A Governance Approach for Managing Public–Private Partnership Renegotiations

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Introduction

High inflation, fiscal consolidation, and high debt burdens weigh heavily on infrastructure investment, which is also affected by other global development issues including Russia’s invasion of Ukraine and the coronavirus disease (COVID-19). On top of this, the world is experiencing volatility in financial markets and the continuing threat of climate change. Research by the Asian Development Bank (ADB) demonstrates significant impact from climate change in multiple sectors, including risks to health and natural ecosystems resulting, for example, in an 11% loss of gross domestic product (GDP) in Southeast Asian countries by 2100.¹

Infrastructure procurement through public–private partnership (PPPs) is particularly vulnerable to this disruption. PPP contracts are inherently incomplete because decision-makers cannot possibly anticipate all events over the 30 years or more that is typical of a PPP contract. PPP contracts tend to be rigid and highly prescriptive, which can result in circumstances where the procuring agency is tied to contractual clauses which may not apply over the course of the contract’s life span. Renegotiations may be necessary to adjust to a changing environment and unanticipated circumstances. A strong regulatory framework and project preparation capacity in line with best international practices can help to mitigate or manage renegotiations. However, the frequency with which PPPs are renegotiated suggests that renegotiations may be unforeseen events due to poor design of contracts and opportunistic firm behavior.

Notes: In this publication, “$” refers to United States dollars. ADB recognizes “Russia” as the Russian Federation.
ADB’s Asian Development Outlook shows economic recovery of 5.2% in 2022 and 5.3% in 2023, which should help to reduce vulnerability to external shocks in most countries. Public investment, including for PPPs, will need to be a vital component of the post-COVID-19 recovery to maximize economic development in a fiscally constrained environment. An effective public investment management framework is necessary to ensure investment in cost-effective and affordable PPP infrastructure, procured competitively through transparent and predictable rules, and that direct and contingent PPP liabilities are included within the medium-term expenditure and fiscal frameworks and budget to safeguard fiscal sustainability. PPPs, when properly prepared, structured, and implemented within a sound public investment management framework, represent a viable procurement alternative to increase private sector investment and reduce the infrastructure gap. The need for private sector investment including through PPPs will intensify as many countries face fiscal consolidation and higher debt levels after spending heavily on health and economic recovery.

PPPs may be a relatively small part of overall developing country infrastructure investment, but they tend to be used for larger and more strategic projects. PPP investment in developing countries account for around 10% of overall infrastructure investment, and around 3% if including developed countries. Figure 1 shows the growth of investment commitments by the private sector in developing countries between 2020 and 2021; but despite this

Figure 1: Investment Commitments in Public–Private Partnership Infrastructure in Developing Countries, 2016–2021

Note: The World Bank defines East Asia and the Pacific as including Cambodia, the People’s Republic of China, Indonesia, the Lao People’s Democratic Republic, Malaysia, Mongolia, Myanmar, Papua New Guinea, the Philippines, Samoa, Solomon Islands, Thailand, Timor-Leste, Tonga, Viet Nam, and Vanuatu. South Asia includes Afghanistan*, Bangladesh, India, Nepal, Pakistan, and Sri Lanka. ADB developing member countries included in Europe and Central Asia are Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan.


sign of recovery, these commitments are still 12% lower overall than from 2016 to 2020 with variation among regions. East Asia and the Pacific, for example, have investment commitments reaching $28.1 billion in 2021, 196% over 2020, but still 21% below the past 5-year average. Part of the reason for this relative decline in PPP compared to prior 5 years before 2020 is the increased perception of risks associated with PPPs over the life cycle of a PPP contract.

According to ADB’s governance brief on Restoring Confidence in Public–Private Partnerships – Reforming Risk Allocation and Creating More Collaborative PPPs: “Among other concerns, there is, on the government side, a perception that PPPs are not delivering value for money and, on the private side, that the risks associated with PPP transactions have become excessive and unpredictable.” It goes on to say that stakeholders in the private and public sector bound to long-term financing arrangements in PPP contracts are not well suited to addressing unanticipated changes especially in a time of rapid technological and social changes that can affect the life cycle of a PPP contract.

The brief proposed alternative collaborative models such as alliance contracting in which the government and the private partners commit to sharing risks and rewards and agree on a target cost to undertake the project, with parties agreeing to share equally if gains or losses are more or less than the agreed upon target cost. Alternative risk-sharing approaches and proactive dispute resolution can help to avoid renegotiations and costly termination but require adequate institutional capacity to implement.

**Global Data on Public–Private Partnership Renegotiations**

Nearly one-third or 48 out of 146 PPP projects, or 1 in 3 projects, experienced renegotiation. Even countries with good regulatory frameworks for PPPs, such as Chile, experienced excessive renegotiations.

“...the failure of dispute processes to achieve a successful result has often led one or both parties in a PPP transaction to seek the renegotiation of their contract or, in extreme cases, its termination.”


Latin America had the highest rate (58%) and transport was the most affected sector (42%). East Asia and Southeast Asia had the least renegotiation events compared to other regions with 12% and 13%, respectively. North America and Europe fared worse than Asian regions with 40% and 28%, respectively. Although this Global Infrastructure Hub (GIH) data show a high percentage of renegotiations, it should be interpreted with caution. The data do not indicate if the renegotiations restored value for money in a distressed project and avoided cancellation or resulted in a reduction in the value for money of the project in the original tendering of the contract (Table 1).

Although one in three PPP projects globally experience renegotiation, a PPP renegotiation does not necessarily result in a negative outcome. When new technologies and new priorities such as combating climate change and sustainability are evolving rapidly, it is not a surprise that PPPs are renegotiated. PPP renegotiations can have positive impacts if they help avoid more costly project failure and termination. Renegotiation may also be needed to redefine a scope of work due to an unexpected increase in demand by users and to improve alignment with new policies or to effectively address changes in technology, such as adding charging stations to a road to enhance the use of electric vehicles that was not envisioned in the original scope of work.

As an example, Jordan’s Queen Alia International Airport was modernized and expanded in an initiative of the Government of Jordan to expand the tourism industry and establish Jordan as a regional travel hub. The project company initiated a renegotiation 3 years following financial close to deal with scope changes and the

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1. ADB defines value for money in PPPs as follows: “Value for money (VFM) in public–private partnership (PPP) projects is gained through the engagement of private sector efficiency, effectiveness, and economy, and through the appropriate allocation of risks in the project. The assessment of the potential to secure VFM is a key element of the PPP assessment process. The conclusions on VFM potential will inform governments in developing member countries (DMCs) on whether to proceed with a PPP procurement, and, if so, the form of PPP that could be used.” See ADB. 2012. Institutional Document: Public–Private Partnership Operational Plan 2012–2020, Appendix 3. Manila.


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acceleration of the stage two development. The project included two construction stages. The first stage of expansion was not able to meet the actual growth in passenger demand and both parties agreed to a renegotiation. The parties agreed that the procuring authority would invest an additional $50 million. The project company agreed to borrow $150 million in new debt. The procuring authority was able to reach the operational stage sooner. Both the government and the project company and its lenders were willing to implement this change due to its positive impacts on overall project performance and revenue. The government contribution required approval of the Council of Ministers and was not subject to a unilateral decision of the procuring authority.

Lessons learned from this renegotiation include the importance of a dedicated project team to manage the project, flexibility of the procurement authority to deal proactively with unforeseen circumstances, and approval from a senior government body outside the procuring authority.  

Among the most frequent causes of renegotiation are increased construction costs (21%), policy changes by government (19%), and changes to tariffs or tariff regulations (16%) (Figure 2). This analysis by GIH does not analyze whether the renegotiations were opportunistic by firms to get a bigger profit or a breach of contractual obligation by government; it does, however, show that renegotiations occur relatively frequently.

### Opportunistic Renegotiations

Renegotiation is defined as adjustments in the PPP contract if the changes are negotiated between the government and the project company outside, instead of through the adjustment mechanisms that are part of the existing contract. Renegotiations may be justified over the long period of a PPP contract. However, misuse of the renegotiation process for corrupt purposes is “opportunistic renegotiation.” The concept of opportunistic renegotiation applies to the private sector and may also involve government officials who are involved for personal gain.

Weak government capacity in project preparation and risk allocation, tender processes, poorly drafted contracts, corruption, and weak contract management can lead to renegotiation, whether for justifiable reasons to save a distressed project or as an opportunistic move.

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6 GIH and Turner & Townsend. 2018. Managing PPP Contracts After Financial Close. GIH.

A study by the World Bank, which analyzed a data set of more than 1,000 projects covering the period 1985–2000 in Latin America, found renegotiation reflected weak regulation, inadequately designed tender processes, or opportunism by the government or private sector. Most renegotiation events had outcomes advantageous to the private operator resulting in higher tariffs or a delay or reduction in investment obligations. While it is not possible to quantify the degree of opportunism in PPP renegotiations, there are several studies that show it is a risk factor for PPPs (Engel, Fischer, and Galetovic, 2019; Lohmann et al., 2022).

Mechanisms for change within the contract can be abused if internal controls and anti-corruption measures are not effective. Opportunistic renegotiation undermines public confidence in transparent and accountable governance of infrastructure. One of the most egregious examples is the Odebrecht scandal that took place in Brazil resulting in the arrest of its chief executive in 2016 (Box 1). The company, one of the largest construction conglomerates in Latin America, was able to misuse economic equilibrium clauses with PPP contracts. Economic equilibrium clauses in a PPP contract refer to rebalancing the financial conditions agreed to in the initial contract to restore the agreed upon economic equilibrium such as the rate of return specified in the PPP contract.

An example of economic equilibrium is if a connecting highway bypass boosts demand and therefore toll revenue exceeds the level anticipated in the contract. In this case, rebalancing could benefit the government by lowering user tolls, sharing additional profits of the project with the government, or reducing the length of the contract period. In this case, the economic equilibrium is activated in favor of the public sector.

Rebalancing is also subject to abuse. Odebrecht and its collaborators in government who were motivated by bribery enabled Odebrecht to underbid contracts and to win in competitive procurement processes due to having the lowest price. In the construction phase, the company would renegotiate the contracts using the rebalancing clause to increase the cost paid for the project and ensure the company earns a positive rate of return in the renegotiated contract.

“...experience has shown that the main efficiency gains of PPPs are improved life-cycle maintenance and earlier completion of projects. Those benefits can be substantial.”

Mechanisms for Change within Public–Private Partnership Contracts

PPP renegotiation cannot occur in circumstances when tariffs are adjusted based on a formula agreed to in the contract or indexed to inflation or some other index specified in the contract. Renegotiations do not apply to automatic triggers for required investments, payments to the operator regulated under the contract, or corrections of errors in the contract that do not result in new obligations or commitments such as typos or contradictory language that could affect the implementation of a PPP contract.

PPP frameworks and contracts will provide some flexibility through variation clauses. The government, for example, can usually request variations for works and services offered in the PPP contract. Examples of variations include minor scope changes and claims procedures. This flexibility in contract design enables governments to manage circumstances that were not foreseen at contract signing, without the need for a renegotiation. Other more complex negotiations may fall under clauses for material adverse actions by government, change in law, dispute resolution, force majeure, and contract termination. The contract may also stipulate limitations on the size or nature of variations that the government can ask for or require the private sector partner to carry out.

A PPP contract typically will include a procedure for the private party to consider and respond to a request for a contract variation. Other variation clauses may address the process for government to decide if the variation costs provide value for money. Variations can also address how any additional cost or savings from proposed variations are allocated between the public and private sectors. Streamlined processes may also be provided for small variations. PPP contracts also may have clauses that offer flexibility for events such as a change in law and unilateral termination by the private sector or government.

In addition to variations embodied in the contract, a procuring agency may wish to proactively consider noncontractual initiatives to avoid a renegotiation leading to project termination. This reflects a mutual interest between the public and private sectors to seek resolution without resorting to a dispute resolution procedure and the long lead times for these processes. In the Philippines, for example, in response to concerns regarding the impact of the pandemic on the infrastructure sector in its “Build, Build, Build” program, the Government of the Philippines suggested proactive arrangements to extend terms of the concessions, to give the private sector more time to earn a return; and deferring the obligations of the concessionaires to share project revenues with the government.8

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ADB’s publication titled COVID-19 and Public–Private Partnerships in Asia and the Pacific provides guidance for projects under distress due to COVID-19, but can also apply more broadly as practical steps under other distress scenarios to provide noncontractual relief.9 These recommendations include the following:

- Government should create an action plan or agreed principles to guide coordination and support the effective management of challenges facing a project.
- Any additional support provided by government should be integrated with (i) legal, regulatory, and institutional frameworks enabling fiscal soundness and best practices for project implementation and management; and (ii) quality contract design and risk allocation for effective and flexible implementation of the PPP project across parties.
- Proactive management by government to support and reach out to PPP partners before insolvency. An insolvent concessionaire is not in the interest of government. Assistance to contractors facing delays may be more fruitful than imposing contractual enforcement actions. Open and ongoing dialogue with all PPP stakeholders will help government understand project risks, such as the pandemic-induced risks, and help in developing pragmatic solutions.

### Hidden Debt and Fiscal Impacts of Renegotiation

Debt in Asia and the Pacific is sustainable overall, but “sustainable does not mean riskless.”10 The Sustainability of Asia’s Debt: Problems, Policies, and Practices highlights the fact that many middle- and high-income countries in Asia and the Pacific shifted most borrowing to domestic capital markets. Others are implementing structural reforms to improve debt and fiscal sustainability, and global investors continue to see the region as a good investment opportunity. PPPs represent a source of potential government liabilities due to a renegotiation or other indirect contingent liabilities.11

ADB estimates that possible PPP contingent liabilities as a percentage of GDP are, as of end-2019, 0.7% in the PRC, 3.4% in Indonesia, and 5.3% in India. The ADB report argues that dangers still loom over the debt and fiscal outlook. Economic growth is yet to fully recover its past trajectory since the onset of COVID-19 and recent macroeconomic and geopolitical events have posed a risk to the growth outlook. Aging societies, for example, in East Asia, can potentially result in a magnification of current debt levels. Finally, regarding PPPs, central governments are ultimately responsible for fiscal obligations arising from contingent liabilities associated with PPP projects.

The most common implicit PPP contingent liabilities arise due to renegotiation and early termination. Contingent liabilities can lead to added fiscal costs that were not anticipated at contract signing. Compared with other regions, South Asia (Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka) has more risk exposure to hidden debt and contingent liabilities from state-owned enterprises, state-owned commercial banks, and PPPs. This is due to more reliance on public sector off-balance sheet operations. In South Asia, around 8% of PPP contracts result in early cancelation before the planned expiration of the contracts. While 8% may not seem high, it has significant economic impact on the stakeholders, including the private sector, community beneficiaries, and state-owned enterprise banks.

For example, the State Bank of India has the most nominal amount of debt associated with Indian highways. About 20% of its loans to ports and highways were nonperforming in status by the end of 2016. The Indian national road PPP program initially had a very low rate of renegotiation, which was followed by a wave of arbitrations in the mid-

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11 Not all countries report on liabilities related to PPPs, and organizations such as the International Monetary Fund (IMF) and the International Public Sector Accounting Standard (IPSAS) 32 recommends treating PPP debt as creating public sector liabilities. This report estimates liabilities based on the World Bank’s Private Participation in Infrastructure database in low- and middle-income countries, which include the dollar amount of each project, investment year, percentage of project that is privately financed, and the length of the PPP contract. The estimate assumes the government’s possible contingent liabilities for each PPP project listed in the database is equal to the total initial private investment with a straight-line decline until the end of the contract when it is zero.
12 The term contingent liability refers to costs that may occur depending on the outcome of an uncertain future event such as when a government agrees to a minimum traffic guarantee in a transport PPP.
Renegotiation could be a double-edged sword: it can either lead to a positive outcome by tackling the essentially imperfect nature of a long-term PPP contract, or it can create potential for opportunistic behaviors in the renegotiation process that can produce negative outcomes.

2010s, with roughly 100 road contracts in arbitration at a single point in time. According to the World Bank, a systemic macro financial crisis could cause the failure of PPP projects with a potential fiscal liability to South Asian governments of more than 4% of revenues.

Often, PPP contracts are not standardized and the contractual clauses that create contingent fiscal costs may not be disclosed. The details and clauses that generate potential fiscal obligations are sometimes not sufficiently shared—even with the public debt managers. According to the World Bank Hidden Debt Study of South Asia, the fiscal costs are not regularly reported when PPP contracts are renegotiated. When the public and private parties to a PPP do not agree to a renegotiation, and the project is terminated, the government often ends up compensating the private partners for the debt, equity, and earnings that would have accrued to the private partner from the terminated project.

The public sector has the option to create another PPP for implementing the project, implement the project as a purely public sector project, or decide not to do the project. Such actions can carry high fiscal costs or high economic costs in terms of generating benefits from the building and operation of the infrastructure.

Combined with political pressure to deliver on need infrastructure, delays in completion can put pricing power more in the hands of the private partner. This pricing power increases when PPPs are off-balance sheet and costs are not disclosed. Fiscal implications may not be made public at the time of the renegotiations and potentially higher fiscal impacts can result if the project is terminated. If renegotiation results in the need for the government to fund additional works, value for money may be negatively affected by the lack of competition for the additional work.

If additional works are directly contracted with the concessionaire, renegotiations may also lessen the transparency that was present in the original competitive tendering of the project. The lack of competitive tension for the additional works may result in higher costs than would be obtained through a transparent competitive process. When a renegotiation occurs without competition and the risk allocation changes after awarding of the contract to the project company in the original procurement process, it is not a certainty that the project company that was awarded the project will continue to offer the most cost-effective solution.

Establishing a regulatory framework for PPP renegotiation helps to provide a safeguard against opportunistic contract amendments that would weaken the benefits of a competitive procurement. Renegotiation has aspects of a double-edged sword. It can lead to a positive outcome by tackling the essentially imperfect nature of a long-term PPP contract. At the same time, it creates the potential for opportunistic behaviors in the renegotiation process that can produce negative outcomes.

The World Bank’s Benchmarking Infrastructure Development 2020 examines regulations to prepare, procure, and implement large infrastructure projects in 140 developing countries. It includes survey data on the regulation of PPP renegotiations. It collects survey data on third-party approvals that govern changes such as modifications and/or limitations of the scope of the contract; duration; risk allocation; and clauses governing agreed upon price, tariff, and annuity payments. This study finds that the vast majority (89%) of the developing countries surveyed have some form of regulation for PPP renegotiations thought the survey did not independently evaluate the quality of these regulations.

A sound regulatory framework governing PPP renegotiation can reduce the frequency and lower the cost to the public sector. Chile reformed its PPP legislation including for renegotiations in 2010 after having experienced a high rate of renegotiations in the past (Box 2). Key features of this reform are establishing thresholds for changes to a contract, establishing clear lines of

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14 Footnote 13, pp. 11–12.
15 World Bank. 2020. Benchmarking Infrastructure Development
responsibility for approval, and public disclosure of costs. The government must present a public report that is reviewed by an independent panel, justifying the amendment to the contract including that (i) the facts surrounding the amendment to the contract could be predicted at the time of contract award; and (ii) if awarding the new works to the existing concessionaire, it must be justified as more efficient than granting the work to a different company, for reasons such as performance, level of expertise, social and environmental impacts, or economies of scale.

In 2007, Chile began using present value of revenue (PVR) contracts, for most transportation PPPs. Under a PVR contract, project developers propose as part of their bid a minimum gross revenue discounted at a predetermined discount rate. The PPP contract terminates when the net present value of gross revenue is reached. These PVR contracts constrain the use of renegotiations by extending the term of the contract when the demand is less than anticipated, raising tolls, or by government subsidy, without having to modify the contract, thereby enabling more time for the private sector to earn its return and avoiding the need for a renegotiation. The combination of both policy innovations in the PVR and PPP legislative reform led to a decrease in renegotiations, as a percentage of investment, of around 90%.16

A good regulatory and policy framework broadly helps to avoid renegotiation. This can be achieved through effective implementation of clearly defined management structures, monitoring and evaluation capacity, a politically independent regulator to oversee the PPP contracts, establishing dispute resolution procedures, tariffs setting, and the regulatory framework for changes in ownership of the PPP. A framework for managing negotiations should also consider establishing thresholds for changes in scope, risk allocation, economic and financial balances, prices, tariffs, and annuity payments. The World Bank benchmarking survey includes some fundamental survey questions reflecting best practices for managing renegotiations, such as whether there is no regulatory framework for renegotiation and modification of contracts, no approval is required from a government agency apart from the procuring authority for PPP contracts, unilateral modification of a PPP contract, and establishment of threshold for changes to risk allocation or tariffs.

Table 2 presents data concerning these fundamental questions, with many countries having some form of regulatory framework; few countries lack a regulatory framework for PPP renegotiations. Several countries do not, however, require approval from a government authority, other than the procuring authority, for a renegotiation of a PPP contract. In addition, Table 2 shows few countries have regulatory thresholds for making changes in risk allocations or changes in price or tariffs in PPP contracts.17

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17 World Bank. 2020. Benchmarking Infrastructure Development For information on how the World Bank classifies countries by region, see https://bpp.worldbank.org/methodology or refer to Figure 1 notes in the introduction.
Table 2: World Bank Public–Private Partnership Benchmarking Survey Data on Asia and Pacific Renegotiation Frameworks

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<th>No regulatory framework to regulate renegotiation/modification of PPPs</th>
<th>No approval from a government authority, other than the procuring authority, for renegotiation</th>
<th>Can the procuring authority unilaterally modify a PPP contract?</th>
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Lao PDR = Lao People’s Democratic Republic, PPP = public–private partnership.
Source: World Bank. 2020. Benchmarking Infrastructure Development. The original figure has been adapted by the ADB for selected countries only.

Governance Recommendations

Governments should seek to reduce the frequency of renegotiations in PPPs. If a renegotiation is unavoidable, they should create frameworks and strategies for managing them. Good practice for a framework to reduce renegotiations should include a framework that defines under what circumstances a renegotiation can be undertaken while ensuring needed flexibility for success of long-term PPP contracts.

It is critical that renegotiations are transparent and subject to similar approval mechanisms that are applied to PPPs. Governments may also want to consider an independent body, as in the case of Chile, to determine when a renegotiation would be the most reasonable option. In line with best practices, the government should establish a regulatory framework that will lessen incentives to use these changes opportunistically by the private partner or the public entity responsible for procuring the project.

The following are recommendations for the policy and regulatory level:

- Renegotiations should not be used to deal with issues the project company would contend with in the normal course of running its business. This includes faulty assumptions by the contractor in pricing a bid for the project, issues stemming from deficient contractual performance, and inability of the project company to secure needed financing.
- Establishment of independent monitors, such as the technical panel of independent experts in Chile, to review and make recommendations on requests for renegotiation whether coming from the government or the private sector. If private operators perceive the government as open to renegotiations, this could incentivize opportunistic behavior and submission of low-ball bids, as in the example from Brazil.
Budgeting over the medium term should be accompanied by transparency of the procurement process, competition at the tender stage and for any new works, and public disclosure of the award and any variations to PPP contracts. For transparency, PPP expenditures should report all direct payments included in current and future budgets, including that of additional costs generated by renegotiations. Guarantees and other contingent liabilities should also be provisioned for to avoid unexpected future liabilities, and included in the budget documents and medium-term fiscal framework. Any additional budgetary flows should be reflected in transparent financial reporting, accounting, and audit exercises.

Variation clauses—change in the law, force majeure, materially adverse government action, refinancing—that can occur over the term of the contract should be also expressly regulated and included in the PPP contract. As emphasized in ADB’s governance brief on *Restoring Confidence in Public–Private Partnerships*, proactive dispute resolution and alternative risk-sharing mechanisms can help parties involved in a PPP contract settle differences efficiently while benefiting stakeholders without adversely affecting a project.

Significant works to be made through a renegotiation should be tendered competitively to prevent the private partner taking advantage of the renegotiation to create additional work on a sole-source basis.

Government should make public a full justification and consideration should be given to an audit of the PPP to ensure that the public interest is served. The justification should disclose evidence based on long-term costs, risks, and potential benefits. It should be demonstrated that the project distress is material and is likely to lead to default and unfavorable outcomes for the public sector and/or end users of the service.

In cases where governments have weak institutional frameworks or no frameworks governing renegotiations, or when renegotiation is a continual issue, the government may also consider banning renegotiations during the first few years of a contract. However, this approach risks failing to address justifiable reasons for a renegotiation and cannot substitute for good project preparation practices.

Adjustment mechanisms included in the contract can help to resolve issues through processes set out in the contract to find mutually acceptable solutions between the government and the private partner. It is not possible to predict all the possible developments that may occur during the long life of a PPP project. While one may foresee events such as a pandemic, no one can accurately predict when it could occur and its impact. Therefore, changes in long-term contracts are inevitable. However, if the built-in contractual mechanisms for change do not resolve disagreement between the parties, it may lead to a renegotiation or project termination.

If substantial changes are to be made to the scope of works in a PPP contract through renegotiation, that is, changes that can alter risk allocation agreed to in the contract or affect the value for money, the following recommendations apply:

- The government should make a distinction between the occurrence of a risk that was allocated to the project company in the contract and a change in circumstances that was not envisaged in the contract. Otherwise, these could negatively affect the expected social and economic benefits of the PPP project. A risk that was identified and allocated to the project company should normally not trigger a renegotiation.

- Bids for additional works should be evaluated on best overall value for money to avoid the risk of lowballing the bid with a low price. Value for money represents the optimal combination of whole-of-life costs and quality outcomes in accordance with the requirements spelled out in the project tender.

- Procuring agencies should consider present value of revenue (PVR) contracts that can automatically extend the PPP contract term when user demand is lower than expected, without having to modify the contract, thereby enabling more time for the private sector to earn its return and avoiding the need for a renegotiation.

- Giving lenders step-in rights in PPP contracts when the project company is at risk of default or if the contract is likely to be terminated for failing to comply with contractually binding service obligations can help to prevent early termination and reduce the associated fiscal costs of early termination. Establishing well-defined bases for termination in the PPP contract can also help to reduce fiscal costs from early termination.
Governments need to “invest in investment,” that is, invest public resources to build institutional capacity for quality project preparation. This will reduce the likelihood of project failure or renegotiations.

• Good project preparation, underpinned by thorough due diligence, identifying risks up front, and allocating these risks to the party that is best able to manage or mitigate the risk, can reduce the risk of a PPP renegotiation. These risks also need to be priced and included in the government budget projections.

Conclusions

A key recommendation of this brief is for governments to consider adopting PPP laws, regulations, or guidelines that govern underwhat conditions to consider renegotiation. Many developing countries lack strong institutional capacity for planning, project preparation, and implementation of PPPs. Policy makers need to develop effective regulations that clearly lay out what agency is responsible for decision-making, and the process, procedures, and thresholds for making decisions. The use of standardized contracts that are in accordance with the regulations will make the process more efficient for public sector decision-makers as well as for the private sector.

Additional unanticipated expenditures due to renegotiation should be considered as current and future public expenditures, and they must be transparently accounted for, disclosed, and included in the budget and medium-term fiscal framework. The public financial framework is normally geared toward annual appropriations. PPPs incur long-term direct and contingent liabilities over time through government grants, availability payments, and uncertain payment obligations due to compensation clauses, termination payments commitments, debt guarantees, or other credit enhancements. These fiscal obligations should be subject to transparent financial reporting, accounting, and audit exercises.

Governments need to “invest in investment,” that is, invest public resources to build institutional capacity for quality project preparation. This will reduce the likelihood of project failure or renegotiations. This includes managing a competitive tendering process in which the rules and regulations are standardized and widely available to a broad range of potential bidders—competitive, with internal controls—and supported by anti-corruption programs.

PPPs must be effectively managed, and problems must proactively addressed to avoid potential PPP contract renegotiation. This can help to resolve or mitigate potential problems before they become more serious disputes requiring more costly measures such as arbitration or renegotiation. Having a dedicated project team to manage the renegotiation and flexibility of the procurement authority to manage unanticipated circumstances can help to manage renegotiations effectively. As recommended in ADB’s COVID-19 and Public–Private Partnerships in Asia and the Pacific: Guidance Note, proactive problem-solving is essential to obtaining value for money and resolving problems early before they metastasize as full-fledged and more difficult to resolve disputes.

Governments often do not have the necessary capacity to implement project preparation in line with best international practices and should seek expert, high-quality legal and financial advice for managing renegotiations. Multilateral development banks can play this role as a source of unbiased and balanced technical advice to help resolve problems, as well as to improve the regulatory environment and strengthen project preparation and project management capacity.

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