

PANEL 2: PUBLIC PRIVATE PARTNERSHIPS IN INTERNATIONAL ENERGY & INFRASTRUCTURE PROJECT FINANCE

MODERATOR: Kevin E. Davis

PANELISTS: Nicholas Bliss, Chantal Kordula, Kent Rowey,
Ana Karina Esteves de Souza, Carlos Umaña

JESSE GERO: Welcome back from lunch, everyone. I am particularly excited about this next panel, which is on Public Private Partnerships in Infrastructure Project Finance.

It is my distinct pleasure to introduce to you Professor Kevin Davis, who will moderate the next panel. Professor Kevin Davis is Vice Dean Responsible for Global Affairs in the L.L.M. Program here at NYU. He teaches courses on contracts, law and development, and secure transactions, as well as seminars on financing development and contract theory. His current research is focused on contract law, anti-corruption law, the governance of financial transactions involving developing countries, and the general relationship between law and economic development. Please join me in welcoming our panel.

PROFESSOR KEVIN E. DAVIS: Thank you, Jesse. It's a real pleasure to have you here, and especially for a discussion of this particular topic, because financing energy and infrastructure is one of the most pressing challenges confronting a lot of societies around the world these days, and especially, or including, the United States. And because of the scale and complexity of those projects, they're challenging. And the role of lawyers in those projects is particularly challenging. And that's especially true when governments are involved and we've got partnerships between government and the private sector.

And so that's the focus of today's session, or this session, where we're going to be talking about Public Private Partnerships ("PPPs") and what's being done around the world in terms of structures, new models, and new challenges. And we'll hear first of all from a couple of speakers about the general topic, and then we'll move into a discussion of experiences in specific countries, starting with the U.K., then moving to Brazil, and then to Colombia.

So with that, we've got a very distinguished group of speakers here with a tremendous amount of experience. And I am looking forward to learning a lot from them, because this is an area in which I have a strong personal interest. And so we will begin with Kent Rowey and Chantal Kordula, who will be just giving us a general overview of PPPs and their structure and some of the key issues that come up. Thank you.

MR. KENT ROWEY: Thanks a lot, Kevin. First of all, I want to say what a pleasure it is to be here. I am a class of 1987 from NYU, and it's been several years since I've been in this room, and I have forgotten just how attractive a place it is to go to law school. So it's fantastic to be here.

As Kevin said, Chantal and I are going to start our panel by providing some context around what a Public Private Partnership is. And then we'll talk a little bit about some of the war stories that we have and some of the issues that have come up in the transactions that we've done. And then we'll go on onto regional presentations.

So first of all, what is a Public Private Partnership? Well in its broadest sense, it's pretty much what it says on the tin; it's a partnership, usually contractual, between a governmental entity and a private party.

What it means for us as deal lawyers is narrower, and it's basically a financing and procurement delivery technique that has been developed by governments to bring private capital into, and allow it to be invested in, assets that are traditionally owned, operated, built by governments. And that is especially true in the transportation infrastructure sector and the social infrastructure sector.

So for example, toll roads, bridges. In the case of social infrastructure: schools, courthouses, things like that. And the reason governments have adopted Public Private Partnerships is primarily financially driven. I mean, you'll hear people talking about it, and there certainly are a lot of other elements and reasons to do it. For example, risk transfer in connection with the asset, et cetera.

But at bottom I think the reason that a government looks to do a Public Private Partnership is because it wants to utilize capital from the private sector to leverage up public funds and then transfer the operation (the construction sometimes) of that asset into the private sector to take advantage of private

sector expertise, to institute best practices from the private sector, and at the same time get the benefit of the investment from the private sector.

The typical structure of a Public Private Partnership is contractual. There is a governmental entity that will enter into a franchise agreement or a concession agreement with the private entity under which the private entity will carry out the construction, the operation, and the financing of the asset.

Unlike other types of business practice and business law, here in the U.S. Public Private Partnerships are really behind the rest of the world. It's sort of an emerging market here in the U.S. for Public Private Partnerships, especially in the transportation infrastructure sector. The U.S. has sort of a strange separation of private and public when it comes to infrastructure in the U.S. that the rest of the world reconciled many years ago.

So for example, here, energy infrastructure is private, and almost always has been private, whereas transportation infrastructure is owned by the public and is funded through a combination of tax at the state and municipal level and grants provided at the federal government level, which are funded by a gasoline tax that's administered by the federal government.

But because of that division between transportation and energy for infrastructure financing, the idea of private finance and private construction and operation of infrastructure in the U.S. is new here. And it's foreign, and it's been a challenge to implement it to the same degree and at the same scale that it's been implemented in other countries.

But it is picking up a head of steam, and we are involved in a lot of transactions on both the greenfield side, that is a new build of infrastructure, and also privatizations or monetizations of existing assets, which involve essentially the same technique.

So hopefully that provides a little bit of context for what we're going to be talking about, what a Public Private Partnership is. And I think Chantal is then going to give you sort of the details and sort of the architecture of how one of these deals is actually structured.

MS. CHANTAL KORDULA: Thanks, Kent. What we thought we'd do is just take you through some examples of structures of Public Private Partnerships, because they really vary widely.

And a lot of different types of deal structures get under the rubric of Public Private Partnership. And it really depends a lot upon what's going to be the extent of the government's role in the venture, and also what's the extent of the private sector's role in that venture.

And if you look at a spectrum, we think about it as a spectrum of going from one end, where there is more government involvement, less private sector involvement, to the opposite end of the spectrum, which is much less government involvement and much more private sector involvement.

So if you start at one end of the spectrum, where the government still stays very much involved, the government still managing, operating the assets and the like, and they might just need the private sector participant to come in for certain services.

So those would be service contracts. These are usually short term, one- to five-year contracts, fixed fee, and you provide a particular service, let's say billing or collection, metering, something of that nature. And the idea really is that the government still maintains ownership/operation, and it's just using the private sector expertise for very specific things.

If you keep going across the spectrum, the next thing would be something more in the nature of an O & M Agreement, which we call Operation Maintenance Agreement, where the government essentially is asking the private sector participant to take over the operation maintenance of some sort of infrastructure and do that operation maintenance instead of the government doing it.

These are usually longer-term contracts, maybe five to ten years. The idea there is that there is a tariff that's usually paid to the private sector participant. And to the extent that the private sector participant is able to reduce the cost of operating the facilities, then they will have their return effectively—they will have greater return because their return is essentially the difference between the tariff and the operating expenses.

And then if you continue along the spectrum you get into sort of longer arrangements. So for example, the concessions that Kent was mentioning. These are 10- to 20-, 30-, 40-year arrangements where essentially the government hands over the operation, the maintenance, the long-term capital expenditures of these projects, which are pretty significant when we're

talking about toll roads, water facilities, where there's a lot of underground piping that requires a lot of maintenance and repair. And essentially the private sector participant takes over that whole process.

One variation of that, as Kent mentioned, is sort of—sometimes you're working on existing projects, what's called brownfield projects, where it's an existing facility that a private sector is going to come in and sort of operate, maintain, and do the major maintenance for. And sometimes it's greenfield facilities, which literally means what it means: It's a green field and you're going to start building something.

And then you see things like variations on concessions, things like build, own, operate, transfer projects, where essentially the private sector participant comes in, builds the facility, owns and operates it for a certain period of time—30, 40, 50 years, whatever it is—and then turns it back over to the government entity at the end of that term.

And then if you go finally to the full end of the spectrum, it's closer to what you would consider privatization. The government will essentially privatize fully the asset, meaning a public sector participant comes in and takes over. They'll do sort of quasi-privatizations, where essentially it's a 99-year lease which is like a privatization.

And sometimes you'll see situations where it's a joint ownership. And some of these projects can be fairly political. For example, to the extent that you are doing a water project, and there is a perception among the people, if you will, that the private sector participant wants to come in, raise rates, make a quick buck at the expense of the population, if you will; there are political considerations, and a government entity really has to tread lightly in the manner in which they package the project, in which they present it to the outside world.

And so in some arrangements like that you might have a situation where effectively the government might be quasi-privatizing, but they structure it more as a joint relationship between the government and the private sector participant for political or similar reasons of that nature.

So that gives you a sense of what it might look like.

MR. ROWEY: So what kind of deals have been done on this basis? I'll give you some examples so you can put it in further context.

We're involved now actually with Chantal's firm in the privatization of the Luis Muñoz Marín Airport in Puerto Rico. I don't know if any of you have flown to Puerto Rico recently. The airport is an okay airport, but it definitely is in need of some improvement and upgrades, and the Puerto Rican government is looking to repay the debt that it incurred in connection with the airport.

So they're essentially leasing the asset for a 40-year term to a joint venture, which is basically a private equity firm and an airport operator. And we expect to close that transaction on February 15th. It's just right on the verge of being financed with the capital markets issuance, and then a bank facility to finance it.

So you can see this being applied in the airport context. Especially interesting for the U.S., because in the U.S. all airports are essentially public. There was a pilot privatization program that was enacted about ten years ago that created five slots for privatization. That was expanded last year to ten slots. And Luis Muñoz Marín is going to be the first sizeable airport to be privatized under that statute.

And then if you're following the news in the sector you would have heard that Midway Airport in Chicago is the next to be privatized, and there is actually a request for quotation that's out at the moment for people to prequalify to get on the list for the privatization of Midway Airport.

Another example: We're involved in the Goethals Bridge project, where the Goethals Bridge is basically going to be rebuilt but under a Public Private Partnership concession agreement. So the Port Authority of New York and New Jersey is now talking to bidders, there's a list of four bidders, getting their feedback on a concession arrangement. They'll get a technical solution proposed by these bidders. They'll get a construction price and a capital cost price that will be proposed. And then the Port Authority will choose a winning bidder and enter into a concession agreement.

And that winning bidder then will be responsible to build the new Goethals Bridge and to operate and maintain the Goethals Bridge, to collect the tolls from the drivers on the bridge, and then turn those over to the Port Authority.

And then the concessionaire is compensated for doing that by a so-called availability payment, where it gets a monthly

unitary charge that is paid on the basis that the bridge is available to riders. So it doesn't take any traffic or demand risk—that's taken by the Port Authority—but the Port Authority pays back the concessionaire for the cost of constructing it and operating it and maintaining it, and provides a return to the investors who have invested equity from this availability payment.

One final example, which is very current and is also regional so I thought you might like it, is the Bayonne water and waste water system, which we just privatized at the end of last year. So that was a joint venture of KKR and United Water based in New Jersey. And basically what the City of Bayonne did was enter into a 40-year concession agreement in exchange for an upfront payment by this joint venture. So this is what Chantal was referring to as a "brownfield" concession.

So the City of Bayonne or the Bayonne Municipal Utility Authority handed the asset over for a period of 40 years pursuant to a contract. And in exchange for that this joint venture paid the City of Bayonne \$172,000,000. And so for this 40-year term what this joint venture will do is collect water bills from the citizens of Bayonne and will be responsible for maintaining the system and upgrading it. So for those of you in the audience who live in Bayonne, your water bills are going up. In fact, you might have received the notice already, which I think went out at the beginning of the year.

So those are three examples of deals that have actually been done utilizing this Public Private Partnership technique.

Ms. KORDULA: And just to touch on that, and then maybe we can let some other panelists talk. One of the things that Kent is talking about is there have been some significant successes with a number of these Public Private Partnerships, particularly when you look at some of these transactions that involve kind of a concession arrangement where a private sector participant comes in and pays \$172,000,000 to a government entity. Or there have been some splashy ones. Chicago Skyway was another big one; it was in the billions of dollars. The Indiana Toll Road; it was another multi-billion dollar payment right into the government coffers.

And obviously those upfront payments are attractive to a government entity that might be facing fiscal or budgetary issues. Instead of the government being required to maintain the toll road, maintain the asset, put money into that, that's

money that they are saving that they can deploy to other needs of the government and the like.

So there is this sense that Public Private Partnerships allows the government to not only bring in money from a budgetary perspective, but also defer outlays of cash the government would have otherwise been required to do.

But the one thing to note is there have also been some failures in this arena. One notable one was the Pennsylvania Turnpike. They tried—I think people saw the dollar numbers of Chicago and Indiana and the government of Pennsylvania said me too. And they tried to sort of do a Public Private Partnership with their toll roads and had gone very far down the road, where they had negotiated with bidders, selected a winning bidder. But it was a situation where you had to go back to the legislature to approve it, approve the selection and approve the process. And the legislature didn't approve it in a timely fashion, and the concessionaire dropped out.

And so you have to make sure that you have the right elements to have a successful environment for a PPP. And obviously these are transactions that tend to have high transaction costs. These are not short-term projects. These are not small-scale projects usually. It only makes sense most of the time to do these types of things on sort of long-term, larger-scale projects.

MR. ROWEY: Just maybe one final word for intro. These are contractual arrangements basically. I mean there are some PPPs that are done on the basis of a regulatory framework, but by and large it's done pursuant to contract. It is fantastic work for lawyers.

A PPP project, although it represents an interest in infrastructure, from our point of view is a stack of contracts about that high. We get to structure, we get to negotiate these contracts. It's immensely interesting work. It really is the intersection between transportation, public policy and private transactional practice.

So for the law students in the audience who were thinking about a career in corporate or banking practice, PPP is a great road to go down because they are very lawyer and documentation intensive.

PROFESSOR DAVIS: Just one question on that, Kent. To what extent do you get involved when things go wrong as well

as a lawyer? I mean, in your practice, in either the restructuring or the litigation?

MR. ROWEY: There's an involvement throughout. We like to call it sort of "cradle to grave," or "cradle to exit" is what you tell your private equity clients before you start.

But as Chantal said, there have been some high-profile projects that either have gone into a bankruptcy proceeding or in workouts right now.

A case in point is the Indiana Toll Road that Chantal referred to. It's not in workout yet, but that was bought by the current concessionaires for a purchase price that was over a billion above the cover bid for that transaction. It was highly levered. It has an accreting swap on it. And the debt comes due in a little over a year; and traffic is down by about 25% from projections.

So that's a transaction which will need to be restructured. And the restructuring of it is going to require a lot of legal work. The concessionaire could go into bankruptcy. It will at the very least require a renegotiation of the financing facilities. And so the law firms involved will have to get together with their clients and to negotiate an extension of financing facilities. Or in a worst-case scenario, it goes into bankruptcy and they'll hand the keys to the facility over to the 33 banks who provided the financing for the facility.

One bit of good news though on the restructurings is that these deals have failed before, but have been restructured successfully. And one of the beauties of the PPP structure, and maybe Nick will touch on this because the U.K. is a much more mature market than the U.S. in this respect, is that there is an orderly contractual framework for workouts.

So, for example, if there is a concessionaire default, it doesn't mean that the government just takes the asset away and is floundering around trying to figure out what to do with it. There are actually contractual provisions that provide for a retendering of the asset, a repayment to the original concessionaire for what it's invested. And there have been deals, many deals actually, where by using these contractual provisions the workout and the transfer from a defaulting concessionaire to a new concessionaire has been functional and has worked.

PROFESSOR DAVIS: Thank you very much. So now we're going to take a quick trip across the ocean. Nick Bliss is joining us from London. He is going to give us some perspectives on the U.K. market.

MR. NICHOLAS BLISS: Thanks very much, Kevin. Well I'd just like to say like Kent it's great to be here, back at university. In fact, although it's terrific to be introduced as a distinguished practitioner as we have been all day, which is great for the ego, my real claim to fame is that I rowed at university with Hugh Laurie, who is as I understand from him when I last met him the most highly paid television actor in the United States. So although it's great to be a distinguished lawyer and all the rest of it, I clearly made a mistake while I was at law school, and didn't enter the acting profession. Well arguable. So anyway here goes. Thank you Hugh.

So while Hugh was busy doing Jeeves and Wooster, and House and so on, I was doing work in relation with the Project Finance Initiative ("PFI"). The U.K. is an interesting case study. And I am always hesitant about stepping outside the U.K. and preaching to people that this is how to do it, this is how it should be done. The U.K. is an interesting case study in perhaps how to do it, and perhaps some of the consequences of what happens when the commercial and legal and business sector interfaces with the political sector, because PFI, from 20 years ago, 1992, until today, has had continual buffeting in the U.K. in a political sense. More of that anon.

But very briefly what is it, the Private Finance Initiative? It's the delivery of social infrastructure, by which I mean hospitals, prisons, serviced accommodation. And then going further into the more exotic: secure military satellite communications I've done for satellites for the U.K. Ministry of Defense, air-to-air refueling for the U.K. Royal Air Force, you know, tankers, fueling fast jets, procuring a fleet of tankers, the atomic weapons establishment, that simulation of atomic explosions.

And this is all done basically by the U.K. government letting a long term service contract, in the course of which a capital asset will be delivered, an output specification, a service specification will be delivered; i.e., I don't want a hospital with four walls and a roof, I want accommodation for 1,000 patients who will be subject to 5,000 procedures a day, with an outturn

of the following, and the hospital has got to be available 24/7, 365 days a year. That kind of thing. So you can do it in bars, you can do it in an envelope, you can do it whatever way you want, but these are the outputs that I want and these are the outputs that you will get paid for. And if I don't have those you will not get paid.

It's been a success, arguably. Over 700 projects have been delivered since the mid-1990s, with about a 55 billion sterling cap ex value, so that's \$85,000,000,000, to a year ago. And it really comprises, as Chantal and Kent have said, the delivery of private finance, the capital asset, and through life services. And you get paid for delivery of the services.

PFI projects are very susceptible to highly structured financing, because fundamentally it's a long-term service contract let by the Crown, U.K. terms, the government, the federal government, the still-AAA-rated entity. And therefore, as long as you have an entity which is going to deliver these services to this service output specification and has a track record of doing it, you can lever it up very high. And classically that delivers about a 90:10 debt equity ratio in a PFI project.

So we use our project finance technology. We have the long-term service contract. We let construction contract and then a service contract. We have bank contracts or bond contracts or whatever. There's very careful risk allocation, there's very careful due diligence. Every scenario is hopefully thought about. And the PFI vehicle, the special purpose company which has been established to deliver this hospital, the satellites, whatever it is, will be completely contractualized.

So to some extent, looking at it negatively, it will be trust and bound and be able to carry out a very focused service delivery. And the cheapest way of delivering that is with a maximum element of debt and a relatively minimum amount of equity, because debt is cheaper than equity.

And in our terms, PFI is a subsector of PPP, because PPP as Chantal mentioned can cover all manner of Public Private Partnerships. So it can simply be an outsourcing PPP. It can be the entry into a contract by the U.K. government with a strategic partner, which together with the government will work out how to do something. Or it can be these highly structured project financings which I am talking about. And in the

immortal terms of someone who said to me in sort of 10, 20 years ago, PFI is a slice of the PPP pizza, it's a subset of PPP.

So what's happened in the U.K. is that PFIs become something of a cause célèbre. This introduction to the latest policy on PFI, which is now called PF2, Private Finance 2 from December 2012, "[t]he Private Finance Initiative[], the form of PPP used most frequently in the United Kingdom, has become tarnished by its waste, inflexibility, and lack of transparency." So that's what the politicians thought of PFI. That was the foreword of the new white paper, the new policy document which was issued in December, *A New Approach to Public Private Partnerships*. So why have we got PF2? We've got it for political reasons basically. Something had to be done to detoxify PFI.

And what really had become toxic about PFI was the fact that people were making money out of it. The people were making too much money out of it.

Now, it's very important that the profit element is there to incentivize the private sector, because no one is going to do this on a pro bono basis, notwithstanding whatever any politician thinks. To cut a long story short, the political classes and the press thought that some people, principally in the equity element of these deals, had made too much money out of them. And therefore this detoxification process has taken place.

So '97 to 2010 there was little—certainly at the outset—there was little politicization of PFI. When Tony Blair came to power in the U.K. in May 2010—sorry, in May 1997—all of the political parties were aligned on PFI, it wasn't a political issue. It was accepted that the National Health Service required a hell of a lot of refurbishment, a lot of new hospitals, that a lot of government accommodation needed replacing and a lot of Ministry of Defense Army barracks need replacing, et cetera, et cetera.

Through the intervening 13 years as the market developed, those 700 projects were delivered, the market matured and it went through phases of delivery, construction delivery, de-risking as you move to your operational phase, so the original developers might sell out of that stage.

On an equity stake in a successful PFI project, that equity was worth a lot more at the end of the highest risk period when you were just entering into your 20-year, 25-year or 30-

year availability payment period, than it was at the beginning. So people made profit there.

The project was then susceptible to refinancing, so people extracted cash in that way. Debt was cheaper, interest rates had come down. The project had been de-risked. That high-risk construction phase had been completed successfully.

And so a vibrant secondary market grew up in PFI equity assets. And it was felt that there wasn't enough transparency as to how much money people were making, so there were a series of Parliamentary inquiries into basically why were people making so much money? Why didn't we the politicians know about it? Why is the taxpayer paying so much money for X, Y, and Z to make too much money? That sort of thing.

So political pressure, scrutiny by parliamentary committees, a new government comes in in 2010, and as everyone in this room knows new governments like to distinguish themselves from the previous government. If something becomes unpopular you blame the previous lot, don't you? And it was under the previous lot that PFI delivery had been at its peak and its most successful.

So you blame the previous lot. A call for evidence was started in December 2011. And then this evidence was received. People were invited to respond to about 60 different questions through a 20-, 25-page questionnaire.

And when you think about it, it was a bit of a minority pursuit, because out of a population of about 60 million, 139 responses were received. Having said that, the responses were received by the market players, by the principal market players: advisors, investors, contractor services providers, academics, public sector, even three MPs. Usually they're the MPs that were out to make a name for themselves by bashing PFI delivery. And then 16 individuals.

All of this evidence, including the evidence which I submitted, Freshfields submitted a paper, as also did Allen & Overy—it was interesting to see which law firms did and didn't actually, about ten did—is publically available. It was published when the policy document was published. And for those real sort of techies amongst you, you can go on to the website address I've given you there and read all of this stuff, as well as the new policy document, as well as the new guidance.

And some of it is quite interesting, because some of it is a genuine commentary from the person submitting the evidence's perspective on the lessons that have been learned: what has been good, what has been bad, why is there a lack of transparency, why are these things so contractualized, et cetera, et cetera.

So what is it? It was issued, it was born in December 2012. Well, effectively, it is PFI with tweaks. PFI certainly does work in terms of asset delivery and service delivery. Peoples' feet are held to the fire. Poachers are turning to gamekeepers.

Pre-PFI, whenever a new road, a civil engineered road was delivered in the U.K. there was some statistics in the early nineties there would generally be cost overruns in the region of 30% to 50% of the original contracted for cost of the capital asset. And then it probably wouldn't be maintained during the course of its life, because obviously the public sector are always subject to different calls on their expenditure, and will be inclined to put off through-life maintenance.

You don't get that with PFI or PF2, because this thing, the incumbent owner is responsible for the through-life delivery of the services that have been provided for. So the incumbent owner, whatever constraints the public person might be subject to, doesn't care. It wants to re-tarmac the road. It wants to look after its hospital. Because if it doesn't, the thing breaks down and then it either stops getting paid or it has to pay a lot more on maintaining the thing. So people are incentivized to deliver and to maintain.

But looking at what PF2 has done, it's hit those parts of the old PFI model that the politicians and the call for evidence said needed sorting out. So equity. There was a complaint about lack of transparency. There was a complaint about the private sector making too much money on their equity return. So now it's been laid down that the public sector will take up to 49% of equity in every SPV, special purpose company, which owns a PF2 asset.

And also, at the preferred bidder stage—you submit your bid, you're selected as a bidder, and then you negotiate for a period of time to sort out the final details of the PF2 arrangement—at that stage there will be a competition for equity. So you as a preferred bidder will have won the deal, and then you

will have to compete the equity to get the most, you know, the cheapest equity.

That's not great if you're an equity player in the PF2 scene. What's going to happen? Well let's see. But equity and the people that it made a lot of money, the equity investors, the funds was public enemy number one as far as the politicians were concerned.

Delivery is a matter of 18 months delivery phase from preferred bidder to award of the contract. Service provisions, soft services have been taken out. That's sort of the grass-cutting, the laundry, the cleaning, because it was felt that it was pointless letting a long-term service contract when you could re-let one and retest it every one year, three years, five years. So that's been held back by the public sector.

Periodic reviews of efficiency; public sector to retain some minor maintenance; the light bulb effect, cause célèbre of light bulbs, you know: Public sector saying please change my light bulb, PFI companies saying that'll cost 50 Pounds, 100 Pounds, 150 Pounds or whatever, possibly because they want total coverage, someone there on hand all the time to change the light bulb. And a share in the life cycle funding—that's the through life major maintenance account that's provisioned all of the time as you look forward to see where that's spent, is going to be spent on. And there are savings to be made there. Transparency; more reporting of equity return information, how much are those equity investors really making? And then the U.K.'s own off-balance-sheet contingent liabilities represented in terms of compensation on termination, contingent liabilities through the PF2 contracts. More efficient risk balance. So it was felt it wasn't value for money to try and transfer unforeseen change in law risk to the private sector—utility supply risk and these other risks. A bit sort of more sophisticated tweaking of the risk balance between the public and private sector.

And then, critically, one of the most important changes possibly post crisis: the debt equity ratio is going to be brought down from 90:10 to something in the region of 70:30, 75:25. A linkage to the previous panel, because now government is focused on reopening the capital markets to these projects, and it's felt that to reopen the capital markets to these projects you need to target at least a single A rating for a project.

Conclusion: Evolution not revolution, focused on equity and procuring authorities, attempts to deal with the main criticism of PFI and re-launch a new policy project, i.e., we the new guys are getting rid of what these old guys have done before us. Bankable certainly, but it's going to be more expensive as we said, a more conservative debt equity ratio. And very specifically, a product of the U.K. market and subject to some particular U.K. political processes.

But for the U.S. possibly lessons to learn: You're dealing with politics. This is the delivery of public services. And it's useful to look at what's happened in a little incubator which has been doing this for 20 years to see what the issues have been there: The contractualization, the highly structured nature of it.

And so what is it? Well, it's a political solution influenced by the market. You've got your 75/25, trying to access new sources of debt for it, but you've also got these guys gunning for the equity investor who it was felt made too much money out of the old PFI.

PROFESSOR DAVIS: Thank you very much, Nick. So now we're going to switch to Brazil, and Ana Karina Esteves de Souza is going to speak about the Brazilian experience and lessons to be learned from that. Thank you.

MS. ANA KARINA ESTEVES DE SOUZA: Good afternoon ladies and gentlemen. It's my pleasure to be here. First of all I would like to thank you for the kind invitation of the *Journal of Law & Business* of NYU to be here. As a former NYU student I am also delighted to be able to share with you a little bit about Brazilian regulation on PPPs and what we have so far in the Brazilian market, when we talk about these highly necessary PPP projects, at least from the Brazilian standpoint.

I will start by saying that Brazilian regulation on PPPs has evolved throughout the years, starting first through regulation where private involvement in those contracts was not really remarkable.

So we started the first regulation in Brazil back in the 1980s with governmental contracts where you had public bids launched by the government where the private party was contracted for a specific provision of service or delivery of goods, what we call like the Brazilian bid law.

That structure was successful for a while, but more and more what we saw is that there was a need for additional involvement of the private party with the government, especially when we talk about funding restrictions of the Brazilian government.

So back in the end of the 1990s, we have the first concessions law in Brazil. So the Brazilian economy is suddenly opened to private investors as a first place, because by then we had just public companies performing energy or public services in general. So when we had the concessions law in Brazil back in 1997 that was a big change in Brazil, because for the first time we could see private companies exploring activities that were then only performed by public companies.

And coming back a little bit earlier now, back in the 1990s, we had finally what we call like the PPP law. And that was—and of course that is the scope of my presentation today.

And when we refer to PPP law, what we refer to are those projects where we have a closer involvement between the private and the public sectors in specific projects that are targeted at strategic, delivery of projects for services to the economy of Brazil in general.

And when we think about the background that resulted in the enactment of the PPP law, what we see is that there was and still is a big infrastructure deficit in Brazil. We need projects, we need infrastructure to be built. And the PPP law came as a solution to be able to have those projects being built and developed in Brazil.

What we also see behind enactment of the PPP law in Brazil is a scarcity of public funds. So we have the private sector being able or serving as investment to or funding to through those projects in Brazil.

What we also see as a background of the PPPs law is a lack of incentives then for the private investors to actually develop those projects, because in Brazil, because of the regulations and because of the environment, the private investors were not willing to bear the risk of developing highly complex infrastructure projects. So when the government offers a long-term agreement to a certain risk-sharing arrangement, all of a sudden we can have those PPP arrangements in place in a more effective way. So here when we refer to the PPP laws we can

see a clear structure allowing a risk sharing between the public and the private sectors.

And one final comment to that, it's important to have in mind that even though Brazil is a federation strongly influenced by the federal government, when we talk about PPPs what we see is that the states and the municipalities have a stronger presence as opposed to the federal government. So when we think about PPPs in Brazil, most of the PPPs are at the state level. We have one PPP at the federal level and some PPPs at the municipal level. So, interesting: When the PPP law was enacted the states, the member states were the ones that were interested in putting that regulation in place and having those PPP projects being developed.

So this is just for your reference. The PPP law provides basically for two types of PPP projects.

The first one is what we call a sponsored concession. When we have a concession being exploited by the private party, through an additional consideration that the state provides to the investor. So in that case we have the private investor actually operating and developing the project. And in addition to the tariffs that the private party gets from the users of this service, we have an additional consideration that is paid by the government directly to the concessionaire.

The second type of PPP in Brazil is what we call an administrative concession. And in that case we have the private party providing services directly to the government, not to final users but directly to the government, also receiving a consideration.

This is just a brief overview of the sectors that have PPP projects in Brazil. So you can see a lot of participation in the logistics transport sector, sanitation, corporate mobility, urbanization and public assets, as well as social infrastructure. So as you can see, when you think about PPPs, we have a presence in almost all of the segments of the economy.

As I mentioned, this is just a flip chart about how many projects, how many PPP projects, have been implemented in Brazil. And as you can see, if you think about projects that have been already developed and are operating now, we have more or less 20 projects ongoing, successfully ongoing, most of them at the state level, as I mentioned.

Most of the projects are related to social infrastructure. And when I refer to social infrastructure that includes hospitals, as well as stadiums and sports centers. So when we talk about stadiums we think about the World Cup. So because of the stadium infrastructure required under the World Cup Games that will be held next in Brazil, we could see a lot of PPPs in the sports segment.

Just a small reference to energy. When we think about energy in Brazil, we don't have that many PPP projects in energy. When we think about consideration from the government, what we usually have for energy is concession regime projects where the private party is awarded a long-term concession agreement, and the consideration is directly paid by the users of the service. So, interesting: For energy projects we don't have that many PPP projects except a certain few smaller energy projects that are starting to be implemented in Brazil, where you can see an additional level of structuring in addition to the consideration from the users who can get consideration from the government.

For instance, the operation of co-generation power from waste in Brazil, so those type of projects are brand new, they are starting to be developed in Brazil where you have the municipality providing to the private party a certain amount of waste/fuel to be run into thermal power plants that are implemented into these wasteland fuel projects.

When you think about project finance and PPPs, I'd just like to make a reference that the PPP law in Brazil has been structured in order to provide that those projects be financed under a project finance scheme.

So for instance, the PPP laws have certain provisions which from a legal standpoint in Brazil could be seen as pretty innovative when we talk about public agreements. Such as for instance, step-in rights. So step-in rights that are provided in the PPP laws have been able to make possible that those PPPs be implemented in Brazil. And that's an innovative provision in the Brazilian system.

Other terms of the PPP agreements as per the law which are also targeted of project finance include the concession necessarily being arranged to a specific purpose company so those companies cannot develop it or create any other type of activities or projects, fixed terms, penalties applicable to the

government in case of default, performance evaluation and guarantees provided by the government to the private party.

Also when I think about project finance, I would like to remind you that today most of the project finance is done through BNDES, which is the national development bank in Brazil. So just for you to have a reference, in 2012 BNDES disbursed roughly R\$121 billion Brazilian reals. I would say that to be like \$70,000,000. So it is the major player by far of PPP projects in Brazil, which is a challenge also to private banks and private institutions in Brazil because today the market still has not been able to evolve in a way not to depend that much on the public funding that is offered by BNDES. What we expect to see is that more and more innovative structures be implemented in order to provide the private investors with funding alternatives not necessarily related to BNDES. For instance, what we discussed today in the morning about infrastructure bonds, that's just a brand new mechanism that was included in the present regulation and may be one of the alternative methods for funding of the PPP projects other than the BNDES.

So just to conclude here: Challenges for PPPs and project finance in Brazil. I would say that the consolidation of a guarantee mechanism from the government to those private investors under the PPP projects is still a challenge. In Brazil we have a very bureaucratic procedure, so the offering of guarantees from the public authority to those private parties is always a challenge to be implemented. We expect that the guarantee mechanism available today in the market will get more and more developed and evolved in order to allow more efficient allocation of risk.

I would say a second challenge we have in Brazil is that unfortunately we lack specialized bodies at the government level in order to be able to structure those PPP projects. So recently what we see is that the governments, before launching a PPP bid they launch what we call a "PMI," which is a bid for private parties to be able to offer models, PPP models to the government for a certain project.

So let's say that the government wants to establish a hospital PPP, the government first says okay, whoever wants to prepare studies and offer a model for this project, please participate in the bid. And in case I choose that model you'll be

remunerated for the model that you offered. And once the model is chosen of course we have the second phase, and that is the PPP bid itself. Finally, reducing bureaucracy, that's always unfortunately an issue when you think about Brazil.

So what is expected of the future of PPPs in Brazil? Expect consolidation of course in infrastructure sectors. As I mentioned there is a big deficit in infrastructure, so we think that PPPs are the future when it relates to implementation of infrastructure projects in Brazil because it adequately is a tool for sharing of risk between the private and the public government, it may be an additional source of funding from the government, so we still think that PPPs are the future for that infrastructure that is needed.

Diversification, of course. We expect that other areas will be covered or be included as examples of PPP projects. And improvement of institutional mechanisms. It's important to mention that the PPP laws expressly provide for the parties to be able to elect arbitration as a dispute resolution mechanism, which is also an innovation under the present regulation. We previously did not have any such provision for government with the public authorities. We expect that arbitration as a dispute resolution mechanism will be more and more adopted in those agreements.

Finally, just for your reference, some selected cases for PPPs in Brazil. I would start by referring to a municipal PPP for the revitalization of the port in the city of Rio de Janeiro. That was a recent PPP where the government did the implementation and revitalization of an area in downtown Rio de Janeiro. Basically the private party will receive consideration from the government under a 15-year term arrangement in relation to all the services and the works that will be done.

And the interesting thing here is that further to the PPP agreement itself, for the revitalization of the area, there was a funding structure that was implemented in order to allow the government to raise funds to pay the concessionaire under the port concession. In other words, there was an issuance of bonds from the municipal company which would be allocated to the payment of the consideration of the concessionaire. So this was a very innovative structure in Brazil for PPPs.

Another example: I would say when you think about the World Cup, I would refer to the Fonte Nova PPP project that

consisted of implementation and operation of a soccer stadium in Brazil. In that case we had a 35-year term PPP concession agreement. The private party will be remunerated through annual compensation to be paid by the government in addition to the tariffs usually collected from the users of the stadium. Here we had also a financing of the project that was related to that.

And finally, I just refer to the subway PPP project in the state of São Paulo.

So thank you very much for your attention.

PROFESSOR DAVIS: Thank you very much, Ana Karina. Thank you. So our final speaker is Carlos Umaña, who is going to be speaking about the experience in Colombia. And as we heard this morning, this is a booming market for PPPs and project finance in general. So, Carlos.

MR. CARLOS UMAÑA: Good afternoon. Thank you for the invitation to the organizers, to the members of the *NYU Journal of Law & Business*. I am very excited about being here. I studied here back in 1985. Perhaps Ken keeps the same memories as I do. Ben's Pizza is still around.

MR. ROWEY: Absolutely.

MR. UMAÑA: And Mike is still the doorman at 240 Mercer Street. I was told by Kevin that Professor Chase is still around, so perhaps we can go upstairs and greet him.

Putting that aside, the Ambassador said many things about Colombia. One of these was the law on PPPs. This law was enacted last year. The implementing legislation was enacted six months after. And last Thursday the last decree was put in place. So when we talk about expedience about PPPs in Colombia, I have to confess that the expedience with this law has been none.

But yet we now have implemented legislation. There have been already some requests filed with the National Agency on Infrastructure. There are a number of them. There is another one that was filed for the light subway of Bogotá that was filed with the city of Bogotá and that is now going from the pre-feasibility stage to the feasibility stage.

So at least things are moving on. And Ken said already the same, and Chantal, about what PPPs are all about. So I will skip this part, because I have to say that under Colombian law it is the same, we are simply following international standards.

This is the number of the law, Law 1508; and this is the implemented legislation. And Decree 100 was enacted last week.

And this is the very purpose of the law. The very last paragraph is the very purpose. And you can see that follows international standards.

What is the description of what the law says? Normally there is an agreement between the state, the Colombian government. We are not a federal government—we don't have a federal system, but a unitarian system—but nevertheless, this type of agreement may be executed between private sector entities and the national government, to the departmental government, or the municipalities.

The purpose is a sign of construction of infrastructure. When we refer to construction, we refer to construction improvement, reinforcement, refurbishment, or the provision of equipment to a given infrastructure work.

In addition to that we're supposed to, as Chantal was saying, have an O & M Agreement in place, and the government grants the commercial exploitation of a given asset. And the concessionaire is paid provided that the work is available, that some service levels are reached, together with some quality standards, and that obviously provided that the concessionaire keeps rendering the service and continues leases.

These PPP projects apply to those projects which exceed 3.4 billion Colombian pesos, which amounts more or less to one divided by one half, which is \$1.7 million.

Risk allocation follows a general international principle, according to which the risk has to be borne by the party that is in the best condition to manage the risk. The term is 30 years. But exceptionally it may be for a longer period of time, provided that the planning department gives it a special permit.

In the case of the conditions of payment, as I said, the infrastructure has to be available, has to meet quality standards, service levels. And obviously a right of payment comes normally from fares that result from the commercial exploitation, from the equity of the concessionaires, and from the money of lenders. That money, according to this law, has to be put in a single trust that serves as a security for creditors.

My partner Carlos Fradique-Méndez and to some extent the Ambassador made reference to the fact that this law pro-

vides for the notion of functional units. So imagine that there is a PPP on a road that has 100 kilometers; the project can be divided into, say, seven different functional units, provided that each unit would stand as a road alone, on an independent and separate basis.

Why so? The idea behind that is that, as we will see later, those functional units are remunerated independently as well. So the risk of the project is divided up into sections, and exposure of the project is not taken as a whole.

In connection with the conditions for payment, the law provides that the payments have to be updated. And also there is something that is very special: The PPP also has to provide for gradual deductions whenever the concessionaire doesn't meet the timeline for the project or service levels or *et cetera*.

The PPP does not—this régime does not—apply to sectors and entities with special régimes. One of them is electricity. What is the régime for this sector? For partly government-owned own entities, where the government has more than 50% of its capital or its affiliates, associations between public entities, public utilities. Why? Because in Colombia we have a law on public utilities that was enacted back in 1994 very successfully. Also we have a special law on electricity, so it is excluded. Also, it does not apply to industrial and commercial companies of the state.

So let me rush a little bit on the types of PPPs that we have. We have PPPs of public initiative. The government has the ability to basically invite the private sector to make offers. There is a prequalification system that goes from two to ten participants. Sometimes this is not a good idea, because you have more than ten interested people, but that is the way the law addressed this issue. The law procurement applies whenever, unless this law says otherwise.

And then there is a list of requirements to open these types of initiatives. It requires studies and assessments on the costs and benefits, cost-benefit assessment of the project, justification of the project, and also a detailed study on risk allocation.

And then the PPPs may have a private initiative. In that case the private sector may request the government to put money in. Or in other circumstances, the situation may be

that simply you want the government to give you concession but without asking the government to put money in.

This is just to let you know that normally public initiatives are related to traditional projects, normally to roads. Private initiatives to real estate, official developments, and the private initiatives without public money refer to local projects.

How does it go whenever there is a private initiative? You have to file a pre-feasibility study that has obviously some degree of confidentiality. Then the government has three months to study the application. And if it says yes, I like the project, the government has up to two years—too long—to say no. No, it has three months to say I like it, then file a feasibility study. And then once you file the feasibility study, the government has up to two years to execute a concession agreement.

If the applicant is asking for money, it cannot ask for more than 20% of the total price of the project. In that event, if the whole application goes into the feasibility study and the feasibility study is approved, then there is a public tender in which case the initial applicant has an incentive that goes from 3% to 10%. And if the applicant loses, then the studies will be paid to it pursuant to an agreed price.

If the private applicant is not asking for money, once the feasibility study is approved there is a publication in the public procurement website of the Colombian government, from two to six months. And if there are no offers from third parties, simply the agreement is signed.

If there are offers from third parties, there is a very short-term public bid process, and then the agreement is awarded.

Then, this is something that the Ambassador said. Kevin, I will rush. In PPPs all of the money of the project goes into a simple trust, so it serves as a security for the project. The PPP law provides for termination payments that will serve as a security for the banks and also provides for the step-in rights, which is in my opinion something that is absolutely critical for banks or for institutional investors.

Now this is simply to tell you why we have a law on PPPs. There were already some other sectors that had special régimes. One is mining. Mining companies, under their mining titles and mining concessions, may construct infrastructure, which infrastructure would revert back to the Colombian gov-

ernment once the mining concession expires. So this is simply for you to keep in mind.

Same happens in the utility sector, for solid waste management, water utilities, like aqueduct and water disposal.

And this, the very last one, is concerned with electricity. In Colombia the system has a reliability charge that is paid by the whole system and that goes into a single basket for those who raise their hand to install backup capacity for the sector. So really, the underlying security is this reliability charge that is distributed among those who make or construct newly made power plants.

So that's about it. I know that I have covered a lot in a few minutes, but I hope that it was clear. Thank you very much.

PROFESSOR DAVIS: Thank you. We've actually all covered a lot of ground over the past little while. Four different régimes is a lot to pack into a single panel.

We started a bit late, but we do have a few minutes for questions. So I believe there are mics floating around. And there is a standing mic there. So if anyone has questions the floor is open.

AUDIENCE MEMBER: I just had a real quick question on the structure of the SPV, meaning who puts them together, who is on the board of directors, who is the management, those type of things. And the second part of the question is, idea generation: Does it always come from the government or do you have bankers or PE guys out there pitching ideas to governments for new PPP projects?

PROFESSOR DAVIS: Who would like to start?

MR. BLISS: I'll say something. Well from a U.K. perspective, the jurisdiction I work in, the SPV will be put together by the sponsors, and the sponsors will normally comprise the private sector promoters of the project, i.e., a prime equity fund of some type or other, probably a contractor, probably a service provider. That's the general rule.

Directors will be a nominee from each of them, maybe an independent chair, sort of a non-executive chairman. But private companies are usually private companies, so there'll be no sort of stock exchange reporting requirements.

And then PF2 has seen the requirement for first of all an observer to be present from the procuring authority. So if it's a hospital they would expect someone from the hospital board

or whatever to be an observer or possibly even a director at director board meetings. But that's a recent innovation.

As to unsolicited bids, yes, these guys can talk more about it than I can, I expect. But certainly in South Africa where I've done PPP deals there is a right for the private sector to approach the public sector and put forward its best shot, and then the public sector—or its best offer—then the public sector will normally say, okay, we've got a feasible deal here, we're going to market test it and then we'll put the concept out to the market, and effectively then the person that originated the idea has a right to match any better terms. So that's the kind of approach I've seen from unsolicited bids.

MS. KORDULA: Just to add something I think on the consortium point, I think when you're looking at it from a financing perspective it's always great when you have these PPP projects where the consortiums are actually made up of the different players, if you will, that are going to have to be involved in the project.

So, for example, if you have a consortium that's sort of the sponsors, the shareholders of the special purpose vehicle, and it includes your construction contractor, it includes perhaps your operator, it includes your financing sources, then as a lender you know that you're minimizing certain risks associated with the project—for example, construction risk or operational risk—because since those people have skin in the game if you will, they are likely to look at it not just from the perspective of receiving their tariff or their payment under their construction contract, but they are also looking at it as equity holders in the special purpose vehicle. And that incentivizes them if you will to do a better job on these projects and minimizes some of the large categories of risks, construction risk being a big one that's often associated with these projects.

MS. ESTEVES DE SOUZA: I think that I'd also like to mention from a Brazilian perspective that Brazilian government has been incentivating the private parties including financial institutions to be part of the financial modeling and the contractual modeling of PPP projects through specific pre-bid processes that are called PMIs in Brazil. So basically the government opens to any private party who wants to participate in offering types of concessions or PPP modeling for the government, for the government to choose which one to use basi-

cally. But that's a process that has been in progress so far, and successfully.

MR. UMAÑA: In connection with the SPV there is something that is very important to highlight in the case of Colombia. The SPV does not solve the joint liability issue. You have the sponsors, let's say an engineering company and a private investment fund. They made the proposal to the government. The government says yes. You follow the whole proceeding, and then you end up signing a concession agreement with the SPV, but with a joint liability of the sponsors.

And that has raised many worries, because the sponsors at least would expect not to be liable once the work is completed and not doing the operation of the project. Or even before, obviously they would expect not to be liable once they sign the concession agreement. But some would expect at least that once the work is completed not to be liable anymore.

PROFESSOR DAVIS: So we're actually at our allotted time, but I'll stretch things slightly. But if I could ask all of the three people who are standing to ask their questions serially, and then we'll have the panel respond to them as a group.

AUDIENCE MEMBER: Sure. There was some discussion of the political nature of these deals, either in terms of scrutiny of the whole régime in the case of the U.K. or where projects go wrong down the track. I'm wondering more, in your experience, how does the political nature of the public nature of the goods and services being provided factor into the project-by-project negotiation at the front end, and how does it also shape the kinds of advice that you give to your client on the lawyering end?

AUDIENCE MEMBER: Hi. My question is about aligning incentives, which Ms. Kordula mentioned a few moments ago. And I am curious about for PPP projects, especially if a local government wants foreign private companies to come in and collaborate in these projects, what's the best way for the government and the private party to align their incentives, not just in the near term, but in the future? Is it better done through contract, explicit contractual agreements, or is it better done though maybe an international investment treaty, or national legislation that really protects foreign private companies coming in? Thank you.

AUDIENCE MEMBER: Good afternoon. My question is to Mr. Bliss, who referred to the change of the debt equity ratio in the Private Finance Initiative from 90:10 to 70:30: What is the impact in the price that the special purpose vehicle collects to the government or to the users of infrastructure? Thank you.

PROFESSOR DAVIS: Shall we just move down and answer whichever questions you'd like?

MR. ROWEY: I'll speak just briefly to the first question about the politics of PPP and especially in the U.S.

As Nick has described in the U.K., it's a very politicized procurement delivery method, and politics really informs it really at every stage. And what we have found is that there is much more scrutiny put on the PPP method for core infrastructure. So if it's a road or a bridge we find that the government is usually all over it, and it often can become extremely controversial.

By contrast, governments tend to be less worried about so-called non-core infrastructure. And especially at the municipal level, the way governments look at it is that look, we're in the business of providing schooling and policing, should we really be running parking garages? And the answer to that in the case of certain cities, Chicago for example, New York City even flirted with it for a while, is why don't we sell our parking, and use the proceeds of that then to provide the services that we really should be providing.

We were involved in a transaction in Chicago, for example, where they privatized their metered parking system. We've had some fairly tense conversations with Rahm Emanuel recently about that transaction. But by and large it's been seen as a model for other cities that are cash-strapped, they're almost at the point of sort of capitulation. They can't raise taxes, you can't cut services, so what do you do? You sell stuff.

And you sell stuff which is considered non-core, use the proceeds of that to find things that are core. So that's where we're seeing, especially here in the US where it's political more on the core side rather than for some of the non-core assets.

MS. KORDULA: Just to add to that, but in terms of the question in terms of structure, I think there are interesting ways, and I think to go to Kent's point earlier, that's where it's fun

for the lawyers, because you do—these political issues come up and then it is your job to sort of help the government entity structure around them.

For example, we were involved in a privatization of a water company in a Latin American jurisdiction, and water is sort of seen as a basic human staple. Access to water, clean water, is something that governments are very focused on. There had been an example in Bolivia of people basically protesting against the private investor that had come in and raised the tariffs, and so the government was very focused on this.

And so even though they really wanted to privatize the system and sell more than 50% if you will of the system to a private investor, they structured it as a strategic minority investment, whereby the private investor bought less than 50%, but then the government entity in a shareholders agreement agreed to vote in the same way as the private investor on a series of key decision-making that effectively gave the private investor control if you will, so that they still had control of the system, they could make the decisions and the like, but sort of vis-à-vis the public it didn't look like the government entity was selling off its assets to a private investor.

And so that structuring is kind of the interesting fun stuff that you as lawyers get to do.

PROFESSOR DAVIS: Okay, I think we are at the end of our time. I'd like to thank all of our panelists for a very informative session, and thanks to all of you for your attention.