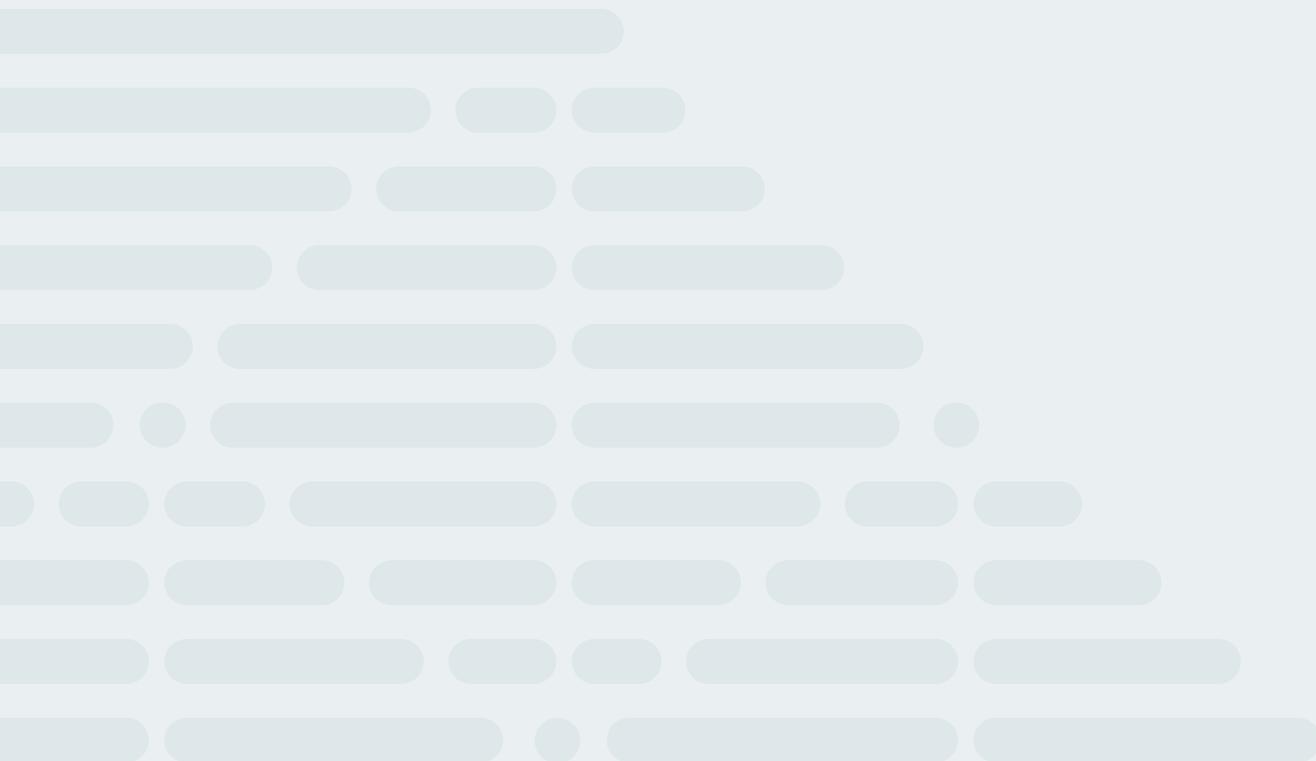


CHAPTER 4

Renegotiation



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4 Renegotiation

As PPP contracts are long term in nature, they will be exposed to various external changes arising from political, social and economic circumstances over their duration. As such, renegotiation is likely to occur at some stage during the contract term.

Renegotiation is a significant event in a PPP project as a change to the contract can have a major impact on the success or failure of a project, can demand significant resources and time from the Procuring Authority to effect, and can lead to disputes over the life of the contract.

The essence of renegotiation centres on the allocation of risk. Appropriate allocation and management of risk is an important aspect of ongoing financial sustainability, and any changes to the PPP contract may alter the risk allocation.

Renegotiations carry the risk of being adverse to the interests of the public good. For example, parties may initiate a renegotiation because of a change in the competitive landscape that may offer an opportunity to improve profit margins or achieve other benefits..

The study found 48 instances of renegotiation in the 146 projects for which data was available, which roughly equates to one in every three projects. When the data was filtered by region and sector, it was interesting to note the significant prevalence of contract renegotiation in Latin America (58%) and in the transport sector (42%). In addition, the most common cause of renegotiation was found to be increased costs in construction or operations, while the most common outcome of a renegotiation was a change in tariffs. It should be noted that the timeframe for the study (projects that reached financial close between 2005 and 2015, inclusive) meant that almost all the projects are still in progress, and therefore may incur further renegotiations in the future. This suggests that the true prevalence of renegotiation is likely to be higher than was found in the study.

CHAPTER STRUCTURE

This chapter provides a background to renegotiation of PPP contracts in Section 4.1 (Background) and provides guidance on successfully managing renegotiation. The key elements of successful renegotiation are summarised below and detailed in Section 4.2 (Guidance).

- A. Introduce policies to limit frequent renegotiations
- B. While limiting frequent renegotiations, also be mindful of opportunities that may be available through renegotiation
- C. Fully assess the appropriateness of a renegotiation
- D. Consider termination as an alternative to renegotiation
- E. Ensure adequate resourcing is employed during a renegotiation
- F. Consider the transparency of the renegotiation process and ensure good record keeping practices
- G. Ensure compliance with the regulatory framework in relation to a renegotiation
- H. Consider the associated private partners' roles (including the lenders' role) in a renegotiation
- I. Be aware of the broader implications of a renegotiation, including assessing opportunities for procurement of better PPP projects

Section 4.3 (Summary data analysis) provides a summary of the data analysis with respect to renegotiation of PPP contracts.

4.1 Background

Definition of renegotiation

A renegotiation of a PPP contract involves a change to the original contract terms and conditions. This is distinct from an adjustment (such as a minor scope change), which is contemplated in the PPP contract.

The scale of the change determines whether a renegotiation of the contract will be required. Large changes with major cost implications and the potential to change the agreed risk profile often require a renegotiation. For example, a renegotiation may be required where major changes to the scope of the project are involved.

PPP contracts typically include several mechanisms, such as scope change provisions for minor scope changes and claims procedures, to manage circumstances that were not fully understood or envisaged at financial close, without the need for a renegotiation. Minor changes will generally fall under the scope change or variation provisions, rebalancing provisions or other similar provisions in the PPP contract. Claims and scope changes are detailed in Section 3.5 (Claims).

Simple correction of errors or clarification of contract drafting can also typically be dealt with under existing provisions in the PPP contract and do not require renegotiation.

Some jurisdictions have a concept of economic rebalancing, which allows changes to be made that in other jurisdictions would require a renegotiation. This concept is described in more detail below under the heading 'Economic rebalancing'.

Typical processes

The approach to renegotiation depends on the regulatory framework of each jurisdiction, which can prescribe how renegotiation can or should be carried out. It may also depend on the process agreed in the PPP contract.

PPP contracts can set out a renegotiation clause which will typically specify under what conditions the renegotiation can be initiated and what the process will be. For a renegotiation initiated by the Project Company, this process might include a requirement for the Project Company to submit a request along with an explanatory memorandum as to why it is requesting a renegotiation. The explanatory memorandum should set out the detailed background to the renegotiation request, together with all relevant legal and/or contractual justifications that validate the need for the

renegotiation. The process may include time limits to mitigate the risk of delay in effectively implementing the renegotiation.

However, it should be noted that parties can also renegotiate at any stage without an explicit procedure, as long as the amendment to the PPP contract has the agreement of all relevant parties.

It is common in civil law jurisdictions for the Procuring Authority to have the power to make unilateral changes to the PPP contract. This unilateral power will typically also attach the condition that the Procuring Authority will fairly compensate the Project Company for making such unilateral amendments. For this reason, the approach in these jurisdictions will not differ greatly for renegotiations, as the parties should still negotiate the amendments and the compensation payable.

Economic rebalancing

Economic rebalancing refers to the practice of modifying the financial conditions (i.e. 'economic equilibrium') that were agreed as part of the original contract, with the intention of preserving or restoring the original economic equilibrium of the PPP contract. This can occur after a risk borne by either party has materialised and has been determined to have economic consequences for a party. For example, a force majeure event, a scope change, change in macro-economic conditions, change in law, or a major change to demand.

Rebalancing principles and provisions are specific to particular civil law jurisdictions (e.g. several countries in Latin America) and differ from the provisions of a typical common law PPP contract. In common law jurisdictions, events such as scope changes and changes in law are typically managed under specific scope change provisions and claims procedures, which are detailed in Section 3.5 (Claims). Rebalancing regimes, when compared to comparable provisions in common law jurisdictions, are more fluid mechanisms to deal with a variety of issues.

Rebalancing may also be available after an opportunity has materialised in favour of the Procuring Authority. For example, if the construction of an adjoining bypass increases demand and therefore toll revenue on a PPP road project, the PPP contract could be rebalanced in favour of the Procuring Authority with reduced tariffs or a reduction to the contract period.

Rebalancing may also be required because of a contract renegotiation. For example, if the Procuring Authority requested a significant increase to the scope of the project and this was agreed to by the Project Company through a renegotiation. Rebalancing may then be needed to restore the economic equilibrium of the PPP contract.

A perspective from Germany

In Germany, it is not common for a Procuring Authority to be successful in demanding a rebalancing, unless this option – and a procedure for achieving it – are already set out in the contract.

In general, rebalancing can be implemented through a broad range of mechanisms. For example, Project Company compensation, change in tariff rates, change in contract duration or a change in future investments payable by the Project Company. A combination of these and other economic/financial measures may also be available.

A typical process involves the Procuring Authority calculating the economic and financial rebalancing it considers is required and presenting it to the Project Company with a proposed approach to effect it. If the Project Company is not satisfied with the proposed rebalancing, it has a right of appeal against the Procuring Authority through administrative rights or it can trigger arbitration or court proceedings to receive a final determination.

For the purpose of the data analysis explored in this chapter, the study results do not differentiate between renegotiation and rebalancing.

4.2 Guidance

The following guidance outlines the key issues that should be considered when approaching renegotiation of a PPP contract.

A. Introduce policies to limit frequent renegotiations

If the private partner perceives the Procuring Authority as being excessively open to renegotiation, this may encourage opportunistic private sector bidders to make more aggressive (and potentially unrealistic) bids to secure a project, hoping to then renegotiate the PPP contract shortly after financial close in the absence of competition. As a result, the private partner may attempt to transfer risks back to the Procuring Authority that the Procuring Authority believed had been contractually allocated to the private partner. This may reward private sector partners who may not be efficient, but who are opportunistic negotiators.

The research suggests that parties sometimes seek opportunistic gains (either financial or political) through renegotiation, although this will always be a subjective interpretation and there will not typically be strong evidence to demonstrate that the drivers for renegotiation were opportunistic. It is therefore difficult to share detailed experiences, but the Procuring Authority should be alert to the possibility of opportunistic renegotiations. In a similar light, opportunistic renegotiations initiated by a Procuring Authority will also be detrimental in terms of the relationship with the Project Company but also the long-term private sector interest in a country or region.

The key issue associated with renegotiation in PPPs is that it can have the effect of retrospectively distorting the competitive tender process.

Where a contract is renegotiated and the agreed risk allocation changes after the preferred bidder has been selected, it is no longer obvious that the Project Company that was awarded the project offers the most cost-effective solution. This is because the originally tendered project and the renegotiated project are in essence two different projects.

Most significantly, a project's value for money becomes less clear in the absence of competition. Other implications of renegotiation that should be considered by the contract management team include the following:

- Renegotiations have the potential to **reduce the transparency** that existed during competitive bidding, which may also be controversial in terms of public perception
- The **efficiency of the PPP model may be jeopardised** by renegotiation: Renegotiations have the potential to reduce the overall economic benefits of PPP arrangements by changing the tendered and agreed risk allocation
- If renegotiations are frequent in a country or region, the **credibility of the process for utilising PPP transactions is called into question**
- From a legal perspective, **competitors might also challenge renegotiated changes** on the basis of competition or procurement laws, which can also have implications for future tender processes
- A renegotiation may **highlight broader issues and set a precedent for other similar projects** (e.g. if a demand risk allocation is changed to the advantage of a Project Company, other Project Companies in similar projects might demand the same changes)

A Procuring Authority will face a dilemma when the Project Company is facing financial difficulties due to the materialisation of a risk that was allocated to the Project Company under the PPP contract. On the one hand, the Procuring Authority needs to ensure it is retaining the value for money forecast at financial close. On the other hand, it has a sometimes-conflicting interest to ensure that the underlying public service continues to be provided. The potential solutions to this dilemma are detailed below under guidance 'C. Fully assess the appropriateness of a renegotiation'.

B. While limiting frequent renegotiations, also be mindful of opportunities that may be available through renegotiation

As described in the European PPP Expertise Centre's *Managing PPPs during their contract life*¹, the Procuring Authority should carry out periodic PPP contract reviews. These reviews should aim to identify any changes required by a changing environment (e.g. a change in the Procuring Authority's requirements) and to assess the Project Company's overall performance under the PPP contract. For example, this may involve a full technical, financial and legal review taking place

every five years, which may lead to a renegotiation being initiated by the Procuring Authority.

Several case studies highlighted the types of opportunities that may arise over the contract period, including increases in demand, availability of new technology and the availability of better financing rates.

EXAMPLE

Opportunities to be assessed

The original plan for expanding the Queen Alia International Airport Expansion project in Jordan had been to execute the project in two stages. Once it became clear that the first stage of expansion would not be sufficient to account for passenger growth, both parties agreed to change the design to allow the expanded terminal to be able to accommodate higher volumes than originally estimated. The incentives for both parties were in alignment, and the changes had a positive impact on the project.

For more information, see the Queen Alia International Airport Expansion Case Study.

C. Fully assess the appropriateness of a renegotiation

For any renegotiation, the starting point should be that the cost implications for the Procuring Authority of renegotiating are less than the financial outcome of doing nothing.

However, the assessment of a proposed renegotiation should be as comprehensive as possible, and should not be limited to the direct consequences of the change. For complex renegotiations, it may be in the interests of the Procuring Authority to carry out a forward-looking audit as well as a review of the relevant contracts. This will help to avoid any unforeseen effects on other contractual provisions that could adversely affect the Procuring Authority's interests.

The Procuring Authority should distinguish between the realisation of a risk that was allocated to the Project Company, and a genuine change in circumstance that was not contemplated at commercial close. Ideally, the former should not trigger the need for a renegotiation. As a general principle, a renegotiation should not be used to address the following:

¹ Available at <http://www.eib.org/infocentre/publications/all/epec-managing-ppps-during-their-contract-life.htm>.

- Any event that was foreseeable at financial close
- Any event that would affect the Project Company in its ordinary course of business (e.g. a general change of law)
- Materialisation of a risk allocated to the Project Company or invalid assumptions made in its pricing or the scope of work required in relation to those risks
- Any distress arising directly or indirectly from the performance, action or inaction of the Project Company
- Any failure by the Project Company to secure financing for the project

EXAMPLE**European Union environmental requirements**

The parties to the Segarra Garrigues Irrigation System project in Spain were forced to change the scope and design after the European Court of Justice ruled that it was not meeting its obligations to protect birdlife. These changes were renegotiated in 2013 and 2015 and the changes will mean that less water is available for irrigation once the scheme is fully operational, so a further renegotiation is likely to take place in the future.

For more details see the Segarra Garrigues Irrigation System Case Study.

In practice, it is not uncommon for the events described above to lead to renegotiation, as is detailed in Section 4.3 (Summary data analysis), where causes such as increased construction costs are shown to be common. However, this does not alter the fact that value for money will likely be diminished where these risks – which were priced into the original bid – are not borne by the Project Company.

This type of circumstance may leave the Procuring Authority in a difficult situation when assessing whether to renegotiate the contract. On the one hand, the Procuring Authority needs to ensure that public sector interests are protected, and the Procuring Authority is retaining the value for money forecast at financial close. On the other hand, it has a sometimes-conflicting interest to ensure that the underlying public services continue to be provided.

The Procuring Authority should weigh up not only the risks of agreeing a worse position for itself, but also of agreeing a better position if it is at the expense of the Project Company. It may be a short-term victory if the Procuring Authority ‘wins’ the renegotiation but finds the Project Company becomes insolvent and the project is back on the Procuring Authority’s books to manage.

This decision also requires careful consideration of the costs of alternatives, which should be informed by public sector benchmarking and assessment of market conditions. Benchmarking with respect to scope changes is detailed in Section 3.5 (Claims).

The success of the project may be the main goal of the Procuring Authority and so, if the Project Company proves that the feasibility of the project depends on the revision of the contract, a renegotiation will be more likely to be considered as appropriate. In some examples, changes appear to have been accepted by the Procuring Authority to ensure the project remains viable. However, where changes are accepted to ensure the viability of a project, this might send the wrong signal into the market, in particular, if it changes the risk allocation.

The outcomes of renegotiations in the collected data suggest that several projects were facing financial challenges and that the outcomes were agreed to preserve the public interest in the project.

D. Consider termination as an alternative to renegotiation

One option which is perhaps dismissed too lightly is termination, either because the project will fail automatically through insolvency if not renegotiated, or because the Procuring Authority has a right to terminate.

Termination may be seen as a taboo subject, in particular due to the political fallout of such a step and the perception that the Procuring Authority has failed to deliver the outcome it promised, even though, in such a situation, it may be that the contract has done exactly what was intended. In most default termination scenarios, it can be expected that the private sector will have taken a significant financial hit – loss of equity and likely a loss of a material part of the senior debt.

A Procuring Authority should not accept a less favourable outcome than simply terminating the PPP contract and making the termination payment. Termination of the PPP contract is detailed in Chapter 7 (Default and termination).

EXAMPLE**Project Company difficulties in obtaining finance**

The Project Company in one of the case studies in Brazil is facing financial difficulties with lower than expected toll revenue, and challenges in raising the required debt finance. The Procuring Authority is considering extending the period in which investment can be completed, as well as whether to take an alternative approach:

- Terminate the PPP contract and retender the project
- Replace the equity investors with new equity investors capable of raising the required debt finance
- Require the existing equity investors to commit additional equity

For more information, see the Brazil Toll Road Case Study.

E. Ensure adequate resourcing is employed during a renegotiation

When faced with a renegotiation, the Procuring Authority should ensure that it has adequate capacity and information to carry out the negotiations. This requires a good understanding of the contractual arrangements, and adequate reporting and measurement systems for tracking the progress of the project.

PPP contracts are complex arrangements and external advisors will typically be needed to make the correct decisions. Engaging external advisors is detailed in Chapter 2 (Contract management team set-up and training). Resourcing and preparation for the renegotiation needs to be on a similar level as the original negotiations in the tender process. The Project Company will often employ specialists, bringing experience from a wide range of projects for these purposes, and the Procuring Authority should aim to match that level of experience.

The Procuring Authority's analysis should involve a prudent combination of advice: commercial, financial, legal and technical. Each stakeholder or advisor may bring a different perspective to the proposed renegotiation and the Procuring Authority's position (and confidence to negotiate)

will typically improve dramatically when a combined analysis of this nature is carried out.

A key consideration is the potential impact that a renegotiation will have on the risk allocation agreed between the parties at financial close. The allocation of project risks between parties is normally carefully developed, negotiated and agreed in the PPP contract and the aim should be for this allocation to be maintained through any renegotiation, though it may have to be adjusted if there are significant changes. For guidance on typical risk allocation arrangements between the Procuring Authority and the Project Company, see the GI Hub's PPP Risk Allocation Tool.²

This decision also requires a careful cost assessment of the proposed renegotiated solution, which should be informed by public sector benchmarking and assessment of market conditions. Benchmarking with respect to scope changes is detailed in Section 3.5 (Claims). The termination payment can also act as the reference price in a renegotiation.

Renegotiations in PPP contracts that are poorly carried out can be very costly for the Procuring Authority (with adverse impacts on taxpayers), for end users of the services, for other government institutions, or all the above, as they have the potential to drastically change what was agreed to at financial close.

In some jurisdictions, advisors are available at the bidding stage to assist with negotiation (e.g. through a project preparation facility). However, such funds for advisors are typically no longer available when circumstances arise that require a renegotiation. This can cause issues particularly where the Project Company is well resourced for the renegotiation. This is an area where development banks can take a role in particular markets.

F. Consider the transparency of the renegotiation process and ensure good record keeping practices

Renegotiation can increase the chance of a dispute or challenge. This is particularly the case in developing markets with weaker institutional frameworks that lack the following features:

- A defined and transparent process and framework for renegotiation
- Transparency of the renegotiation process

² Available at <http://ppp-risk.gihub.org>.

- Established guidelines for levels of compensation
- A transparent framework for conflict resolution in the renegotiation process

The final decision on a renegotiation should be based on full disclosure of long-term costs, risks and potential benefits. The case for a renegotiation should be made explicit and recorded so that the decisions are made in a rational and defensible manner. Evidence should demonstrate that project distress is material and likely to result in default under the PPP contract or other serious adverse implications should it continue. The evidence should demonstrate that the distress is likely to cause adverse outcomes for the public sector and/or users of the service. Information management is detailed in Section 3.4 (Information management).

G. Ensure compliance with the regulatory framework in relation to a renegotiation

As renegotiation can have significant financial (direct and contingent) implications for the Procuring Authority, some form of fiscal oversight similar to the one used in the original PPP contract approval mechanism will typically be required. Regulatory frameworks typically separate responsibility for the approval of amendments from the Procuring Authority personnel who manage the renegotiation.

Oversight measures include procurement laws (to address instances where the risk allocation changes significantly and other bidders could have been more successful under the new structure) and state aid laws (to address instances where an unjustified benefit is granted to the Project Company).

Some specific examples of oversight include relevant thresholds on the project capital value, such as regulation in Chile, which prescribes a limit of 20% of approved capital value for renegotiations before Ministry of Finance approval is required; and a similar threshold in South Africa, which requires any 'material' amendment to be approved by its National Treasury. The applicable law may also distinguish between renegotiations and scope changes, and provide different thresholds.

There may also be merit in the establishment of independent technical panels capable of assessing the merits of a renegotiation. An independent panel demonstrates government commitment to a structured process that is likely to improve market certainty and reduce opportunistic calls for

renegotiation. For example, in the Philippines an Investment Coordination Committee evaluates the monetary implications of major projects.

H. Consider the associated private partners' roles (including the lenders' role) in a renegotiation

Though the Project Company will typically be the key party involved in renegotiating with the Procuring Authority, other private partners will also have interests and likely veto rights with respect to material PPP contract amendments. Such parties include lenders and key contractors in certain circumstances. The contractual review to assess a renegotiation should therefore include a review of any relevant direct deeds the Procuring Authority has entered into with the lenders and/or key contractors (such as the construction contractor). For example, where the Project Company is required to incur additional capital expenditure, that expenditure will need to be financed.

I. Be aware of the broader implications of a renegotiation, including assessing opportunities for procurement of better PPP projects

It is prudent to assess whether a renegotiation on any particular project may be symptomatic of a sector-wide or industry-wide issue. If any systemic factors can be identified, then a more robust (policy) change should be considered for future PPPs.

It is typical that more complex provisions, particularly in respect of remuneration and compensation, bear a greater likelihood of being the subject of renegotiations. Therefore, it is important that details of these provisions are shared between similarly structured projects and are incorporated into the preparation of new projects.

Similarly, if the risk allocation agreed between the parties at financial close is adjusted as part of a renegotiation, it should be assessed whether that adjustment should be incorporated into the preparation of new projects. For guidance on typical risk allocation arrangements between the Procuring Authority and the Project Company, see the GI Hub's PPP Risk Allocation Tool.³

³ Available at <http://ppp-risk.gihub.org>.

EXAMPLE**Reviews in India and Brazil**

PPPs in India were suffering from several systemic challenges, including delays in land acquisition, difficulties in the shifting of utilities and right of way issues, often culminating in disputes. On the private sector side, inadequate due diligence and aggressive bidding led to project failures. As a result, the Indian Finance Ministry appointed a committee to review PPPs with a focus on the assessment of challenges associated with contract renegotiations, the adequacy of risk allocation, contract drafting and institutional capacity. Several recommendations were made for improvement.

Lessons from previous PPP contracts have informed new contracts in the Brazilian electricity sector. The Procuring Authority (the national energy regulator, ANEEL) observed that difficulties in obtaining environmental permits often led to extensive delays and occasional project terminations. Consequently, ANEEL altered the bidding process to introduce a step to assess the feasibility of a proposed project from an environmental perspective, thus reducing the risk of environmental permitting causing delays.

4.3 Summary data analysis

This section provides a summary of the renegotiation data analysis. The full data analysis is available in Appendix A (Data analysis).

The study found 48 examples of renegotiation, out of the 146 projects for which data was available, which is an incidence of 33%. It should be noted that the prevalence of renegotiation results is heavily influenced by the timeframe that was selected for the research (i.e. projects that reached financial close between 2005 and 2015, inclusive). While all projects in the sample have been running for at least two years, this reduces for each subsequent year, and only 50 projects have been in progress for more than eight years. The influence of this is that, while only 33% of projects in the entire sample experienced renegotiation, the data indicates that 45% of PPPs have experienced renegotiation by their fourth year after financial close. This suggests that the true prevalence of renegotiation is higher than was found in the study, due to the timescales involved.

There are several other interesting findings from the data collection on renegotiations that relate to prevalence of renegotiations in particular regions, particular sectors and at particular times after financial close.

As demonstrated in Appendix A (Data analysis), the transport sector has the highest incidence of renegotiations overall, with 42% of transport projects renegotiated compared to 33% of projects overall.

As also demonstrated in Appendix B (Data Analysis), the average period of time after financial close for renegotiation to occur was 3.6 years. Where the renegotiation occurred during the construction phase, it occurred on average 2.5 years after financial close. Where it occurred during the operations phase, it was on average 5.0 years after financial close. For the reasons noted above in relation to the timescales involved, this average period may change for projects as they reach full contract duration. Large numbers of renegotiations took place between two and four years after financial close, with 7% of the 146 projects studied being renegotiated in the third year after financial close.

Table 1 sets out the prevalence of renegotiations in different regions based on data collected on all projects at all stages after financial close. It should be noted that, for the regions with less data available, only a small number of projects

were investigated. The percentage prevalence for the regional information is therefore not statistically significant.

Table 1: Prevalence of renegotiation by region

Region	Projects with data	Renegotiation events	Percentage
East Asia	17	2	12%
Europe	43	12	28%
Latin America and the Caribbean*	43	25	58%
Middle East and North Africa	8	1	13%
North America	5	2	40%
South Asia	14	5	36%
South East Asia	8	1	13%
Total	146	48	33%

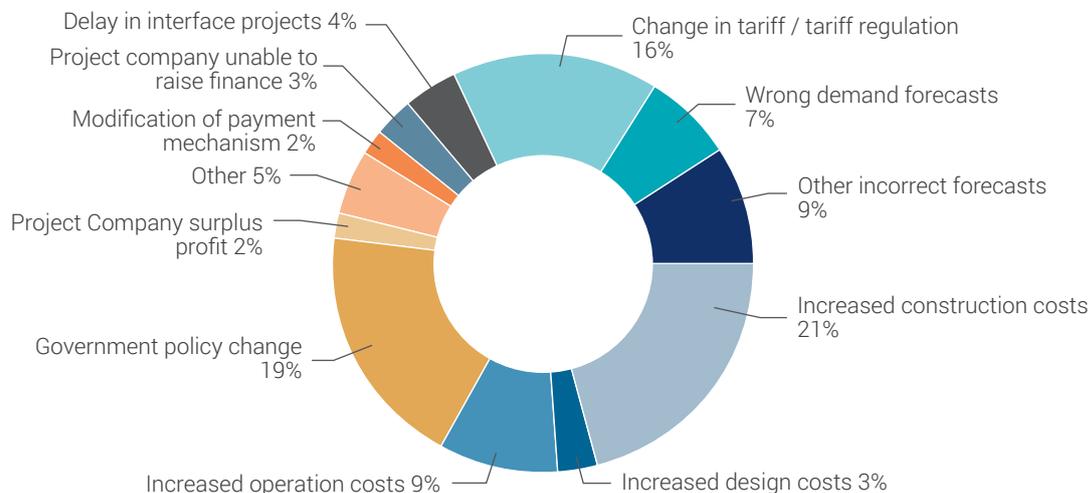
*Note: It is understood that the prevalence of renegotiation in Latin America is due in part to the Brazilian government unilaterally changing electricity tariffs in 2012, which led to many renegotiations on energy projects and hence has skewed these results. Affected Brazilian power projects make up 11% of the projects in Latin America, and 3% of the total sample data.

Typical causes of renegotiation and typical outcomes, including a detailed analysis of some of those causes and outcomes are detailed below.

Causes of renegotiation

Figure 1 depicts the causes of renegotiations recorded on the 48 PPPs globally where renegotiation occurred. This section analyses the causes of renegotiation, including commentary on which party is most likely to commence renegotiation for specific issues.

Figure 1: Causes of renegotiation, based on 48 projects that experienced renegotiation



The causes of renegotiation in the study were varied, with the most common cause being increased costs. In 17 projects the renegotiation was due to increased costs (12 during design and construction and five during the operations phase), while another nine were due to a change in regulation or policy change. A further nine were due to modification of the payment mechanisms and/or a change in tariff. Five were due to incorrect demand forecasts, including in the Queen Alia International Airport Expansion Case Study, where the actual volumes were higher than predicted. Another common cause was delays to interface projects, such as a high speed rail link which relied on the construction of an adjoining high speed rail project, which was delayed.

Renegotiation in the energy sector was mostly caused by a change in tariff, while the causes in the transport sector covered all of those described above.

The party initiating the renegotiation was split evenly between the Project Company and the Procuring Authority. This was the case both overall, and within Europe and Latin America (the two regions with significant numbers of renegotiations).

The study confirmed that the Project Company often initiates a renegotiation when it is facing financial difficulty or potential insolvency. The main causes of this financial stress were increased construction costs (though increased design or operating costs also played a role) and incorrect demand forecasts.

Factors that may affect costs and revenues and lead to renegotiation include aggressive bidding, and a lack of preparatory studies which increases construction risk. They may also be related to weak contract monitoring, or the Project Company's perceived leverage to influence the Procuring Authority to grant them additional benefits through a renegotiation.

The study showed that the main causes of a Procuring Authority initiating a renegotiation include a change in tariff or payment mechanism, followed by government policy changes and changes in scope. Internal drivers from the government include elections, where the new administration changes the underlying policies around PPPs, or changes in user demands over the level of service or the price of the service leading to public unrest. A road project in Latin America (not covered in detail in the study) experienced the latter situation, where public

objection of the toll rates meant the Procuring Authority had to renegotiate the PPP contract to adjust for a lower available toll rate.

Renegotiation can be brought about by external drivers such as significant changes in economic circumstances, including macro-economic conditions beyond the control of the parties, or unforeseen natural events or disasters. Renegotiation instigated by the Procuring Authority for several highway PPPs took place in the Republic of Korea (also not covered in detail in the study) to share the benefits of refinancing.

Both parties are likely to resort to renegotiation in the case of poorly written contracts and ambiguous risk allocation.

Although both parties can have reasonable and legitimate reasons to initiate a renegotiation due to any of these reasons, they also sometimes seek an opportunistic gain through renegotiation. This issue is detailed in Section 4.3 (Guidance).

EXAMPLE

Highways in India

The research indicates a high risk of renegotiation on highway PPPs in India. This is often adopted as a solution to disputes about increased construction costs due to a failure to secure right of way and land acquisition on time, or due to utilities diversion.

Outcomes of renegotiation

The most common outcome of renegotiation in the study was a change in tariffs. There were 13 examples of increased tariffs, mainly across projects in Europe and Latin America. There were another seven examples of reduced tariffs. The outcome of a renegotiation in Portugal resulted in the payment mechanism being changed entirely.

Another common result of renegotiation was a change in construction scope or contract duration. A change in scope because of renegotiation occurred 12 times in the construction phase out of the 146 PPPs for which the relevant data was available globally, but only once in the operations phase. This pattern was particularly common in Latin America, where these results occurred 13 times in total of the 43 PPPs for which the relevant data was available.

The construction scope changes ranged from reductions in scope on the Baixo Highway project in Portugal, to changes in tunnelling works due to ground conditions on two projects in Brazil and the Netherlands, and a large increase in investment in the Queen Alia International Airport Expansion Case Study in Jordan.

Several renegotiations took place in relation to the Sao Paulo Metro Line 4 project in Brazil to address construction delays. The construction phase was extended as a result; however, after ongoing issues, the project was eventually terminated and retendered.