

# PPPs in the Middle East

*by Richard Keenan, in Dubai*

There is currently a lot of focus across the Middle East on the public-private partnership as a viable means of procuring public infrastructure such as power plants, water desalination and wastewater, roads, transports, school and hospitals.

The PPP model undoubtedly has its pros and cons and its supporters and detractors. However, if a PPP project is effectively managed, the participation of the private sector should increase the likelihood that a project will be completed on time and on budget.

## Use in the Middle East So Far

PPP projects have been done in the Middle East since the early 1990s. The Al Manah project in Oman was the first independent power project to be developed in the Persian Gulf using the PPP model. However, until recently, most PPPs have been done on an *ad hoc* basis without there being a PPP law or government policy underpinning the project.

In some sectors, this approach has proven to be very successful, particularly in the power and water sectors.

Some of the stand-out PPP models in the Middle East are the Abu Dhabi Water and Electricity Authority's power and water model, the Oman Power and Water Procurement Company's power and water model, the Bahrain power and water model and the Saudi power and water model.

Each of these authorities has implemented tremendously successful PPP programs. These models have been tried and tested with the international banking market numerous times.

Why have the models used by these authorities been so successful?

There are a number of reasons. The economics of these projects are sound. Equity investors typically achieve an internal rate of return of at least 13%. The essential nature of the service contributes to the success. Electricity and water are basic necessities for which demand has skyrocketed over the last 20 years.

The level of government support behind these projects has also been very important. The support has taken various forms, but has included ministry of finance guarantees,

although there has been a push back on these from certain tendering authorities over the last year or so. The sponsors of the Rabigh and PP11 independent power projects in Saudi Arabia did not benefit from a ministry of finance guarantee and neither will the sponsors of the Muharraq sewage treatment project in Bahrain.

Another form of support has been contractual assurances built into offtake agreements as to both fuel supply and power and water offtake—in effect the equivalent of a tolling arrangement. These structures ensure that the project is not exposed to market risk with respect to the offtake.

Payment regimes typically include guaranteed capacity payments in the event operation of the plant is affected by political force majeure. The project documents also provide for termination compensation that ensures the government is required to buy the project at a price sufficient to pay all outstanding senior debt in most termination cases, except where the project company defaults. There have also been tax and custom duty concessions and sovereign immunity waivers.

Well-structured project agreements with bankable risk allocation also have been a key to success. Mark ups of project documentation on bids for these projects have become lighter and lighter. It has become increasingly difficult for bidders of these projects to take the position that a particular provision is not bankable when it has been banked 10 times before. Mark ups of project documentation for these projects are now more or less confined to deal-specific content.

Another key factor has been very well-managed tendering processes. This has undoubtedly helped foster market confidence.

However, the track record in other sectors in the Middle East has not been so impressive.

There have been very few PPP projects in the transport sector. Abu Dhabi has recently tendered the Mafraq to Ghweifat highway project. There have also been very few projects in the health and education sectors. Abu Dhabi is probably again leading the way in the education sector having recently financed two university PPP projects—the Zayed and Paris-Sorbonne University PPPs.

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### Impediments to PPPs

Despite the success in some cases, significant impediments remain to broader use of PPPs in the region. The reasons for this are many and varied.

They include lack of political will to reduce public sector control over the provision of basic services, political and country risk (perceived or actual), lack of international investor and lender confidence with respect to PPPs in certain sectors, lack of PPP experience by some regional government departments and the absence of comprehensive PPP-enabling legislation or policy frameworks.

Some of these problems have led, in turn, to a difficulty in attracting the number and type of private sector participants needed to achieve the appropriate level of private sector competition that is so important for the successful implementation of PPP projects.

One may legitimately question whether a PPP law is necessary when there are a number of examples of very successful PPP programs in place in the Middle East that have been implemented in the absence of an enabling PPP law.

While most governments tend to have procurement rules, the rules are often not customised for PPP and can impede efficient procurement. In order for the private sector to invest in a PPP, the public sector should have the legal ability or basis to enter into long-term contracts and agreements with lenders and investors. The advantages of having a PPP law and framework are many.

A PPP law would provide a clear legal basis for a project by eliminating the potential for conflicting laws and legislation. This would help instill confidence in the private sector.

The implementation of PPP projects is often hindered by a lack of clarity in terms of how procurement rules are applied to a project. This sometimes delays projects resulting in increased costs for bidders and can even result in the cancellation of projects. One of the primary benefits from a PPP law is the establishment of clear procurement rules and procedures. Having transparent eligibility criteria makes potential bidders more confident they have a reasonable chance of winning the bid and attracting more bidders.

PPP laws often require the relevant authority, prior to tendering a project, to carry out an analysis of the economic benefits of the project and whether it is technically and commercially feasible.

This instills confidence in the market that the government has given due consideration to the need for the project prior to tendering the project and is not going to pull the plug on the project half way through the tendering process.

Most PPP laws embody a value-for-money requirement. The principle behind the value for money and a whole-life costing approach is that the government should seek the best value and not necessarily the lowest initial price. Bid comparison is carried out on whole-life costs (including maintenance costs). The bidders must ensure that their costs are the lowest for the whole life of the concession and not just the initial construction costs.

The way in which disputes are dealt with is often an area of concern for participants in PPP projects.

One area of particular concern to private investors is the enforceability of contracts against the government and the finality of judgements handed down by courts or arbitral tribunals outside the host country. Investors will usually desire some degree of certainty in this respect, seeking waivers of sovereign immunity and assurances that foreign judgements and arbitral awards rendered in accordance with a PPP project agreement cannot be litigated again in the courts of the host country.

One of the advantages of a PPP law is that they often regulate how disputes under project agreements are settled and allow for waivers of sovereign immunity.

### PPP Legislation in the Middle East

Of the six Gulf Cooperative Council nations, Oman, Bahrain and Kuwait have gone the furthest in terms of implementing enabling legislation.

In 2002, the government of Bahrain enacted legislative decree No. 41, "With Respect to Policies and Guidelines of Privatization." In 2004, the government of Oman enacted a royal decree known as the "privatization law." Both the Bahraini and Omani laws are fairly broad in scope and essentially establish a platform for the privatization of industry sectors. The Bahraini law makes specific reference to the tourism, communications, transport, electricity, water, ports and airports, oil and gas and postal sectors.

The Omani privatization law is more prescriptive in terms of regulatory rules.

In contrast, the government of Kuwait in 2008 enacted what is commonly referred to in Kuwait as the PPP law. The legislation is comprehensive and

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establishes a framework for implementation of PPP projects in Kuwait. One of the things this law does is establish a partnerships technical bureau that is the central government agency for the PPP program. The bureau is in charge of the financial and technical evaluation of PPP projects and is involved in all phases of a project, from inception through to financial close.

With respect to the remainder of the GCC countries, Qatar, the United Arab Emirates and Saudi Arabia, the legislative framework is less developed.

That is not to say that these countries are trailing behind the others in terms of numbers of PPP projects. Abu Dhabi is probably leading the way when it comes to the development of PPP projects, and Saudi Arabia is not far behind.

Outside of the GCC, probably the country in the Middle East with the most advanced enabling legislation is Egypt. Last year, the Egyptian government adopted a "Law on Regulating the Participation of the Private Sector in Infrastructure and Public Utilities Projects."

The deal flow coming out of the PPP central unit in Cairo is impressive. The New Cairo wastewater project reached financial close last year. Requests for proposals are expected soon for the Abu Rawash wastewater treatment plant and the 6 October wastewater treatment plant. Two or three additional wastewater treatment plants are scheduled to hit the market within the next year.

Projects in the transportation, health, university and schools sectors have either recently hit the market in the form of requests for qualifications or requests for proposals or will do so shortly.

In terms of the power sector, the Egyptian government has recently adopted a five-year plan for new power generation. The Egyptian Electricity Holding Company is proposing to procure between 2,000 and 3,000 megawatts of new power plants each year for the next five years. The Dairut independent power project will be the first. This project is expected to be tendered in the first quarter of 2011. EEHC reported earlier this year that it received 19 separate applications in response to its request for qualifications in connection with the Dairut IPP.

There is an obvious correlation between the implementation of Egypt's new PPP law and the significant increase in the number of PPPs either currently in the market or very soon to come to the market in Egypt.

## Egypt's PPP Law

Egypt's PPP law establishes a PPP central unit within the Ministry of Finance. The PPP central unit has overall responsibility for the development of the PPP program in Egypt.

The PPP law also establishes a "supreme committee for partnership affairs." Members of this body include the prime minister, various ministers and the head of the PPP central unit. PPP projects cannot be tendered without the approval of the committee.

Article 2 of the PPP law prescribes what must be in a PPP or "partnership contract." The duration of the partnership contract must be at least five years and cannot exceed 30 years from the date of completion of construction, provided that cabinet may, based on the recommendation of the supreme committee for partnership affairs, agree to enter into a partnership contract for more than 30 years if the project is essential to the public interest. The entire value of a partnership contract cannot be less than one hundred million Egyptian pounds. The project company is not permitted to start receiving any payments until an acceptance certificate in relation to the relevant works or plant has been issued by the relevant authority.

There a number of provisions supporting the financing of PPP projects that allow for the creation of share pledges in favor of project financiers or the creation of security interests in favor of lenders with respect to the project company's assets and for the relevant government authorities to enter into direct agreements with project lenders.

The relevant government ministries or agencies are entitled to amend the terms of a partnership contract. Such modification may include changes to the prices of products or the charges for the services, provided that the project company is compensated in accordance with the terms of the partnership contract.

There is an express prohibition on confiscation or compulsory acquisition of project assets by the government.

Each ministry or department of government that procures a PPP project is required to establish a prequalification committee for the purposes of determining whether a potential investor satisfies the eligibility criteria. Investors not included in the qualified investors list may file an objection against the qualification committee.

For each project, a project feasibility study must be carried out by a special committee set up for this purpose. Once this assessment is completed, the PPP central unit reviews the findings of this committee.

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The procuring authority may, with the permission of the PPP central unit, elect to tender a project in two phases. The first phase will be a non-binding bid that includes the broad terms of the bidder's technical and financial offer followed by a "competitive dialogue" with the qualified investors. In the second phase, final bids will be submitted upon which the final evaluation is based.

Like many of the GCC tendering procedures, offers are submitted in two closed envelopes, one for the technical offer and the other for the financial offer.

Offers that are incompatible with the RFP conditions and specifications must be disqualified. Negotiations with a successful bidder may take place with respect to certain technical and financial aspects of an investor's bid. However, these negotiations must not tackle any contractual terms of the RFP that are stipulated as being non-negotiable or any terms that are not subject to reservations raised by the bidder in its offer.

A tender may be cancelled in the event only one offer is submitted or if there is only one offer left after the disqualification process, if all or most of the bids contain reservations that are incompatible with the RFP requirements, if assumptions or reservations made by the bidders are difficult to evaluate, or if the value of the lowest priced offer is unjustifiably more than the government price endorsed by the supreme committee for partnership affairs.

The PPP law establishes a grievance committee composed of various government officials. The grievance committee has the power to consider all grievances and complaints submitted by the investors or consumers during the bidding, awarding and execution phases of partnership contracts. Any decision it renders is final and binding. ©

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