

TOWARDS THE ENACTMENT OF A NEW LAW OF PUBLIC PRIVATE PARTNERSHIPS

STATEMENT OF INTENT OF THE INITIATIVE

On November 10, 2009 the President of the Republic submitted to the Senate the bill on Public Private Partnerships (*Ley de Asociaciones Público Privadas*, LAPP) intended to govern the development of infrastructure projects under joint public and private sector participation.

The innovative aspect of this bill stems from the far-reaching and comprehensive perspective used to determine the schemes under which both the public and the private sectors may participate to develop the country's infrastructure.

The traditional and simplest means, at both the federal and local levels, for infrastructure creation had consisted in undertaking the public works directly or contracting for them against budgetary appropriations, by entering into public works contracts executed as provided in the applicable public works laws.

Moreover, other means had been recently implemented, such as contracts for the projects known as PPS (*Proyectos de Prestación de Servicios*) which allowed for services to be rendered to the government by private sector companies (investor suppliers) which indirectly allowed for the building of the infrastructure required to provide the services involved. It should be pointed out that although there are provisions in federal and local appropriations laws and government procurement laws for the implementation of these projects, the complexity of the projects themselves, and the need in many instances of having to obtain licenses, permits, authorizations and even concessions to carry them out have provided proof that there was a need of having a more comprehensive set of laws.

The laws governing government acquisitions and leases, the procurement of services and public works all contain different contracting modes which differ among them both in the manner in which the financial risks are shared and in the manner in which the service is to be provided or the works are to be undertaken, among which we can find the contracts for financed public works, long-term projects for productive infrastructure, "turn-key" projects, and others.

Finally, we have concessions, under which the private sector may provide public services and build the required infrastructure to do so, which are governed by the specific laws on the matter (i.e., telecommunications, highways, etc.) or by the laws governing public property.

Given this state of affairs, the federal executive branch was of the opinion that in order to speed up the building of the country's infrastructure and accelerate its development it was necessary to have a proper legal framework to provide legal protection and certainty and in addition sufficient flexibility to foster and spur investment in infrastructure.

The LAPP bill contains 137 articles, divided into 12 chapters. This paper is meant to provide a brief outline of the most important aspects of the bill and give brief consideration to its scope.

I. CONTENT

Purpose

The main purpose of this law is to regulate PPP projects in adherence to the principles of articles 25 and 134 of the Mexican Constitution. In this regard, the bill states that these projects comprise any scheme under which the public and private sectors establish long-term contractual relationships to provide the public sector or final users one or more services which entail infrastructure that may be partially or totally developed by either the public or the private sector.

The possibility of allowing the use of any type of scheme opens up a range of possibilities for the development of PPP contracts which, from the legal, financial and technical perspective, take advantage of other types of schemes such as those mentioned in the preceding section and those existing at the international level.

Aside from the various provisions of the LAPP that establish clear parameters regarding the rights and obligations for both the public and the private sector, the expectations are that as these new schemes develop, they will open up the way for greater creativity by the private sector and will drive the public sector to better distribute the risks of the whole project, balancing the relationship between the public and private sectors. Accordingly, the LAPP bill specifies that the Law of Acquisitions, Leases and Services of the Public Sector and the Law of Public Works and Related Services, their respective Regulations and any other provisions deriving therefrom shall not be applicable to the PPP project, except as expressly provided for in the LAPP (i. e., as regards the contracting for advisory and consultancy services, the studies and projects required to determine the feasibility of a PPP).

The LAPP shall be applicable to projects undertaken by:

1. Administrative units of the Office of the Presidency of the Republic;
2. The agencies and entities of the Federal Public Administration;
3. The General Attorney's Office;
4. Federal public trusts not considered to be state-controlled entities;

5. Federal public legal entities, whose autonomy derives from Mexican constitutional provisions, in which case they are subject to their own control bodies; and
6. The federated states, municipalities and their respective public entities and agencies, when undertaken with federal funds, in accordance with the agreements entered into with the agencies and entities of the Federal Public Administration.

A PPP project scheme will at all times require a public bidding process for implementation (regardless of which sector initiates it), in contrast with all other schemes provided for in other statutes where public bidding is optional.

APP Project Preparation and Implementation

Public agencies and entities must conduct prior studies to determine the viability and benefits of a PPP project before it is undertaken. These studies must include those relating to: (i) its technical viability, (ii) required authorizations, including permits and concessions (Authorizations), (iii) the legal viability and social benefit deriving from the project; (iv) its environmental impact; (v) other available options under which the project may be undertaken and (vi) the property, assets and rights required for its implementation.

In regard to the analysis of the requirements mentioned in item (vi) above, the LAPP provides that information must be provided on the title, liens and encumbrances and marginal notations pertaining to property, as recorded in the Mexican public registries of property, on the feasibility of its acquisition, on its value and any zoning restrictions, as well as information on any other property which may be affected by the project.

It should be mentioned that once the studies mentioned above have been conducted the PPP project may be initiated. Nevertheless, the LAPP provides that in duly justified cases, "sufficient progress" in the compliance of such requirements shall suffice to allow interested parties to prepare qualifying bids and start the development of the project. We believe that the lack of objective parameters for application of this exemption might lead again to preventing final implementation of many projects, for example those involving the granting of rights of way (by the acquisition of land either by purchase or expropriation) where once the bidding process is over and a concession is granted, concessionaires may be prevented from executing the project because such rights have not in fact been obtained. The law must make express provision on these parameters since the bill states that the regulations of the law may not provide requirements that are in addition to those contemplated in the LAPP.

Private Sector Initiative

Although the need to undertake a project is, as a general rule, determined by the public sector, the LAPP allows private entities to detect such need and submit a proposal

to undertake the project to the appropriate federal entity or agency. This possibility does not preclude the agencies and entities from publishing in the Official Gazette of the Federation and from posting on their web sites the type of projects and other features and requirements of the proposals they are willing to receive and, in such event, only those that meet such requirements shall be considered.

As regards this matter, although it is true that the intention is to benefit the most from the resources available to the governmental agencies and entities in analyzing projects in the light of the National Development Plan and the relevant sector programs, it is also true that if too many restrictions are imposed on the type and scope of the projects expected to be received from private entities could significantly discourage the exploration, proposal and undertaking of many projects.

Once the proposals submitted by private entities within specified terms have been examined, the agency or entity may:

- (i) Issue an opinion on the viability of the project and implement the relevant public bidding process.

In this event, the agency or entity making the call shall provide the promoting private entity a certificate that will allow it to recover any expenses incurred in preparing and submitting the project, should it decide not to participate in the bidding or should it not be awarded the contract, expenses which shall be borne by the winning bidder as established in the bases for bidding.

The promoter shall be under the obligation of assigning any intellectual property rights and authorizations required to develop the project in the event the awardee is other than the promoter.

One of the advantages of being a promoter is that its proposal will be granted a handicap not to exceed 10% over those of other bidders, which will be specified in the awarding criteria of the bases for bidding. As regards this matter, the awarding of this premium is consistent with the practice followed by other countries in implementing private initiative projects in order to foster private sector participation.

- (ii) Resolve on the acquisition of the studies submitted.

In this event the call for public bidding shall not take place and the agency or entity may resolve on whether it will acquire the studies and any intellectual and industrial property rights by reimbursing all or part of the duly supported costs incurred by the promoter.

In the event two or more proposals are submitted with respect to one single

project, and more than one of these are considered to be viable, the agency or entity shall find in favor of the one providing greater benefit and, should conditions be equal, it shall find in favor of the one submitted first.

The LAPP provides that the only right a promoter has when submitting a proposal is that of having it reviewed and assessed; albeit, the opinion issued on the viability of the project does not constitute an act of authority for which an action for constitutional relief is available.

Finally the bill provides that the rights over the studies submitted are forfeited to the benefit of the federal executive branch in the event the promoter, during the time the study is under review, fails to: (i) provide the information required from it without justified cause; (ii) promotes the project before another entity or in any other manner; or (iii) assigns its proposal to third parties, even if the project is not subject to the bidding process.

We believe that in the last two instances mentioned above the sanction imposed seems to be excessive, since the act of promoting the project before other authorities or third parties does not necessarily imply lost opportunities or the loss of the promoter's know-how to the detriment of the state, and as regards the restriction on the assignment of rights to third parties, this could act as a limitation on the participation of third parties in the project, since even if the rights over a project were transferred to third parties, should the project be subject to bidding the bidding bases could provide for minimum requirements as regards the bidders' experience, capabilities and qualifications.

Project Asset Requirements

The LAPP provides that the assets required to undertake a project may be acquired by the agency or entity making the call, by the developer or by both as specified in the bases for bidding and in the relevant PPP contract. Such acquisition may take place by negotiation with the title holders or by expropriation. Under no circumstance may the acquisition value be less than the value of the asset as appraised for tax purposes.

(i) Acquisition by negotiation

One of the innovations contained in the LAPP in regard to the acquisition of assets through negotiation is that their value may be appraised not only by the Institute for the Administration and Appraisal of National Property (*Instituto de Administración y Avalúos de Bienes Nacionales, INDAABIN*) but also by banking institutions in the country authorized to do so as provided for in the regulations of this law, a possibility which will result in lifting the heavy workload of the INDAABIN while taking advantage of the experience of banking institutions in this field.

Such appraisals may take into consideration, among other factors, the future increase in value of the asset if the project is implemented, its market value, the impact and effect of their acquisition on the remaining portion of the assets or property involved and ancillary expenses not included in the market value, these aspects to be governed by regulatory provisions.

Negotiations may be conducted with other holders of rights *in rem*, of possession, causes of action, as well as any other right over which there is proof of title, and in these cases the amounts covered in each negotiation may not exceed in the aggregate the amount as determined by the INDAABIN or the banking institution, as the case may be.

In the event negotiations are conducted by the private sector entity developing the project, these will take place at the will of the parties and the provisions regarding appraisals, maximum prices and the like will not be applicable. Nevertheless, in these cases, the terms and conditions provided for in the PPP contract shall be complied with regardless of the amounts paid out by the developer.

(ii) Expropriation

The chapter on expropriation of the LAPP is interesting and seems, at first sight, to contravene other bodies of law, since the Office of the President sent a bill to the Senate to make amendments to the Expropriation Law, the General Law of National Property and the Agrarian Law in order to concentrate all matters relating to expropriation into one single statute, that is, the Expropriation Law.

Although it is true that the chapter on expropriation contained in the LAPP has great similarity with the provisions of the Expropriation Law, it is worth noting that there are a few differences which may give rise to diverse interpretations, and therefore we believe that it would have been better to subject any required expropriation to the provisions contained in the specific law on this matter, than to include new provisions in the LAPP.

PPP Contracts and Authorizations Required for Implementation

Purpose and term

As mentioned above, PPP contracts will be awarded by public bidding, may only be entered into with private legal entities whose exclusive corporate purpose is that of undertaking all actions required to implement the relevant project and for terms, including any renewals thereof, which cannot exceed as a general rule 50 years in the aggregate, there being some exceptions, as mentioned further on.

Frequently a PPP project and the use of public property or the provision of services by the developers require Authorizations to be granted. The LAPP is

innovative as regards this matter, since it provides that any such authorizations shall also be awarded through the bidding process as established in the LAPP, and not through the procedure as set forth in the specific laws that govern them.

The effective term of each of such Authorizations shall be: (i) 40 years if the maximum initial term of the law that governs it is equal or shorter, or (ii) greater than 40 years if the law governing the specific Authorization provides for a longer initial maximum term, in which event the longer term shall apply, and (iii) in any event, and regardless of the initial term for which the Authorization is granted, its term and any extensions thereof may not exceed the maximum term specified in the specific law. In this regard it is important to mention that the PPP contract may be for a term in excess of 50 years (including any extensions) when the terms of the Authorizations are for longer periods.

Content of the Authorizations

The Authorizations must specify the minimum and essential conditions to allow the developer, in accordance with the provisions that regulate them, to make use of the assets or provide the services contemplated in the project, provided that all other terms and conditions governing the relationship between the developer and the agency or entity shall be governed by the PPP contract, thus facilitating the interpretation of these instruments while concentrating all provisions regarding the rights and obligations of the parties in the PPP contract.

In order to make PPP projects attractive for investors, the LAPP provides that developers' rights under the Authorizations may be transferred, offered as security or be encumbered if the rights under the relevant PPP contract are also so transferred, offered as security or encumbered, prior consent being required from the granting agency or entity.

To the extent that a PPP contract is closely linked to the Authorizations required for its implementation, the LAPP provides that if the former is amended, the latter shall have to be revised and amended as required.

PPP Contract Characteristics

A PPP contract must provide for the following:

1. The subject matter of the contract.
2. The parties' rights and obligations.
3. The characteristics, specifications, technical standards, performance levels and quality required for execution of the works or in the provisions of the services.

4. The list of immovable property, assets and rights relating to the project and their intended disposal upon termination of the contract.
5. The financial regime of the project, specifying the consideration to be paid to the developer.
6. The terms and conditions under which the agency or entity will, upon the developer's non-compliance, transfer temporary control over the developer's company to the latter's creditors.
7. The risk-allocation regime between the parties to the contract concerning technical, works execution and financial risks, and those arising as a result of acts of God or Force Majeure and any other risks of whatsoever nature.
8. The dates on which the works must start and end, or the date the provision of the services must start, as well as the effective term of the contract and, such being the case, the provisions governing any extensions.
9. The specification of the Authorizations needed for implementation of the project.
10. The events of cancellation and advanced termination of the contract, the effects thereof, as well as the terms and conditions governing these matters.
11. The provisions governing liquidated damages and sanctions upon breach or non-compliance with the obligations binding upon the parties.
12. The procedure for dispute settlement.
13. The specification that Mexican federal laws shall govern and Mexican federal courts shall have jurisdiction.

The main rights of the developer are: (i) to receive the consideration for developing the project; (ii) to be granted extensions on the contract as a result of any delays attributable to the contracting agency or entity, and (iii) be indemnified as provided in the PPP contract for any damages caused as a result of such delays.

The provisions mentioned above are of the utmost importance, since experience has shown that on many occasions the private sector had not been afforded protection under circumstances whose outcome was exclusively in the hands of the public sector, as in cases involving expropriations, where delays may cause significant losses in the execution of the project.

The bill provides that the financial resources to undertake the works or provide the services may be contributed by both the public and the private sectors, provided that the public sector contribution will not entail that the trust or entity into which they are placed will not be considered to be of a public nature.

The LAPP bill provides that guarantees including those required for any Authorizations, if required under the bases for bidding, may not exceed in the aggregate:

- (i) The equivalent of 15% of the value of the works, effective during the time the infrastructure involved is under construction;
- (ii) The equivalent of 10% of the annual consideration to be paid for providing the services, during the time such services are rendered.

As regards this matter, the fact that limits have been placed on the amounts the private sector has to post is a great step forward; however, as regards infrastructure, the percentages established (in particular that relating to construction) may be, even so, very onerous and may, in some cases, discourage its participation in the project. We are therefore of the opinion that other formulas should be devised and used to allow for gradation together with a maximum limit tied to the amounts to be invested in the project.

In addition, the bill provides that depending on the profitability of the project, and if so provided for in the bases for bidding, regardless of that which may be established in other applicable provisions, the contracting agency or entity may demand from the developer one or more of the following:

- (i) Reimbursement of the value of the real estate, property and rights used for the project, contributed by the public sector agency or entity.
- (ii) A consideration for the Authorizations required by the project. This provision may be interpreted in the sense that insofar as the granting of any such Authorization is subject to the LAPP provisions, this consideration is different from those provided in specific statutes governing the relevant Authorizations.
- (iii) The payment of government fees deriving from oversight activities in the execution of the works or in the provision of the services.
- (iv) Any others provided for in the relevant contract.

Transfer, Assignment or Encumbrance of Rights Deriving from PPP Contracts and Authorizations

The rights deriving from a PPP contract may be assigned in part or in whole, used as collateral or be encumbered in any manner whatsoever provided prior consent from

the contracting agency or entity has been obtained. The same is applicable to the developer's stock, thus allowing flexibility as regards the various financing mechanisms available to the developer.

Amendments to the PPP Contract

In addition to the right granted to public agencies or entities of taking over the administration of the project, the bill provides that amendments to the PPP contract may be made during implementation of the project if the purpose thereof is to improve the characteristics of the infrastructure; the performance level of the services; adjust the scope of the project due to supervening causes that could not have been foreseen at the time it the contract was drafted or awarded or to make adjustments in order to balance its financial aspects, provided however that any amendments may not entail a different risk allocation than that originally agreed upon.

In regard to any financial problems which may be encountered in undertaking the project, the bill provides that the developer is entitled to having the contract revised and amendments to be made to it when as a result of acts undertaken by competent administrative authorities, by the legislature or by the courts, the costs for undertaking the project are significantly increased or the benefits in its favor are significantly reduced.

Such variations are considered to be significant if they are of long duration and place the financial viability of the project at risk. Therefore, amendments to the contract may be made if: (i) any such act of the authority occurs after the date bids are submitted in the relevant bidding process, (ii) the act involved could not have been foreseen at the time the project was designed and the contract was awarded; and (iii) it entails a change in the provisions applicable when undertaking the same. Adjustments to the terms and conditions of the PPP contract may affect the amounts to be paid in consideration to the developer.

The contract may be revised also if the financial returns deriving therefrom are greater than those estimated in the developer's financial proposal and the contract itself.

These provisions are of the utmost significance, since they provide both the public and the private sector with tools that will allow them to achieve the contractual purpose of the PPP contract, by taking into account the different variables having a bearing on long-term projects.

PPP Contract Extensions

The parties to a PPP contract may agree upon its extension, provided the developer requests any such one year in advance of its expiry. Any such request for extension may include extensions of the relevant Authorizations, regardless of the provisions applicable to the services relating to the project.

PPP Contract Termination

The bill provides that the main causes for termination of a PPP contract are; the cancellation, abandonment, or delay in the execution of the works, the failure to provide the services contracted for or the suspension in their provision without justified cause, and revocation or cancellation of the Authorizations.

In any event, a PPP contract will make express provision for its early termination, it being understood that the project developer would be entitled to reimbursement of any investments made in the project.

Infringements and Sanctions

One of the innovative aspects of the bill is that it provides that actions against public servants for administrative liability may only be filed when any act or omission by them is of a grave nature, or entails pecuniary damage, the commission of a crime or should they have failed to prevent greater damages or losses to be caused to the contracting agency or entity or been contrary to the public interest. In these hypotheses, the sanctions provided for in the Federal Law of Administrative liability of Public Servants shall be warranted only when any such acts or omissions shall have resulted in unlawful enrichments of the public servant involved.

Dispute Resolution

The bill provides that a committee shall be created that will be in charge of the settlement of technical or financial controversies. This committee will be made up of three experts in the field to which the dispute relates, each party involved having the right to designate one expert and the third one to be designated by mutual agreement of both of those so designated.

Controversies arising from the contract itself, and from the Authorizations, such being the case, may be subject to arbitral proceedings under the provisions contained in the Commercial Code, provided that Authorization revocation or cancellation, and the challenging of acts of authorities may not be subject to arbitration.

Actions involving the legal validity of any administrative act must be brought before the federal courts having jurisdiction.

CLOSING REMARKS

The LAPP bill is an innovative body of law that will certainly contribute to foster and facilitate the undertaking of infrastructure projects that entail public and private partnership participation. Nevertheless, we believe that the aspects relating to project

preparation and design for ulterior bid submission need to be addressed more specifically, this also being the case in order to have objective criteria in the application of exemptions.

Moreover, issues regarding the acquisition of property, in particular if acquired through expropriation, should be consistent with the Federal Executive's efforts to have one single statute providing uniform criteria in regard to this matter. On the other hand, all things relating to Authorizations shall need further attention, in order to avoid conflict of laws in the specific matter to which they relate.

Finally, flexibility will be required as regards amendments to contracts of this type given the size and scope of the projects entailed, in order for them to serve to foster private sector participation and afford legal certainty in their undertaking.

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