

## New Development: PPP Road Projects in Argentina

In 2016, the government of then recently elected Argentine President Mauricio Macri announced a public-private partnership (“PPP”) initiative, which was followed that same year by the enactment of Argentine Law 27,328 on Public-Private Partnership Contracts (the “PPP Law”).<sup>1</sup>

In late 2017, the government officially launched the first phase of its PPP program (“Phase 1”). Titled “Safe Highways and Roads Network,” the six projects to be tendered in Phase 1—all brownfield in nature—will require the construction, operation and maintenance of a combined 810 km of highways, 1,494 km of “safe roads” (*rutas seguras*) and an additional 269 km of bridges and other accessory structures within the provinces of Buenos Aires, Mendoza, San Luis, Entre Ríos, La Pampa, Córdoba and Santa Fe.<sup>2</sup>

According to the estimates provided by Argentina’s Ministry of Transportation, these initial road projects will require, in the aggregate, approximately US\$6 billion in investment during the first four years and an additional US\$2 billion in maintenance and upgrade work during the 10-year period thereafter. In addition, following Phase 1, Argentina plans a rollout of telecommunications, hospitals, prisons, water treatment, sanitation, energy, technology and other projects to be constructed, operated and financed through the PPP model for an aggregate investment of approximately US\$26.5 billion through 2022. The Argentine government opened the tender process on the Phase 1 projects on January 29, 2018. The deadline to submit bids is currently set for April 3, 2018.<sup>3</sup>

The key to the success of Argentina’s ambitious PPP program is the participation of foreign infrastructure investors and developers. Recognizing this, and building on lessons from its own RenovAR renewable energy tenders and from PPP programs in other Latin American countries such as Peru, the Argentine Ministry of Finance has sought to model the PPP contract and tender process on the best practices for private sector investment in public infrastructure works, with a particular emphasis on establishing legal frameworks and instruments to facilitate long-term financing. Examples include references to a rebalancing of financial equilibrium of the contract following material events; allocation of land acquisition risks entirely to the contracting authority; use of a private sector trust to administer compensation, including termination payments; creditor step-in rights; creditors’ consent for certain actions of the PPP contractor; and recourse to international arbitration outside of Argentina for the resolution of disputes.<sup>4</sup>

In this Legal Update, we summarize the key compensation mechanics under Argentina’s PPP program and compare them to similar structures used in other Latin American jurisdictions.

### Compensation Structure under PPP Contract

Pursuant to the proposed form of PPP contract (*Contrato de Participación Público Privada*) (the “PPP Contract”)<sup>5</sup> to be entered into by the contracting entity established by the winning bidder for a project (the “PPP Contractor”) and the *Dirección Nacional de Vialidad*, an independent

agency within the Transportation Ministry (the “DNV”), acting as the relevant contracting authority on behalf of the Argentine government, PPP Contractors will be granted the right to construct, operate and maintain projects for a period of 15 years.

Under the terms of a given PPP Contract, the PPP Contractor is required to perform certain required construction, rehabilitation and improvement works (the “Main Works”) and operation and maintenance services (the “Main Services”), which the PPP Contractor will be required to guarantee through either (i) cash, a letter of credit or a bank guarantee (each considered an on-demand performance guarantee or *garantía ejecutable a primer requerimiento*) or (ii) surety performance bonds (*seguro de caución*). The DNV can unilaterally increase or decrease the scope of the Main Works and Main Services up to 20 percent of the amount of the contract price, and the Contracting Authority will assume the refinancing cost in connection with such adjustment. The DNV can also require the PPP Contractor to perform additional works relating to the project for an additional agreed amount of compensation and adjustment to the works schedule. If such additional works are required by public policy, the DNV may undertake such work at its own expense, whether directly or through its own designated contractors, in which case the PPP Contractor would not receive compensation for such works, but would be entitled to compensation for any resulting increase in its operation and maintenance costs.

One of the key features of the PPP Contract is the establishment of a compensation structure in which a specially formed payment and guarantee Transportation Infrastructure Trust (*Fideicomiso de Infraestructura de Transporte*) (the “PPP Trust”)<sup>6</sup> will issue to PPP Contractors payment certificates quarterly, based on the degree of progress toward the completion of distinct construction and operation phases of their respective projects. These certificates will be irrevocable and transferable, thus permitting the PPP Contractor for a particular road project to

collateralize and/or securitize cash flows in connection with the financing of the project. The primary sources of funding of the PPP Trust will be (i) funds from a petrol fuel tax and (ii) the surplus of toll road revenues of certain projects.<sup>7</sup> The risk of insufficiency of these sources of funding to meet the PPP Trust’s payment obligations across all projects is mitigated by the commitment of the Argentine government to make a contingent contribution in the event that the amounts deposited in the PPP Trust are not sufficient to fulfill the PPP Trust’s obligations with the various PPP Contractors. The amount of the contribution of the Argentine government to the PPP Trust for each calendar year will be established in the national budget law for the corresponding year. And if the government, through the PPP Trust, does not meet its payment obligations, any PPP Contractor will have direct recourse against the Argentine government. Any such legal action against the Argentine government may be decided by international arbitration.

#### CONSTRUCTION PHASE

The winning PPP contractor for a given project will specify the value in US dollars of the Main Works for the project. At the end of each month during the construction phase of a project, the DNV will issue a certificate of acknowledgement (*reconocimiento de avance de inversión*, or “ARAI”) identifying the percentage of the Main Works performed by the PPP Contractor and its value in US dollars. At the end of each quarter (the “Investment Period”) the DNV will instruct the trustee of the PPP Trust to issue one or more freely transferable certificates to compensate for the infrastructure investment (“TPIs”, or *Títulos de Pagos por Inversión*) for an amount equal to the percentage of the Main Works completed during that Investment Period (regardless of any positive or negative variation of the percentage of completion of the Main Works as compared to the expected percentage of completion of the Main Works for such Investment Period based on the construction milestones set forth in the relevant project bid).

Each TPI will be denominated in US dollars, will be irrevocable and governed by Argentine law and will entitle the holder to receive 20 semiannual payments in US dollars (each, an “Investment Payment”) on May 15 and November 15 of each calendar year (each such date, an “Investment Payment Date”). The TPIs will provide for the payment of delay interest in the event the Investment Payments are made past their due date.

Depending on the type of performance guarantee it provides, the PPP Contractor can receive either TPIs that are unconditional and not subject to any deductions (“Fixed TPIs”) or a combination of Fixed TPIs and TPIs that are conditional and subject to certain deductions (“Variable TPIs”). If the PPP Contractor chooses to secure its obligations through an on-demand performance guarantee, then it will receive only Fixed TPIs. If, on the other hand, the PPP Contractor elects to provide surety performance bonds, then the PPP Contractor will receive Fixed TPIs for 85 percent of the value of the completed work, and Variable TPIs for 15 percent of the value of the completed work.

The TPIs may be issued as global certificates for the benefit either of the PPP Contractor or one or more beneficiaries (such as a lender or bond trustee). The TPIs and the rights arising thereunder will be freely transferable by the relevant beneficiary without the prior consent of the DNV. Although Argentine law currently provides that TPIs are not subject to a withholding tax, the TPIs additionally include a gross up obligation for any withholding that may be imposed.

#### OPERATION AND MAINTENANCE

In addition to providing and receiving compensation for the Main Services for a project, the PPP Contractor will be permitted to generate toll revenues and additional revenue from the leasing of service areas and unutilized project property and from the provision of ancillary services. The funds for the payment of the Main Services are expected to come primarily from toll collections, excess cargo charges and the commercial exploitation of the project area (collectively, “User Revenues”). In the event that a

bidder expects that a project may have insufficient traffic to generate User Revenues, the PPP Contractor may, as part of its bid, request compensation in the form of availability payments via the issuance of monthly Argentine Peso-denominated availability certificates (*Títulos de Pagos por Disponibilidad*) (“TPDs”). TPDs share the same basic legal and structural features as TPIs (e.g., they are freely transferable, subject to delay interest and governed by Argentine law). The amount of TPDs, if compensation in the form of availability payments is available for a specific project, will be fixed in the technical specifications for each project.

For certain projects with very strong traffic histories (and hence strong toll revenue) and projected User Revenues above the agreed-upon amounts required to be paid to the PPP Contractor, the PPP Contractor may be required to make payments into the PPP Trust to help fund other projects with lower projected User Revenues.

#### PAYMENTS ON TERMINATION

In the event that the PPP Contract is terminated early, regardless of whether termination is the fault of the PPP Contractor or the DNV, the PPP Contractor will have a right to receive payment for any work that has been completed but not recognized through an ARAI as of the date of termination as well as for any completed work for which an ARAI has been issued but for which the PPP Contractor has not received a corresponding TPI. If the termination is the fault of the DNV, the amount of the termination compensation will be net of any penalties and fines owed by the PPP Contractor under the PPP Contract as well as amounts (*pasivos de liquidación*) required to bring the level of construction or maintenance of the project to the level it would have been at had the PPP Contract not been terminated. If the PPP Contractor owes any amount to the DNV at the time of the termination of the PPP Contract for PPP Contractor Default, such amounts, if not paid in advance, should be deducted from any on-demand performance guarantees and, if no on-demand performance guarantees are posted, may be

deducted from payments under any Variable TPIs issued to the PPP Contractor. Amounts due under TPIs and TPDs are not accelerable.

## Comparison to Other Latin American PPP Programs

While new to the financing of infrastructure projects in Argentina, the issuance of certificates representing a right to payment for completed works has been used in a number of other Latin American jurisdictions. Below is a chart comparing some of the key elements of the compensation mechanism under Argentina's PPP program to those used in PPP programs elsewhere in the region.

Perhaps the best example where a similar compensation mechanism has been successfully used to attract and develop both foreign and local investment in large-scale infrastructure projects has been in Peru. In 2005, in order to attract financing for the development of the Initiative for the Integration of the Regional Infrastructure in South America ("IIRSA") toll road project, the government of Peru introduced a concession structure in which it provided the concessionaire, through the issuance of *Certificados de Reconocimiento de Derechos del Pago Anual por Obras* ("CRPAOs"), a guaranteed stream of payments to cover construction costs. CRPAOs were irrevocable New York law-governed, US dollar-denominated payment certificates issued by, and direct obligations of, the Peruvian government, which could be "securitized" to enhance the credit profile of the project, thus helping to attract financing that would have otherwise not been available (e.g., through local and international capital markets or from pension funds and other institutional investors). The decision by the International Monetary Fund that CRPAOs were to be treated as sovereign debt of Peru led the Peruvian government to discontinue the use of CRPAOs, but the use of bonds or bank loans backed by similar instruments has continued to attract foreign investors. For example, payment instruments called *Remuneración por Inversiones Según Certificado de Avance de Obra*

("RPICAOs")—the successor to the CRPAOs—have been used in the bond financing of the Huascacocha-Rimac and Taboada water projects and in the bank and bond financing of Line 2 of the Lima metro. These more recent Peruvian infrastructure transactions also included *Pagos por Operación y Mantenimiento* ("PAMOs"), which are similar to the Argentine TPDs and cover operation and maintenance costs.

If funds in the PPP Trust are insufficient to make payments under outstanding TPIs and TPDs, the Argentine government commits to fund the PPP Trust to cover such deficiency, subjecting holders of TPIs and TPDs to Argentine government credit and budgeting appropriation risk. In the Panama Metro de Panamá project, payment obligations of Metro de Panamá, S.A., the contracting authority, under *Certificados de No Objeción* ("CDNOs")—the certificates of payment for completed works—were contingently guaranteed by the Panamanian Ministry of Finance. To mitigate budgeting risk and make the project more bankable, the Panamanian Ministry of Finance was required to include payments on the CDNOs as part of its draft General State Budget for the full term of the financing.

Another way to mitigate risk of insufficient revenues and budgetary shortfalls is to ensure multiple sources of funds from which to pay investors. The PPP Trust proposed under the Argentine program contemplates the creation and funding of a reserve account (for one year of expected TPI payments), and the PPP Trust will be funded from tax revenues and excess User Revenues. A similar approach was taken in Colombia's 4G highways program, where minimum revenue guarantees (*vigencias futuras*) ("FBAs") issued by the Colombian contracting authority were dependent on future budget allocations. To address such risk, Colombia's 4G program includes no less than three separate alternative funds to pay investors should the relevant contracting authority fall behind or default on its payments. This alternative fund scheme offers investors a certain degree of confidence that payments would be made from one source or another, helping to mitigate the

	<b>Argentina</b> TPIs and TPDs	<b>Peru</b> CRPAOs	<b>Peru</b> RPICAOs	<b>Colombia</b> FBAs	<b>Panama</b> CDNOs
<b>Nature</b>	Tradable instrument	Tradable Promissory Note	Contractual obligation under concession agreement	Contractual obligation under concession agreement	Promissory note
<b>Payment Denomination</b>	USD/ARS	USD	USD/PEN	USD/UVR/COP	USD
<b>Grantor</b>	DNV	Ministry of Transport (MTC)	SEDPAL +Ministry of Housing (MVCS)  Ministry of Transport (MTC)	Agencia Nacional de Infraestructura (ANI)	Metro de Panamá, S.A. (MPSA)
<b>Applicable Law</b>	Argentina	New York	Peru	Colombia	Panama
<b>Sovereign Guarantee</b>	Contingent guarantee	Absolute guarantee	Contingent guarantee	Quasi-absolute <sup>8</sup> & Contingent guarantee	Contingent guarantee

risk of the granting authority needing to seek special budgetary approval by the legislature.

## In Conclusion

Although the structure of Argentina's PPP program mirrors that of other successful PPP models in the region, securing financing for infrastructure projects in Argentina will not be without its challenges. Unlike Peru, where local pension funds are significant investors in that country's infrastructure projects, Argentina does not have an established local investor base, which means that financing will need to come primarily from international investors who may still be hesitant to take on Argentine risk despite the PPP program's structure.

Argentine government payment risk—whether in respect of a pay out on TPIs or replenishment of the PPP Trust or a payment on a termination claim—presents another issue for creditors. Although the PPP Trust Agreement and the TPIs are governed by Argentine laws, Argentina has accepted that dispute resolution will be international arbitration (and not Argentine courts).

A broader challenge will be for parties to structure and arrange financing on six concurrent projects in the timeline proposed by the government. Still, the current Argentine government's commitment to the use of PPP structures is a welcome move

toward a more market-friendly approach to public sector infrastructure development.

*For more information about the topics raised in this Legal Update, please contact any of the following lawyers.*

### **Gabriela Sakamoto**

+1 202 263-3029  
[gsakamoto@mayerbrown.com](mailto:gsakamoto@mayerbrown.com)

### **Douglas A. Doetsch**

+1 312 701-7973  
[ddoetsch@mayerbrown.com](mailto:ddoetsch@mayerbrown.com)

### **Christopher P.B. Erckert**

+1 202 263-3808  
[cerckert@mayerbrown.com](mailto:cerckert@mayerbrown.com)

### **Pablo C. Ferrante**

+1 713 238-2662  
[p ferrante@mayerbrown.com](mailto:p ferrante@mayerbrown.com)

### **Sean G. Kulkarni**

+1 212 506 2604  
[sgkulkarni@mayerbrown.com](mailto:sgkulkarni@mayerbrown.com)

## Endnotes

<sup>1</sup> See “Argentine PPP Law,” Mayer Brown Legal Update, 31 August 2017, <https://www.mayerbrown.com/argentine-ppp-law-08-30-2017>.

<sup>2</sup> Description and location of projects can be found at <http://ppp.vialidad.gob.ar/proyecto/>.

<sup>3</sup> Bidding rules and terms can be found at <http://ppp.vialidad.gob.ar/descarga-pliegos/>.

<sup>4</sup> A risk allocation matrix produced by the Ministry of Transport can be found, in Spanish, on the Ministry of Transport’s website at <http://ppp.vialidad.gob.ar/contrato-ppp/>

<sup>5</sup> The model form PPP Contract can be obtained on the Ministry of Transport’s website at <http://ppp.vialidad.gob.ar/wp-content/uploads/2018/01/PPP-RARS-Contrato-PPP.pdf>.

<sup>6</sup> The model form of the Trust can be obtained on the Ministry of Transport’s website at <http://ppp.vialidad.gob.ar/wp-content/uploads/2018/01/FIDEICOMISO-INDIVIDUAL-PPP-y-otros.pdf>.

<sup>7</sup> Resolution 147-E/2018, <http://ppp.vialidad.gob.ar/wp-content/uploads/2018/01/document.pdf>.

<sup>8</sup> FBAs are backed by the full faith and credit of a subnational or public-sector entity. However, if the concession agreement is amended such that the payment and/or works schedule is modified, the granting authority may reschedule the FBA payment profile.

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