

THE PUBLIC–PRIVATE
PARTNERSHIP
LAW REVIEW

NINTH EDITION

Editors

Matthew Job and Tom Marshall

THE LAWREVIEWS

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PREFACE

It has been a privilege to contribute to and edit *The Public–Private Partnership Law Review* over the past three years and we are very pleased to present this ninth edition. Doing so has provided an insight into how public–private partnerships (PPPs) are used and perceived around the world and has introduced us to people and opportunities that would otherwise not have arisen for us. Since the publication of the eighth edition a year ago, there have been significant developments in the design and use of PPPs in some parts of the world, while in other parts little has changed. The purpose of this volume is chiefly to report the current state of PPP across a range of jurisdictions around the world.

Twelve months ago the world was finally beginning to look beyond the impact of the covid-19 pandemic and we speculated that PPP might have a role to play in the economic recovery that was then anticipated. In practice, the past year has been dominated by fallout from the war in Ukraine. While the conflict may be geographically limited, the economic consequences have been felt around the world.

Many international businesses have closed down their operations in Russia and most of Europe has been forced to move its supply of natural gas from Russia, resulting in an energy price spike and fears about energy security. Russia's blockade of Ukrainian food exports has resulted in food shortages and higher food prices across the globe. Energy and food prices have triggered global inflation, which many commentators felt was always a latent but inevitable consequence of quantitative easing and covid lockdown support measures. Higher inflation has led to fiscal tightening and higher interest rates, finally calling time on the low (often virtually zero) interest rate environment that has prevailed since the financial crisis in 2008. All in all, the economic background for PPPs could hardly be more different than it was a year ago.

Against that backdrop, PPP continues to be a key procurement tool for both national and local infrastructure projects in a diverse range of countries such as Australia, France, Italy, Pakistan, Saudi Arabia, South Africa, Thailand, the United Arab Emirates and Uzbekistan. PPP legislation has been bolstered in Indonesia and Italy, following on from the new PPP laws that we saw in 2021 in Senegal and Uzbekistan. Indonesia continues to have an ambitious PPP pipeline although progress to implement its national development plan has been slow. Perhaps the most impressive national performance for PPP has been in Uzbekistan – in a year that our contributors describe in Chapter 15 as 'truly pivotal', Uzbekistan has signed 178 PPP projects with a total capital value estimated at US\$4.5 billion.

Meanwhile, PPPs continue to be under examination in a number of jurisdictions, particularly in European countries that have long-established and relatively mature relationships with PPPs (such as the United Kingdom, the Netherlands and Portugal), but also in Latin American countries such as Argentina and Mexico (where some large projects

that were previously slated to be PPPs have been restructured as traditional public works contracts). As ever, the principal case against PPP is the embedding of a private sector cost of capital in place of cheaper sovereign borrowing and the assertion that this makes it an expensive procurement model whatever the benefits in terms of risk transfer and private sector procurement expertise.

Climate change and energy transition has been a global trend for several years, but arguably it has been concerns about energy security as a result of the Ukraine war that have accelerated a push towards new privately financed energy transition projects in Europe, particularly in the United Kingdom and France, which have seen new revenue models and legal structures for new nuclear power, carbon capture and storage and hydrogen projects. PPP projects for renewable energy and grid stability to support renewable energy have also been seen in Australia and South Africa.

So where does this leave the outlook for PPP during 2023 and beyond? Concerns regarding value for money, flexibility and, not least, the validity of the fundamental element of partnership within the PPP model remain. In addition, attention has been given in many places to the most appropriate contractual model for PPPs, and industry consultations have been undertaken as to the extent to which those models remain best suited for the purpose. However, the inclination of many governments to invest in new infrastructure is arguably stronger than at any time in the past 50 years; energy transition alone will require huge infrastructure investment that is largely incremental. The question for those in the industry is how PPP can evolve in order to respond to this opportunity and we are already seeing evidence of this in the United Kingdom in particular.

Furthermore, the advent of inflation and higher interest rates is squeezing growth in many countries, but in particular in Europe. This comes on top of ruinously expensive covid support schemes that have pushed national debt above GDP in many cases and make it less attractive to finance new infrastructure on the national balance sheet. The role that PPP could play in alleviating this remains unclear. In countries such as Germany and, to a lesser extent, the Netherlands and Portugal, there are still concerns as to the suitability of traditional PPP and whether it represents value for money. This has been a particular issue during the past 15 years of very low-cost borrowing for governments and it remains to be seen whether the return of a higher cost of government borrowing will dilute the incremental cost of private sector borrowing in a PPP when compared with sovereign debt.

Meanwhile there is an expectation that infrastructure development will benefit PPP and PPP-like structures in other countries such as Italy, France and the United Kingdom (in those 'consumer pay' sectors where private sector investment in infrastructure is prevalent). In these jurisdictions the prospect of stimulating the economy and delivering new infrastructure, without an immediate cost to the public purse, may be more attractive than ever – especially in sectors where the costs can be routed directly to consumers rather than being a burden on taxpayers and the public finances.

In the United Kingdom we are now seeing the cycle of private finance initiative (PFI) projects from the 1990s turning to hand-back on contract expiry. Although the number of early projects reaching expiry in 2023 will only be in single digits, it rises steadily into double digits over the next two or three years and then continues to rise to a peak of 80 projects scheduled to expire in 2037 alone. Inevitably this begs the question of what will come next and how the government will wish to handle facilities management and refurbishments on a fleet of ageing projects as the existing arrangements come to an end.

Perhaps the most important characteristic of PPP in 2023 and beyond will be its adaptability. PPP in countries as diverse as Argentina, Indonesia and Uzbekistan has never followed the mould of UK 1990s PFI. Elsewhere we have seen the PPP model adapting, for example, in countries such as Norway and the Netherlands where public sector capital contributions on completion reduce the impact of private sector cost of capital over the life of the project, while preserving typical PPP risk transfer and efficiencies during construction. In the United Kingdom and Australia, we have seen the advent of price adjustments and risk sharing based on how the outturn construction cost compares to a target cost; in parallel, the regulated utility model that was traditionally reserved for established operating monopoly networks is increasingly being used to procure new greenfield infrastructure assets.

At Herbert Smith Freehills we are proud of having a long and successful history working within the PPP industry for more than 30 years. We were at the forefront of the market when the PFI model was introduced in the mid-1990s and have followed its evolution around the globe since that time. We continue to believe that PPPs, where used appropriately, are and will remain an important tool for creating the most financially advantageous development, financing, operation and maintenance of infrastructure assets. The use of the PPP model, in addition to financial benefits, imports added scrutiny, rigour and arm's-length contracting practice, which ultimately benefit both the public and private sectors and, most importantly, the consumer and taxpayer. This may prove to be all the more important following the economic shocks of the covid pandemic and the Ukraine war.

In this, the ninth edition of *The Public–Private Partnership Law Review*, our contributors are drawn from the most renowned firms working in the PPP field in their jurisdictions. We hope that you will enjoy and find useful this edition of *The Public–Private Partnership Law Review*. We look forward to hearing any thoughts or comments that you may have on this edition and any thoughts for the content of future editions.

Matthew Job and Tom Marshall

Herbert Smith Freehills LLP

London

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PORTUGAL

*Manuel Protásio and Catarina Coimbra*¹

I OVERVIEW

The public–private partnership (PPP) model started to be widely used from the 1990s onwards, with the purpose of equipping the country with modern infrastructure and services. The sectors that have attracted more private investment in PPP have been the road and railway infrastructure sectors and the health sector, the latter with the innovative feature of placing clinical national health service (NHS) hospitals under private management with an aggressive risk allocation to the private sector. Such PPP activity was boosted further after the international financial crisis of 2008, with the purpose of enhancing the Portuguese economy’s poor performance.

As a consequence of the sovereign debt crisis experienced in Europe in 2011 and, more specifically, of the bailout advanced to Portugal by the European Union and the International Monetary Fund (IMF), public expenditure under PPP contracts was significantly reduced, which has led to the renegotiation of several PPP projects, in particular in the road sector.

Portuguese companies experienced difficult conditions, mainly owing to liquidity constraints and to the slowdown of the Portuguese PPP and construction markets in connection with the economic crisis, leading many of those companies to search for new opportunities in foreign markets, particularly in the Portuguese-speaking countries in Africa.

At the beginning of 2014, the government approved the Strategic Plan for Transport and Infrastructure, which selected some infrastructure projects that could bring positive economic effects to Portugal between 2014 and 2020. The modernisation of the Portuguese rail freight sector, the development and increase in the capacity of the major Portuguese ports, a few projects in the road sector deemed essential to complete the road network, as well as an increase in cargo capacity at Lisbon Airport, are some priority projects. Owing to diverse aspects, such as the limitations of the new European funds framework, some of these future infrastructure projects may be launched and executed under a PPP model.

Existing PPPs were the subject of public disapproval, given the heavy burden that payments by the state under most of those projects – particularly in the road sector – has imposed on the national budget. However, the PPP model has not been completely abandoned, and recently the government awarded the Hospital Lisboa-Oriental Complex project, probably the most important project launched under a PPP model in recent years. Moreover, recent changes to the PPP legal framework, carried out in 2019, are a strong indicator of the government’s willingness to enhance the adoption of the PPP model.

¹ Manuel Protásio is a partner and Catarina Coimbra is a senior associate at Vieira de Almeida.

II THE YEAR IN REVIEW

The year 2022 saw some signs of recovery of public investments further to the covid-19 pandemic, although there is still some uncertainty compounded by the war in Ukraine and its impact on all aspects of social and business activities, particularly on the increase of inflation.

Over the past few years, the growth of PPP businesses in Portugal has been slow, with few greenfield projects coming to the market.

In addition to recurring renegotiations within existing road PPP contracts, the renegotiation and restoration of the financial balance of existing road PPP contracts (which covered the reduction of service requirements and availability payments and, in some road PPP contracts, the possible extension of the maximum duration of the concession contracts) are still the main subject matter, and they still substantially contribute to the public expenditure. Moreover, some PPP contracts (mainly in the road sector) are also under renegotiation for the purposes of financial rebalance arising from the exceptional regime for the financial rebalance of long-term contracts enacted in the context of the covid-19 pandemic, which suspended any clauses and legal provisions providing for the right to financial rebalance or to compensation for loss of revenue between 3 April (the effective date of the state of emergency's first renewal) and 2 May (the expiry of the state of emergency), preventing private parties from relying on these clauses in respect of events that occurred during this period.

Portugal is still one of the European countries with the highest costs assigned to PPP projects (mainly in the road sector), notwithstanding the slowdown in relation to new PPP-based projects over the past few years. In fact, according to the statistical information provided by the European Commission, Portugal recorded the highest ratio of PPP over total gross fixed capital formation between 2000 and 2014, which demonstrates the relative weight of PPP projects within the Portuguese economy.

Evidence of this is seen in the choice of Portugal as the host country for the International Centre of Excellence on PPPs in water and sanitation, in May 2017, with the signing of a memorandum of understanding between the United Nations Economic Commission for Europe (UNECE) Executive Secretary and the Secretary of State for the Environment in Portugal. The Centre, affiliated to the UNECE International PPP Centre of Excellence in Geneva, will be hosted by the National Laboratory of Civil Engineering in Lisbon, and was created with the aim of assisting low and middle-income countries to utilise PPP-based projects for water supply and sanitation services.

As regards the legal framework for PPPs, it is worth noting that the Public Contracts Code has undergone several revisions ever since it was approved, and 2022 was no exception. In order to harmonise the solutions outlined in European directives, Decree-Law No. 78/2022 of 7 November 2022 has introduced some changes to the Public Contracts Code concerning the criteria for the adoption of a direct award (a public procurement procedure in which the contracting authority directly invites an entity of its choice to submit a proposal, subject to legal requirements). In addition to that rule, this reform also brought in new labour requirements. In accordance with the Public Contracts Code, awarded entities must now include a clause on the regime applicable to the employment contracts of workers assigned to PPPs in the specifications. In concession contracts with terms longer than one year, it is mandatory to enter into an open-ended employment contract, and failure to do so could result in a fine of up to €44,800.

The year 2022 was also quite relevant for PPPs in the health sector. The government awarded the construction and concession for the Hospital Lisboa Oriental for 30 years, and it will be built under the PPP regime. The Hospital will be built upon a total area of

180,000 square metres in Marvila (Lisbon) and will have 875 beds, ensuring most of the activity currently performed by the Centro Hospitalar Universitário de Lisboa Central, which includes six hospitals (Hospital de São José, Hospital Santa Marta, Hospital Santo António dos Capuchos, Hospital D Estefânia, Maternidade Dr Alfredo da Costa and Hospital Curry Cabral) in addition to covering all the clinical specialties available in the six current units in the Lisbon region (including rheumatology, nuclear medicine and radiation oncology). It is expected that the new Hospital will benefit not only the citizens of Lisbon but also those who live in Alentejo and Algarve.

Additionally, a Spanish group has been awarded the contract to manage the Cascais Hospital PPP, which had been under the management of a Portuguese group since 2008. During the past 14 years, the Hospital has carried out 1.9 million consultations, 134,000 procedures, 2.1 million emergency room visits and 32,000 births in its maternity unit. Cascais Hospital is one of the PPPs in the Portuguese health sector that achieved the greatest notoriety at the time, both financially and in terms of service provision.

III GENERAL FRAMEWORK

i Types of public-private partnership

Both institutional and contractual PPP structures are available in Portugal. However, institutional PPP structures are not commonly used. In fact, the majority of PPP projects closed to date in Portugal are based on project finance contractual structures and typically follow a build-operate-transfer or design-build-finance-operate model.

The underlying contractual framework of a PPP transaction in Portugal traditionally includes a concession contract giving the project company the right to carry out the project or the relevant activity, equity subscription and shareholders' agreements to regulate the relationship between the sponsors or project company's shareholders and the equity contributions to the project, a typical set of finance documents, as well as project implementation and sector-related commercial contracts. Among these, there is typically a construction contract and an operation and maintenance contract in infrastructure PPP projects. Supply agreements, sales agreements, or both, may also be entered into in connection with the project.

In the vast majority of the Portuguese PPP transactions closed to date, the concession-based construction contracts used do not follow any standard form, such as those issued by the International Federation of Consulting Engineers, the Joint Contracts Tribunal or the Institution of Civil Engineers. Hence, the form of construction contract used in each case has varied depending on the sector of industry at stake or the sponsors involved.

In relation to the infrastructure projects closed in Portugal in the 1990s and early 2000s, it was generally accepted that, given the need to adapt the legal structure of facility agreements to international syndication, the whole financing package other than the security documents had to be governed by English law, while the project documents, notably the concession contracts, were subject to Portuguese law. That ceased to be the case from the mid-2000s onwards, at which point project financiers active in Portugal had become sufficiently comfortable with Portuguese law and, therefore, most finance documents executed thereafter have been governed by Portuguese law, notwithstanding closely following the structure of a typical English law project finance documentation package.

PPP projects are governed by Decree Law 111/2012 of 23 May 2012 (as amended by Decree Law 170/2019 of 4 December 2019 and Parliament Resolution No. 16/2020 of 19 March 2020) and by the Public Contracts Code (approved by Decree Law 18/2008 of 29 January 2008, as amended from time to time).

PPP major projects in the health sector, the second-most relevant sector concerning PPP projects, also have some particularities in Portugal. Until recently, PPP projects in the health sector were governed by a specific legal framework, approved by Decree Law 185/2002 of 20 August 2002, which established rules regarding the development of PPPs for the construction, financing, operation and maintenance of healthcare units forming part of the NHS. An important feature of these PPPs is that they may envisage the private partner not only managing the hospital facilities but also providing clinical services as part of the NHS. When both managing facilities and clinical services provision are foreseen, two separate project companies must be incorporated. In such case, both project companies are bound to comply with their own obligations under a sole concession agreement, and one concessionaire is liable before the other provided that non-compliance with its own obligations may give cause to the other concessionaire's infringement under the concession agreement. Health sector concession agreements set out different contractual periods for each concessionaire (10 years for clinical services providers – which may be extended for additional 10-year periods up to a maximum of 30 years – and 30 years for concessionaires responsible for the design, construction and operation of hospital buildings). Law 95/2019 of 4 September 2019, which approved a new Health Basic Law and established the revocation of Decree Law 185/2002 of 20 August 2002, was further regulated by Decree Law 23/2020 of 22 May 2020, which sets out that the creation of new PPP projects in the health sector may only occur on a temporary and supplementary basis and depends on the existence of a justified necessity for the creation of such PPP project (that necessity having to be demonstrated by a study elaborated by the Health System Central Administration and approved by the government member responsible for the health sector). Additionally, the Decree also established the main guiding principles for entities responsible for the management of health-related facilities that are the object of a PPP contract.

Recent evaluations carried out by the Health Regulatory Authority (ERS) regarding PPP projects in the health sector show that the quality of clinical services provided by a private partner is similar to that of services provided by state-run public utilities while reducing the public expenditure. Notwithstanding that positive performance, the government has set a target to reduce PPP projects in the health sector.

In the road sector, different solutions have been put in place regarding concessionaires' payment mechanisms and risk matrices. Shadow toll systems were introduced in some road projects during the 1990s and onwards, but in all those projects such payment systems were replaced by road availability payments and real toll payment systems. An exception was made in Madeira and Azores, where the regional political authorities chose to maintain the shadow toll systems previously adopted in their respective road projects. More recently, real toll payment mechanisms were also substituted by road availability solutions under the recent renegotiation process on PPP projects in the road sector. This renegotiation process also brought about specific solutions, including a set-off mechanism against toll revenues for the benefit of concessionaires and an upside-sharing mechanism to encourage concessionaires to promote traffic in their concessions. At a municipal level, PPP activity took place through the launch of several projects for municipal water supply, wastewater

treatment and waste management; Decree Law 90/2009 of 9 April 2009 and Decree Law 194/2009 of 20 August 2009, as amended, established the rules applicable to PPPs in the aforementioned sectors.

ii The authorities

Pursuant to Decree Law 170/2019 of 4 December 2019, the Council of Ministers (which is composed of all the ministers of the government) is the competent authority for the preparation, launching, awarding, execution and modification of PPP contracts.

Notwithstanding this, responsibilities related to the preparation and execution of PPP contracts remains with the Technical Unit for Monitoring Projects, which was created by Decree Law 111/2012 of 23 May 2012.

Other PPP projects at a municipal or regional level are prepared and executed by the respective public structures, and such projects are not subject to the Technical Unit for Monitoring Projects' control.

Depending on the sector of industry in question, there are also some specific regulatory authorities, such as:

- a* IP-Infraestruturas de Portugal, SA, a public company responsible for the management of road and railway infrastructure;
- b* the Institute of Public, Real Estate and Construction Markets;
- c* the Electricity Services Regulatory Entity;
- d* the National Directorate of Energy and Geology;
- e* the Water and Waste Services Regulatory Entity; and
- f* the ERS.

iii General requirements for PPP contracts

The legal framework applicable to PPP projects expressly foresees the need to accommodate this type of expenditure within budgetary regulations and requires the preparation of economic and financial surveys to confirm the figures for the public sector comparator, as well as establishing general procedural rules applied to any type of PPP contracts.

Projects that require a global public cost above €10 million and an investment not higher than €25 million for the entire contractual period are not subject to the legal regime of Decree Law 111/2012 of 23 May 2012.

Since the previous PPP Decree Law, dated 2003 (Decree Law 86/2003 of 26 April 2003), procurement procedures may only be launched and awarded after approval of the relevant environmental impact declaration and, once the relevant environmental and urban planning licences and permits have been obtained, must ensure an effective transfer of execution risks to the private partner.

The regime concerning environmental impact assessments for each project was approved by Decree Law 151-B/2013 of 31 October 2013, as amended, pursuant to which any application for an environmental approval must enclose a detailed environmental impact study and the procedure for granting the relevant environmental impact decision, implying a coordinated effort between a different array of entities for the better assessment of the environmental risks associated with each project.

Depending on the sector of industry in question, a project may also be subject to environmental licensing under the new integrated pollution prevention and control legal framework, approved by Decree Law 127/2013 of 30 August 2013. The environmental licence (which is required, in particular, for industrial projects) must be obtained before

operation commences and must be successively renewed during the entire period of operation of the plant, although simplified licensing procedures may be in place in accordance with the scope of the activities carried out.

Furthermore, in the context of the EU emissions trading system, for projects in certain industrial sectors and meeting certain conditions or thresholds, operators must hold a permit to emit greenhouse gases, and be the holder of emission allowances.

Other industrial and construction licences and permits may be required depending on the type and specific conditions of each project to be implemented.

Finally, compliance with all legal conditions and procedures is subject to validation by the Court of Auditors. After the execution of a PPP agreement by any public entity, the Court of Auditors will verify and confirm whether all legal requirements are fulfilled, and payments under those contracts can only be made further to such validation.

IV BIDDING AND AWARD PROCEDURE

i Expressions of interest

Pursuant to the PPP legal framework established by Decree Law 111/2012 of 23 May 2012 (as amended by Decree Law 170/2019 of 4 December 2019 and Parliament Resolution No. 16/2020 of 19 March 2020), prior to launching the procurement process, the public sector can consult private sector entities regarding their position towards the project under consideration, thus identifying the general market conditions and any private entity directly interested in the project. In addition, during the preparation of the PPP, it must be considered whether or not to gauge the private sector's positioning regarding the type of project with the purpose of identifying potential interested parties and the conditions offered by the market.

ii Requests for proposals and unsolicited proposals

The Portuguese Public Procurement Code (PPC) approved by Decree-Law 18/2008 of 29 January 2008, which was amended by Decree Law 78/2022 of 7 November 2022, applies to every public tender procedure launched by a public authority. The Code sets out different procedures for the procurement process applicable to administrative contracts, including those to be entered into in connection with PPP projects: the direct agreement, the public tender, the limited tender by pre-qualification, the negotiation procedure and the competitive dialogue.

Unsolicited bid mechanisms are not foreseen in Portuguese law. Unlike the former legal framework for public procurement, the PPC does not automatically require a public tender for public works concessions or public services concessions, the awarding entity being entitled to choose between the launch of a public tender, a limited tender by pre-qualification or a negotiated procedure, depending on the specific features of the project and the public expenditure involved.

iii Evaluation and grant

In each procedure allowed by the PPC, administrative principles of equal treatment, legality, transparency and competition are duly reflected in the respective regulation. Moreover, such principles are directly applicable to each procedure and may be invoked by any interested party. If an interested party considers that an act under the procurement procedure does not comply with applicable regulations and principles, it may claim directly to the awarding

entity but also to a court. In such case, the interested party may ask the court to declare the suspension of all subsequent acts in the procurement procedure by means of a temporary injunction to ensure that its rights are not irreversibly threatened.

Substantive provisions dealing with public works and the public services concessions are included in the PPC, some of which are mandatory in nature. These mandatory provisions refer to relevant features of a PPP, such as termination by the contracting authority, and sequestration or step-in. Other substantive provisions of the PPC will only apply in the absence of express provisions in the relevant contract.

The granting of an approval by the Court of Auditors is a condition for the contracting authority to make any payments under the contract; the contract may, however, enter into force prior to the validation, and all rights and obligations contained therein may be performed, except for public payments.

In February 2014, the European Parliament and the Council adopted Directive 2014/25/EU (procurement in the water, energy, transport and postal services sectors), Directive 2014/24/EU (public works, supply and service contracts) and Directive 2014/23/EU (concession contracts). The new Public Procurement Directives were published in the Official Journal of the European Union on 28 March 2014 and entered into force on 17 April 2014.

Decree Law 111-B/2017 introduced into Portuguese legislation the above-mentioned European Union Directives, and puts forward several modifications to the existing legal framework. Among other things, the new PPC introduced the following amendments:

- a* the most economically advantageous tender becomes the rule criterion for awarding;
- b* the value of the performance bond is reduced to a maximum of 5 per cent of the contract price;
- c* a simplified procedure for the provision of health and social services is foreseen; and
- d* the report obligations of the awarding authority on practices susceptible of distorting competition rules are enhanced.

V THE CONTRACT

i Payment

Remuneration mechanisms diverge according to the different sectors of activity and the different PPP projects.

In the road sector, different solutions were put in place regarding concessionaires' payment mechanisms. Real toll systems and shadow toll systems coexisted under different projects, but the shadow toll systems were generally replaced by road availability payments and real toll payment systems. In addition, some real toll payment mechanisms were replaced by road availability solutions under the recent renegotiation process on PPP projects in the road sector. Upside-sharing mechanisms were set out thereunder to encourage concessionaires to promote traffic in their concessions.

Payments due under PPP projects in the health sector are linked to the clinical services provided in accordance with a list of medical acts and complexity levels, and also to the availability of hospital facilities. Both concessionaires are subject to payment deductions if any contractual requirements are not totally fulfilled, and additional revenues can be obtained through the performance in hospital facilities of other related activities (the revenues of which are to be shared with the awarding entity).

Water supply concessions are generally paid by consumers – both at the bulk and retail level – in accordance with water consumption, the applicable tariff being determined in accordance with the concession agreement.

ii State guarantees

The law establishes a type of sovereign guarantee that may be granted by the government to secure payments by the state and related parties, such as state-owned companies or government departments. The maximum amount of guarantees that may be provided in any given year must be approved and set out in the relevant state budget. However, PPP projects in Portugal usually do not include any type of sovereign guarantee to secure payments from the government or other public entities.

iii Distribution of risk

According to Decree Law 111/2012 of 23 May 2012 (as amended by Decree Law 170/2019 of 4 December 2019 and Parliament Resolution No. 16/2020 of 19 March 2020), project risks are to be shared between the public and private partners according to their capacity to manage such risks. Moreover, a PPP project should imply an effective and significant transfer of risks to the private partner. The concession contract, which is the most common form of PPP, allocates the relevant project risks between the contracting authority and the project company. The risks that remain with the contracting authority are usually covered by the financial rebalance mechanism, which is a key concept in all concession-based transactions in Portugal.

Typical financial balance events include unilateral variations by the contracting authority, *force majeure* events, specific changes of law and construction delays caused by the contracting authority.

Traditionally, archaeological and ground risks were borne by the public partner. That was, however, not the case in the PPP1 Póceirão-Caia high-speed rail project closed in May 2010 (which was cancelled as part of the austerity-led review of PPP projects) and in PPP hospital projects, where that risk was partially assumed by the project company and transferred by the latter to the contractor.

Nationalisation, expropriation or requisition of private property can only take place on the grounds of public interest and provided that private entities are duly compensated. Public interest may also constitute grounds for termination of a concession contract by the contracting authority, in which case the contracting authority shall compensate the project company for all the damage caused (which may include loss of profit). Some concession contracts set out the method for calculating the damage incurred by the project company in the case of termination by reason of public interest. Such calculation usually takes into account the status of construction.

Other political risks such as war, civil disturbance or strikes may be considered as events of *force majeure* and, therefore, the project company shall be relieved from its obligations under the concession contract to the extent affected by the relevant event of *force majeure*. *Force majeure* events may trigger the financial balance mechanism and, hence, the project company (and, consequently, the construction contractor) shall be compensated. In the case of prolonged *force majeure* or if the restoration of the financial balance of the concession proves too onerous, the concession contract may be terminated.

Changes in law may also be treated as a political risk. Only a specific change in law entitles the project company to financial rebalance. The risk of a change in general law is typically assumed by the project company.

In water concession projects, additional events may give cause to the application of the financial rebalance mechanism, as is the case regarding water consumption levels below certain limits or additional infrastructure investment requirements.

The project company generally passes on to the contractor all design and construction obligations, liabilities and risks under a construction contract, which is fully back-to-back with the concession contract.

The contractor usually undertakes to perform the design and construction obligations on a turnkey and fixed-price basis and, hence, it bears the risk of price escalation of materials, equipment or workers. In some cases, the contractor is allowed to revise the price annually to reflect inflation.

Other risks that are transferred by the project company to the contractor under a classic concession-based construction contract include a delay in the completion of works, approval risk, the risk of damage to works and defects during the defects liability period.

The risks generally covered by the financial balance under the concession contract do not entitle the contractor to suspend works or in any way relieve the contractor of its obligations under the construction contract. The contractor shall, however, be entitled to compensation in accordance with the 'back-to-back, if and when' principle, (i.e., the contractor will only receive compensation for any of the relevant events to the extent the project company is compensated for those same events under the concession contract).

With regard to limitation of liability, under general Portuguese law, any party is liable before the other for the breach of its obligations under the relevant contract. All damage caused by a breach must be compensated, including all direct damage and loss of profit but excluding indirect or consequential damages. Portuguese law expressly forbids prior general waivers of the right to compensation, although specific waivers after the occurrence of the fact giving rise to the right to compensation are permitted. It is possible, however, for the parties to agree an amount of liquidated damages for breach of obligations, provided that it represents a reasonable estimate of the damage that may result from such breach. Caps on liability are also generally admitted.

Portuguese project concessionaires usually have unlimited liability under their respective contracts. In recent years, the subcontracts executed by concessionaires with construction and operation and maintenance contractors set out liability caps in line with the commercial practices in other countries.

In contracts where a liability cap is foreseen, the same is often equivalent to the contract price and, since no restrictions are made to the type of damages that are considered for compensation purposes, the relevant legal provisions will apply. In recent projects, contractors have successfully demanded the introduction of tighter liability caps and the exclusion of loss of profit suffered by the project company.

iv Adjustment and revision

The risks that remain with the contracting authority are usually covered by the above-mentioned financial rebalance mechanism. If a financial balance event² arises, causing a deterioration in the levels of the project ratios, the contracting authority agrees to compensate the project company with a view to restoring the financial balance of the concession.

In general, any amendments to PPP concession contracts should be subject to the procedures set out in Decree Law 111/2012 of 23 May 2012 (as amended by Decree Law 170/2019 of 4 December 2019 and Parliament Resolution No. 16/2020 of 19 March 2020). These procedures include the creation of a negotiation committee to prepare and execute the negotiations with the private partner to reach a new agreement, which will be subject to a final report and approval process by the Council of Ministers or by the regional government members responsible for finance and sectorial authority. Other adjustment mechanisms not focused particularly on payments are also set out, as is the geographic area the clinical services should encompass under hospital PPP projects. In fact, subject to certain constraints, the public health authority can modify the reference area for each type of medical treatment merely by a decision to be notified to the private partner.

v Ownership of underlying assets

Other than assets in the public domain (e.g., the hydric domain, mineral resources, roads, railways), which may not be appropriated by private entities, the ownership of land or other assets may be acquired by the private partner.

However, the exercise of a specific economic activity by use or operation of such assets may require a licence and, in the case of an asset of public domain, the attribution of a right of use (of the relevant asset, normally through a concession regime).

It is usual to set out that the private partner should deliver any assets within the term of the contract, even though such assets are owned by the private partner, provided that the same are required to perform the relevant activity under the agreement. The new PPC further provides for new rules on the transfer of movable assets by public entities, pursuant to which the transfer may be temporary or permanent, including, for instance, the lease of the relevant assets to the private partner.

vi Early termination

Concession agreements may be terminated by either party owing to an infringement of the other party's obligations. In addition, concession agreements usually foresee the possibility of redemption or early termination on grounds of public interest.

Some concession contracts set out the method for calculating damage incurred by the project company in such situations, which usually takes into account the status of the construction and, in some circumstances, the financing agreements entered into by the private partner for the purposes of implementing the project.

Termination due to one party's failure to comply with its obligations usually does not entitle the non-compliant party to any compensation rights. However, in some PPP

2 i.e., an event that typically triggers a unilateral (but permitted) variation of the terms of the contract by the awarding entity or public party, a third party action or event (e.g., certain *force majeure* events), the risk of occurrence of which is allocated to the public party under the contract or the law.

projects – as is the case in hospital PPP projects – compensation may be due in such situations taking into consideration the significant investments made by the private partner that should revert to the public partner.

VI FINANCE

Most PPP projects in Portugal have been financed pursuant to the project finance structure. The use of project bonds or monoline structures to finance projects was not common until recently, but these instruments have now started to be considered as an alternative or complementary financing tool to traditional project finance (particularly in a brownfield context).

The finance package usually comprises a commercial bank credit agreement (as well as a European Investment Bank (EIB) credit agreement and an intercreditor agreement whenever the EIB is also providing finance to the project), an accounts agreement, a forecasting agreement, security documents and direct agreements between the lenders and the contracting authority or the major project parties, all in a form consistent with international market standards.

The two main types of security that can be created under Portuguese law are mortgages and pledges. Mortgages will entitle the beneficiary, in the event of a default, to be paid with preference to non-secured creditors from the proceeds of the sale of immovable assets or rights relating thereto or of movable assets subject to registration (such as automobiles, ships or planes). Pledges will confer similar rights to those created by mortgages, but are created in respect of movable (non-registered) assets or credits. Portuguese law does not recognise the concept of a floating charge. It also does not permit the creation of security over future assets and, therefore, promissory agreements and assignments in security are entered into to overcome this hurdle. However, since Portuguese law does not recognise the concept of assignment by way of security as existing in most (if not all) common law jurisdictions, the instrument used is a true assignment of rights, with the occurrence of an event of default being either a condition precedent to the assignment or a termination event, depending on the bargaining power of the borrower and sponsors (as applicable). It also should be noted that Portuguese law does not foresee the concept of a security trustee; therefore, there is some uncertainty as to whether a Portuguese court would immediately recognise the authority of a security agent to enforce security interests on behalf of the secured creditors (the collateral takers) on terms similar to those accepted in a common law context.

In addition, Portuguese law does not allow for remedies other than outright sale, other than in the case of financial pledges where appropriation of financial collateral is permitted on enforcement of the pledge, provided that the parties have agreed a commercially reasonable mechanism for evaluating the price. Financial pledges may be granted over cash on bank accounts or financial instruments (including shares but not quotas in Portuguese limited liability companies) and, more recently, credits over third parties.

Portuguese project finance documentation generally includes direct agreements between the lenders and the contracting authority and the lenders and any major contractors. All direct agreements contemplate step-in rights in favour of lenders, which may be exercised upon the occurrence of certain events: default of the concessionaire under the underlying contracts and, in certain cases, default of the concessionaire under the finance documents.

Shareholders are generally required to provide on-demand bank guarantees to guarantee their equity subscription and other funding obligations. Standby equity commitments to fund general investments, operational cost overruns or loss of revenues are often also supported by on-demand bank guarantees.

In health sector PPPs, shareholders have been requested to provide a corporate guarantee that, in the proportion of their shareholding in each project company (the ClinicCo and the InfraCo) and up to a certain amount, include any lack of funds in the project and any breach of the obligations of the project company.

VII RECENT DECISIONS

No significant dispute under the existing PPP procurement procedures has been registered recently. However, some relevant disputes have arisen from the performance of those contracts. The main reasons evoked by the concessionaires included variations imposed by the contracting authorities that were not settled by negotiation under the financial rebalance mechanism. In the first quarter of 2019, the total amount for the restoration of financial rebalances requested by concessionaires to the state amounted to approximately €565 million. According to the Stability Programme 2019–2023, presented by the Minister of Finance, the most relevant request for financial rebalance is in respect of a road PPP.

Notwithstanding the above, several disputes in the context of water municipal concessions have taken place in recent years between the concessionaires and the municipalities in connection with rebalancing claims arising, in most cases, from a material variation of the average monthly water or wastewater flows from those foreseen in the financial model of the concession.

It is also worth noting that the regime approved by Decree-Law 19-A/2020 of 30 April 2020, which establishes significant restrictions to the entitlement of private parties to resort to the financial rebalance mechanism in PPP contracts, as a result of the covid-19 pandemic, is expected to be contested before the judicial bodies, since this exceptional regime may entail constitutional issues.

VIII OUTLOOK

The effects of the covid pandemic and the war in Ukraine have taken a heavy toll on all aspects of social and business activities in Portugal and around Europe, including on PPP projects. At the same time, there is still some uncertainty associated with political pressure to avoid PPP schemes, at least in areas of greater social sensitivity, such as health and public transport.

Notwithstanding, in 2022 there were some relevant developments, particularly in regards to PPP projects in the health sector, and some important projects in the infrastructure sector may be expected in the coming years.

In fact, although there is still debate whether the PPP model is really more effective than the public model, the ongoing health crisis, compounded by the pressure caused by the covid-19 pandemic on healthcare services, has revived the importance of resorting to private parties as a mean to reduce the public burdens, at least insofar as what concerns the construction and operation of hospital buildings. While the Cascais Hospital is currently the only hospital managed under a pure PPP model (i.e., both the hospital building and

the clinical services are managed by private parties), the recent award of the construction and operation of the Hospital Lisboa Oriental shows signs that the PPP model will not be abandoned in the health sector.

Another sign is the recent government announcement of the setting up of a monitoring committee to supervise the launch, in 2023, of a public tender for the construction, operation and maintenance of the building of the new Algarve Central Hospital under a PPP model (the clinical services remaining on the public side), which will replace the Faro Hospital, addressing the lack of specialised healthcare in the southern region of Portugal.

In addition, the new Lisbon International Airport has once again become a topic of discussion in the infrastructure sector; this has gone back and forth since 1969. The government has recently restated its commitment to move forward with the construction of the new Lisbon Airport, and although all signs point to a PPP regime, there is still some uncertainty as to the location of the new Airport.

In the railway sector, it is possible that the tender for the construction and maintenance of the high-speed line between Lisbon and Porto will be launched in 2023. The high-speed line, which will connect Porto to Lisbon in one hour and 15 minutes, will be built in three phases and is expected to be completed post-2030. The high-speed line project also provides for a high-speed connection from Porto to Valença (bordering with Spain), which is also expected to be completed in 2030.

Other opportunities may arise from the recent focus of the government in developing the green economy and green growth in Portugal in relevant areas such as climate and energy (with a particular focus on hydrogen), water and waste management, biodiversity and sustainable cities.

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