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Risks, Renegotiation and Regulation of PPPs in the Road Sector in Portugal

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Contents

- Introduction
 - Portuguese Road Sector
- Risks
- Renegotiation
- Regulation
- Conclusion / Key Ideas

Introduction

Portuguese Road Sector

Problem

- Poor Highway Network
- Safety Issues

Restriction

- Public funds have to be available for other areas
- EU public debt and budget deficits restrictions

Solution

- Portuguese government used PPP arrangements (concessions) to deliver road infrastructures

Result

- The country is now equipped with an highway network that allows to travel on quality roads with ease and convenience



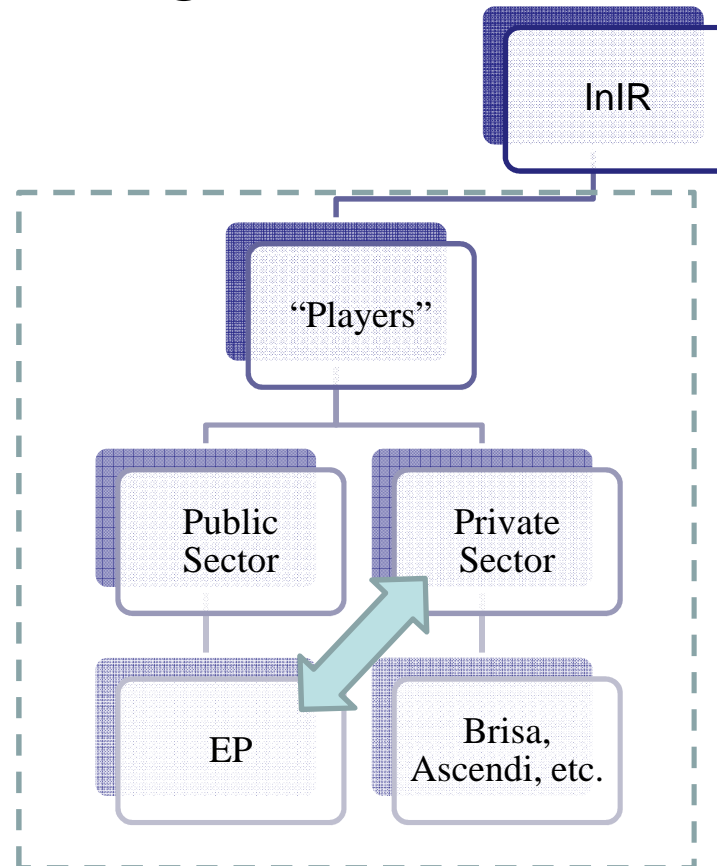
Introduction

Portuguese Road Sector

- In 2007, with the implementation of the **New Road Sector Management and Financing Model**, several changes have been introduced, including:
 - New role to the *Portuguese Road Company* (EP);
 - The Creation of a **new sector regulator**, the *Institute for the Road Sector* (InIR)

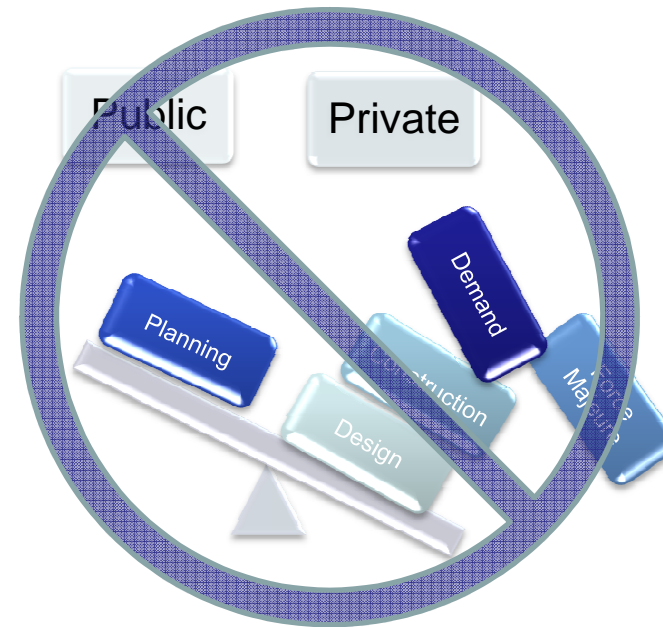
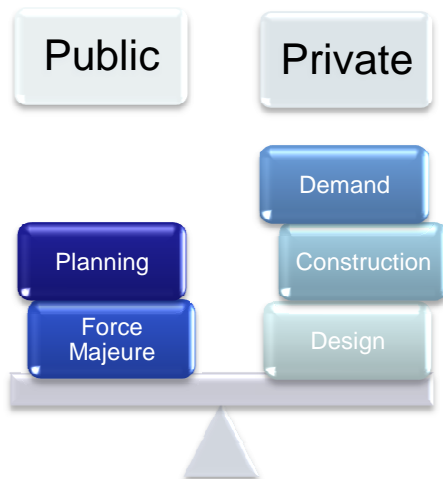
Introduction

Portuguese Road Sector



Risks

- The general principle is that “each risk should be carried by the party best able to assume or mitigate it” (Shaw, 1996)
- A poor risk allocation may compromise the value for money of the project.



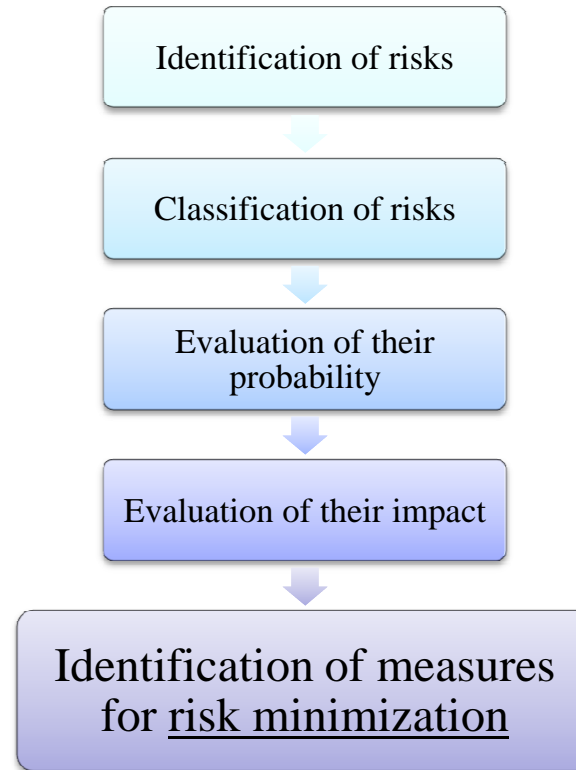


Sharing the road

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Risks

- The evaluation of risks in a PPP involves a number of steps (Marques and Berg, 2009) that should be taken before the risk allocation:



Risks

Major risks and their generic allocation in Portugal's PPP road projects:

Risks	Responsibility	
	Public	Private
Planning	■	
Design		■
Environmental Compliance	■	
Land Acquisition		■
Construction		■
Operation		■
Technological		■
Performance		■
Maintenance and Major Repairs		■
Demand (Traffic)	■ *	■ **
Capacity		■
Competition		■
Inflation		■
Financing		■
Public Contestation	■	
Unilateral Changes	■	
Regulation		■
Change in Law	■	
Force Majeure	■	

* Shadow tool **Real tool

Renegotiation

- There are **no perfect** and complete contracts
- Renegotiation is an **unavoidable** part of a road concession life cycle

“In principle, renegotiation can be a positive instrument when it addresses the inherently incomplete nature of concession contracts. Properly used, renegotiation can enhance welfare” (Guasch, 2004)

Renegotiation

- However, it can be seen as the contract **major failure**, since all initial rules defined in a competition level are perverted.
- In the “renegotiation table” there are **no competitive environment**, and sometimes, it might lead to **opportunistic behavior** by the parties involved.
- In Portugal, most of the contracts have been renegotiated. Due to asymmetric information and to the better resources of the private partner, sometimes, the public partner accept terms that might not be the most beneficial for society.

Renegotiation

Regulation

“The establishment and implementation of a set of specific rules, essential for the balanced operation of a particular sector on the basis of public interest” (Marques, 2005)

- Regulation has currently assumed an **increasing importance**;
- The existence of an independent and efficient regulator may bring **benefits to both parties**;
- The regulator will take into account the objectives and concerns of the private partner without forgetting the PPP main purpose which is to **maximize value for money**;

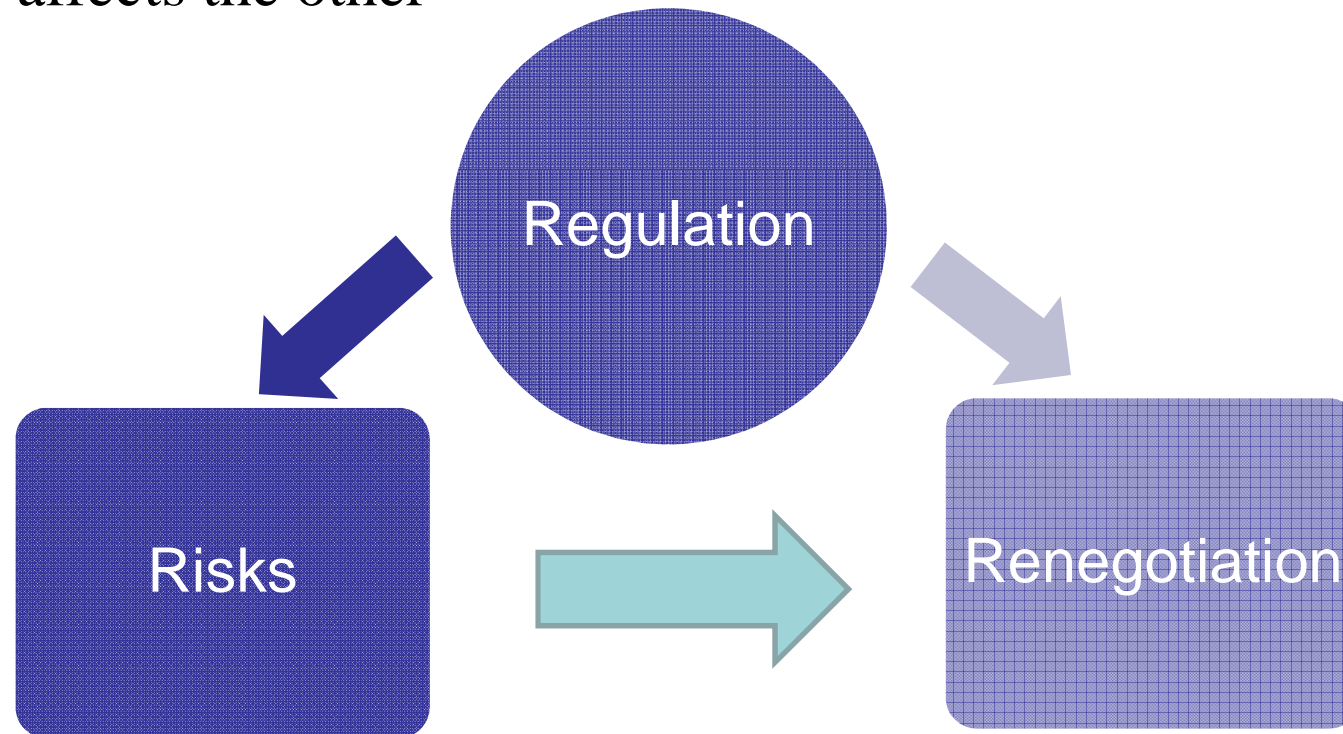
Regulation

- In Portugal, InIR is the sector specific regulator for the road sector;
 - Due to his recent creation, InIR is not yet performing his functions with the desired completeness;
 - It should assume a more active role in tender and contract renegotiations processes and at the risk management issues.
- EP still plays an important role in economic regulation and contract management functions of the public sector;
- There are other public entities with regulation and supervision powers, among them, the Portuguese Court of Auditors.

Conclusion/Key Ideas



- Risks, Renegotiations and Regulation have to be studied as a whole, because each one of them affects the other



Conclusion/Key Ideas



- The **risk management** process must be set depending on the specifications of each project.
- Before the **risk allocation** itself, the public sector should go through risk identification, classification, evaluation and mitigation steps.
- **Renegotiation** could be seen as a useful tool in maintaining the sustainability for both parties still involved in the agreement.
- Nevertheless opportunistic behavior may arise, taking advantage from the non competitive environment at renegotiation table.

Conclusion/Key Ideas



- The level of **regulation** required increases or decreases according to the contract incompleteness;
- InIR, which is under development, taking its first steps as the **sector regulator**, may have a more active role relating to risk management and renegotiation matters, in the latter, should always be one of the elements present when these processes take place.

In Portugal, it's unquestionable that PPPs in the road sector brought development in a area that was far behind schedule. However, there is still room for improvement, for instance with better designed contracts which allocate better the risks and mitigate the possibility of renegotiation or if the regulator becomes more independent and is endowed with more tools.



Questions or opinions??

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