the various parties involved. For instance, the required price level to allow profitable exploitation of a toll road may exceed the paying capacity of low-income segments of the public. Thus, the contracting authority may have an interest in maintaining open to the public a toll-free road as an alternative to a new toll road. At the same time, however, if the contracting authority decides to improve or upgrade the alternative road, the traffic flow may be diverted from the toll road built by the private partner, thus affecting its flow of income. Similarly, the Government may wish to introduce free competition for the provision of long-distance telephone services in order to expand the availability and reduce the cost of telecommunication services (for a brief overview of issues relating to competition, see “Introduction and background information on PPPs”, paras. 28–31). The consequence of such a measure, however, may be a significant erosion of the income anticipated by the private partner.

83. Generally, it may be useful to authorize the Government, where appropriate, to give assurances that the private partner’s exclusive rights will not be unduly affected by subsequent changes in governmental policies without appropriate compensation. However, it may not be advisable to adopt statutory provisions that rule out the possibility of subsequent changes in the Government’s policy for the sector concerned, including a decision to promote competition or to build parallel infrastructure. The possible consequences of such future changes for the private partner should be dealt with by the parties in contractual provisions dealing with changes in circumstances (see chap. IV, “PPP implementation: legal framework and PPP contract”, paras. …). It is particularly advisable to provide the contracting authority with the necessary power to negotiate with the private partner the compensation that may be due for loss or damage that may result from a competing infrastructure project subsequently launched by the contracting authority or from any equivalent measure of the Government that adversely affects the private partner’s exclusive rights.

(g) Ancillary revenue sources

84. One additional form of support to the execution of PPP projects may be to allow the private partner to diversify its investment through the provision of ancillary services or the exploitation of other activities. In some cases, alternative sources of revenue may also be used as a subsidy to the private partner for the purpose of pursuing a policy of low or controlled prices for the main service. Provided that the ancillary activities are sufficiently profitable, they may enhance the financial feasibility of a project: the right to collect tolls on an existing bridge, for example, may be an incentive for the execution of a new toll bridge project. However, the relative importance of ancillary revenue sources should not be overemphasized.

85. In order to allow the private partner to pursue ancillary activities, it may be necessary for the Government to receive legislative authorization to grant the private partner the right to use property belonging to the contracting authority for the purposes of such activities (for example, land adjacent to a highway for construction of service areas) or the right to charge fees for the use of a facility built by the contracting authority. Where it is felt necessary to control the development and possibly the expansion of such ancillary activities, the approval of the contracting authority might be required in order for the private partner to undertake significant expansion of facilities used for ancillary activities.

86. Under some legal systems, certain types of ancillary revenue source offered by the Government may be regarded as a concession separate from the main concession and it is therefore advisable to review possible limitations to the private partner's freedom to enter into contracts for the operation of ancillary facilities (see chap. IV, "PPP implementation: legal framework and PPP contract", paras. … and …).

F. Guarantees provided by international financial institutions

[*Paragraphs 87–97 correspond to paras. 61–71 of chapter II, as they appear in the Legislative Guide, except for the terminology changes explained in A/CN.9/939, paras. 17–19 and 31, and other adjustments to reflect the expanded scope of the* Guide *and the deliberations at the Commission's 51st session and at the Intergovernmental Expert Group meeting (Vienna, 26–30 November 2018).*]

87. Besides guarantees given directly by the host Government, there may be guarantees issued by international financial institutions, such as the World Bank, the Multilateral Investment Guarantee Agency and the regional development banks. Such guarantees usually protect the private partner against certain political risks, but under some circumstances they may also cover breach of the project agreement, for instance, where the private partner defaults on its loans as a result of the breach of an obligation by the contracting authority.

1. Guarantees provided by multilateral lending institutions

88. In addition to lending to Governments and public authorities, multilateral lending institutions, such as the World Bank and the regional development banks, have developed programmes to extend loans to the private sector. Sometimes they can also provide guarantees to commercial lenders for public and private sector projects. In most cases, guarantees provided by those institutions require a counter-guarantee from the host Government.

89. Guarantees by multilateral lending institutions are designed to mitigate the risks of default on sovereign contractual obligations or long-maturity loans that private lenders are not prepared to bear and are not equipped to evaluate. For instance, guarantees provided by the World Bank may typically cover specified risks (the partial risk guarantee) or all credit risks during a specified part of the financing term (the partial credit guarantee), as summarized below. Most regional development banks provide guarantees under terms similar to those of the World Bank.

(a) Partial risk guarantees

90. A partial risk guarantee covers specified risks arising from non-performance of sovereign contractual obligations or certain political force majeure events. Such guarantees ensure payment in the case of debt service default resulting from the non-performance of contractual obligations undertaken by Governments or their agencies. They may cover various types of non-performance, such as failure to maintain the agreed regulatory framework, including price formulas; failure to deliver inputs, such as fuel supplied to a private power company; failure to pay for outputs, such as power purchased by a government utility from a power company or bulk water purchased by a local public distribution company; failure to compensate for project delays or interruptions caused by government actions or political events; procedural delays; and adverse changes in exchange control laws or regulations.

91. When multilateral lending institutions participate in financing a project, they sometimes provide support in the form of a waiver of recourse that they would otherwise have to the private partner in the event that default is caused by events such as political risks. For example, a multilateral lending institution taking a completion guarantee from the private partner may accept that it cannot enforce that guarantee if the reason for failure to complete was a political risk.

(b) Partial credit guarantees

92. Partial credit guarantees are provided to private sector borrowers with a government counter-guarantee. They are designed to cover the portion of financing that falls due beyond the normal tenure of loans provided by private lenders. These guarantees are generally used for projects involving private sector participation that need long-term funds to be financially viable. A partial credit guarantee typically extends maturities of loans and covers all events of non-payment for a designated part of the debt service.

2. Guarantees provided by the Multilateral Investment Guarantee Agency

93. The Multilateral Investment Guarantee Agency (MIGA) offers long-term political risk insurance coverage to new investments originating in any member country and destined for any developing member country other than the country from which the investment originates. New investment contributions associated with the expansion, modernization or financial restructuring of existing projects are also eligible, as are acquisitions that involve the privatization of State enterprises. Eligible forms of foreign investment include equity, shareholder loans and loan guarantees issued by equity holders, provided the loans and loan guarantees have terms of at least three years. Loans to unrelated borrowers can also be insured, as long as a shareholder investment in the project is concurrently insured. Other eligible forms of investment are technical assistance, management contracts and franchising and licensing agreements, provided they have terms of at least three years and the remuneration of the investor is tied to the operating results of the project. MIGA insures against the following risks: foreign currency transfer restrictions, expropriation, breach of contract, war and civil disturbance, non-honouring of financial obligations.

(a) Transfer restrictions

94. The purpose of guarantees of foreign currency transfer extended by MIGA is similar to that of sovereign foreign exchange guarantees that may be provided by the host Government (see para. 75). This guarantee protects against losses arising from an investor's inability to convert local currency (capital, interest, principal, profits, royalties and other remittances) into foreign exchange for transfer outside the host country. The coverage insures against excessive delays in acquiring foreign exchange caused by action or failure to act by the host Government, by adverse changes in exchange control laws or regulations and by deterioration in conditions governing the conversion and transfer of local currency. Currency devaluation is not covered. On

receipt of the blocked local currency from an investor, MIGA pays compensation in the currency of its contract of guarantee.

(b) Expropriation

95. This guarantee protects against loss of the insured investment as a result of acts by the host Government that may reduce or eliminate ownership of, control over or rights to the insured investment. In addition to outright nationalization and confiscation, “creeping” expropriation – a series of acts that, over time, have an expropriatory effect – is also covered. Coverage is provided on a limited basis for partial expropriation (for example, confiscation of funds or tangible assets). Bona fide, non-discriminatory measures taken by the host Government in the exercise of legitimate regulatory authority are not covered. For total expropriation of equity investments, MIGA pays the net book value of the insured investment. For expropriation of funds, MIGA pays the insured portion of the blocked funds. For loans and loan guarantees, the Agency insures the outstanding principal and any accrued and unpaid interest. Compensation is paid upon assignment of the investor’s interest in the expropriated investment (for example, equity shares or interest in a loan agreement) to MIGA.

(c) Breach of contract

96. This guarantee protects against losses arising from the host Government’s breach or repudiation of a contract with the investor. In the event of an alleged breach or repudiation, the investor must be able to invoke a dispute resolution mechanism (for example, arbitration) under the underlying contract and obtain an award for damages. If, after a specified period of time, the investor has not received payment or if the dispute resolution mechanism fails to function because of actions taken by the host Government, MIGA will pay compensation.

(d) War and civil disturbance

97. This guarantee protects against loss from damage to, or the destruction or disappearance of, tangible assets caused by politically motivated acts of war or civil disturbance in the host country, including revolution, insurrection, coup d’état, sabotage and terrorism. For equity investments, MIGA will pay the investor’s share of the least of the book value of the assets, their replacement cost or the cost of repair of damaged assets. For loans and loan guarantees, MIGA will pay the insured portion of the principal and interest payments in default as a direct result of damage to the assets of the project caused by war and civil disturbance. War and civil disturbance coverage also extends to events that, for a period of one year, result in an interruption of project operations essential to overall financial viability. This type of business interruption is effective when the investment is considered a total loss; at that point, MIGA will pay the book value of the total insured equity investment.

(e) Non-honouring of financial obligations

98. This guarantee protects against losses incurred from the failure of sovereign and sub-sovereign entities, as well as state-owned enterprises to make a payment when due under an unconditional financial payment obligation or guarantee related to an eligible investment. The primary beneficiaries are commercial lenders that provide loans to the public-sector entities involved in development investments. This coverage may be made available to investors only if the financial payment obligation is unconditional and not subject to any defences – meaning that there are no grounds on which the sovereign, sub-sovereign or state-owned enterprise could defend legally against the fact that the obligation is due and payable. A further advantage of MIGA’s non-honouring of financial obligations (NHFO) is that it does not require an investor to obtain an arbitral award to file a claim for compensation with MIGA.

G. Guarantees provided by export credit agencies and investment promotion agencies

[*Paras. 99–101 correspond to paras. 72–74 of chapter II, as they appear in the Legislative Guide, except for the terminology changes explained in A/CN.9/939, paras. 17–19 and 31, and other adjustments to reflect the expanded scope of the* Guide *and the deliberations at the Commission's 51st session and at the Intergovernmental Expert Group meeting (Vienna, 26–30 November 2018).*]

99. Insurance against certain political, commercial and financial risks, as well as direct lending, may be obtained from export credit agencies and investment promotion agencies. Export credit agencies and investment promotion agencies have typically been established in a number of countries to assist in the export of goods or services originating from that country. Export credit agencies act on behalf of the Governments of the countries supplying goods and services for the project. Most export credit agencies are members of the International Union of Credit and Investment Insurers (Berne Union), whose main objectives include promoting international cooperation and fostering a favourable investment climate; developing and maintaining sound principles of export credit insurance; and establishing and sustaining discipline in the terms of credit for international trade.

100. While the support available differs from country to country, export credit agencies typically offer two lines of coverage:

(a) *Export credit insurance*. In the context of the financing of PPP projects, the essential purpose of export credit insurance is to guarantee payment to the seller whenever a foreign buyer of exported goods or services is allowed to defer payment. Export credit insurance may take the form of "supplier credit" or "buyer credit" insurance arrangements. Under the supplier credit arrangements the exporter and the importer agree on commercial terms that call for deferred payment evidenced by negotiable instruments (for example, bills of exchange or promissory notes) issued by the buyer. Subject to proof of creditworthiness, the exporter obtains insurance from an export credit agency in its home country. Under the buyer credit modality, the buyer's payment obligation is financed by the exporter's bank, which in turn obtains insurance coverage from an export credit agency. Export credits are generally classified as short-term (repayment terms of usually under two years), medium-term (usually two to five years) and long-term (over five years). Official support by export credit agencies may take the form of "pure cover", by which is meant insurance or guarantees given to exporters or lending institutions without financing support. Official support may also be given in the form of "financing support", which is defined as including direct credits to the overseas buyer, refinancing and all forms of interest rate support;

(b) *Investment insurance*. Export credit agencies may offer insurance coverage either directly to a borrower or to the exporter for certain political and commercial risks. Typical political and commercial risks include war, insurrection or revolution; expropriation, nationalization or requisition of assets; non-conversion of currency; and lack of availability of foreign exchange. Investment insurance provided by export credit agencies typically protects the investors in a private partner established abroad against the insured risks, but not the private partner itself. Investment insurance cover tends to be extended to a wide range of political risks. Export credit agencies prepared to cover such risks will typically require sufficient information on the legal system of the host country.

101. The conditions under which export credit agencies of most member countries of the Organization for Economic Cooperation and Development (OECD) offer support to both supplier and buyer credit transactions have to be in accordance with the OECD Arrangement on Guidelines for Officially Supported Export Credits (also referred to as the "OECD consensus"). The main purpose of the arrangement is to provide a suitable institutional framework to prevent unfair competition by means of official support for export credits. In order to avoid market-distorting subsidies, the

Arrangement regulates the conditions of terms of insurances, guarantees or direct lending supported by Governments.

Model legislative provisions

II. Project planning and preparation

Model provision 5. PPP project proposals

1. A contracting authority envisaging to develop infrastructure or services through a PPP shall carry out or procure a feasibility study to assess whether the project meet the conditions for approval set for in [*these provisions*].

2. The feasibility study shall:

(a) Identify the public infrastructure or service needs to be met by the proposed PPP project and how the project meets relevant national or local priorities for the development of public infrastructure and services;

(b) Assess the various options available to the contracting authority to satisfy those needs and conclusively demonstrate the comparative advantage, strategic and operational benefits of implementation as PPP, in particular that the project:

(i) Offers a more economic and efficient solution as a PPP than if it were to be procured and carried out by the contracting authority or another public body ("value for money"); and

(ii) Will not lead to unexpected financial liabilities for the public sector ("fiscal risk").

3. In addition to the feasibility study, the request for approval of a PPP project shall:

(a) Assess the project's social, economic and environmental impact;

(b) Identify the technical requirements and expected inputs and deliverables;

(c) Consider the extent to which the project activities can be performed by a private partner under a contract with the contracting authority;

(d) Identify the licences, permits or authorizations that the contracting authority or any other public authority may be required to issue in connection with the approval or implementation of the project;

(e) Identify and assess the main project risks and describe the proposed risk allocation under the contract;

(f) Identify any proposed form of Government support for the implementation of the project;

(g) Determine the capacity of the contracting authority to effectively enforce the contract, including the ability to monitor and regulate project implementation and the performance of the private partner;

(h) Identify the appropriate procedure for contract award.

Model provision 6. Approval of PPP project proposals

1. The [*the enacting State indicates the competent body*] shall be responsible for [approving proposed PPP projects submitted to it by contracting authorities] [advising the [*the enacting State indicates the competent body*] as to whether a proposed PPP project meets the approval conditions set forth in [*these provisions*].

2. The [*the enacting State indicates the competent body*] shall be responsible, in particular for:

(a) Reviewing PPP project proposals and feasibility studies submitted by contracting authorities for purposes of ascertaining whether a proposed project is worthwhile being carried out as a PPP and meets the requirements set forth in [*these provisions*];

(b) Reviewing the contracting authority's capability for carrying out the project and making appropriate recommendations;

(c) Reviewing the draft requests for proposal prepared by contract authorities to ensure conformity with the approved proposal and feasibility study;

(d) Advising the Government on administrative procedures relating to PPPs;

(e) Developing guidelines relating to PPPs;

(f) Advising contracting authorities on the methodology for conducting feasibility and other studies;

(g) Preparing standard bidding and contract documents for use by contracting authorities;

(h) Issuing advice in connection with the implementation of PPP projects;

(i) Assisting contracting authorities as required to ensure that PPPs are carried out in accordance with [*these provisions*]; and

(j) Performing any other functions in connection with PPPs that the [*the enacting States indicates the competent body to issue regulations implementing the model provisions*] may assign to it.

Model provision 7. Administrative coordination

The [*the enacting State indicates the competent body*] shall [establish] [propose to the [*the enacting State indicates the competent body*] the establishment of] institutional mechanisms to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of PPP projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned.