

# OBTAINING SUSTAINABLE DEVELOPMENT RIGHTS IN OUTBOUND PPP PROJECTS

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Legal Briefings

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Overseas PPP projects are in essence a long-term cooperation between the investors and the host country government. The Government is the client to serve, and at the same time a business partner. The dual-role played by the Government has added complexity to the Projects. As a preventative measure to manage the risks of revocation, procurement compliance has proven challenging for the investors.

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## **A COMPREHENSIVE AND ROBUST DUE DILIGENCE INVESTIGATION IS CRITICAL TO THE SUCCESS OF PROCUREMENT COMPLIANCE**

The investigation and research must cover the government procurement regulations, PPP regulations and industry-specific regulations

### **Government Procurement Regulations**

The Government Procurement Regulations usually apply and public tenders are usually required. Some exceptions may apply, such as when specifically required by the financial institutions.

### **PPP Acts**

Quite a number of developing countries have passed PPP Acts to promote their markets and projects. The Government may have to follow another set of rules in addition to the Government Procurement Law before they can award the Development Rights.

## **Industry-Specific Regulations on Operation and Maintenance**

Industry-Specific Regulations may also impose requirements on procurement. For instance, in Pakistan, Public Procurement Ordinance (2002) does not apply to the procurement by the IPP Project Co because of its private nature. It, however, falls into the ambit of NEPRA Licensing (Generation) Rules 2000 which regulate the power industry. Therefore, the IPP Project Co has to organize competitive negotiations for certain service procurements such as EPC.

## **THE COMPLIANCE STRATEGIES SHOULD BE TAILORED TO THE PROCUREMENT METHODS**

### **International Competitive Bidding**

Some bidding committees expect Letter of Financial Support and/ or Bank Guarantee, while others simply request the Term Sheet be produced. The investors and the banks need to agree on the structure of the project and the key commercial terms in advance, so as to prepare the bidding documents in time.

Early involvement of the banks may also benefit all the relevant parties commercially and logistically. The banks will have the chance to study the project closely and adjust the proposal so that the project is more likely to be deemed bankable. The investors will have a more willing lender, and therefore a better position in the negotiation with the host countries.

Bidding consortium may be a sensible choice in some circumstances such as to meet the local content requirements, or to complement each other with the local expertise or business resources.

The consortium members can agree on the key terms of the cooperation in a sketchy manner to join together for the bidding. However, if the consortium is awarded the project, the members should immediately incorporate the key terms of cooperation and develop a full-fledged joint-development agreement to formalize the right and interests, members' shares, management and exit plans. The agreements between the consortium members cannot wait till the financial closing or the execution of other project documents, because then will be a bad time for sponsors' disputes.

Some key terms in the project agreements are not negotiable. It is imperative that the investors spot risks in the agreement, understand their magnitude, and prepare the mitigations.

### **Exclusive Negotiation**

Projects licensed through exclusive negotiation may be deceptively flexible and manageable for some inexperienced investors. Some risks are often overlooked.

**Risk 1:** *Compliance with Host Country's Regulations on Procurement through Negotiation*

Most international PPP projects are awarded through bidding or other competitive methods. Negotiations can be used for technically and financially challenging projects. However, in some industries, such as IPP, negotiations are widely used. For instance, the Pakistani authorities provide, in the forms of policies for the power industry, the specific steps for the procurement through negotiations.

The investors are charged with the responsibilities to find and study the relevant rules, and make the proper arrangements to comply with them.

### ***Risk 2: Forfeiture of Bank Guarantee***

Sometimes, the Governments or the Procurements Department requests letter of guarantee and will forfeit the guarantees if the investors fail to develop the project as agreed. In Pakistan if a project is going to be procured by negotiation, the investors have to provide a bank letter of guarantee for US\$ 1,000/ MW before the Government can issue the Letter of Intent. The guarantee is subject to forfeiture if the investor fails to complete the feasibility study or acquire the tariff approval on time. Another guarantee of US\$ 5,000/MW needs to be posted before the government can issue the letter of support. In the event the investor cannot close the financing on time or fails to perform other obligations under the letter of support, the guarantee will be forfeited. In an IPP project initiated by a Chinese investor, the investor was forfeited the guarantees for the letter of intent.

### **UTILIZE THE HOST COUNTRY RULES AND BE CREATIVE IN PROJECT STRUCTURING**

The better the investors understand where the lines are drawn, the more feasible the project structuring will become, and likewise the more attainable the business goals.

For Example, the relevant laws in Ecuador mandates that the Governments select the private sector service providers through competitive bidding. However, the same restriction does not apply to the public companies in Ecuador when entering into a strategic alliance with i) another public company of a foreign government for ii) infrastructure projects.

The Project was in the charge of Municipal Government and also in the service scope of a public company incorporated by Municipal Government. As a state-owned public company, the Chinese investor managed to circumvent the competitive bidding requirements by entering into a strategic alliance with the public company of the Municipal Government, and at the same time secured the government supports through the Strategic Alliance Contract (“SAC”) and Investment Protection Agreement (“IPA”).

### **KEEP A CLOSE EYE ON THE POLITICAL AND DIPLOMATIC CLIMATES**

The investors should also keep abreast with the political and diplomatic changes, and recognize the early signs of deterioration. Sri Lanka Colombo Port City Project is a lesson exactly on point.

China Harbour Engineering Company (“CHEC”) is an investor in this project. After the administration transition in 2015, the Sri Lanka cabinet suspended the project on approval issues. The project, renamed “Colombus International Financial City”, resumed a year later with a new tripartite agreement replacing the original one. The new agreement increased the site reclamation and public spaces in that area.

CHEC’s experience of crisis management in securing the development right in Sri Lanka highlights the dire consequences of deviation from proper procurement protocols. Friendly terms with host country governments are not sufficient to insulate the investors from the risks of revocation by a new government. In the meantime, the investors should also be mindful of all the interested parties including the incumbent and non-incumbent parties, central and local governments, the media, the populace and the NGOs.

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## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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