

Amendments to contracts and dispute resolution

Renegotiation and Amendments to PPP Contracts

A crucial activity of the Contract Management team is to try to prevent disputes and if they arise, the ways to minimize serious impacts on the project/parties to the contract.

Renegotiations are becoming more common features of public-private partnerships (PPPs) and Governments need to recognize this and limit the risks involved. The increase in renegotiations has been noted in an increasing number of reports and if it does become increasingly common and changes become significant it can make all previous project preparation and bidding meaningless.

This is especially so if the winning bidder has intentionally prepared the bid with renegotiation in mind. Renegotiation is a double edged sword for public authorities. A major reference study on renegotiation is referenced below;



Granting and Renegotiating Infrastructure Concessions - Doing it Right. WBI Development Studies. J. Luis Guasch, 2004.

Basic Disadvantages

A particular case occurs when the private party initially overestimates the potential demand and later attempts to renegotiate the agreement, so that the public party is obliged to bear the costs related to demand risk to avoid the complete failure of the PPP.

In those circumstances, the private party can bargain favorable contract terms that would have never been obtained under competitive conditions. The absence of other competitors during early renegotiation phases significantly weakens the public party's bargaining position, and in turn reduces the chances to achieve real value for money from the PPP agreement at stake.

Renegotiation is thus generally regarded as undesirable because:

- It eliminates the competitive effect of the auction allocating the concession: questions credibility of model
- Renegotiation takes place away from competitive pressures in a bilateral government/operator environment

- Competitive bidding is distorted
- It decreases the benefits of concession and the welfare of users, and might have fiscal impact
- The most likely winner is not the most efficient operator but the most skilled in renegotiation
- While some renegotiations are efficient, many are opportunistic and should be deterred.

Occasional Advantages

- Renegotiation is also a way to correct mistakes by adapting the contract characteristics to new developments that were not foreseen or taken into account from the beginning of the PPP arrangement.
- Furthermore, renegotiations can be used to reallocate wrongly distributed risks to the party that is best suited to bear them.

It is of utmost importance to distinguish between contractually scheduled renegotiations and (early) unforeseen renegotiations that are initiated at the request of the private party. For example, early renegotiation sometimes takes place when the private operator realizes, during the operational phase, that it is not able to abide to the terms of the contract and/or needs more financing.

Reasons and outcomes of renegotiation

Renegotiations occur for a number of reasons including;

- Poor concession design; many due to rushing to contract before the project is ready
- Adjustments to macro economic or political shocks
- Changes in governments or in priorities/policies; At least 26% of renegotiations are by government
- Taking advantage of lack of credible commitment to no-renegotiation
- Aggressive/Opportunistic bidding often tolerated by governments
- Securing additional investment or projects bypassing due diligence
- Abusing financial equilibrium principle i.e. balance in contracts
- Exploiting leverage opportunities-political capital
- Perceived opportunities for corruption
- Fear of corruption attacks dissuades disqualification of aggressive/opportunistic bids

CONTRACT FEATURES AND INCIDENCE OF RENEGOTIATIONS IN LATIN AMERICA AND THE CARIBBEAN MID 1980S-2000		
Main Feature	Detailed Feature	Percent of Occurrence
Award Criteria	Lowest Tariff	0.6
	Highest Transfer Fee	0.11
Regulation Criteria	Investment	0.7
	Performance	0.18
Regulatory Framework	Price-Cap	0.42
	Rate of Return	0.13
Regulatory Body	Exists	0.17
	Does not exist	0.61
Legal Framework	In Law	0.17
	In Decree	0.28
	In Contract	0.4

Source: Guasch 2004

Common mistakes which can lead to renegotiation

Guasch lists a number of common mistakes, many of which can be characterized as *poor design and too hurried implementation lead to subsequent financial disaster*

- 1 **Pre concession Issues**
These include not accounting for labor issues, political support, faulty sector restructuring, faulty tariff adjustments and excessive government forecasts.
- 2 **Concession Design**
These include poor prequalification, favoring means over performance, ambiguous conflict resolution, improper use of guarantees, not accounting for universal service obligations and inappropriate risk allocation.
- 3 **Award Issues**
A number of situations related to awarding concessions have contributed to renegotiation including direct rather than competitive awards, multiple award criteria, questionable single criteria and choosing fiscal objectives rather than longer term efficiency objectives.
- 4 **Regulatory Issues**
These include absence of frameworks, disregard for institutional issues, inappropriate initial tariffs, failure to include adequate information and accounting requirements on concessionaires and failure to hold bidders accountable.

Outcomes of Renegotiation

On average the terms of the contract improved for the operator/investors.

- Efficiency gains are reduced
- Users are, on average, worse off
- Adverse fiscal impacts are common

Who initiates the renegotiation process?

In addressing the issue of renegotiation, it must be remembered that over 25-30 years there will likely be continuous ‘fine tuning’. In this respect, renegotiation may be initiated by both the public and private sectors for the following reasons:

- Initiated by Government
 - Opportunistic (politically)
 - Change in priorities/policies
- Initiated by Operator
 - Opportunistic (rent seeking)
 - Shock related
 - Ambiguous

INITIATORS OF RENEGOTIATION UNDER PPP CONTRACTS				
	Both Government and Operator	Government	Operator	Total
	(% of total requests)			
All sectors	13%	26%	61%	100%
Water and Sanitation	10%	24%	66%	100%
Transport	16%	27%	7%	100%

Lessons learned in contract renegotiation

A report by Dr S. Ping Ho provides some insights into what can go wrong with concessions and that lead to the need for renegotiations. His report goes into depth on the Taiwan High Speed Rail project which opened in 2007 at a cost of over USD 18 billion. Within his analysis of many of the problems (mainly financial) that occurred, his report showed that of the two bidders, one provided a bid that in hindsight was too optimistic and that the government with its limited experience of PPP could not easily evaluate and which did not call on experienced advisors.

Also for such a mega project, the government stated a number of times that the project would not be allowed to fail. Further, the project sponsors were mainly contractors rather than a consortium of developers who he believes concentrate on short-term contract profits rather than longer term operational returns.

According to Dr. Ping, the lessons learned from the perspectives of his work include taking extreme care with PPP projects that;

- Will not be allowed to default e.g. high profile, political projects
- Focus too much on the bidder’s financial proposal
- Are adopted too abruptly when government has limited experiences and incomplete supporting systems

- Are forced on local governments
- Do not consider the separation of the developer and contractors
- Are not prepared with the possibility of default in the planning stage
- Do not use adequate or experienced professional help



Government Policy on PPP Financial Issues: Bid Compensation and Financial Renegotiation. Ho, S. Ping. CRGP Working Paper #0029, 2007.

Gausch considers a different set of recommendations but ones which are also very valid. These include;

- Government reputation matters: establish early on a reputation for not easily conceding renegotiation demands
- Contracts should stipulate approach to renegotiations e.g. last resort, publicly considered etc
- Have credible commitment to no-renegotiation beyond contract clauses
- A freeze period on demands, say no significant changes for the first five years or more
- Sanctions against frivolous demands-requesting a large fee to be lost if request is denied and considered frivolous
- Use a Panel of experts to advise

Although in practice there are many guidelines for various PPP schemes in countries such as UK, these guidelines cannot be universal to every country in the world. Guidelines and policies need to be reexamined to fit the specific environment of a country according to certain logic.

Make certain that any proposed amendments and renegotiations are subject to scrutiny, both within relevant government departments and by the public in general. The reference from South Africa notes the Systems Act of 2003 obliges a municipality to inform and consult on proposed amendments to PPP contracts. Extensions of the 2003 Act and detailed regulation in 2005 go much further in terms of consultation. Chile has attempted to go further by placing prohibitions on any changes that alter the financial balance of a contract.

Amendments must be consistent with the PPP rules and regulations of the government.

In conclusion, while experience and lessons learned from various countries are useful each country has its own specific experience and needs to consider when framing contracts. However, considering where a contract may go wrong is a good start when considering whether a contract is a candidate for potential future renegotiation.



Public Private Partnerships, Models and Trends in the European Union. Dg Internal Policies of the Union-Directorate A, Economic and Scientific Policy. 2006.

Other Contract Amendments

Over the course of say 30 years there will be a continuous need for amendments to PPP contracts. This is normal. Many of these requested changes will be for mutual benefit of both partners.

Refinancing after the project is constructed is becoming more frequent as once the construction risk is passed, and a project has opened, cheaper financing is often available.

As with all requested changes, such refinancing negotiations should be as transparent as possible (as the situation allows) and the public sector should carefully balance all short and long-term impacts of change and try to obtain the best deal for the 'public' including reduction in tolls say for some targeted users.

Any requested changes that are more than just minor changes should be considered by the contracting authority with input from advisors-legal and financial at least.