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New Argentine Public-Private Partnership Regime Expected Soon: Another Step In The Right Direction

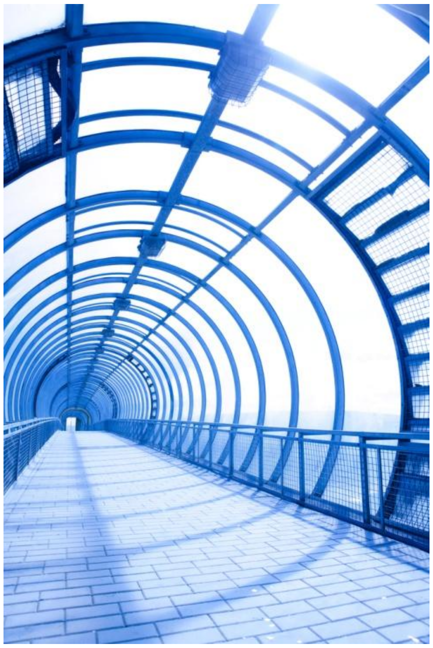
Last June, Argentine President Mauricio Macri sent a public-private partnership ("PPP") bill to Congress, which was designed in consultation with local business chambers and multilateral entities, and has also drawn support from various members of the legal and financial community.

Macri and his market-minded ministers assumed power in December 2015 pledging to open up Argentina's economy and boost foreign investment. Since then, Argentina has introduced sweeping measures seeking to overhaul the country's public image and restore investor confidence. In particular, Argentina settled its prolonged dispute with holdout creditors, allowed the Peso to float freely once again, lifted most capital and trade restrictions, reduced subsidies to public services and increased utilities' tariffs significantly. These and other business-friendly reforms, along with a marked shift in its foreign policy, allowed Argentina to return to the global capital markets with the largest ever emerging market bond sale (a several-times-oversubscribed $16.5 billion issuance) and are paving the way for much awaited international investment.

Energy and infrastructure are the two key sectors that require substantial investment. Recently, the government awarded some 2 GW of thermal projects and launched a 1 GW renewable energy tender to be followed by further tenders aiming to increase the use of renewable resources progressively from the current 1.8% of power demand to 20% by the end of 2025. The PPP bill represents yet another step in the right direction for the second-largest economy in South America which had minimal investment in infrastructure over the last 15 years. In addition, its passage will be essential for Argentina to implement its ambitious $30 billion-plan[1] to upgrade its road and railway networks and modernize airports, ports and urban transport systems over the next four years.

[1] "New Challenges in Infrastructure" presentation by Manuela López Menéndez, Transport Works Secretary at the Ministry of Transportation of Argentina, Latin American Energy and Infrastructure Forum, Miami, U.S.

Highlights of the PPP Bill



A deliberately high-level legal framework laying out the foundation for a modern regime

The PPP bill is a high-level framework that outlines the general guiding principles and certain mandatory terms that must be included in any PPP contract related to infrastructure, services, production or innovation. For example, each PPP contract must specify the form, sources and other particulars of compensation, the minimum performance standards, a penalties regime, the contract termination process and payment of compensation where applicable, and must also allocate risk efficiently among the parties.

The strategic decision to limit the scope of the PPP bill to just the key guiding principles and mandatory terms applicable to any PPP project seeks to facilitate its enactment in a Congress controlled by the opposition while leaving the door open for the Executive Branch and granting authorities to subsequently develop the implementing regulation and project-specific tender terms necessary to establish a comprehensive regime, which is expected to be consistent with the most advanced regimes of other Latin American jurisdictions.

While the framework set out in the PPP bill would only apply at the federal level, it also invites the provinces and the City of Buenos Aires to join.

Transparent and flexible procurement process

Consistent with the best international practices, the PPP bill requires a transparent, public and competitive procurement process, which can be initiated either through a tender or by way of private initiative. In addition, the PPP bill allows projects to be tendered on a competitive dialogue basis. Such a flexible procurement process should allow Argentina to advance the public interest while reaping the benefits of private sector expertise and resources to achieve a more efficient outcome for each project.

Guaranteed economic equilibrium; ordinary compensation protections

Economic equilibrium is guaranteed by the PPP bill, which allows for unilateral variation by the government only as it relates to the scope of works and so long as it does not exceed 20% of the contract value and the contracting party is appropriately compensated[2]. In addition, the PPP bill partially mitigates currency risk by allowing compensation to be paid in a foreign currency or to be indexed for inflation if denominated in local currency.

Adequate compensation for early termination

While the PPP bill does not specify a formula to calculate early termination compensation[3], it affirms that the contracting party must be compensated prior to any such early termination in an amount at least equal to the then-outstanding financing for the project. In addition, the bill provides that if the early termination is at no fault of the contracting party, the compensation will be at least equal to the unamortized investment in the project. The ability of the financiers to ultimately be made whole through an early termination payment by the government will help minimize the financing spread of the project to the sovereign.

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2 The adjusted compensation must be such that it maintains the economic equilibrium of the original contract and does not disrupt the availability and terms of financing for the project.

3 This formula is expected to be included in the PPP implementing regulation and/or the project-specific tender terms.

Ample choice of financing and security structures

The PPP bill includes a menu of options for projects to be financed and collateralized based on the project-specific tender and contractual terms. Compensation for a project can come from any combination of demand-based, shadow or availability payments, government allocations and third-party funds. Any of these cash flows may be securitized or collateralized for the benefit of the financiers, which should allow for a variety of structures to finance PPP projects, including traditional commercial bank and development agency loans as well as project bonds and hybrid structures. In addition, the PPP bill permits the granting of step-in rights to the financiers and the creation of any type of security interest.

International arbitration may be available to resolve disputes

Flexibility in the selection of the applicable dispute resolution rules and venue constitutes another tool embedded in the PPP bill to potentially mitigate country risk. Although the bill does not stipulate international arbitration as the means to resolve any dispute with respect to PPP contracts, it defers the selection of the dispute resolution rules and venue to the project-specific tender terms thereby making international arbitration possible on a case-by-case basis.

Room for Potential Improvement

Although undeniably positive overall, there is still room for improvement with respect to certain aspects of the PPP bill. Some of these areas may be covered by the implementing regulation or project-specific tender or contractual terms.

Beyond the four corners of the agreement

Public law and precedents in Argentina grant extraordinary rights to the government to, among other things, unilaterally amend or terminate administrative contracts or impose penalties. While the PPP bill includes important protections such as the economic equilibrium test and a requirement to undergo judicial review prior to voiding or suspending a PPP contract alleged to be illegal, it does not entirely remove the possibility of a potential application by the government of these extraordinary rights.

Milestone-based Projects

The use of physical certificates that are issued upon the completion of a milestone and which are transferrable to third parties and represent an unconditional and irrevocable obligation of the sovereign to pay on a date certain, have transformed the infrastructure sector in countries such as Peru. Inspired by the successful Peruvian model, Paraguay recently adopted a similar approach that is luring international sponsors and investors into its upcoming tenders. While not limiting it in any way, the PPP bill does not stipulate whether PPP projects will be undertaken on a construction milestone basis or the characteristics of any certificate issued upon the completion of a milestone.

Sovereign debt considerations

Argentine law defines sovereign debt very broadly to comprise any government obligation for borrowed money, including guarantees and essentially any other type of government support. Any such support would be recorded as a line item on the national balance sheet.

Furthermore, Argentine law requires all future annual budgetary allocations of the federal government[4] to be previously approved by Congress.

While defining government support to a PPP project as sovereign debt may result in better financing conditions for the project due to the potential for cross-default to all other sovereign debt, a similarly favorable outcome from a credit perspective could be achieved by simply providing for cross-default among government obligations in respect of all PPP projects. If government support to PPP projects did not constitute sovereign debt, the approval of future budgetary allocations for that purpose would not require going through full Congressional deliberation. In addition, it would not limit the government's ability to seek financing as a whole if the sovereign debt stock is perceived to exceed manageable levels or fails the IMF's public debt sustainability analysis.

A Positive Outlook

While there still are several questions about the opportunities and challenges that the new PPP regime may present for sponsors who wish to undertake infrastructure projects in Argentina and investors seeking to fund them on a project finance basis, the PPP bill and the preliminary discussions leading to it suggest that Argentina is embarking on a path to adopt a modern and market-friendly PPP model that will attract international sponsors, investors and financiers to address its substantial infrastructure needs. With Congress expected to commence deliberation on the PPP bill shortly, it remains to be seen whether the PPP bill will ultimately become the law and, equally important, whether the implementing regulation and terms of future tenders will appropriately fill in the gaps of the PPP framework being proposed.

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4 This is also the rule in most Argentine provinces and the City of Buenos Aires.