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Enhancing Public Private Partnerships in GCC

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Current market conditions for infrastructure finance present numerous challenges. Government revenues are shrinking and private infrastructure investors are both scarce and risk averse, thereby creating an acute need for alternative sources of capital. Privatisations have become increasingly unpopular and difficult to execute, largely eliminating another source of government liquidity.

Despite declarations by some economists that emerging economies are no longer interdependent with developed ones, the countries of the Gulf Cooperation Council saw a drop of US$44.6 billion in project lending in the first quarter of 2009 as compared to the same period in 2008 [1]. Declining oil prices put additional pressure on GCC government budgets, while lenders tightened credit standards, increased spreads and shortened loan tenors. In this harsh environment, well-structured Public Private Partnerships are viable alternatives for implementing major infrastructure projects, and comprehensive legislation to support programmatic deployment of P3s is receiving increased attention.

a. P3s in the GCC

Over the past decade, members of the GCC [2] have been at the forefront of global infrastructure spending as measured by volume of expenditures. A young and rapidly urbanising population combined with historical under-investment in infrastructure has created significant pressure on GCC governments to address pent up infrastructure demand. Governments in the region have responded decisively, undertaking projects valued at over US$2 trillion dollars through January 2010 [3]. However, significant additional infrastructure needs remain unmet.

The P3 model is directly responsive to these needs. When effectively managed, private sector involvement increases the likelihood that infrastructure projects will be completed on time and on budget and introduces efficiencies and innovations in complex projects. Skilful use of the P3 model can improve the quality and availability of public services and, where desirable, take expensive projects off the government's balance sheet. However, the opportunity to use a P3 model for a large volume of projects begs the question of how best to implement P3s quickly, effectively and in furtherance of applicable government policies.

b. Legislative vs. Ad Hoc Approach to P3s

P3s can be implemented using programmatic enabling legislation or ad hoc transactional documents. Programmatic enabling legislation facilitates uniform implementation of government polices, while ad hoc documentation only supplies terms for the specific deal at hand. Although such legislation is not a substitute for transactional documentation, it does provide a baseline of uniform guidelines that support and implement government policies and reduce the time and resources required to negotiate and document each transaction.

By contrast, the absence of effective legislation may result in projects that fail to adhere to governmental objectives or, worse, end in disputes that diminish governmental credibility and exacerbate public scepticism about the transparency of P3s. In the current environment, where competition for capital extends beyond individual projects to entire markets, countries and regions, programmatic legislation is an important tool for managing costs, mitigating risks and securing competitive advantage.

This article focuses on recent P3 developments in GCC countries and the prospects for using legislation to increase the efficiency and effectiveness of P3 transactions. Part II of this article summarises the development of ad hoc P3s in various GCC countries. Part III of this article offers recommendations regarding key elements of a statutory approach to P3s, with an eye to addressing some of the shortcomings present in an ad hoc approach.

II. Ad Hoc P3s in the GCC

In the absence of enabling legislation, key elements of a P3 are memorialised in contracts among the parties. This ad hoc approach forces the parties to cover more ground in each contract, effectively 'starting from scratch' with every new P3 project. Ad hoc P3s also run a greater risk of interpretational ambiguities that may have to be resolved by regulators, arbitrators or courts. As a result, ad hoc projects may be less attractive to private partners than those implemented pursuant to a clearly articulated statutory framework.

A brief survey of P3s in the GCC reveals a region where benefits of P3s are recognised, but most projects are implemented on an ad hoc basis. While governments of the region have recognised the need to promote private sector participation in public services and infrastructure, there remains a considerable gap between rhetoric and results, particularly with regard to formalising a legal framework for P3s.

Of the six GCC nations, Oman, Bahrain and Kuwait have made the greatest strides toward formalising a programmatic legal approach to P3s. Both Oman and Bahrain have implemented P3-frameworks as part of privatisation programs aimed at encouraging private participation in government owned assets. In 2004, Oman promulgated a statute which authorised a broad range of P3 structures and created a high-level Ministerial Committee to oversee a national "privatisation" program that includes the use of P3s[4].

Bahrain enacted a similar law in 2002, contemplating "privatisations" in the tourism, communications, transportation, power and water, oil and gas, and municipal services sectors, as well as "any other service and production sectors."[5] In 2004, the Bahraini government set out to develop an administrative and legal framework for P3s and has continued to pursue programmatic use of the model [6].

Kuwait has embraced a similar approach. After an extended period of deliberation, the Financial and Economic Affairs Committee of the National Assembly of Kuwait approved a "privatisation draft law," establishing a framework for private sector investment in power, education and telecommunications projects [7]. This step was preceded by the passage of a Build Operate Transfer Law in 2008 and, more recently, the creation of an entity called the Partnerships Technical Bureau to implement its P3 program [8].

In the remainder of GCC countries, Qatar, the UAE and Saudi Arabia, the legislative framework for P3s is less developed. For example, Qatar only recently began to privatise its water and power sectors under a P3 format and, despite much discussion about the privatisation of port and municipal services, progress toward a formal P3-enabling framework remains in its early stages.

In the UAE, the governments of Abu Dhabi and Dubai have made sizable investments in power and desalination plants, airports, roads, schools, water facilities and hospitals, displaying a strong commitment to infrastructure development and creating a number of interesting prospects for private sector participation. Abu Dhabi also has implemented ad hoc P3s in the power, water and education sectors (including the Abu Dhabi campus of Zayed University and the Paris-Sorbonne P3 project on Reem Island). However, despite recent calls for further private sector participation, there does not appear to be any P3 legislation on the horizon for the UAE [9].

A similar situation prevails in Saudi Arabia where there is no formal P3 law and regulation of P3s is typically addressed in deal documentation. While there is no specialised P3 ministry in Saudi Arabia, the government has established a Supreme Economic Council (SEC) to supervise privatisation and monitor implementation of P3s and other structures involving private sector investments [10]. The SEC has approved a nationwide strategy, authorising privatisation of the telecommunications, power, water, industrial parks, postal services, education, and air and rail transportation sectors [11]. Under this mandate, P3s have been implemented in air transportation and desalination.

Still, potential for more projects remains untapped and would likely benefit from programmatic P3 legislation. In summation, the countries of the GCC fall into one of two categories: those that have taken tentative steps toward well-developed P3 programs and those that have taken few if any such steps. Given the potential for increased use of the P3 model, the stage is set for a more comprehensive approach to P3s in the region.

III. Creating an Enabling Legal Framework for P3s

Statutory frameworks for P3s can encompass a wide variety of transactions, assets and public service sectors. For purposes of this article, the discussion below assumes projects with (1) expected useful lives in excess of 40 years, (2) capital costs in excess of US$100 million, and (3) at least partial ownership of the project by the relevant private parties. The assets of the P3s may revert to the sovereign government at the end of an established period, or may be transferred and conveyed to the private party. Thus, P3s may be viewed either as traditional "concession" contracts or as privatisation vehicles.

Effective statutory frameworks identify and implement key governmental objectives (typically focusing on the desire to attract private capital), while allowing flexibility to accommodate varied investor requirements regarding project structures, risk profiles and return of capital. Equally important, effective frameworks establish basic legal and structural paradigms that can be reused (not reinvented) in each successive P3 project. These considerations are especially important with regard to three key elements of the framework: delegation of public duties to private parties, procurement rules and procedures, and dispute resolution.

a. Key Elements of Legislation Authorising P3s

Effective P3 programs hinge on the ability of governmental entities to delegate some of their functions to one or more private parties. Thus, P3 legislation should unambiguously identify the governmental entities authorised to enter into P3s, the types of functions or services that may be delegated to private parties and the types of assets or facilities that may be developed, constructed, owned and operated under a P3 structure. These determinations require careful balancing of government policy objectives, the public interest and the need to incentivise private sector participation.

Legislation authorising government entities to enter into P3s also may specify categories of permissible transactions. For example, some jurisdictions may wish to limit P3 transactions to a build-lease-transfer format, while others may contemplate more long-term (or even more permanent) arrangements for private participation. At a minimum, the P3-enabling legislation should identify the sectors in which P3s are authorised and any limitations on the structure and duration of private sector participation.

Legislation also should designate, or create, a governmental entity to oversee and facilitate P3 development and implementation (P3 Entity). For example, a P3 Entity should be authorised to both receive P3 proposals from constituent government entities (e.g., authorities, municipalities, etc.) and propose P3 projects and issue "requests for proposals" (RFPs) for P3s.

In evaluating proposed projects, the P3 Entity should be required to perform an economic analysis (see "value for money" discussion, infra) and an initial risk/reward assessment of the proposed project. The P3 Entity also should have the authority to enter into P3 contracts (see

infra) and ancillary arrangements including contracts to retain professional advisers (e.g., engineers, financial advisers, attorneys) and take other actions necessary or desirable to effectuate the goals of the P3 statute.

Finally, P3 legislation may authorise certain types of government financial support including credit enhancement instruments (e.g., bonds, letters of credit) and, in limited cases, sovereign guarantees. Other types of governmental support may be appropriate depending on the project and the government's objectives. At bottom, however, P3 legislation must answer the central question of whether the delegation of public functions will require the commitment of public credit to or on behalf of private parties and, if so, whether such commitments conflict with constitutional or public policy constraints in the relevant jurisdiction.

b. Procurement Rules and Procedures

P3s are often hindered by a lack of clarity regarding how existing procurement laws should be applied to the project at hand. Ambiguity in this area can lead to inefficiencies, increased costs, delays or even cancellations of projects. Where management of the P3 procurement process is tasked to a P3 Entity, such entity's responsibilities may include setting eligibility criteria and methodology for selecting and evaluating projects, preparing RFPs, and evaluating proposed projects with a view to prioritising those that should proceed and eliminating those that should not.

The P3 unit also should perform economic assessments and feasibility appraisals of potential projects. For example, the Private Finance Initiative implemented in the United Kingdom utilises the concept of "value for money" to determine whether a particular project is suitable for implementation through a P3 [13]. To ensure continuity and uniformity, it is advisable that value for money assessments within a particular sector be undertaken by a single governmental entity. In essence, the goal should be to create a degree of sector specialisation among the government officials that will be charged with reviewing, developing and implementing P3s.

Once it is determined that a given transaction is suitable for the P3 structure and a private partner is selected [14], the transactional details of the P3 will be set out in a P3 contract. The contract, among other things, should address the following matters:

- A detailed description of the project and/or services;
- A description of the respective commitments of the public and private partners regarding project financing and project completion (in particular government actions necessary to achieve financial closing and commencement of construction, as well as conditions to the private partner's receipt of project revenues);
- A description of the government commitments (if any) regarding credit support for the project;

- The respective rights of the government and private partners regarding the property and income of the project before, during and after the execution of the P3 contract;
- In cases where the project will be charging fees to citizens, or to the government itself, the terms and provisions for establishing and adjusting such fees;
- The term of the contract;
- The extent to which the government will have ongoing rights to regulate the project (including, where appropriate, "step-in" rights structured to co-exist with, rather than supervene, the rights of senior project lenders);
- Tax matters, including tax holidays and/or income or property tax incentives granted to the private partner;
- Dispute resolution procedures; and
- "Standard" legal provisions relating to, for example, a narrowly-tailored waiver of the government's sovereign immunity, assignments, indemnification, liquidated damages (if and as applicable), choice of law, events of default and termination.

c. Dispute Resolution Mechanisms

Dispute resolution provisions simultaneously present some of the most simple, and the most complex, issues encountered in negotiating public/private transactions. Some issues may be considered simple because the basic principles of transparency, impartiality of decision maker(s) and neutrality of fora are intuitive and widely understood. Nevertheless, different parties often will view these basic principles from vastly different perspectives. Even greater complexity arises where different dispute resolution processes apply depending on the type of transaction, the type of document, or even the particular contractual clause in dispute.

The basic elements of infrastructure projects consist of the operational components (i.e., hard assets) that comprise a project and capital investments necessary to bring them into existence. Generally speaking, debt (and sometimes equity) participants in capital intensive projects will require that investment disputes be litigated in the courts of a jurisdiction with a well-established reputation for predictable and consistent decisions on such matters. For commercial lenders and international financial institutions, New York or London are typically the jurisdictions of choice. This preference is heightened where, as in P3 transactions, the government participant is perceived to enjoy a "home-field" advantage in its own courts. Thus, a P3 program that fails to reasonably accommodate such lender preferences to the extent appropriate is at risk of reducing its pool of potential investors.

By contrast, a somewhat different analysis applies to issues arising in the context of "operational" aspects of a project. Although a detailed discussion of the topic is beyond the scope of this article, it may be said that some operational disputes where relatively small amounts are at issue may be made subject to binding arbitration under the aegis of an internationally recognized institution (e.g., ICSID, ICC, UNCITRAL) using impartial arbitrators in a neutral location.

Such arrangements may be structured consistent with the preferences of international sponsors and investors and should also serve the objectives of achieving an expedited hearing of the disputes by a panel of arbitrators/experts with specialised expertise in the matters at issue (e.g., allegedly defective construction materials). One area of particular concern to private investors is the enforceability of contracts against the government and the finality of judgments handed down by courts or arbitral tribunals outside the host country. Investors will desire certainty on this count, seeking waivers of sovereign immunity and assurances that foreign judgments and arbitral awards rendered in accordance with the P3 contract will not be litigated again in the courts of the host country.

To the extent, consistent with constitutional and public policy constraints, P3 legislation should provide an appropriate degree of certainty by authorising narrowly tailored waivers of sovereign immunity and allowing for the enforcement of foreign decisions against public or semi-public entities in the host country. Given the political sensitivity attached to such considerations, P3 statutes of various countries reflect a variety of approaches to achieving such certainty.[14] Nevertheless, P3 legislation should make every effort to conform with best international practices in this area, to the extent consistent with local law and with the objectives of the P3 program.

IV. Conclusion

In light of the mounting population pressures confronting countries of the GCC, P3s have an important role to play in meeting long term public infrastructure needs. The implementation of a comprehensive P3 statute can improve the volume and efficiency of P3 transactions while mitigating the costs assigned to government balance sheets. Effective P3 statutes also will improve the ability of governments to compete for private sector partners and capital. Although natural resource wealth will mitigate the short term need for such capital, the GCC's long term infrastructure needs will require increased utilisation of P3s as a cost-effective vehicle for programmatic infrastructure development.

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NOTES:

[1] Presentation by Adil Marghub titled "MENA Infrastructure Opportunities and Challenges." International Finance Corporation, December 2009. Available here...

[2] The GCC includes Bahrain, Kuwait, Qatar, United Arab Emirates (UAE), Oman, and Saudi Arabia.

[3] MEED Projects estimates value of projects planned and underway in the GCC as of January 18, 2010 at $2.26 trillion dollars. Cited in Presentation by Nasser Saidi, "Future of Capital Markets in the ME." DIFC Knowledge Series, 26 January 2010. Available here...

[4] Royal Decree 77/2004, Sultanate of Oman. Available here... See also "Privatization Methods Adopted," Sultanate of Oman: Ministry of National Economy. Available here...

[5] Legislative Decree No. 41 of 2002 with Respect to Policies and Guidelines of Privatisation, Kingdom of Bahrain. Available here... See also "Making Reforms Succeed: Moving Forward with the MENA Investment Policy Agenda," Organization for Economic Cooperation and Development. 2008, 277.

[6] Ed Attwood, "In the works." Arabian Business, 14 September 2009. Available here...

[7] B. Izzak, "Panel approves privatization bill." Kuwait Times, 22 March 2010. Available here...

[8] "Kuwait Moves Towards Water/Power Privatization Through First IWPP." MEES, 2009. Available here...

[9] Angela Giuffrida, "Contracts fall short of legal standard for PPP." Arabian Business, 1 July 2007. Available here... See also Andy Sambidge, "Abu Dhabi eyes $15bn infrastructure spend by 2012." Arabian Business, 5 November 2009. Available here...

[10] Decision of the Council of Ministers No. 257. Kingdom of Saudi Arabia, 5 February 2001. See also "Privatization Objectives and Policies," Kingdom of Saudi Arabia: Supreme Economic Council. Available here...

[11] "Saudi Arabia committed to privatization." MENAFN, 14 October 2009. Available here...

[12] See generally "Value for Money Assessment Guidance." HM Treasury, November 2006. Available here...

[13] Procurement rules should specify whether private partners will be selected pursuant to an objective scoring system or whether the government will be permitted to exercise a degree of subjective discretion (e.g., by entering into "competitive negotiations" with multiple bidders). The former approach offers the benefits of clear-cut transparency, while the latter offers the potential for achieving better results for the government if pre-established rules and procedures for avoiding ex parte communications are observed.

[14] For example, Brazil and India were for some time viewed as difficult jurisdictions in which to enforce foreign arbitral awards against public entities. However, in recent years, Brazil has adopted legislation that facilitates the enforcement of arbitral awards subject to the requirements that (a) the arbitration is held in Brazil; (b) the language of the arbitration is Portuguese; and (c) the proceeding is carried out in accordance with Brazilian arbitration law. India is said to be evaluating similar reforms. See Arnold Wald & Jean Kalicki, "The Settlement of Disputes Between the Public Administration and Private Companies by Arbitration under Brazilian Law." Journal of International Arbitration, August 2009.