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Technology

# Renegotiation, Government Step-in rights, Termination, and Dispute Resolution

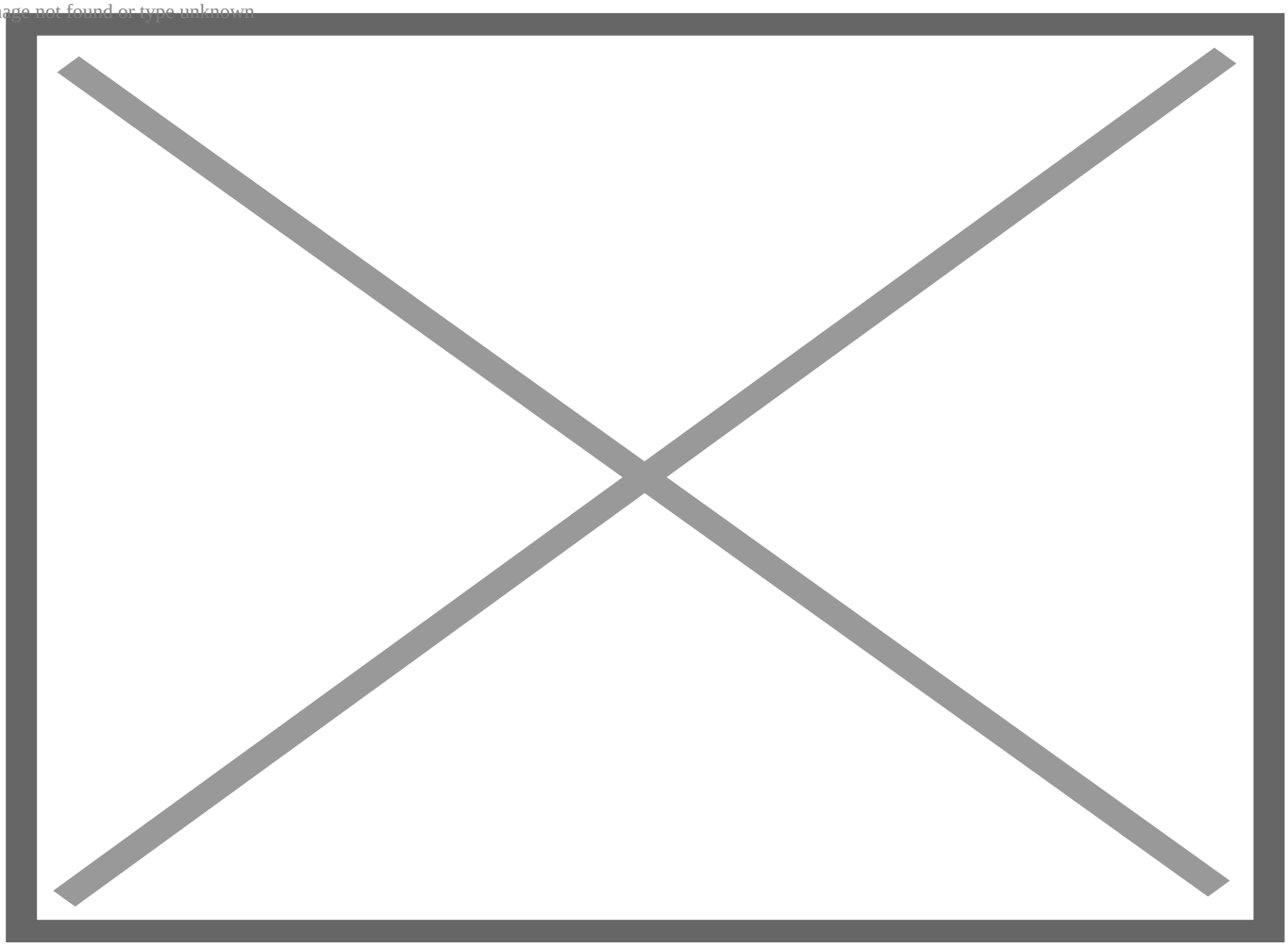
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***On this page:*** *Find interpretations of PPP contractual provisions, adjustments of contractual obligations, or requests to renegotiate or terminate the PPP contract can be amicable or contentious.*

**Renegotiation, Government Step-in rights, Termination, and Dispute Resolution**

If the applicable adjustment mechanisms do not resolve the issue caused by disruptive technology, the parties may still want to find out if they can continue the project by revising the terms of the PPP contract for the long term through renegotiation. It is, however, always possible that the disruption has made the project so difficult that one party seeks to terminate the contract or that the contracting authority decides to step in. In cases where the parties do not agree—for example, on the interpretation of output specifications or adjustment mechanisms provided for in the PPP contract—and renegotiations fail, or one party is not interested in solving the conflict through renegotiations, then the disagreement between the parties may need to be resolved through the dispute resolution mechanisms described in the contract.

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**Renegotiation**

The contractual adjustment mechanisms described above together with legal principles that may apply to the PPP contract in a specific jurisdiction provide some flexibility to deal with changes in circumstances that were not anticipated when the parties entered into the PPP contract. However, these mechanisms may not be sufficient to deal adequately with some of the changes that may happen during the life of a PPP contract, in particular if more fundamental adjustments are required due to technological disruption. In these cases, a renegotiation of the terms of the long-term PPP contract, i.e., the rewriting of certain parts of the contract, may be the only way to find an adequate solution.

> *"If more fundamental adjustments to the PPP contract are required to deal with fast-paced advances in technology, a renegotiation of its terms, i.e., the rewriting of certain parts of the contract, may be the only way to find an adequate solution."*

**Box 11: Renegotiation of the United Kingdom National Air Traffic Services (NATS) PPP after Decline in Demand Due to 9/11 Terrorist Attacks**

In the case of the United Kingdom National Air Traffic Services (NATS) PPP, the private partner had agreed to accept all demand risk under the PPP contract. The 9/11 terrorist attacks on the World Trade Center and Pentagon in the United States caused the loss of a large proportion of revenue from North Atlantic traffic. At the same time, total traffic had not declined as a result of the growth of low-cost carriers at the time, which actually increased the operational burden resulting from more landings and takeoffs. Due to these disruptions, the private partner looked certain to default on its debt.

The contracting authority (Board of the Civil Aviation Authority) was split regarding a renegotiation of the PPP contract. The board member directly responsible for the contract insisted the government should not renegotiate, stating the solution was a private sector financial restructuring, in which the lenders to the company would bear some of the losses. The majority of the board disagreed, however, and instead agreed to change the terms of the contract as part of a package deal that also involved debt restructuring and traffic risk-sharing arrangements.

Sources: PPPLRC. "Dealing with Change".

Erhardt, David, and Timothy Irwin. 2004. "Avoiding Customer and Taxpayer Bailouts in Private Infrastructure Projects."

World Bank and PPIAF (Public-Private Infrastructure Advisory Facility). 2010. Investment in Air Transport Infrastructure, Guidance for developing private participation.

(See also "Case Study 4: Portugal – Renegotiation of PPP Highway Contracts after the Global Financial Crisis in 2008.")

Many PPPs are renegotiated. A Global Infrastructure Hub (GIH) study found 48 instances of renegotiation in the 146 projects for which data were available, which roughly equates to one in every three projects. When filtered by region and sector, the study noted a significant prevalence of contract renegotiation in Latin America (58 percent) and in the transport sector (42 percent). In addition, the most common cause of renegotiation was found to be increased costs in construction or operations, and the most common outcome of a renegotiation was a change in tariffs. The timeframe for the study (projects that reached financial close

from 2005 through 2015) meant that almost all the projects are still in progress, and therefore may incur further renegotiations in the future.

It is difficult to quantify the number of renegotiations causally related to disruptive innovation. Disruptive innovation is, however, likely to modify projections; to impact project performance and revenue streams across infrastructure sectors; or to require investment in new technology, including AI, big data, or cloud hosting to make the project more digital and efficient. Technological disruption has therefore the potential to increase the number of PPP projects that need to be renegotiated in the future.

With the rapid advancement of renewable energy technology, many governments worldwide are, for example, already considering renegotiating a large number of PPAs with outdated tariff schemes. In addition, renegotiation of PPP contracts may be requested more frequently going forward with regard to PPP urban transportation or parking projects if demand for public transport or parking garages will decline due to an increased use of shared ride systems or autonomous vehicles. With power generation shifting64 from fossil fuel to renewables, infrastructure assets may also require renegotiation and perhaps even restructuring to convert them to low-carbon use and avoid early shut down, and renegotiation may also be required to adopt new technologies that may be suitable for the particular market. If the contractual mechanisms are not sufficient to deal with the unexpected changes, the question for investors and governments alike is whether the terms of the contract can be renegotiated under the new circumstances.

Renegotiation may sometimes be unavoidable to deal adequately with fast-paced advances in technology that transform long-term PPP infrastructure projects and sectors. Nevertheless, renegotiation should also be avoided to the extent possible. Contracting authorities are subject to public procurement rules that do not give the parties unlimited rights to renegotiate. Fundamental changes of the terms of the contract through renegotiation can undermine competitive and transparent procurement and also lead to opportunistic behavior.[1]

In order to prevent abuses and third-party challenges,[2] renegotiations of PPP contracts are regulated to some extent in most economies. PPP contracts can also include a renegotiation clause. This framework sets out under what conditions renegotiation can be initiated and how any renegotiations should be conducted. Contract managers need to consider in each case the specific PPP contractual and statutory provisions.[3] To prevent abuses, avoid conflict, and ensure buy-in from key stakeholders, PPP renegotiations need to be managed in a strategic and transparent manner and in parallel if several PPP projects are affected.

Once the parties agree to revised terms of a PPP contract, it is recommended that details of renegotiations and circumstances leading to renegotiations are published, including specific changes caused by the renegotiated clauses, e.g., regarding risk allocation as well as roles and responsibilities relating to the project.[4]

**Considerations for Future PPP Contracts:**

PPP contracts should specify under what conditions the renegotiation can be initiated and what the process will be.

The following are examples for best practice PPP contract renegotiation schemes:

- To address lowball bids some countries, such as Colombia and Peru, find it helpful to impose a **moratorium on renegotiation during the first three years of a project**.
- Avoiding opportunism gives justification to requiring **approvals by government agencies other than the procuring authority itself**. This approval process provides more impartial oversight over renegotiations of PPP contracts. Many countries have therefore introduced approval requirements. The **South African** regulations require, for example the procuring authority to

obtain Treasury approval for any material amendment. It also stipulates that the Treasury will approve a material amendment only if it is satisfied that the PPP agreement, if so amended, will continue to provide substantial technical, operational and financial risk transfer to the private party.

- Moreover, contracting entities in the different economies have been regularly instructed to keep contract amendments within certain limits. When renegotiations exceed these **thresholds**, a new tendering process is necessary to support competition. The objective is to ensure value for money for additional works and to give all bidders a level playing field.
- **Modifications that alter the contract substantially** might affect competition and might lead to a breach of procurement law. Therefore, many renegotiation regimes specified in the PPP agreement limit, e.g., changes that affect the risk allocation of the PPP contract as well as other amendments that may be considered a "substantial" change. **In the United Kingdom**, for example, the regulatory framework specifies the conditions under which a change to the contract is deemed "substantial." The general rule is that if substantial modifications are made, a new procurement process may be required.80 However, in cases where the modification results from circumstances that the procuring authority could not have foreseen, does not change the overall nature of the contract, and increases the price by no more than 50 percent of the original contract value, then the modification is not deemed to require a new procurement procedure.

Source: World Bank. 2020. Benchmarking 2020 Infrastructure Development.

**Relation management and dispute resolution**

Interpretations of PPP contractual provisions, adjustments of contractual obligations, or requests to renegotiate or terminate the PPP contract can be amicable or contentious. The accelerating availability of disruptive technology worldwide will likely result in more conflict between the parties of PPP contracts.

For example, unilateral changes to conditions of PPP contracts by the contractual authority have led to many disputes in the energy sector globally. Generally, courts or arbitration panels will uphold a signed contract. Therefore, a contracting authority that would like to reopen a contract that takes changed technological circumstances into account will be unlikely to succeed through dispute resolution mechanisms and would likely be best served by attempting amicable discussion and negotiation with the counterpart.

> *"Contract managers need to consider going forward that disruptive technology may result in more conflict between the parties of PPP contracts. Maintaining an ongoing relationhip between the parties and promoting collaboration between all stakeholders throughout the entire project lifecycle is key to prevent conflicts or their escalation."*

One way to prevent disagreements from escalating is through collaboration of all stakeholders and relationship management over the project's life cycle. Maintaining an ongoing relationship between the parties is therefore key for the prevention of conflicts.

Effective collaboration can be supported by digitization and disruptive technology (see Sections 3.2 and 3.3). If the parties are unable to resolve the situation informally through negotiations, they may want to enter into a formal dispute resolution, resulting in litigation, arbitration or the application of alternative dispute resolution mechanisms. Such mechanisms are typically set out in the PPP contract but can also be contained in statutory provisions, depending on the governing law.

> *"Contract managers need to be aware that in the light of disruptive technology it may sometimes make economic sense for the government to terminate the PPP contract unilaterally so that it*

*can upgrade or replace the infrastructure asset, depending on the specific circumstances."*

Dispute resolution provisions in PPP contracts set out a pre-agreed mechanism for the resolution of any disputes that may arise out of the PPP contract. These clauses aim to provide as much certainty as possible about where and how disputes will be resolved and avoid disagreements about where a claim can be heard.

They typically provide a three-staged process:

1. As a first step, the parties typically try to resolve their conflict themselves, through a more formalized negotiation. They consult each other for a fixed period of time in order to come to a solution.81 The contract manager will play a central role during this stage and will manage the communication between the parties. To avoid further conflict, adequate documentation of the agreement that has been reached between the parties is essential.
2. If these consultations fail, the parties may then put their case to mediation or to an expert to decide. The expert appointment is regulated by the PPP contract.
3. In case either party is not satisfied with the expert's decision, the dispute is referred either to arbitration82 or courts, depending on the PPP contractual provisions.

Conflict management procedures should be invoked as soon as possible after a conflict arises, before it becomes a real dispute or impedes the project. The inclusion of an alternative dispute resolution mechanism, including the use of dispute review boards, can be a particularly useful tool to prevent and resolve conflicts arising in the context of disruptive technology because they allow the parties to settle disputes informally at an early stage.

**Considerations for Future PPP Contracts:**

PPP contracts should contain well-drafted dispute resolution clauses that include:

- The governing law of the PPP contract (if not specified in a different clause).
- An obligation to first discuss the issues amicably and in good faith (possibly through the use of an alternative dispute resolution mechanism, such as mediation or a disputes board).
- A provision for the resolution of specific technical disputes by an independent expert.
- A recourse to either (i) the courts that will have jurisdiction to determine the dispute or (ii) international arbitration to finally determine all disputes not resolved informally or by expert determination. An arbitration clause should specify the "seat" of arbitration and usually also should reference institutional procedural rules. It may also set out certain bespoke procedural rules to govern the arbitration process, and joinder and consolidation provisions in the event the dispute concerns multiple related contracts and/or multiple parties and arbitration has been selected.
- An obligation to continue carrying out the PPP contract during the resolution of the dispute.
- Possibly a waiver of sovereign and other immunities and consent to enforcement and execution.
- Provisions on allocation of costs.

In addition to the informal negotiation provision, contracting authorities should consider including a specific alternative dispute resolution provision. In particular dispute review boards may be helpful to prevent and resolve conflicts arising in the context of disruptive technology. In this case, a respective provision needs to be added to the dispute resolution clause that sets out the requirements for the establishment of a dispute review board and the process to be followed.

Source: World Bank. 2019. Guidance on PPP Contractual Provisions, Chapter 11, in particular 11.2.1 and Schedule 1.

**Government step-in rights and emergency clauses**

Some PPP contracts provide for governments to "step-in" to the project and take control of the project company (usually in agreement with project lenders), for reasons of national security, health and safety, to discharge a statutory duty, or where the project company is not performing its obligations and the project is delivering an essential service. This should not be confused with a lender's step-in rights to cure a performance breach of the private partner.[5]

Government step-in could take place, for example, if a disruption leads to an emergency situation that prevents the private partner from providing an essential service, e.g., drinking water, electricity or waste management. In the context of disruptive technology this could, for example, be the case if due to a cyber attack, port or airport cargo services get interrupted (essential to keep food and other supply chains open), water supply or power plants are not operating (essential to provide water and electricity), or public transport operators cannot operate (essential workers still need to get to jobs).[6]

Generally, the procedure and timeline for step-in, responsibility for costs and liabilities for both parties, and other rights will be set out in further detail in the contract. Whether there will be compensation for the private partner usually depends on whether it is at fault. Some clauses are drafted such that the step-in rights are only triggered where the private partner is not performing, in which case it will not get compensation. Others allow public policy reasons for step-in, in which case some form of compensation to the private partner is usually offered. Either way, the government should only invoke step-in rights if it (or a third-party that it appoints) has the relevant expertise to do a better job than the project company.[7]

For disruptions that lead to emergency situations, some PPP contracts have an emergency services clause that may be triggered in the case of a cyber incident. [8]

**Considerations for Future PPP Contracts:**

With disruptions likely to continue and a potentially increased number of cyber incidents expected to occur in the future, it will be important for governments to maintain the option of emergency clauses and step-in rights to ensure that essential services continue to be provided to the public despite any disruption. However, governments must ensure that any step-in duration is limited to only the emergency at hand and must be sure to "step-out" of the project as soon as the emergency is over, to restore confidence in the PPP.

**Early termination**

If the adverse impacts caused by the disruption continue for an extended period of time, and it is not possible to remedy the scenario or change the contractual relationship in a way that is satisfactory for both parties, one or both parties may wish to terminate the PPP contract. In general, parties of a PPP contract must comply with its terms and cannot simply step away from it entirely on the basis that it is no longer advantageous to continue because technological disruption has dramatically changed the economic conditions.

In some civil and common law jurisdictions, there may be underlying laws addressing certain termination rights and consequences which apply without specific PPP contractual provisions. In practice, however, the parties almost always seek to include express contractual mechanisms in the PPP contract that set out comprehensively what circumstances may give rise to termination, which party may terminate, and what the consequences of termination will be for the contracting authority and the private partner, and for lenders or other key third parties.[9]

The ability of parties to terminate a contract will depend on the express terms of the contract. Typical early termination events expressly addressed in PPP contracts are:[10]

- The contracting authority will usually want to protect itself against being tied into a long-term contract which is not being performed to the agreed contractual standard by the private partner (default by the private partner).
- Similarly, the private partner will usually wish to include the express right to terminate the PPP contract itself (and be compensated) for breaches by the contracting authority which have a material adverse effect on the project or the private partner (default by the contracting authority).
- The contracting authority will commonly also seek a right to terminate the PPP contract, at its discretion, for convenience or for public policy reasons (voluntary decision by the contracting authority).[11]
- Both parties will also want to protect against being tied into a long-term contract that is incapable of being fully performed due to a particular occurrence that is typically neither party's fault, and where no solution has been agreed upon in order to continue with the PPP contract (e.g., due to prolonged occurrence of a force majeure event or unavailability of a key insurance).
- A prolonged change in law/MAGA event may be treated similarly to a prolonged occurrence of force majeure depending on the specific PPP contractual provisions.[12]

In the event of termination, the government is usually required to compensate the private partner in exchange for the asset. The compensation is typically based on a formula depending on fault:

- If the contracting authority is at fault, then compensation is usually all outstanding debt + costs + forecasted return on equity or some variation thereof. Similar considerations apply usually for voluntary termination, MAGA, change in law.
- If the private partner is at fault, then compensation is usually outstanding debt or market value.
- If the PPP contract is terminated because of a force majeure event, it may be somewhere in between.

In the context of disruptive technology, termination may, for instance, be considered if an infrastructure asset has become obsolete due to technological advancements, such as a fossil fuel plant or a parking garage that cannot be used anymore. In these cases, it may sometimes make economic sense for the government to terminate the PPP contract unilaterally so that it can upgrade or replace the infrastructure asset, depending on the specific circumstances. Unilateral termination can, for instance, make economic sense if the contracting authority can negotiate reduced compensation or has economically attractive options to recycle the asset.

Generally, voluntary termination should, however, only be considered where other PPP contractual provisions or negotiation cannot provide a satisfactory outcome. Together with legal fees for dispute resolution, early termination payments for unilateral termination can entail large fiscal costs for governments. It is therefore usually in each party's best interest to find a negotiated way out of a situation where technological obsolescence or other impacts of disruptive technology justify termination. In practice, where there is a risk of termination, termination provisions are often used to initiate discussions about how to continue the PPP contract or to negotiate a government buyout.

**Considerations for Future PPP Contracts:**

An early termination provision that allows for voluntary termination by the contracting authority adds some flexibility to PPP contracts because it gives a contracting authority the possibility to terminate a contract at its discretion, for convenience, or for public policy reasons. In practice, this solution should, however, only be considered in exceptional cases because it comes with a high price tag for contracting authorities.

*Footnote 1: One prominent example for an opportunistic renegotiation is the Odebrecht case that took place in Brazil. Although the scandal relied on an elaborate bribery scheme involving public officials and the media, the bribery was also linked to renegotiations. Odebrecht obtained contracts through a competitive process but underbid the contracts, and in at least one case, its bid was below that of the next lowest technically qualified bidder by 25 percent. Once Odebrecht won with a lowball bid and came to commercial close, it was able to renegotiate the contracts because Brazil allows economic rebalancing to manage changes in a PPP contract ("Managing Public-Private Partnership (PPP) Renegotiation" in: Bloomgarden, David. 2020. Enhancing Government Effectiveness and Transparency: The Fight Against Corruption. World Bank Group).*

*Footnote 2: In some civil law countries, renegotiations would generate the need to terminate the contract early and re-tender the project, unless the solution is endorsed by a higher-ranking instrument (such as a decree).*

*Footnote 3: Whether the parties can restructure infrastructure assets under these renegotiation frameworks in a changing technological environment depends on the specific renegotiation framework but is so far not common.*

*Footnote 4: World Bank Group. 2015. A Framework for Disclosure in Public-Private Partnerships.*

*Footnote 5: World Bank Group. 2021. Covid-19 and PPPs Practice Note.*

*Footnote 6: World Bank Group. 2021. Covid-19 and PPPs Practice Note.*

*Footnote 7: World Bank Group. 2021. Covid-19 and PPPs Practice Note.*

*Footnote 8: For example, management contracts and operations and maintenance contracts will typically require the operator to develop an emergency management plan, which will have provisions for the operator to take steps in an emergency which is subject to compensation at the cost of the government where such measures are not contemplated in the ordinary course of operations and maintenance (World Bank Group. 2021. Covid-19 and PPPs Practice Note.)*

*Footnote 9: World Bank Group. 2019. Guidance on PPP Contractual Provisions, p. 103.*

*Footnote 10: For more details, see: World Bank Group. 2019. Guidance on PPP Contractual Provisions, p. 106.*

*Footnote 11: Although unilateral termination rights for the contracting authority typically need to be stated expressly in PPP contracts to be invoked, this is not always the case. In some jurisdictions (typically civil law jurisdictions) the contracting authority maybe entitled to terminate the PPP contract on the grounds of public interest, even without an express contractual right based on underlying national law (World Bank Group. 2019. Guidance on PPP Contractual Provisions, p. 107).*

*Footnote 12: World Bank Group. 2019. Guidance on PPP Contractual Provisions, p. 53 and p. 68.*

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