

Reflections on the Importance of PPP Contract Management and Possible Shortcomings in the Region

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Discussion Papers

PPP Americas 2021

Reflections on the Importance of PPP Contract Management and Possible Shortcomings in the Region

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About the Discussion Papers

The Discussion Papers – PPP Americas 2021 are a set of documents drawn up ahead of the X Edition of PPP Americas, the main forum for Public-Private Partnerships (PPP) in Latin America and the Caribbean (LAC), which is organized every two years by the Inter-American Development Bank (IDB).

The PPP Americas 2021 event brought together eight groups of experts, professionals, consultants and academics directly involved in the planning, identification, structuring and management of PPP projects in the countries within the region. The groups, coordinated by IDB specialists, reviewed the main topics of interest and current issues and concerns in the realm of PPPs. They also exchanged experiences and discussed success stories and lessons learned from the projects ongoing throughout the region.

Following an open call in March 2020, which attracted applications from more than 200 specialists, professionals and academics from the region, around 90 people were selected to be contributors. They actively took part in discussions on the following topics: reliability of state payments, project selection criteria and determinants of value creation in projects, best practices in contract management, diversification of the capital structure of projects, contract termination rules and their consequences for project feasibility, planning and prioritization in infrastructure development, fiscal impacts of PPP projects, and the role of control bodies.

Each topic discussed by the groups led to a Discussion Paper, reflecting the views and opinions shared by the specialists during their joint discussions between June 2020 and April 2021. In addition, in January 2021 each group of specialists shared their insights with the other groups to help generate a richer and deeper dialog and to unlock synergies between the different areas.

This initiative aims to help consolidate an environment conducive to the exchange of experiences and best practices in PPPs for the region. Its main purpose is to serve as an input for the discussions that will take place at PPP Americas 2021—where solutions will be proposed on all fronts.

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Reflections on the Importance of PPP Contract Management and Potential Shortcomings in the Region

Perhaps one of the aspects that receives the least scrutiny in the realm of PPPs is the management of contracts during their life cycle.

The purpose of this discussion paper is to offer reflections on key aspects of contract management, based on a selection of topics, or "management areas", as we discuss international good practice. It also seeks to draw attention to the complexity of this function and the need for greater awareness of its importance. This is to help governments give it the attention it deserves, improve the design of the contract management function, or rethink their practices.

Some specific objectives that this document aims to meet:

- To understand the importance of defining, entrenching and institutionalizing a sound PPP contract management strategy and the areas of activity involved.
- To help eradicate "transaction myopia", whereby governments think their job is done upon signing the contract. Signing the contract is only the beginning of the project; how it is managed will define its future success.
- To become aware of the relationship between good contract management and good contract design in order to visualize the essential aspects that a contract must cover so that it we have the right mechanisms in place to react to change and respond to threats.
- To explore and scrutinize the main management tools and attitudes that we will need in order to adequately perform the function.
- To attempt to highlight the areas of contract management that are perhaps more neglected from the perspective of the PPP framework, contract design, or from the management praxis, or at any rate to offer a framework to improve the treatment and development of this important aspect within each country and in each project.

To meet these objectives, the document is split into eight sections that seek to answer the following points:

Section 1: What is PPP contract management? What is the objective and main activities?

PPP Contract Management is defined as: "the set of processes, methodologies and resources that enable the proper development of the project from the time the contract is signed through to the end of its operational life" (the life of the contract).

The aim of contract management is to protect and ensure the sound development of the project throughout its operational life in order to achieve the desired results in terms of

benefit to society, by controlling at all times its affordability, balance and compliance with the obligations and responsibilities incumbent upon each party.

This management entails a number of activities beyond the obvious control of private obligations (see figure below).



Section 2: What are the main obstacles and what is required at country and project level to reliably overcome the challenge of good contract management?

This section discusses the importance of having proper resources, tools and attitudes, as well as a framework that enables the institutionalization of the contract management function and good practice in the preparation and drafting of contracts (which are ultimately the operational framework steering the management of the project).

We also address the limited vision of the functions of a contract manager (generally thought of as the monitoring of any traditional public works contract), the scarce resources with which the function is generally endowed (essentially focused on “audit myopia”), the absence of a “project management” culture and such essential tools as the “contract handbook”, not to mention others such as the lack of use of a financial model, or information systems, and the absence of a partnership culture, as well as shortcomings when it comes to incorporating upstream governance of PPPs (from a whole-of-government perspective) without properly considering central agencies as an “internal stakeholder”.

Sections 3, 4, 5 and 6: Describe the main activities and management areas flagged by the group of experts, attempting to answer questions such as:

What is performance management, or change management? What tools are required? What should a good contract include to address risk management challenges?

These sections seek to provide an initial understanding of what is involved in the management areas that we have flagged and the main challenges involved.

We describe the aspects that need to be taken into account in the contracts, tools and attitudes required for the good management of each of the areas or activities that we have analyzed in greater depth as they are considered to be the most demanding in terms of proactive management (performance and compliance management in section 3; risk and complaints management in section 4, change management in section 5). We propose a list of the main focal points, commenting on how the region “scores” in terms of good practices and where the main areas for improvement lie.

To highlight a number of the key aspects analyzed in this regard, this document focuses specifically on:

- In relation to performance management:
 - o how managing the performance of the private partner (control of its good performance and compliance with obligations) should focus more on anticipating and preventing breaches or non-compliances and not so much on punishing it when it happens;
 - o how the excessively fiscal focus of traditional works contracts — still very much present — undermines the benefits offered by PPPs;
 - o how the clear and objective definition of realistic service requirements and the minimum standardization of payment mechanisms (of similar projects) matters, and how more reliance should be placed on “self-monitoring” by the private partner.
- In relation to risk management:
 - o how risk allocation matters and how it should be improved and made more precise/clear in its contractual implementation;
 - o how risk management should encompass the management of all risks, including transferred risks, and why.
- In relation to the management of contractual changes or modifications
 - o the need for good governance when it comes to changes in the scope of obligations (particularly in relation to additional work) or service requirements, and how these should be subject to the same cycle of reviews and approvals by central agencies;
 - o how changes of shareholders (transfer or sale of shares from the original promoter) —which is becoming more and more common— should be addressed and covered in contracts by granting greater flexibility under clear and objective principles as to the necessary authorizations;

- the importance of ensuring clear treatment and risk sharing of the impact of certain regulatory changes, especially sector-specific technical regulations.

Last but not least, we provide a shorter description and explanation of certain other activities (section 6), but not because they do not matter as much. This includes the need to manage stakeholders and how they correlate with contract management (especially in terms of the need for transparency and accountability mechanisms); the proper management of early contract termination (which is based on the need for contingency plans, a culture that is in principle largely absent within the region); information and document management (where there is a significant lag when it comes to the proper use of systems and information management); and dispute management (which is very well regulated in contracts within the region).

Section 7: How might COVID-19 impact a PPP contract and what steps are being taken to adapt the contract to this unforeseen event?

This section offers some brief observations on the impact of the COVID-19 pandemic on contract management. On this point, COVID-19 is largely viewed as a “force majeure” event and treated as such (though not always, depending on the contractual framework and the country’s legal framework), or sometimes as a “direct adverse government action” or “discriminatory legal change” event. In some cases, this has led to the renegotiation of the relevant contracts, which, depending on the jurisdiction concerned, may require the enactment of a decree (e.g. Spain) to give it legal effect.

Section 8: What should the PPP Framework incorporate to institutionalize and facilitate good contract management? What contractual standards should be defined to consistently incorporate flexible yet bounded management mechanisms?

In this section, we present some final thoughts in relation to the need for contractual standards that guarantee the proper incorporation in the contract of certain tools and “contractual resources” in relation to PPP frameworks. We also discuss the need to ensure that these standards reflect the function and responsibilities of contract management properly integrated within the institutional architecture, thus affording it the necessary institutionalism. Here, we offer a checklist of standard issues that need to be adequately included in a contract before putting it out to tender.

Introduction

PPP contract management should be recognized as a discipline in its own right that goes beyond the mere supervision of the private partner's obligations, which, while certainly important, is just one of the activities that need to be carried out.

Managing a contract, especially one of this nature, means managing the obligations, responsibilities, threats and risks that can undermine the objectives of a project, which in this case often takes a long time to complete. These aspects include contract changes, risks, contractual disputes, communication problems and fractious decision-making, among others. A contract is not only the legal or administrative document through which a project is defined, agreed or implemented; it is also a tool that establishes all the characteristics and factors that will influence or affect the project.

Yet, this requires awareness of the magnitude of the task and proper groundwork. It also requires the State to regain ownership of the project, even though it may have been awarded under the PPP modality (with the consequent broad delegation of functions to a private partner). We need to properly understand the meaning of this delivery mechanism, which cannot be managed with the same resources or the same attitude as more traditional government contracts. PPPs are a much more complex form of contracting than traditional public works, so treating infrastructure contracts or the provision of services through PPPs in the same way as a traditional arrangement is a mistake that can cost the project and its results a great deal. Therefore, when undertaking this type of project, it would be wise to learn from the mistakes made by governments both within and outside the region in relation to past projects and those in progress today.

The purpose of this discussion paper is to offer reflections on key aspects of contract management from a public perspective, based on a selection of issues or “management areas” from among those commonly described in existing literature and guidance¹ and reflecting on international good practice. We also draw attention to the complexity of this function and the need for greater awareness of its importance. The aim of this is to provide a better approach to the design of the contract management function, or to reassess the government's contract management practices².

¹ There is little in the way of literature and few specific national guidelines or instructions on this subject, which is clearly lagging behind other aspects such as project preparation and appraisal management, or risk management and sharing. In the section on bibliographical references (“Recommended reading”) we provide those sources that the main author of this document largely relies on, without prejudice to any other sources that may exist. However, this document does not contain that many references or citations, as it has been decided to follow a more informal approach based on personal experience and opinions.

² One of the main reasons why a PPP project may fail is a lack of adequate preparation or groundwork (identification of the right project, sound preparation and evaluation, and proper structuring of the contract and bidding process). Rushing a project, without completing the previous phases or without it being properly studied and calibrated by evaluating the different aspects, will undoubtedly cause problems when it comes to managing the contract. That said, this document does not address good practice in project preparation and structuring, but focuses on good contract management during the life of the contract, after it has been awarded and signed. However, as we

Approaching the subject from a public standpoint does not mean we are downplaying the crucial importance of the private partner's involvement over the life of the project. It is undeniably a matter of joint management and heavy collaboration between the public and private sectors³.

The document contains the discussions of a group of experts representing the knowledge and experience of the following countries: Brazil, Mexico, Uruguay and Colombia, and who have taken part in the discussions on the key issues and in some cases provided their views and thoughts on how this has been applied in their respective countries⁴.

Some specific objectives that this document seeks to satisfy:

- To help understand the importance of defining, entrenching and institutionalizing a sound PPP contract management strategy and the areas of activity involved. To help eradicate the “transaction myopia” whereby governments think their work is done upon signing the contract or treating as they would a traditional public works contract.
- To become aware of the relationship between good contract management and good contract design in order to visualize the essential aspects that a contract must cover so that it we have the right mechanisms in place to react to change and respond to threats.
- To explore and scrutinize the main management tools and attitudes that we will need in order to adequately perform the function.
- To attempt to flag those areas that are perhaps more neglected from the perspective of the PPP framework, contract design, or the management praxis, or at any rate to offer a framework to improve the treatment and development of this important aspect within each country and in each project.

In order to meet these objectives:

- Section 1 of this paper contains an analysis and reflections by defining the contract management function, as well as its objectives and contents (main activities).
- Section 2 outlines what is required at country and project level to succeed in the challenge of good contract management.
- Sections 3, 4, 5 and 6 describe the main areas of contract management under analysis and their particularities, with the aim of providing a deeper understanding of the tools and resources required, as we also reflect on some specific challenges.
- Section 7 offers a number of observations on the impact of the COVID-19 pandemic on contract management.

shall see in due course, and strictly from the perspective of good contract project management, it is essential for the contract management function to be present during all stages of preparation and structuring, so as to ensure that the resources that will be needed for the proper management and administration of the project (monetary and human) have been duly taken into account and the tools that will enable its effective management have been incorporated into the contract. We discuss this aspect further in the central sections of this paper in relation to the main management areas.

³ For further discussion on the subject, we would refer the reader to the PPP Certification Guide (2016) in chapter 7.

⁴ For certain relevant aspects, a “self-assessment questionnaire” or checklist is provided to ensure the best possible management of contracts.

- Last but not least, in section 8 we present our final thoughts in relation to the need for contractual standards to guarantee the proper inclusion in contracts of certain tools and “contractual resources” in relation to PPP frameworks, as well as the need to incorporate in these the function and responsibilities of contract management duly integrated into the institutional architecture, thus affording it the necessary institutionalism.

1. PPP Contract Management: Concept, Objectives and Activities

1.1. Definition and scope of Contract Management

For the purposes of this discussion paper we will define PPP Contract Management as:

“The set of processes, methodologies and resources that enable the proper development of the project from the time the contract is signed through to the end of its operational life” (the life of the contract).

Various international guides, which have been embraced nationally in certain countries, propose similar definitions. For instance: *“Process that enables both parties to a contract to meet their respective obligations in order to deliver the objectives required from the PPP agreement.”*⁵

1.2. Aim of Contract Management

The aim of contract management is to ensure the sound development of the project throughout its operational life in order to achieve the desired results in terms of benefit to society, by at all times controlling its affordability, balance and compliance with the obligations and responsibilities incumbent upon each party, as well as the corresponding economic and financial equation.

The initially estimated net benefit of a project may become severely eroded over the life of the project in the absence of proactive contract management, meaning management that:

- helps ensure that the respective obligations under the contract are fulfilled;
- enables the contract to adequately respond to necessary changes and to risks and other threats (e.g. opposition from stakeholders).

All of the above with fluidity, which means minimizing disputes, and if they exist, managing them efficiently to preserve the life of both the contract and the project.

1.3. The importance of Contract Management

The government's responsibility for good project management does not end once the project has been prepared and the contract signed. Efficient management is necessary throughout all phases of the PPP project cycle.

While the longest or most extensive stage is none other than the very “life” of the contract, it is also the stage for which most administrations carry out the least preparation or planning.

Even the best project (expected to have substantial economic significance/impact, well evaluated and prepared, well structured as a PPP and tendered effectively) can fail because of poor contract management.

⁵ South African National Treasury 2004. National Treasury PPP Manual.

Threats to the outcome of the PPP project (the contract) are many and varied: contractual or regulatory changes, materialized risks, disputes, stakeholder opposition, and so forth, or simply the failure of one of the parties to fulfil its obligations and responsibilities.

These changes and variations can compromise the outcome (the quality of service or availability of infrastructure), undermine the sustainability of public finances (when they require increased spending effort) or user affordability, affect users and other stakeholders and tarnish our reputation.

We sometimes forget that the project is a government project: a PPP is still a public investment (whether or not it appears on the government's balance sheet, depending on the standards applied in each country). Whether a project can move forward is largely down to how the contract is managed, bearing in mind that under this type of contract a significant part of the responsibilities and obligations for the project are delegated to the private sector. Thus, the government remains (or should remain) accountable for the results, and this accountability is continuous throughout the life of the contract.

The integral nature of project responsibility is well exemplified in risk management. The administration responsible for the project (government) must manage all risks, which includes collaborating in the sound management of the risks that have been transferred: if a risk adversely affects the financial health of the private partner, it will also affect the service and ultimately the sustainability of the contract. If the project runs into serious difficulties and the contract has to be terminated early, this can have dire fiscal⁶ as well as reputational consequences.

Proper contract management also helps to avoid inadvertently reversing risks, which would effectively alter the risk allocation matrix.

1.4. Activities included in Contract Management

Supervising and monitoring performance and fulfilment of obligations is an essential part of contract management: control of construction, commissioning, operations/service performance, and hand-back obligations, along with other contractual obligations (such as those relating to reporting and compliance with the various regulations that apply to the special purpose entity, or SPE), as well as their proper audit and control and the application of sanctions and penalties (i.e. "performance management"⁷) all lie at the heart of contract management.

Yet there is a misperception that PPP contract management is essentially or largely the activity of controlling and monitoring obligations. Nothing could be further from the truth.

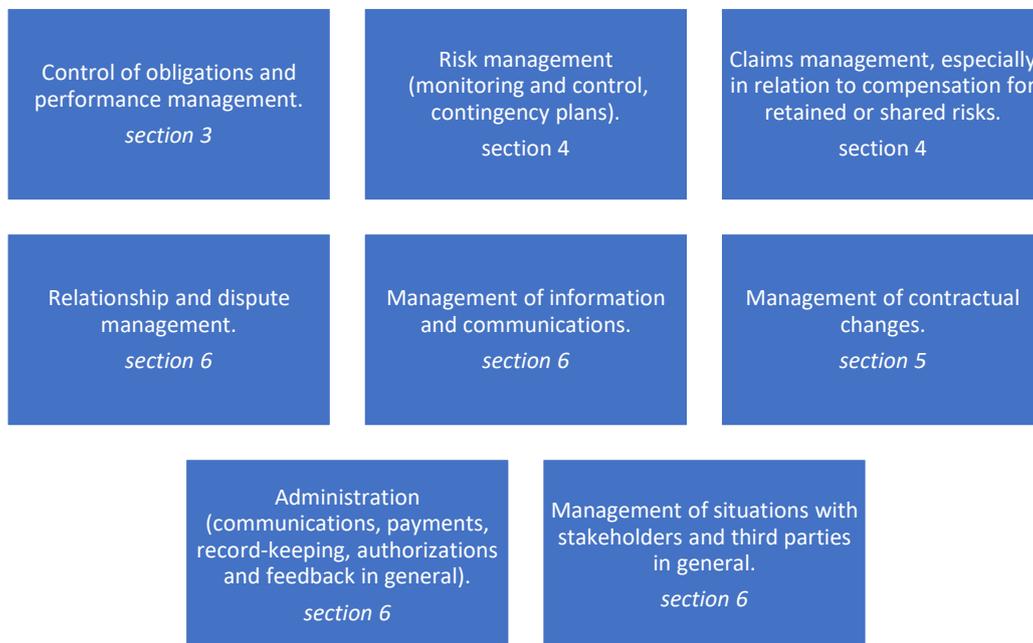
Management of the contract essentially covers:

⁶ While certain jurisdictions within the region auction off the contract (sale of ownership of the contract for its residual term) into their termination mechanisms following a breach of contract, thus avoiding having to pay compensation for early termination, most countries maintain the traditional approach of contractual termination, involving settlement of the contract and redemption of the assets.

⁷ Performance management is the management of the remedial mechanisms or disincentives against poor performance by the private partner, essentially encompassing the application of malus deductions, penalties, incremental audit and termination notices for breach.

- Control of obligations and performance management.
- Risk management (monitoring and control, contingency plans).
- Claims management, especially those related to compensation for retained or shared risks.
- Relationship management and dispute management.
- Management of information and communications.
- Management of contractual changes.
- Administration (communications, payments, registrations, authorizations and feedback in general).
- Management of situations with stakeholders and third parties in general.

- **Figure 1: Management areas and their coverage in this discussion paper**



This discussion paper describes below (sections 3 to 6) the activities that we consider most relevant (what these activities consist of and what tools should be available from a contract and project management perspective), together with some observations on how they are being approached within the region.

2. Problems and Obstacles to Good Contract Management Strategy

2.1. Problems and obstacles to good contract management

The root problem here is a general **lack of awareness of the importance of the contract management function** and the need to institutionalize it. This is clearly manifested in the absence of contract management guidelines for PPPs in the region, the **unfulfilled need for recognition of a specialized professional profile**, or failure to **integrate the contract management function into the governance and overall project cycle of PPPs**, with a stable and structured involvement of central agencies⁸.

We know that proper fulfillment of the contracted services is a primary concern for the government. Yet there is, in general, a **limited vision of the contract management function**; one that is highly focused on the **control of obligations** and with an **extreme fragmentation** of activities, without the necessary holistic and integrated approach that the activity requires (as in the project preparation and structuring phases).

Part of the problem stems from a lack of **understanding of what a PPP contract entails**, which should be oriented toward results and the achievement of objectives and not on obligations of means. These contracts are also **highly complex** when compared to direct or conventional management contracts. Even though the contract may be properly designed in this sense, the risk of the **traditional engineering vision** in the supervision of the work persists, as we will discuss in due course.

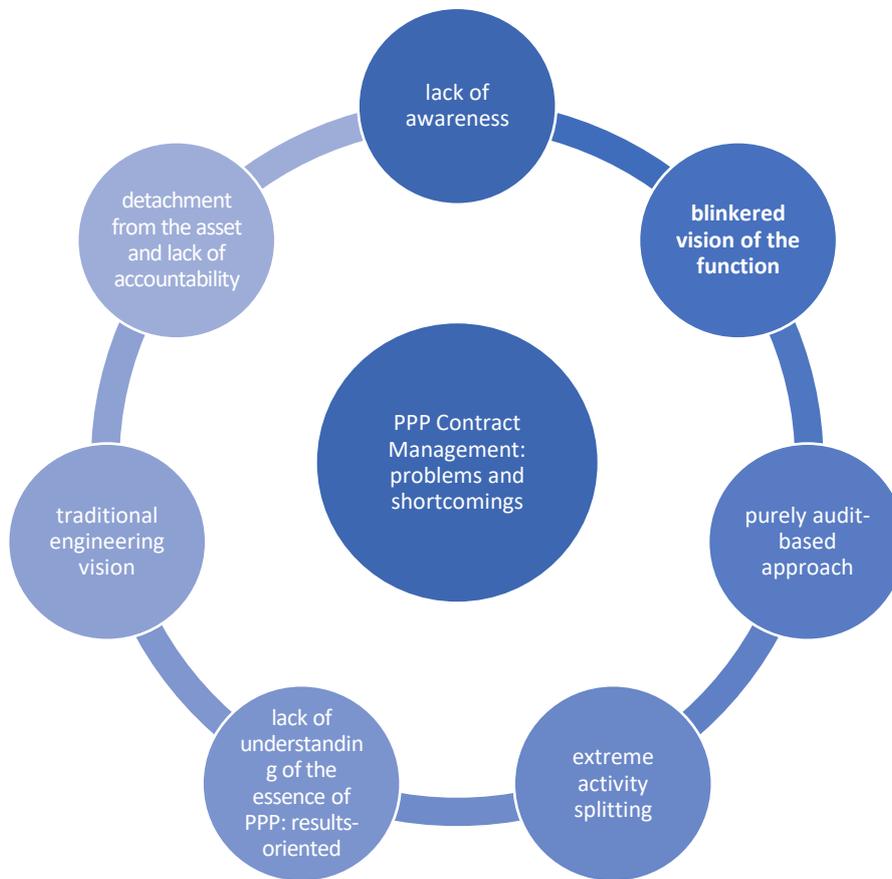
Another factor that generates problems when talking about a lack of proactive management is **detachment from the asset**; the false sensation that it is **no longer “our project”**. We have observed that the transfer of design and construction risk to the contractor frequently results in the contracting authority **no longer feeling “responsible”** and not applying the necessary measures to supervise/manage the project (i.e. lack of accountability)⁹.

This description of problems and obstacles is inspired by what we understand to be happening within the region, broadly speaking, and in most countries with emerging markets or non-mature or undeveloped PPP markets.

⁸ It is common for a project to require approval from central agencies (e.g. Ministry of Finance) before being put out to tender. However, it is also often the case that approval is not required for contractual changes when these should be viewed in themselves as an investment decision, where the value for money and affordability of their fiscal impact should be verified.

⁹ One PPP framework aspect that helps to regain ownership and build accountability is to institutionalize ex-post evaluations of projects and programs.

- **Figure 2: Obstacles and threats to good contract management approaches**



2.2. What does good contract management require?

The management of any public contract requires compliance with the law and the evaluation of contractual efficiency, whereby the parties determine whether the expected results are being achieved at the expected cost while ensuring the optimization of existing resources.

Yet in the case of PPPs, additional aspects are required to ensure the proper development and ultimate success of the entire project. In the first instance, this means having additional or more specialized attitudes or resources and different or new capabilities. In addition, the contractual function or responsibility must be effectively and clearly entrenched in the PPP framework (incorporated and integrated into the overall governance of PPP programs and afforded the necessary degree of institutionalization).

- **Good management requires a good contract.** Contracts must be drawn up to accommodate change and respond to threats efficiently. The contract is the framework, in the first instance, for the management of the project: it should contain not only legal or audit provisions but also provisions on payment management (the obligations of the public partner), the framework for implementing changes in scope or requirements, the assessment and approval of possible changes in financing or shareholding, the framework for dispute resolution, or for early termination, the procedure for the hand-back of the asset, etc. The contract must be endowed with

“limited flexibility”, on the understanding that what is not envisioned in the contract may require renegotiation.

Flowing down from the contract, as an operational tool, will be the Manual and other management tools discussed below.

In general, some countries in the region have good contracts, although there are gaps in the regulation of contract management, which are discussed in the following sections.

The following sections, which cover the main areas of management, include reflections on key aspects to bear in mind when designing and drafting a contract. In Section 8:

Matters Relating to the PPP Framework and Contractual Standards. Recommendations”
we provide a checklist of these key issues.

- **Good management requires skills and knowledge management, as well as information management, document management and other project management tools¹⁰.** The contracting authority is often unprepared in terms of both capabilities and processes to take on this set of tasks required for the various stages of the contract.

Trained human resources and a sufficient budget are needed to ensure a sound team with good knowledge of PPPs and with a sufficient degree of specialization in different branches of knowledge (financial, legal and technical, the latter with experience in the infrastructure sector in question). Management tools are also a necessity, starting with the need to have the funding that will be required from the early stages of the project and to name, right from the outset, the key figure (person/civil servant) who will steer and lead the management of the contract (the “**contract manager**” or “**contract administrator**”) and who must possess the freedom and autonomy needed to make decisions by delegation and with specific skills: interpersonal skills (leadership, communication, problem-solving, relationship management), deep technical knowledge of PPPs (ability to communicate in technical jargon and credibility as a PPP specialist), and administrative skills (as planner, organizer, supervisor and coordinator).

There is also an overriding need to manage (harness or capitalize on) the project knowledge acquired during the preparation and contract award phase¹¹, and to curate that knowledge over the life of the contract. This requires a number of strategies and tools, which are summarized in the box below.

¹⁰ Here we are talking about contingency plans, protocols, operating handbooks, a risk control and monitoring system, an information management and document management system, and so forth.

¹¹ A common approach is for at least one professional from the project team responsible for preparation and structuring to subsequently be part of the project management team, at least during the initial stages. Alternatively, some of the people who will work (or who currently work) in the realm of contract management should be involved to some extent in the structuring phase (perhaps by providing comments).

- **Box 1: Essential elements for good knowledge management**

-
- Planning, at an early stage (ideally before the contract is awarded), for resource needs, internal availabilities and the possible need for external support¹².
 - Developing and implementing a training plan for management team members.
 - Having an “induction manual” for new team members and a “succession plan” that ensures the transfer of knowledge and responsibilities from an outgoing team member to another team member.
 - Drawing up and maintaining/updating a **Management Handbook** to describe, in an accessible and practical manner, the provisions of the contract and provides a more practical or hands-on explanation of the procedures to be followed for its management.
 - Having adequate information management and document management systems and other management tools (risk and contingency management plans, a financial model, a payment mechanism model, etc.).
-

In most of the cases observed, there was a undeniable lack of resources for the proper management of contracts (small internal teams, next to no support in the form of public sector experts and external advisors, other than purely technical experts to assist with auditing).

There are no contract management or administration handbooks, with next to no contingency planning or risk monitoring systems (a relatively common problem in Mexico, according to the expert’s observations, though common in many other countries in the region).

Certain countries sometimes name a contract administrator, although their remit seems to be limited to the task of supervising obligations (interestingly, this figure is sometimes known as the “contract auditor” (Colombia), or “inspector” (Brazil), though this figure is a far cry from the concept of “contract manager” as someone holistically responsible for the administration and effective management of the contract.

In the following sections dedicated to the relevant areas of contract management, we will comment on the relevant tools in relation to each.

- **Figure 3: Questionnaire on skills, knowledge management and information management**

Is the need for resources and budget properly assessed at an early stage? Is it being considered where the funding will be obtained for these activities?

Is there an identifiable contract manager (below the senior contract officer), with appropriate powers/level of delegation?

Is a contract management unit or project-specific teams in place or planned to be put in place?

How do the parties ensure that the project knowledge generated during the preparation, structuring and tendering phases is put to good use?

Are financial and legal advisors available to manage the contract or only resources in the form of technical expertise/know-how?

What knowledge and information management tools are being planned?

Are there management handbooks?

Are risk management plans and contingency plans in place?

Is a mutually agreed financial model —ideally attached to the contract— being used to monitor and agree upon impacts relating to risks, changes and contract rebalancing? What is the financial model governing the contract?

Are document and records management systems being organized/used?

- **Good management requires a collaborative and transparent attitude.** An adversarial attitude will cause further problems, it being wise to remember that we are essentially dealing with an “association” or “partnership”. It is important to have a clearly defined forum to ensure the proper monitoring of the public-private relationship (monitoring committees). This is what we might call “alliance management”. Transparency is where the manager provides access to the flow of information, ensuring the absence of concealed data and making their actions clearly visible both inside and outside the organization.

Accountability also requires transparency and regular, scheduled dialog (stakeholder management), based on a stakeholder map and a good stakeholder communication or engagement strategy.

As mentioned above, only a few countries institutionalize public-private monitoring committees. Effective stakeholder management, however, does seem to be more present (as is apparently the case in Brazil).

- **Figure 4: Questionnaire on attitudes and transparency**

Are there public-private monitoring committees in place? Who is involved?

How often?

Are there stakeholder maps and a stakeholder communication strategy?

Are ex-post evaluations of projects and programs carried out?

- **Good management requires efficient incorporation into the overall governance of PPPs¹³ within the PPP Framework that institutionalizes the function.** There needs to be institutionalization upstream, i.e. at the framework level, with clearly defined roles and responsibilities for the various agencies and institutions involved and forums for monitoring matters at PPP program level.

There should be clarity from the outset on how the Ministry of Finance/Treasury and other agencies should be involved in granting approvals and making decisions during contract management¹⁴ (what changes or decisions need to be approved by the Department of the Treasury/Finance? When should¹⁵ it be informed? Should central agencies approve contract changes and rebalancing?). There should also be clear planning on how to manage “internal stakeholders” and to get them efficiently involved in the management cycle.

In most of the cases/countries discussed, the central agency — usually Finance/Treasury Department — must grant its approval for any contract change or rebalancing to take effect. However, the involvement of such central agencies in

¹³ We can view governance as a set of rules and procedures that establish the incentives and restrictions shaping the decisions and strategies of both public and private agents.

¹⁴ A figure with growing relevance in the governance of PPP projects during their life is that of sectoral regulatory agencies, in countries and sectors that have this figure, especially in relation to their role in monitoring projects and the possible determination of non-compliance or imposition of penalties or fines. In all cases, these agents/entities need to be explicitly identified and their powers and prerogatives clearly set out in the contract. There should also be a clear delimitation as to the extent of their participation in contractual supervision so as to ensure that it does not conflict or overlap with the powers of the entity responsible for contract management, which is none other than the contracting authority. Another important aspect to take into account when it comes to regulatory bodies is that some projects are structured on a regulated tariff basis, in the sense that the rules for determining the tariff are clearly stated in the contract, which contains compensation mechanisms when such updating differs from what was initially foreseen at the time the contract was signed. We will provide more information on this aspect in due course (see Box 4).

¹⁵ A problem we repeatedly see is when subsequent requests are made to central/decision-making agencies (notwithstanding other agencies or entities that have a role to play within the life of the PPP contract), such as Ministries of Finance, asking them to approve or implement contract changes or requirements. Bearing in mind that at central agency level there should be a more continuous and fluid contact over the life of the contract.

contract management is not clearly provided for in most PPP frameworks and there are no contract monitoring committees or commissions to keep central agencies abreast of contract developments.

In some countries (e.g. Brazil, Mexico), liabilities, including contingent liabilities, are monitored by the Finance/Treasury Department, though it would seem that there are no specific rules or instructions on how often contracting authorities should issue reports, and nor are their reporting obligations for such liabilities precisely defined.

- **Figure 5: Questionnaire on Governance and PPP Framework**

Is the involvement of central agencies (e.g. Ministry of Finance) in the management of the contract clearly laid out?

How are “internal stakeholders” managed in order to involve them in the management cycle, and do the parties envision the ongoing involvement of central agencies through monitoring committees or commissions?

Must these central agencies approve contract changes and readjustments? When is their assistance necessary?

Does communication with the contracting authority take place as it would with a stakeholder?

3. Control of Obligations and Performance Management

3.1. General framework

3.1.1. Contract management and performance management

Performance management lies at the heart of contract management, though it is often given too much value to the detriment of other functions, or it is viewed in a very blinkered fashion as involving purely the monitoring of performance and the imposition of fines and penalties. Yet it is not all about spotting breaches and handing down fines.

The performance management function should focus primarily on ensuring compliance with the contract and all related responsibilities and commitments, as well as preventing breaches. The overriding aim should essentially be that of preventing the breach of any part of the contract that might greatly affect the project and lead to early termination.

With this in mind, it means the effective management of all the tools provided for in the contract, especially “remedial mechanisms” (i.e. financial incentives/disincentives to ensure good performance, such as fines/penalties, intervention and termination upon breach). This requires:

- Proper surveillance (“monitoring”)
- Alerting/notifying breaches in a timely manner
- Keeping a proper record of any such events and controlling them on an aggregate basis
- Using good judgment to assess possible breaches, on the understanding that in many cases they may be caused by an event for which the contract provides relief¹⁶
- It is important to know how to gauge future levels of performance and progress and anticipate possible breaches (such as by inspecting the state of the asset ahead of its hand-back a few years before the end of the contract, or anticipating eventual delays in completing the work).

The focus of performance management, and especially its primary function (monitoring), is different depending on the phase of the contract in which we find ourselves; surveillance resources and mechanisms during the construction phase will be different to those used during operation. It is important to recognize that there are three milestones that require special attention: approval or non-objection to the design, completion of construction, acceptance for commissioning and hand-back).

¹⁶ In most of the specialized literature, “relief events” (known in some countries as “exonerating events”) are considered to be those that entitle the parties to avoid the enforcement of a penalty or to avoid being considered in breach. Whether such an event exists is often open to interpretation, which requires good faith and good judgment in order to maintain a healthy relationship between the “partners”.

As with many other contract management issues, the framework for performance management is set out in the actual contract. Good performance management, like any other contract management function, means having a good contract, though the contract is not the definitive management framework. There are other complementary tools and instruments (as in all other facets of contract management).

3.1.2. Performance management mechanisms that should be provided for in the contract

These mechanisms are, or should be:

- Access to information / reporting obligations of the private partner and authority to carry out inspections (e.g. to review the state of the assets for hand-back, or to inspect the quality management system related to monitoring).
- Performance bond as a mechanism for enforcing fines and penalties
- Penalty system: explicit fines/penalties (with early warnings) and deductions/adjustments to service payments
- Imposition of additional technical audits at the cost of the private partner
- “Step-in”, or service intervention, by the contracting authority
- Admission of the “step-in right” or take-over by financial institutions (see “points of attention”)
- Termination for persistent breach (usually part of general termination for breach) (see “points of attention”)
- Early termination for material breach (see “points of attention”)
- Obligation to post and maintain reserve funds for reinvestment
- Indirectly, a good dispute resolution system or process

All of these tools and remedial mechanisms must be duly included in the contract, which provides the basic framework governing performance management¹⁷.

3.1.3. Other tools for good performance management

- A good information and document management system (a must for all facets of contract management) to ensure the proper recording of information relating to breaches, alerts and penalties.
 - Good information management means recording the information properly, evaluating it, interpreting it, and also managing outgoing information (early alerts, warnings, fines, etc.).
- Contingency plans for critical breach events, in particular contingency planning in the event that project step-in/takeover is required, or in the event of early termination due to material breach.

¹⁷ Table 1: Potential performance management problems, points of attention discussed and their source or origin contains a list of “points of attention” for ensuring sound performance management, describing those that relate to the contents of the contract (and potentially to the desirability of developing contractual standards), those that apply to other management tools, and those that apply to a problem or issue that requires an attitude change.

- Protocols (to be included in a Contract Management Handbook) for serving notice and imposing and collecting fines and penalties (that help prevent the right to enforce a penalty from lapsing or creating an unintended waiver of a breach).
 - A breach that goes unnotified or is not alerted may be construed as a waiver that can in some cases be binding. This does not imply that a fine is always the right course of action in response to a breach.
- Protocols for assessing performance/analyzing information and process for calculating payment deductions

3.1.4. Attitude needed for good performance management

- The outputs/results are what matter, not the means (although the adequate provision of means and resources must still be monitored as set out in the contract).
--- for example, see our discussion on the need to monitor the posting of maintenance reserves below ---.
- The attitude must be based on mutual trust and collaboration, with the parties open to dialogue: the private partner should be aware that the public partner is both well-informed and vigilant, yet it must also know when to be proactive and to engage in dialogue.
 - Mechanisms for early dialogue on potential problems (monitoring committees) should be implemented.
 - Monitoring activity should be based on trust in the first instance, relying on the quality management system as the basis for information. It is important to move away from an audit-based approach to one of monitoring and evaluation.
 - Delays can occur for numerous reasons, many of which are beyond the control of the private partner, who should therefore receive support and assistance even when the risk is transferred to them.
- Realistic attitude (when preparing and structuring the project): knowing how to define realistic, achievable requirements (in terms of KPIs, insurance requirements, etc.).

3.2. Analysis and discussion of main problems, challenges and points of attention for good performance management

3.2.1. Most common problems and points of attention

Many of the most common problems and points of attention in the strategy and approach to performance management are down to shortcomings or the need to improve the terms of the contract (which we would argue can be addressed by developing a praxis of standard contract terms¹⁸), or sometimes the absence or lack of proper management tools.

Another problem, as explained in the introductory sections, is the common misperception of what contract management as a whole and in particular performance management entails (“attitude” problems), as also discussed earlier in this section.

¹⁸ See “The need to implement contractual standards” in Section 8.

Table 1: Potential performance management problems, points of attention discussed and their source or origin provides a summary of the most relevant problems, indicating their relationship with the contract, management tools or problems relating to attitude or perception.

Some of them are discussed at greater length in the following paragraphs of this section.

- **Table 1: Potential performance management problems, points of attention discussed and their source or origin**

Problem / point of attention	Related to
Failure to clearly define obligations and breaches	Contract
Failure to precisely define amounts (or ranges) of fines/penalties duly categorized by breach materiality	Contract
Failure to precisely define material breaches that grant the right to early termination: clear, objective, with materiality, relating to obligations that can be categorized as essential (see <i>The need for adequate regulation of early termination for breach below</i>)	Contract (standards)
Lack of a clear and objective description of how compensation is to be calculated, where applicable, or other consequences of early termination due to breach	Contract (standards)
Poorly stated or poorly implemented service requirements (performance criteria/KPIs). Service requirements/conditions must be clear, objective, measurable and realistic (as discussed below in due course). Properly incorporated (in the case of government payment PPPs) into a clear and understandable payment mechanism (as discussed in <i>The need for challenging, yet clearly defined and realistic performance indicators below</i>)	Contract (standards)
Failure to be realistic when defining obligations, or defining obligations that are imbalanced or qualified by risk sharing criteria	Unrealistic attitude to project structuring
Lack of an effective and efficient monitoring system: performance monitoring systems should be based substantially on self-monitoring on the part of the private partner using its own quality management systems (subject to minimum requirements) (as discussed in <i>The problem of monitoring: Who should do it?</i>)	Perception and contract (standards)
Failure to clearly define the role of regulatory bodies in contract management	Legal framework (should clarify the exact role of regulatory or oversight bodies so as not to conflict with the contracting authority's contract management function) and contract
Excessive focus on audit and enforcement in the traditional sense and risk of reverting design and construction risk (as discussed below in <i>"Traditional enforcement approach"</i>)	Attitude and framework
Lack of proactivity and collaboration in the management of certain transferred risks, leading to delays (and cost overruns), e.g. expropriations, relocation of those affected by the project, environmental licensing, etc. (as discussed in <i>The need for a collaborative and proactive approach to risk management</i>)	Attitude (and standards)
Lack of legal regulation and consequences of intervention/step-in by the government	Framework/standards
Legal feasibility (or lack of minimal regulation) of the step-in rights of creditors/banks	Framework (if not supported) / standards
Lack of funds / budget for monitoring	Project preparation / evaluation
Lack of in-house capacity / insufficient equipment or budget	General attitude (lack of institutionalization of the contractual management function in the country)

Absence of risk and contingency management culture and contingency planning	Attitude / awareness
Lack of dialogue / proper relationship management, with early and transparent exchange of information and monitoring committees with more informal dialogue between the parties	Attitude / partnership culture
Absence or insufficiency of internal protocols or manuals with which to properly manage / administer performance assessment, payment calculation, determination of breach, calculation and imposition of fines, etc.	Attitude / management tools / contract
Absence or inadequacy of information and document management systems	Attitude / management tools
Absence of persistent breach monitoring and control systems	Contract / tools
Lack of clear processes in the contract regulating the review and acceptance of the commissioned asset	Contract
Failure to control maintenance reserve funds	Contract
Absence of mechanisms to control compliance with hand-back requirements and conditions (as discussed in <i>The importance of having the hand-back obligation regulated in the contract</i>)	Contract / Management tools

3.2.2. Ideas and recommendations in relation to some of the problems that have been shown to exist

This section offers some ideas and recommendations on how to address the potential problems and points of attention that we have flagged as being the most important or relevant.

i) The need for a collaborative and proactive approach to risk management

As explained in Section 2 above, there is a tendency for the government to act as if it no longer owns the project, when ultimate responsibility for the project vis-à-vis the public rests with the government. This also means assuming responsibility for the proper management of all risks, even if they have been transferred. On many occasions there may be a breach (particularly relevant in the case of construction delays) that the private partner is theoretically responsible for causing, but which would not have occurred had the public partner adopted a more collaborative attitude.

Common examples here include the availability of land, the process of securing environmental licenses, or acceptance among the affected communities of the project going ahead or charging fees for its use.

While much of the responsibility for managing these issues may have been delegated to the private partner under the terms of the contract, these matters are often beyond the control of the private partner and active government management is therefore needed to overcome the problem.

We must underscore the importance of joint management. While contracts in the region usually seem to have clear rules governing breaches and delays, this coordinated management is necessary to determine which causes of delay are genuinely attributable to the private partner and which are not.

ii) The problem of the traditional audit-based approach to projects

Responsibility for the design and effective delivery of infrastructure under PPP contracts, unlike those of traditional public works, should generally rest with the private partner, who, by relying on its expertise and as the party responsible for the maintenance and quality of the work in the long run, must propose and then deliver a solution whereby the desired service is provided at an optimized and suitably controlled cost. At this point the public entity must be able to manage the contract in such a way as to achieve its objectives (either the minimum quality required or the quality offered if better) without falling into traditional supervisory practices. It must succeed in ensuring that the private partner honors and fulfils the contract.

Broadly speaking, PPP contracts in the region contain the general scopes and capacity sought for the infrastructure, which should be sufficient to ensure that the design is ratified without any objections raised, so as not to be committed to an approval that implies responsibility for the designs. However, in practice the role of the auditor or supervisor tasked with overseeing the works is often such that they behave more like scrutineers under a traditional public works arrangement, rather than what they should be doing under a PPP contract. This will depend on the responsibilities set out in the laws of each country.

In the particular case of Colombia, although the PPP law is clear in attributing responsibilities for design and construction to the private partner, there is a lack of clarity at the framework level with respect to the responsibilities of the supervisor, who continues to fulfill its role as it would under a traditional public works project. This approach is not aligned with the way the contract should be managed and generates conflicts, delays and potential breaches in the work flow.

With this in mind, it is advisable to align all of the agents involved in PPP projects under the same line of legal responsibility, so as to ensure that the spirit of the incentives envisioned under the PPP business model is genuinely met and so that these incentives do not conflict with those of the supervisors or even of the control entities, inspectors and comptrollers, which become relevant in later stages of the execution and maintenance of infrastructure and are intended for the public officials responsible for decision-making.

In Uruguay, it is also recognized that when managing certain contracts there is a clear risk of unintentionally assuming the design and construction risk due to this traditional approach to work supervision, which is present on both sides (public/private). Indeed, this situation commonly occurs in many countries. However, significant efforts have been made to evolve from the concept of traditional public works to that of public works under the PPP modality, from both the private and public sphere. The need to rethink the supervisory role of the contracting authority has been addressed and countries are recognizing the challenge of seeing to it that supervision (especially of construction work) preserves the distribution of risks originally agreed between the parties.

On the positive side, and as an example of a less supervisory attitude (in this case, in relation to performance during the operational phase), one can observe that in Mexico performance awards are frequently offered as a form of incentive. For instance, this approach has been followed in the program of PPP Road Maintenance Contracts

undertaken by the Ministry of Communications and Transport. The contracts provide for an additional payment of 5% if the developer achieves 100% compliance with the standards for a particular section or stretch of the road, with the possibility of forfeiting all that incentive with a single deduction for breach applied to the section. For example, there may be an incident where the relevant party fails to repair a broken road surface or replace signage within the agreed response times and this causes them to forfeit the incentive (Compliance Factor) along the whole section for the other standards relating to Surface Course, Signposting, Functionality of Right of Way, Drainage, Slopes and Road Services. The purpose of this system is twofold: if achieved it functions as an incentive, while if the compliance factor is not met, it can also be seen as a penalty or loss for the developer.

iii) The need for adequate regulation of early termination for breach

Proper regulation of early termination for breach is essential if this mechanism is to function as an effective incentive in controlling or preventing material or recurrent breaches.

To this end, the contract must clearly state the following points:

- The types of breach that grant entitlement to early termination
- All such breaches to be clearly flagged as being essential and material
- A remedy period before the right to termination can be enforced
- Prior step-in rights granted to the lenders
- An objective description of how compensation is calculated for early termination due to breach

There is general consensus among the contributors to this document as to the reasonableness of the contractual regulation of early termination scenarios for breach, especially with regard to the objective definition of the grounds and the need for materiality in the breach (Mexico and Uruguay in particular). However, there is sometimes a lack of a clear and objective definition on how to calculate compensation for termination (Mexico)¹⁹.

iv) The need for challenging, yet clearly defined and realistic performance indicators

It is essential to clearly define realistic service requirements that can be objectively measured through the use of KPIs. Failure to do so will create serious problems in the proper monitoring of performance and lead to recurring disputes. It is also certain to result in a higher payment costs for the contracting authority due to the resulting premium for the higher risk perceived by the private party of having to endure potentially unfair deductions.

¹⁹ We are struck by how infrequent it is in the region to re-tender the contract as a means of ending the contractual relationship with the private participant in breach. This system is relatively prevalent in Europe, whereby the SPE is auctioned off among interested investors/operators through a competitive bidding process, with the winning bidder thus acquiring the company from the outgoing private partner. The amount offered by the successful bidder goes first to the existing bank or financial institution and then, if there is any left over, to the shareholders. This way the government does not have to fork out any money, and the contract does not need to be terminated but will continue for the years remaining at that time under the original terms.

Meanwhile, and as regards the need for flexible, realistic and collaborative attitudes, it is not uncommon for the private and public parties to a contract to find that a certain service condition (such as the level of quality determined in a service requirement) is unattainable, or that complying with it in full would require an investment that is not profitable for the private partner (even when due to an unintentional error in the design of the payment mechanism), who may therefore prefer to remain in breach and sustain a slight loss of revenue. This may require a readjustment of the relevant requirements so that both parties benefit.

The numerous indicators used to control and monitor performance during the operational phase are generally well defined in terms of quality requirements and availability of the service provided.

One can see that the contracts have clear monitoring indicators, cure or rectification mechanisms and effective discount mechanisms on expected revenues in the event of breach. Breaches tend to be well categorized, based on their relevance or severity.

However, it is essential that the level of indicators reflect the intended use of the asset, the costs associated with its maintenance and the practicality of its monitoring. In Colombia, for one, certain paving quality indicators, for example, are perhaps stricter than is necessary and could place the private partner at risk of falling short of the indicator and therefore suffering hugely significant discounts on its expected revenues. Moreover, this situation could only be avoided by incurring excessive construction or maintenance costs that are not profitable for the private partner.

The panel of experts has observed that there is also too high a level of variation in the design of KPIs, even in the same country and for projects in the same industry. In this sense, greater standardization of payment mechanisms at both country and sector level is required, to help bring about a permanent improvement in their use and greater consistency in the structures used, thus making them less daunting to the private partner.

It was noted that under the PPP model or scheme used in Mexico there is generally a good practice in the design and definition of the mechanisms of payment for performance/availability, especially in highways though also in the case of hospitals²⁰.

v) The importance of having the hand-back obligation regulated in the contract

The requirements that the asset must meet upon hand-back must be clearly set out in the contract from the very outset. Yet there must also be mechanisms to control compliance, which should be based on two closely related pillars: inspections to be carried out by a third party / the government itself each year once a certain number of years remain until the end of the contract (for example, five years), and the obligation to set up a reserve fund to undertake the investments needed to satisfy the hand-back requirements, according to the

²⁰ Some concrete examples cited were, the case of roads, the M&R (Maintenance and Response) contract for the Guadalajara – Colima Highway with BANOBRAS, or the PPP Querétaro – San Luis contract signed with SCT; or, in the case of hospital PPPs, the contracts signed for the Bajío Regional Hospital with Specialty Services or the Ixtapaluca Regional Hospital with Specialty Services.

outcome or result of the aforementioned inspections (with the government authorized to make withholdings or compel the private partner to post additional funds if deemed necessary).

On this point, good practices are generally followed within the region: the conditions and requirements for asset hand-back are typically established from the outset in the contract and there are mechanisms for inspecting compliance with them. Mexico is once again a case in point²¹.

However, sometimes a better or clearer regulation of the process or mechanism for monitoring compliance with hand-back requirements would be required.

vi) The problem of monitoring: Who should do it?

The global practice followed by countries that are more mature in their PPP strategies reveals the need to base the monitoring activity largely on the information generated by the private partner through the proper management of its quality management system. This information will then be confirmed through random checks, without prejudice to the fact that it should always be duly reviewed and analyzed. The reasoning for this is simple: the private partner will always have an incentive to inspect the condition of the asset and monitor the quality of service to the extent that its revenues (or possible penalties) depend on this.

Its inspection and reporting obligations will be based on minimum requirements under the terms of the contract, subject to possible improvements when bidding.

However, in the region, a different practice is usually applied, whereby the resources for inspecting service levels, while funded/paid for by the private partner, are actually defined by the public partner.

Moreover, when the information used for monitoring purposes is generated in the first instance by the private partner, when thinking about how best to manage that information, it is important to figure out how we are going to ensure immediate access to such information by the public partner.

On this point, it is worth highlighting the approach taken in certain projects in Mexico with respect to monitoring, as explained in the following box.

• **Box 2: The case of automated monitoring systems in Mexico.**

It is worth highlighting the use of automated monitoring systems (self-monitoring units) of road conditions in certain projects in Mexico, as required under the maintain, repair, operate contracts of BANOBRAS and in the road maintenance PPPs of the Ministry of Communications and Transport, both with payment based on attainment of performance standards. Under these contracts, the developer is required to have a self-monitoring unit that relies on high performance equipment to measure compliance with standards and a computerized road management system to record and monitor any incidents or non-compliances with contractual standards, as well as the maintenance and repair work carried out on the road. The information recorded in the management system by the self-monitoring unit must be readily available for external supervision (company contracted by the

²¹ See, for example, the Guadalajara – Colima M&R or the State Concession of the Celaya Bypass.

government entity and entrusted with project resources) and for the designated officers at the contracting authority. These entities may also carry out their own measurements to confirm the information and conduct scheduled and unscheduled inspections for validation of monthly payments.

Another recent market trend at the global best practice level is the search for greater participation among users in monitoring the service.

3.3. Example of self-assessment of approach and readiness for good performance management: Mexico vs. Uruguay

In the following diagram, we show a (subjective and personal) assessment carried out for the purposes of this document on a list of the main factors or elements of success for good performance management, including, in particular, aspects that are or should be part of the contract, as well as certain other tools and attitudes²².

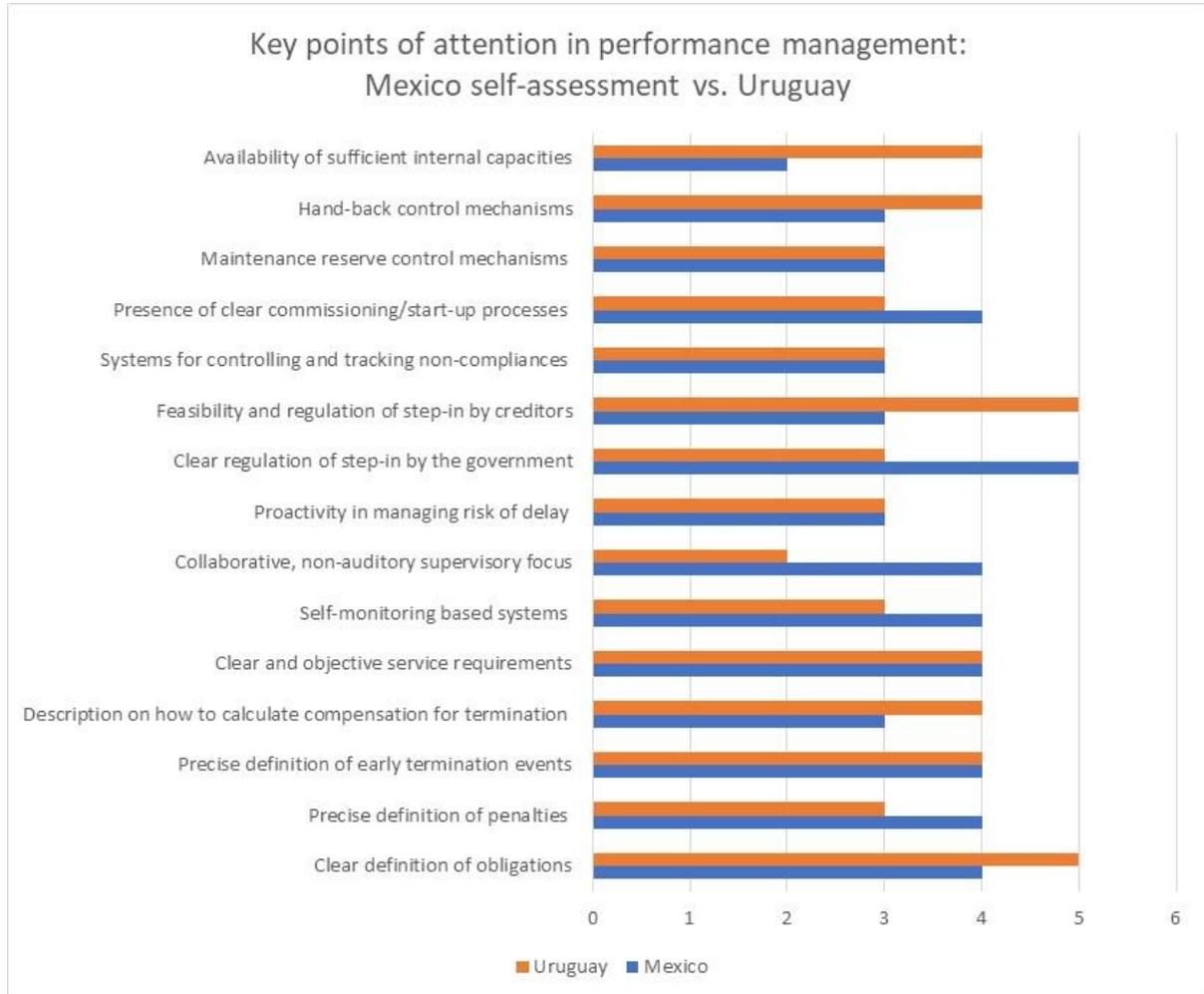
They were asked to award a score of 1 to 5, according to their knowledge or perception of each factor or aspect relating to good performance management in question, with 1 being “not met or very rarely met” and 5 being “always met and very satisfactorily met”.

It is interesting to note how in Mexico, for instance, aspects such as the regulation of step-in is viewed in a positive light, as is the clarity in the way obligations are defined in contracts (scored 5 out of 5). Further positive points (4 out of 5) include internal capacities/provision of management teams by the public partner, among others. Conversely, the main negative is the excessive focus on contract oversight.

In the case of Uruguay, the main shortcoming pointed out is none other than internal capacities or the provision of resources for proper management.

²² It would be an interesting option for the countries to have some system for evaluating the quality of their contracts, approaches and contract management systems, whether by independent experts, internal staff or the private investor/promoter, the aim being to help identify the most relevant points for improvement in each case. Such a possibility, or a more precise definition of an evaluation system such as the one just suggested is, however, beyond the scope of this paper.

- **Diagram 1: A free and subjective assessment of the key points of attention in performance management**



Source: Author's own contribution based on a survey designed for this document.

4 Risk Management (and Management of Retained Risk Claims)

4.1. General framework

4.1.1. Risk management and claims for transferred risks

Here we are talking about the continuous management of risks during the life of the contract with the aim of minimizing their impact on the cost and availability of the service. This should be carried out through various means, such as:

- Collaborating to minimize the probability of occurrence of transferred risks and the extent of their potential impact (which starts with good project groundwork, including in-depth studies of risks related to soil conditions, relocation of residents and eminent domain, but which should continue throughout the life of the contract under a comprehensive and proactive management of all risks). *See i) The need for an adequate allocation of risks and in any case the importance of assuming responsibility when managing all risks.*
- Mitigating the potential impact of retained risks, especially through sound management of retained activities and responsibilities (e.g. eminent domain). *See (i) idem above.*
- Duly complying with the commitments acquired under the contract in relation to the compensation of retained and shared risks, as well as with the commitments to grant relief for breach or non-compliance.

4.1.2. Contract tools for good risk management

These include:

- Clear allocation of responsibilities and risks (and the requirements for obtaining relief or compensation).
- Compensation mechanisms (e.g. direct payment, tariff/toll review, extended timelines, etc.).
- Rebalancing/compensation calculation protocol
- Dispute resolution process (in relation to conflicts or disputes regarding the existence of the right to compensation or relief, on the valuation of impacts or on the effective implementation of compensation or rebalancing). *(See point iii) The role of dispute resolution mechanisms).*
- Precise regulation of force majeure *(see text box titled "Definition and treatment of force majeure")*
- Possibility of early termination in the event of force majeure or other extraordinary events generating an extreme impact. *(See iv))*

4.1.3. Other tools supporting sound risk management, beyond those provided for in the contract

- Risk control and monitoring system (as discussed later in this section)
- Contingency plans (for force majeure or termination events due to an extraordinary impact risk, e.g. insolvency of the project company due to low demand for the asset²³).
- Contingency funds
- Claims management protocols for retained or shared risks, detailing the process for requests, evaluations, discussions, impact estimations, etc. (As discussed later in this section)

4.1.4. The necessary attitude for good risk management

- Open to dialogue
- Ownership (i.e. acting as the true owner of the contract and assuming responsibility for the project vis-à-vis the public) and proactive management: the government is ultimately responsible for the project and therefore for all risks, and a transferred risk can revert back to the government in the event of a bail-out or early termination. The government must assist with the management of all risks and honor its obligations as explicitly set out in the compensation agreement in due course.
- Professional risk and project management attitude/approach (Project Management)

4.2. Main problems, potential shortcomings or points of attention for performance management

Many of the most common problems and points of attention in the strategy and approach to performance management are down to shortcomings or the need to improve the focus and terms of the contract (which we would argue can be addressed by developing a praxis of standard contract terms²⁴, notwithstanding the importance of having an experienced and multidisciplinary team in place), or sometimes the absence or lack of proper management tools.

Another problem, as explained in the introductory sections, is the common misperception of what contract management as a whole entails and, in particular, in this case, what responsibility for risk management entails (“attitude” problems).

Table 2 then provides a summary of the most relevant problems and indicates their relationship with the contract, management tools, or problems of attitudes or perception.

Some of them are discussed at greater length in the following sections.

²³ This issue is also addressed in section 6.5. “Contract management and early termination”.

²⁴ See Section 8 – The need to implement contractual standards.

- **Table 2: Potential risk management problems and points of attention discussed and their origin or source**

Aspect / possible problem or point of attention	Related to
Failure to adequately allocate risks	Preparation (standards)
Failure to properly implement these standards in the contract, with an exhaustive definition of all risk events	Contract
More precisely, there is a failure to accurately define the concept of force majeure in some jurisdictions	Framework and contract
Lack of project preparation with early risk mitigation (e.g. conducting adequate studies/investigations into soil conditions, or in relation to the eminent domain process, or social and environmental impact assessments, beginning to manage these aspects effectively prior to tendering, etc.)	Preparation
Lack of proper management of retained responsibilities (e.g. eminent domain)	Attitude / management approach / management tools
Lack of assistance/support in managing the transferred risks (e.g. permitting)	Attitude
No available funds for compensation payments or late payment of compensation (lack of mechanisms such as contingency funds or other flexible budget solutions)	Management tools
Excessive or sometimes absolute reliance on the private partner to finance the impact/loss (overuse of rebalancing)	Attitude
Lack of in-house capacity / lack of specialized equipment or budget	General attitude (lack of institutionalization of the contractual management function in the country)
Delays/difficulties in settling claims for retained or shared risks, and absence of effective dispute resolution mechanisms	Framework and contract
No risk management plans drawn up and no risk control and monitoring systems in place (including all risks and not only retained risks)	Management tools / Management attitude
Lack of contingency planning (e.g. a plan to manage an early termination event due to the occurrence of an extraordinary impact risk)	Management tools / Management attitude
Lack of "upstream" reporting (to the central agencies) of risk values (contingent liabilities) and their trend	Framework / general attitude to incorporating "upstream" governance

A few issues or points of attention to consider when managing contract risks

- i) ***The need for proper risk allocation and its proper implementation in the contract and the importance of taking responsibility for the management of all risks***

- **The need for proper risk allocation**

Risk allocation is the bedrock of risk management over the life of the contract, since the management of those risks that are transferred or shared is transferred to the private partner in the first instance (even so, let us not forget that they must be adequately monitored and there must be ongoing collaboration to ensure their proactive management).

From the time the project is prepared and structured, the backbone of the PPP business model is developed based on the allocation of risks (not allocation of blame or of whatever proves to be the most convenient arrangement) to the party that is best able to manage them efficiently (thus mitigating likelihood of occurrence, or transferring them to a third party in a cost-effective manner, or absorbing them by being able to mitigate their financial consequences or impacts, or being able to value them with greater reliability or confidence).

Over the last few decades, Latin American and Caribbean countries have been embracing standard practices in risk identification, allocation, valuation and mitigation. The result is contracts that offer greater legal stability and, at the same time, the proper alignment of incentives for both parties (Peru and Colombia are particularly notable in this regard as they also incorporate risk allocation standards²⁵).

However, some of the risks, such as those related to tariff revenues (mainly tolls) and property costs, have experienced extraordinary fluctuations between the project preparation phase and the construction and operation phases and this situation has generated problems in relation to project financing and cash flow, while also triggering compensation clauses or risk-sharing claims.

In a nutshell, countries within the region have been assigning risks beyond the theoretically recommended level, which has ended up impacting both parties. We need to reflect on the desirability of transferring of certain risks.

A good example here is land risk (when management of eminent domain has been transferred to the private partner) and also social, environmental, geotechnical and network risks, which to a certain extent can be managed by the private partner, but in many cases are largely beyond its control because it lacks the instruments needed for their effective management (for example, eminent domain or permitting), or because it has insufficient information with which to carry out a proper assessment (subsoil conditions, service networks, etc.)²⁶.

- **The need to accurately identify and describe retained and shared risks**

Yet it is not all about getting the risk allocation right when seeking to achieve greater value for money. Risk allocation should be clearly and unambiguously set out in the contract, including precise definition of events, a full list of those risks that are retained or shared, and absolute clarity when it comes to rights regarding compensation or contract rebalancing. This is something that should take place during the initial project structuring phase and must be approached with the utmost diligence.

One specific aspect that is crucial in terms of the need for greater clarity is the concept of force majeure risk, which should have either a closed/exhaustive list or definition of events (to be defined according to each contract), or at the very least a non-exhaustive list of events, together with a precise definition of how and when an event may qualify as force majeure.

²⁵ See, for example, the CONPES documents approved by various DNP resolutions in Colombia.

²⁶ It is recommended that you read section 5 of Chapter 5 of the CP3P Certification Program Guide and its appendix for good practice in risk allocation.

On this particular point the region does not score well (broadly speaking), as there is a definite lack of clarity and completeness in defining the risk events that give rise to compensation (e.g. Mexico), and more specifically a failure to properly define the concept of force majeure (e.g. Mexico and Uruguay).

- **Box 3: Definition and treatment of force majeure**

In most (if not all) countries in the region, the term force majeure in the context of public contracts is given a broad definition, depending on characteristics (e.g. Colombia), when the definition or doctrine under civil or commercial law is not directly applied, and in many cases no definition is provided in the contract.

Although a closed definition approach through an exhaustive list of events (more common in countries governed by common law, though also others such as Spain) is not absolutely necessary, it would be advisable to establish a standard definition that is as precise as possible and certainly not as ambiguous as the term “unforeseeable risk”, which focuses on covering events of a truly irresistible nature (natural disasters —acts of God— or geopolitical events such as wars). It would also be wise to provide a list of specific events that qualify as force majeure, despite not being a closed list.

In all cases, it might be wise to implement the most common international standards and regulations, in countries where they are not already present, to regulate the following aspects: the power of either party to effect the early termination of the contract subject to a special compensation regime, which does not include compensation for loss of profits or earnings but solely compensation for the part of the investment that has not been recovered. However, this should only be possible once a minimum period of time has elapsed without it being possible to perform the contract, and only to the extent that insurance has already been arranged by the private partner subject to minimum coverage requirements as defined in the contract.

- **The need to take responsibility for providing support in relation to transferred risks**

Where these risks are assigned to the private partner (without prejudice to the desirability in certain cases of sharing the risks or limiting the transfer to ensure a degree of certainty) without proper support or management by the public partner, the inability [of the private partner] to effectively expropriate assets²⁷ or to reach agreements with environmental

²⁷ The risk of expropriation (eminent domain) is a risk on which there is no consensus. It is clear that the private partner, provided it has the right legal mechanisms, can be more effective in managing expropriations. However, it is also clear that the risk of cost overruns is enormous, especially in terms of the probability of occurrence, but also in terms of the potential extent of the impact. Even so, it has become evident that the solution of retaining not the risk but the responsibility for the (direct) management of the eminent domain process has caused, in some cases, unforeseen problems in the form of severe delays in starting or progressing with the work. The ensuing financial impact on the private partner is very hard to cope with (in many cases rendering it impossible to secure financing even before the impact of the delay in completing the construction). It is believed that a possible option would be to assign the management of eminent domain to the private partner under a regime of cost risk sharing, with an absolute limit on the financial impact that the private partner could potentially sustain. This option is viable to the extent that the appropriate legal mechanisms are in place or created to enable the private partner to effectively manage the process and only if the local legislation allow for this.

entities or with local communities can often cause the construction work to grind to a halt, or lead to termination of the contract or considerable delays in completing the work. Only when the public sector steps in to manage, mediate or decide on these issues have the parties been able to resolve their disagreements and get back on track toward successful completion of the project.

Lenders in some countries (e.g. Colombia) insist that the land be purchased and the environmental licenses (or their essential instructions) and community consent obtained before they will release the funds. Failure to succeed in this task within the expected timeframes will generate delays in the construction and therefore entail increased costs due to additional contributions of capital (equity) in the project or simply failure to meet the work completion deadlines.

Governments need to properly analyze all the risks and their potential impact on project appetite among investors²⁸, with a view to retaining those risks for which the private partner does not have the capacity to add value in their management, or otherwise sharing or limiting their transfer²⁹. There should still be incentives for the private partner to manage the risks, but with the public partner assuming part of any potential cost overruns. This might occur, for example, where previous studies are out of date and there are uncontrollable causes that led to the increased costs. This would also generate incentives for the public partner to contribute proactively in the management of these costs.

This is always without prejudice to the need to carry out better and more in-depth studies and research before drawing up the definitive contract (eminent domain studies, archaeological maps, environmental and social impact studies, studies of demand, subsoil conditions, etc.), because even when the related risk is going to be transferred, credible and detailed information reduces uncertainty and therefore reduces the transfer price of the respective risk.

It is also important for the contract to allocate contingent liabilities among both participants, so as to provide predictable coverage of the risks and minimize the impact of any unforeseen events that could delay the completion of the project.

²⁸ Note that it is also advisable and considered good practice for governments to carry out market soundings for this purpose, among others, from the structuring phase onwards. For example, the State of São Paulo, in Brazil, carried out permanent sounding rounds with market agents, associations and other stakeholders to gather information that will help the government to properly define the contractual subject matter and any special circumstances that may exist.

²⁹ In the case of Colombia, for example, land, community-environmental, network and geotechnical risks were shared under a banding system in the 4G highway projects. Under this arrangement, the first 20% of the cost overrun was assumed by the private partner, followed by a band shared by both parties if the cost overruns were between 20%-80%, and in the event that the cost overruns exceeded 100% the public partner would assume the additional cost. This seeks to incentivize and make the private partner responsible for managing the risks, recognizing to a certain extent the possibility of management and limiting the private partner in its functions and information.

- **Box 4:** *The specific problem of projects subject to regulated tariffs.*

It was observed that conflicts and problems are commonplace in contracts that operate under a regulated tariff framework.

Apart from the view that in many countries tariffs are perceived as being high (and might well be in some cases), especially for energy and water, concession schemes with regulated tariffs have a high impact on the management of complaints and contract rebalancing requests, especially when the tariff is not being reviewed and updated as expected. These problems can only be resolved ex-ante, i.e. by ensuring that they are foreseen in the contract from the outset and generating an efficient structure for resolving or eradicating them.

One example given was the “technical” tariff concept used in transportation PPPs in Spain, which can be seen in almost all subway and tram PPP projects in the country (e.g. Barcelona trams, Seville subway or Malaga subway). It is essentially a contractually established “shadow toll” that is indexed to the CPI and automatically generates the revenue to be settled by differences (where the government/contracting authority pays the difference between the revenue calculated with the technical tariff and the revenue actually received based on the real tariff).

A similar approach is applied in toll road PPP projects in Colombia, and can be seen in the country’s 4G program projects.

ii) The need to adequately manage compliance with commitments for retained risks

The right to claim for compensation events should be clearly set out in the contracts, with a clear description of the compensation mechanisms in general, as well as the process for rebalancing the positions of the parties to the contract.

In general, the region seems to score well on this point, according to the experts who took part in the panel discussions, although on this latter aspect (contract rebalancing processes) there is sometimes a lack of clarity in the rebalancing calculation process, or it is pegged to the NPV indicator instead of the capital IRR indicator and with respect to the debt-service coverage ratio (DSCR), which we believe should prevail. Another notable shortcoming observed across most of the region is the tendency to extend the term of the contract as a rebalancing mechanism; something that (except in projects based on per-user payments, where it is a natural rebalancing mechanism) should only be used a last-resort mechanism because of the financial inefficiency it can generate³⁰.

But beyond that, the public partner must ensure the prompt payment of its compensation commitments and, above all, see to it that the impacts of risks that entail additional investments are financed directly by the contracting authority, without insisting that the

³⁰ Extending the term can be effective in rebalancing the NPV of the project revenue flows, though it can affect bankability by impacting the Debt Coverage Ratio, while also increasing the present value of the fiscal commitments (in the case of government-payment PPPs) and lengthening the period over which we remain subject to the loss of government flexibility. However, using coverage ratios and the IRR as key indicators for rebalancing purposes requires a mutually agreed financial model attached to the contract as a calculation mechanism; an approach that is not followed in certain countries (e.g. Colombia).

private partner meets the cost. If it is asked to secure and provide such financing, then this should be on a best-efforts basis.

In this sense, it would be desirable to post or set up contingency funds, where this proves possible³¹.

Some countries in the region have contingency funds (e.g. Colombia). However, there is uncertainty in the timing of payment or reimbursement of costs even with such a fund in place and this generates further economic impacts on the private partner due to the customary unavailability of funds with which to honor the commitments assumed.

The bad practice of forcing the private party to finance the loss through rebalancing mechanisms (which is relatively common, for example, in Mexico) appears to be rather widespread.

Interest should be payable upon late payment of compensation commitments, although this in itself is not enough to guarantee full payment in due course.

In the case of Colombia, it was observed that a remunerative interest rate is applied for the funds used to compensate retained or shared risk, yet even so, there is uncertainty in the payment periods. This means that the private partner must come up with the money, either via equity or debt, to meet the cost overruns and thus not impact the work timeline or calendar. This places additional financial pressure on the projects, potentially making the mechanism more vulnerable.

Therefore, there is a strong need for effective financial management³² by the contracting authorities and their governments to better ensure the availability of funds for timely payments; otherwise the reputation and credibility of the respective PPP program will be negatively impacted.

iii) The role of dispute resolution mechanisms

Logically, the parties may disagree on whether the right to compensation exists (i.e. whether a compensable event that meets the conditions set out in the contract genuinely exists). They may also disagree on the financial impact that the event has caused and how to calculate the compensation payable (especially in cases of rebalancing, where the private partner provides the financing to absorb the impact in the first instance). It is therefore essential to set up agile and clear mechanisms for resolving these disputes and as a way to improve the management of the retained risk³³.

³¹ Under a contingency fund system, the retained risks are valued and funds are posted to cover the budget so that the retained risk (or part of it) is recorded as an expense right from the outset and funds are made available to avoid having to resort to budgetary appropriation if and when a risk event materializes. This provides great flexibility in fiscal management and makes the government better able to honor its payments for retained or shared risks, which is something highly valued by investors.

³² Such as through liquidity loans by the public bank or a financial agency to advance the amounts provided for in the compensation agreement, easing the requirements for accessing contingency funds or including contingent items in the budget.

³³ Dispute resolution processes are also a crucial tool for good performance management in the event of a disagreement as to the existence of a breach, whether penalties should be imposed, or the calculation of

When it comes to claims and disputes, the panel of experts holds a very positive view of how these are managed in the region. Across most of the region, countries generally follow the good practice of ensuring that contracts contain a hierarchical “dispute resolution process”, with several consecutive instances of dispute resolution, with the parties encouraged to negotiate directly and resolve their dispute by mutual agreement in the first instance. If no direct or amicable agreement can be reached, many countries have a “dispute resolution panel”, typically consisting of three experts (one appointed by each party and one mutually agreed) to hear the case and deliver a decision³⁴. If no such panel exists, the case may be submitted to arbitration (national or international, the latter being considered the best practice), whose decision is usually non-appealable (at least when it comes to the merits of the case), or heard by a court, which is meant as a last resort and usually takes longer.

iv) Possibility of early termination in the event of force majeure or other extraordinary events generating an extreme impact. The potential use of early termination for certain risk events

A final matter worth discussing is early termination of the contract as a risk management tool.

Beyond the usual approach, which is to recognize a right for both parties to terminate the contract with a certain amount of compensation payable to the private partner in cases of force majeure (in some countries), the same philosophy (right to invoke early termination) can be incorporated into other cases of retained or shared risks even if they do not qualify in some jurisdictions as force majeure (where the contract fails to provide an exhaustive list of such events). Otherwise, greater certainty should be ensured in relation to certain risk events for which force majeure could be invoked but would take a long time to confirm.

It is not uncommon for the operator to find itself in serious financial hardship if, for example, demand for the service falls short of expectations, or because of direct action taken by the State, or in other cases that can be classified as unforeseen circumstances or force majeure.

• **Box 5: Possibility of early termination for special causes in the State of São Paulo**

In these special cases, the State of São Paulo, in Brazil, has designed a contractual solution that allows for early termination of the contract. This falls within the scope of contract law, because the Federal Concessions Law (Federal Law No. 8.987/1995) does not provide for this possibility and while the Concessions Law of the State of São Paulo (Law No. 7.835/1992) does allow for early termination of the contract, this is a generic authorization.

In other words, for specific cases, the legal instrument governing regional PPPs offers a prior, amicable exit mechanism to prevent the government from continuing to keep a service contract in effect when it is being poorly performed for reasons not directly attributable to the private partner, or to prevent the private partner from continuing to run a business arrangement that has become heavily financially impaired; something it would normally have to do at the expense of service quality and availability.

remuneration in availability payments, among others matters. Section 6 “Other Relevant Matters Relating to Contract Management” provides a further description of this subject, which affects almost all facets of contract management.

³⁴ Sometimes this is preceded by a negotiation process overseen by a “mediator”.

Contracts arranged in the State of São Paulo come with a specific early termination clause. Early termination can only take place upon the occurrence of specific events such as: (i) acts of God and force majeure that are not insurable in Brazil and whose effects persist for longer than 90 days; (ii) where restrictions are imposed on specific tariff values for the project (in projects in which the operator is free to set the tariffs/tolls); (iii) the materialization of tax risks which, aside from the freedom to set tariffs/tolls, excessively affect the cash flow of the concession to the extent that the parties are no longer able to resolve the resulting imbalance through the instruments provided for in the contract; and (iv) imbalance events when the projected impact on cash flow at present value exceeds the amount set out in the contract.

These are events that generate an extraordinary impact rendering it impossible to rebalance the economic-financial positions of the parties to the contract without seriously impairing the quality and availability of the service.

In any case, the parties have the option to readjust the contract to the initial terms (rebalancing), or to seek early termination. Where the concession encounters tax impacts and in order to avoid termination, the contracting authority may choose not to terminate the concession and assume the financial impact by means of contractual rebalancing, provided this solution proves feasible.

I. For acts of God and force majeure = general compensation formula (parcel of investments related to reversible assets not yet depreciated or amortized).

II. Where restrictions are placed on tariff values and the projected impact of imbalance events on cash flow at present value exceeds the amount set out in the contract = same formula as for surrendering the concession (nationalization of the project; asset reverts to the state).

III. Upon the materialization of tax risks = same formula as for expiry/cancellation of the concession

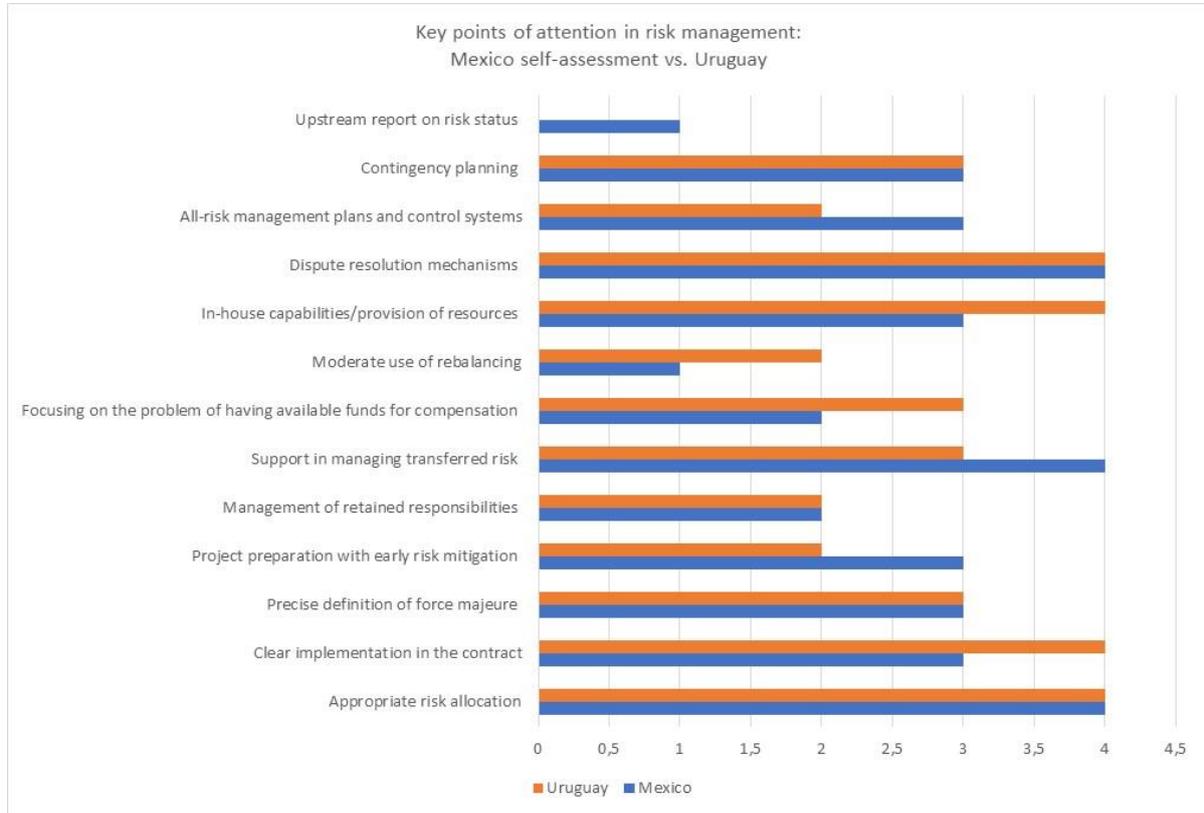
There is also the possibility of amicably terminating the contract so that the Government of São Paulo may put it out to tender again upon the request of the operator, although the hypotheses here are more generic than those for early termination (recurrent or persistent non-compliance with the contractual provisions, or inability to comply with the contractual or financial obligations undertaken). After reaching the decision to re-tender the project, the parties sign an agreement. The rules of compensation are the same as those for when a project expires.

4.3. Example of self-assessment of approach and readiness for good risk management: Mexico vs. Uruguay

As in the previous section in relation to performance management, in the following diagram we provide an assessment (subjective and personal) drawn up for the purposes of this document by the experts from Mexico and Uruguay. In this case, it is a list of the main success factors or determinants of good risk management, including those aspects that are or should be part of the contract, as well as certain other mechanisms and attitudes.

They were asked to award a score of 1 to 5, according to their knowledge or perception of each factor or aspect relating to good performance management in question, with 1 being “not met or very rarely met” and 5 being “always met and very satisfactorily met”.

- **Diagram 2: A free and subjective assessment of the key points of attention for risk management**



Source: Author's own contribution based on a survey designed for this document.

5 Contract Change Management

5.1. General framework

5.1.1. Anticipating and incorporating change into a contract

PPP agreements are long-term contracts that are inevitably subject to change throughout their life.

Many of these changes relate to the technological performance or evolution of the service. It would be immensely naive to assume that the form of service provision, such as telephony, electricity or other technology-intensive sectors, will remain unchanged for 15 or 20 years and will be immune to the technological changes inherent in such sectors.

Other changes relate to the shifting needs to be covered by the project (e.g. the need to expand the service provided to cover a broader segment of the population).

If the contract operates under the PPP regime, changes may be required for a wide variety of reasons. This includes changes of a financial nature: perhaps a change in the shareholding of the contracting authority or in the investment or financing instruments.

There is an inevitable need to implement changes and the nature of most of these changes is known in advance, even though the likelihood of their occurrence is not directly known. Therefore, good change management, like so many other facets of contract management, starts with a good contract that is adept at anticipating changes by incorporating a specific framework for their proper implementation³⁵.

This protects transparency in the procurement process (the contract is awarded upon the understanding that certain changes may be made that may result in additional business) and creates certainty for the private partner (e.g. ensuring that changes to the scope of obligations are duly regulated will clarify the rights that will arise for the private partner in terms of restoring its economic and financial equilibrium).

Changes, therefore, can be explicitly limited in their amount (ring-fenced)³⁶ in order to protect the public interest: in relation to the scope of obligations (new work, extension of service) and also in relation to transparency (when and how a change in the ownership of the

³⁵ There is a fine line between avoiding change and anticipating change. There are times when it is possible to avoid change, though always on an ex-ante basis by defining the project beforehand and anticipating future needs (in clear fashion). Certain changes — especially changes in the scope or technical requirements — can be avoided by taking all reasonable care to ensure that the project to be tendered has been defined as accurately as possible, based on a reasonably long time horizon, or mid-term horizon. For example, this can be achieved by anticipating population growth when this is an evident trend, or forecasting the influence of the network effect when it is reliably known that a transport infrastructure development will impact our project and incorporating this effect from the outset into the scope of the project. In other cases, however, when we are uncertain of when an adjustment to the service or scope of the project will be required, it may be more fitting to include into the contract a forecast of the changes that will probably need to be made to the project down the line.

³⁶ Contract management, when it comes to change management, is not aimed at avoiding or limiting change, but at managing it in an affordable way.

contracting company will be accepted). This limitation of changes has to strike the right balance between protecting transparency and providing the necessary contract flexibility.

For instance, it is good practice at PPP framework level to establish quantitative limits (by law and not only by contract) so that changes in the cumulative value of the contract that go beyond certain amounts (for example, 50% of the initial value of the contract, as provided for in the EU) necessarily entail the re-tendering of the project.

The aim of establishing a framework in the contract that enables changes, and the subsequent management of these changes when they occur or become necessary, should be to avoid, as far as possible, “renegotiation” of the contract (if this is feasible according to the legal framework in question³⁷) and ultimately to avoid early termination of the contract.

Renegotiations, if legally feasible, should be applied in a restrictive spirit and only when there are genuinely well-founded causes in order to ensure the survival of the project and the associated public service by not invoking early termination (an option that should always be on the table in such cases).

5.1.2. Managing change: necessary tools and attitudes

Now would be a good time to discuss the management of the changes themselves, once the events that cause them have occurred.

Essentially, the change must be managed under the terms of the contract. Yet good management in this regard is not only a matter of following what will undoubtedly be largely general projections or forecasts; it will also require:

- As with almost everything in contract management, a good contract management manual³⁸ to describe the provisions of the contract at greater length and on a more practical basis and to provide a practical explanation of the procedures to follow (see Box 6).
- As with all aspects of contract management, the right skills within the team: sectoral technical expertise for changes in scope or requirements; financial analysis skills and project finance knowledge for impact measurement and compensation; PPP financial knowledge to calculate VfM and estimate the fiscal impact; and legal expertise to determine the lawfulness of compensation requirements or to quantify/review financing contracts and the nature of shareholding changes.

³⁷ Renegotiation means negotiating a solution to an event that was not contemplated in the contract or whose solution requires changes or adjustments not contemplated in the contract or different from those contemplated in the contract. A notable example at international level is what are known as SCUT projects (roads “without cost to the user”; shadow toll) in Portugal, or how with the economic crisis suffered by this country, the projects had to mutate into actual toll roads. The renegotiation process led to a dramatic change in the structure of the contract, which switched to an availability-based payment mechanism (a mechanism neutral to demand patterns), with the tolls collected then retained by the public partner.

³⁸ To read more about the meaning and approach of a Contract Management Manual, see “Topic 4 – Adopting a user-friendly contract management manual” of the European Union, EPEC, “Managing PPPs during their contract life”.

- Communications and information management (which requires a good information management system, as discussed in Section 6 “Information management and document management”)
- Dispute management: trying to avoid getting into a dispute.
- Internal stakeholder management (upstream governance), in relation to proper communication with central agencies that need to approve or at least be aware of the need for change.
- Attitude of transparency and trust, within a framework of good management of relations between the partners.

- **Box 6: Example contents of a Contract Management Manual***

Introduction	Construction period	Period of service operation
<ol style="list-style-type: none"> 1. Meaning and objectives of contract management. 2. Objectives and scope of this document. 3. Background of the project/contract. <p>Functioning of governance</p> <ol style="list-style-type: none"> 1. Senior officers and heads of commissions and committees (including internal meetings). 2. Communication and reporting process. 3. Reporting and communication system. 4. Decision-making process. 5. Stakeholder management. <p>Team at the contracting authority</p> <ol style="list-style-type: none"> 1. Organizational chart 2. Roles and responsibilities 3. Key contacts <p>Team at the private partner</p> <ol style="list-style-type: none"> 1. Organizational chart 2. Roles and responsibilities 3. Key contacts 	<ol style="list-style-type: none"> 1. Meetings with the private partner (type, purpose, frequency, attendees, outcomes) 2. Key duties and monitoring [includes calendar management] 3. Authorizations and approvals 4. Reporting obligations 5. Data and information management (collection, validation, logging and feedback) 6. Payments during construction. 7. Risk and claims management [includes risk mapping] 8. Final approvals / authorization for entry into service 9. Contract change management 10. Dispute management 	<ol style="list-style-type: none"> 1. Meetings with the private partner (type, purpose, frequency, attendees, outcomes) 2. Key obligations and monitoring / performance requirements 3. Reporting obligations 4. Data and information management (collection, validation, logging and feedback) 5. Payment mechanism administration, validation and payment process. 6. Risk and claims management [includes risk mapping] 7. Contract change management 8. Dispute management <p>Appendices</p> <p>Map of obligations</p> <p>Risk matrix</p> <p>Risk register</p> <p>Protocols, models/templates</p>

**Based on a real example*

In light of what was discussed in the focus group, and as we have already commented in relation to other aspects of management, the general perception is that the region does not score very well in terms of tools, resources and attitudes when it comes to change management.

5.1.3. Managing change: controlling the impact of change

As a premise, matters of transparency aside (which is protected by the anticipated change and its regulation under the contract), the amendment or modification solution must never reduce or threaten the quality of the service provided (e.g. due to a change of ownership of the SPE's shares that impairs the company's operating capacity), or compromise the fiscal capacity of the awarding authority (especially as a result of new investments due to a scope change). Indeed, the changes should not deteriorate (it should not be foreseeable that they could potentially deteriorate) the value-for-money equation.

On this point, it is good contract management practice, from the perspective of the PPP framework and upstream governance, to submit any contract changes that might impact value for money or financial sustainability to review and approval by the same agents who initially approved the project in relation to these same variables.

It is important to generate the information that is expected (and should be expected), such as the rationale for the change, its net positive or neutral impact on value for money, or the absence of a fiscal impact (or its measurement for evaluation) on the project (either by generating new firm liabilities or contingent liabilities³⁹).

As discussed by the panel, in most cases there is no institutionalized “upstream” control system (at central agency or governing body level) for reporting, reviewing and validating contractual changes. However, in most cases, if they are scope/requirement changes with a potential impact on affordability/fiscal impact, approval from the public finance body is typically required; matters become less clear when reviewing value for money.

5.2. Analysis and discussion of some relevant change events

Below we discuss some of the most relevant change types/events, both from the perspective of their proper incorporation into the contract and their effective management when it comes to implementing (or not) the change.

5.2.1. Modifications to the scope of obligations or service requirements

Changes to the scope or services required are usually initiated by the public partner, though they can also be put forward by the private partner, which does not necessarily mean that the contracting authority that owns the project should not start with the additional costs involved in the change.

However, on many occasions changes promulgated by the private partner (value engineering, during the in-depth project development process) can generate cost savings for the public partner (it is good practice to accept cost optimization proposals from the private partner, provided the ensuing savings are shared).

³⁹ Many contractual changes relating to technical matters or requirements sometimes lead to de facto changes in the risk allocation matrix.

In general, it is useful to insist in the tender specifications that PPP bidders indicate unit prices in order to avoid or minimize, as far as possible, further negotiations of work costs due to largely insignificant changes.

In fact, there are occasions in which the price review of the service is parameterized in advance (under government payment arrangements).

However, modifications to the scope of the contract (design/scope of the project), or to technical or service requirements that have a significant impact on either investment or operation and maintenance costs are more difficult to manage. And this situation can arise where the change generates either a higher or a lower cost, with the latter being particularly complicated. Indeed, one of the greatest difficulties to overcome with reductions in work or services is that of defining the compensation for the reduction in scope when such a reduction could generate a lack of economy due to loss of scale.

Running a cost analysis of additional work has the added complexity of the parties having to agree on the price for the extra work and also having to consider the potential impact on operation and maintenance costs.

- *What does managing these changes entail?*

It involves / requires:

- Assessing the cost-benefit of the change and the impact on value for money
- Determining the desirability of implementing the change with the same contractor / under the same contract, or otherwise weighing up the merits of re-tendering the project.
- Determining the cost/price to recognize for the additional works or services: proposing the cost to the private partner or requesting its best offer, with the final price up for negotiation in all cases.
- Negotiating/arranging the direct cost
- Negotiating/agreeing on the long-term impact on costs
- If the private partner is asked to finance the additional work, determining/agreeing upon the impact on the IRR or finance costs of any new debt⁴⁰.
- The decision on the compensation mechanism (raising service payments, tariff increase, term increase, direct payments, etc.) to apply.
- Calculations / definition of compensation.
 - The effective payment of direct compensation.
 - The “rebalancing calculation” (where the private partner is to finance the cost overrun). In other words, determining the amount of the adjustment to the financial terms of the contract to achieve effective rebalancing; determining how much additional term or how much increase in payment per service.

⁴⁰ An international good practice that does not seem to be made much of an inroad into the region is to make the private partner’s obligation to finance a change conditional on the availability of financing or the private partner’s best endeavors to obtain it. In other words, if it is genuinely unfeasible to secure the financing, the public partner should release the private partner from this obligation and, in the absence of an agreement, pay the costs of the additional works directly. This also applies in relation to compensable risk events with a direct impact on CapEx.

- Its implementation in the contract (usually as an addendum).

Such a process, once suitably defined, should be set out in a good contract management manual.

It will also be necessary to take into account (stakeholder management) the need to inform and involve, where appropriate, agencies with authority to approve changes, particularly those that could impact value for money and affordability (fiscal impact)⁴¹.

In the meantime, a good dispute resolution process is essential to avoid or settle any potential disagreement surrounding the impact assessment and the determination of the financial compensation due.

5.2.2. Shareholding changes

Changes in ownership or control should be regulated in the PPP contract because they may affect the risk profile of the project. The need to regulate transfers of stock is also linked to the transparency and fairness of the bidding process, as the ownership stake of the transferring company was also certainly considered when appraising the bids. Therefore, the contract generally requires the private partner to obtain the prior consent of the contracting authority ahead of certain changes (e.g. changes during construction and any changes tantamount to a change in control). While such authorizations may not be necessary (good practice) for marginal transfers, this is not the case for those involving a change of control (which should be duly defined in the contract, such as any transfer of stock that exceeds 20%). It is also good practice to discriminate between the construction phase (more sensitive to changes and with more severe restrictions on the transfer of stock) and the operations phase.

It is advisable to clarify in the contract the conditions for approval of a shareholder change, avoiding any reference to the term absolute discretion as to whether to grant consent, or that consent must be motivated, and even setting limits so that consent can be refused subject to a limited list of reasons set out in the contract (e.g. the incoming controlling shareholder must meet the original eligibility requirements).

- *What needs to be taken into account when evaluating and deciding on whether to approve a shareholding change?*

From a practical standpoint, the contracting authority should not unnecessarily resist changes in private partner ownership or control, as these are ultimately a desirable feature of an active PPP market.

In general⁴², we should:

⁴¹ Notably, in some countries within the region, project approval is required prior to bidding by the Treasury or Finance Department, usually in relation to the fiscal impact (and sometimes VfM) and yet this is not foreseen (at least explicitly) when implementing a change; even a significant one.

⁴² Based on the “Contract Management Guide” developed with IDB funding by the same author for a specific country in the region.

1. Ensure that the private party has provided all the information the contracting authority needs in order to assess the change.
2. Identify who has “ownership” or “control” of the private partner both before and after the change⁴³.
3. Assess the impact of the change.

The contracting authority should assess how the change in ownership or control will affect the risk profile of the project. Potential risk impacts include the following:

- If the project depends on technology or knowledge provided by a particular investor, there is a risk that access to the technology or knowledge may be lost. In this situation, the contracting authority should request evidence that the private partner will continue to have access to the necessary technology or know-how after the investor has exited the project.
 - The new investor may have less financial capacity than the exiting investor. In this situation, there is a risk that the new investor may not be able to make any planned or unexpected but necessary future capital contributions to the private partner. Here, the contracting authority should request evidence of the financial capacity of the incoming investor.
 - The identity of a new investor may generate public interest risks for the government. For example, it may well be unacceptable to the government and the public for a person with a criminal record to gain control of the private partner and be in a position to influence the administration of services provided to the public on the government’s behalf. The PPP contract may allow the contracting authority to reject any proposed change of control.
4. Consult with other government stakeholders on whether the proposed change is necessary.

The contracting authority should consult with any other relevant stakeholders within government. In some cases, a single investor will be selling or buying two or more government PPP projects at the same time. If the relevant contracts are administered by different contracting authorities, the contracting authorities should consult with each other to ensure that they are adopting consistent approaches in assessing the issues raised by the change.

In general, this is an aspect of management that should be improved upon so as to ensure objectivity in the process of authorizing shareholder changes, under a prism of limited flexibility. This is all the more relevant as it is more common in maturing PPP markets for pure financial investors to enter into projects; a positive aspect that allows developers to recycle capital and undertake new projects.

⁴³ In some cases, this is a simple question. However, where investors use complex ownership structures, it can be difficult to identify which parties fall within the definition of “ownership” or “control” in the PPP agreement. The contracting authority may require legal advice in relation to these definitions.

5.2.3. Refinancing

Another relevant aspect that may require modifications is financing.

We have seen situations in LAC where the project is awarded before financing is secured, and because the initial stages typically last a relatively long time, the successful bidder has to contend with differences in lending conditions when finally arranging the loan with respect to those considered or contained in its bid.

This risk is normally assumed by the bidder and, in principle, it should not be a case where the contract needs to be modified, unless we find ourselves facing a market crisis situation, whether local or international, that substantially affects the financing, the exchange rate, etc. Striking a proper balance between minimizing contractual changes and the need to generate a financially sustainable project in the long term is often easier said than done and it is good contractual practice to consider such possible changes in the contract.

The most common change in financing conditions, including the SPE's own financial structure (usually towards a more leveraged position, i.e. higher debt), relates to refinancing. PPP projects, given their long duration and the relative stability of their financial flows, sometimes have time and space in which to optimize the associated financing, usually after construction and a few years of operation, by which point the project has achieved a certain degree of financial consolidation.

The public partner should provide suitable room for maneuver and flexibility so that the private partner can optimize the financing down the line. However:

- In some developed countries it is common practice to insist that the extra benefit obtained from such an arrangement to be shared (if the improvement in the financial structure was not shared already among the parties in the bidding process upon submission of the bid). This requires a clear ex-ante provision in the contract, and the necessary capabilities to assess and calculate such benefits and how to share them accordingly.
- In any case, the project owner should not be oblivious to the risk that excessively high leverage of the SPE can entail. Again, it is not uncommon for restrictions or constraints in this respect to be included in the contract
- Depending on the causes or grounds for compensation for early termination, this possible additional indebtedness may sometimes lead to an increase in the value of the contingent liability associated with early termination. Therefore, in such cases prior authorization for refinancing should be provided for in the contract.

Broadly speaking, it would appear that the international standard for the sharing of gains or benefits from refinancing is not applied within the region. Nor is there typically any control over the loan contracts signed by the private partner. And this would certainly be useful so as to obtain accurate information on the financial sustainability of the SPE, and to know first-hand exactly what warranties and covenants the financial institutions have insisted on, seeing as they are ultimately a stakeholder and affect the performance risk of the project. In addition, and depending

on the system of compensation in place for early termination, the financing agreement could lead to an undesirable increase in commitments or contingent liabilities.

5.2.4. Technological developments and changes in sectorial regulations

New regulatory requirements may emerge over the life of the contract that affect the project. This might include changes in signposting or road safety standards.

The management of these regulatory changes has a lot to do (or should have a lot to do) with the management of claims for retained or shared risks, in the sense that it is considered good practice to share the risks of cost overruns arising from the obligation to implement any new standards that become binding down the line, according to the technical regulations of the sector in question (e.g. road safety).

From a practical standpoint, in cases where there is a technical regulation change that is believed to have a shared impact, the parties must be suitably prepared and able to:

- Determine the desirability of granting compensation / sharing the financial impact by analyzing the true nature of the change and ensuring that it qualifies as a specific regulatory change or similar concept (which should be defined in the contract).
- Assess the financial impact of the regulatory change (define the impact on investment or operation and maintenance costs), based on own studies and on those aspects that the private partner is able to substantiate.
- Agree on the amount of the impact.
- Proceed as in any other rebalancing exercise (see, for example, our comments regarding changes in scope or technical requirements, as the situation is substantially similar in that respect).

It is not common within the region to specify or standardize these legal or regulatory changes into different categories (usually in international praxis, general legal change, specific or sectoral legal change, and discriminatory change), it being international good practice for these last two categories to be treated as shared risk and retained risk, respectively. However, it is not unusual for changes in technical regulations (e.g. Colombia in its highway or airport PPPs) or in sector-specific tax or tariff regulations (airports in Colombia) to be shared.

6 Other Relevant Matters Relating to Contract Management

It is clearly impossible to address all of the relevant matters surrounding the management of PPP contracts. Some of the topics that were left out of our more meaningful analysis and discussion — and for which we would simply provide a shorter description — are:

6.1. Stakeholder management

Let us now provide a definition of the popular term “stakeholders”. They are essentially persons affected or impacted in some way by one or other aspect of a PPP project.

There are several important aspects to consider in the life of a PPP contract and proper stakeholder engagement and management is certainly one of them, though it is often overlooked. Their involvement is key in the early stages of the project, and also remains so throughout the life of the contract. Proper stakeholder management will mitigate the risk of possible objection to the project and help garner further support for the venture, thus generating trust in general by demonstrating commitment to the project.

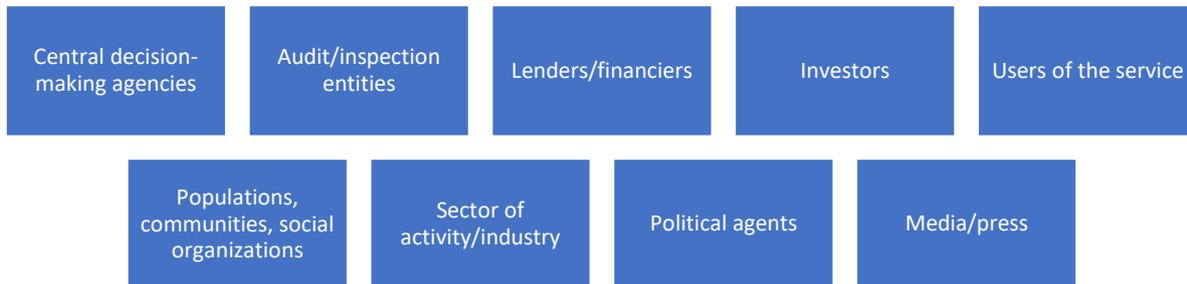
When beginning to restructure a PPP project, there are usually institutionalized instances of interaction and exchange with stakeholders in order to ensure a feasible project from every angle. The relevant agents are summoned for discussions and allies are sought, among other figures: promoters, opponents, skeptics, etc.

Yet in later stages, this becomes less common, when in fact it should be a strategic line that runs throughout the entire project timeline. It is also worth noting that stakeholders can change over the life of the project, and the relevance or importance of this will depend on the stage of the project we find ourselves in.

In our opinion, it is unquestionably important for stakeholders to be consulted once again when making any of the changes to the contract discussed previously. It is desirable that these stages also contain instances of interaction in order to sustain the project and help ensure its acceptance by all stakeholders.

The first thing that stakeholder management requires is their proper identification, which includes a “stakeholder map”, thus enabling us to draw up an appropriate communication strategy.

• **Figure 4: Main stakeholders**



6.1.1. The importance of communication

An individual communication strategy should be drawn up for each stakeholder, after defining them on the basis of the stakeholder map and describing their specific interest in the project (how it affects them), along with their concerns and position with respect to the project (for or against).

This will ensure individual and bespoke treatment when communicating with each stakeholder.

Different mechanisms can be put in place for publicity, exchanging information, networks, and so forth, though in all cases the overriding parameter is one of effective and appropriate communication tailored to the stakeholder concerned.

This communication also requires a professional approach tailored to each stakeholder and with the message drawn up based on the diversity of mechanisms in which people process information. The response to the “change” when undertaking this kind of project is influenced by the degree to which it is perceived as being negative or positive. Therefore, managing the change means managing paradoxes, intentions and perceptions, and ultimately seeking to align incentives for the various stakeholders, among other key elements. While there has already been a great deal of discussion about communication and rhetorical strategies in particular, it bears repeating that this involves three blocks, much like the reasoning for the project: Ethos (values, or what the party making the communication upholds), Logos (logical arguments) and Pathos (emotional arguments or to empathize with the audience). What matters in essence is that the spokespeople possess good communication tools that can be acquired and trained, so that they are suitably prepared to manage stakeholders in projects of this magnitude, based on transparency and trust.

It is also vital to generate spaces for communication and for exchanging information and views with the public and users so as to gauge how the project is progressing in their eyes.

As discussed by the panel of experts, stakeholder management is present to some extent within the region.

6.1.2. Transparency and accountability

Transparency is invariably something that must be addressed and promoted, not only in the pre-investment/groundwork stages of the project but also during the construction phase.

The contractor must be required to disclose information and provide a degree of transparency that allow citizens and stakeholders to learn about the progress of the project.

Transparency must be proactive and not just reactive. Therefore, in relation to the progress/outcomes of the project and its overall performance, it is good practice for ex-post evaluations to be carried out and then published by “supreme audit institutions”.

Unfortunately, it is rare to find such ex-post evaluations within the region, where they are widely referred to as performance or value-for-money assessments.

6.2. Dispute or conflict management

This is an important point when managing a PPP contract because it affects all aspects of the contract.

A dispute can arise when the parties are unable to resolve a problem relating to the management of the contract. Differences can lead to disputes in many ways, such as when measuring performance or making availability payments, or disagreements on how to apply the update rate or whether the legal merits of making a claim for a specific risk.

Good contractual management should, in the first instance, aim to minimize the risk of disputes and problems occurring by ensuring good interaction between the parties (relationship management), addressing possible misunderstandings in advance, maintaining fluid communication and managing information appropriately (good record keeping is particularly important here).

In other words, dispute management is mainly about preventing disputes from happening in the first place.

When a dispute does arise, dispute resolution mechanisms should be provided for in the contract. And dispute management, on this point, will essentially be the sound management of any issues arising from the contract. Again, we are dealing with an aspect of management where the operational framework and the best management starts (but does not end) with a good contract. Dispute resolution mechanisms should provide an hierarchical range of options for resolving the dispute (amicable discussion, mediation, dispute resolution panels), always with the intention of preventing the matter from going to arbitration (usually quite costly), or otherwise to trial.

Dispute resolution mechanisms typically insist on arbitration proceedings (preferably international, which will usually require its inclusion in a law or Act), so as to avoid having to go to court, which can often take a long time and is inherently uncertain, making it the worst possible resolution mechanism in the eyes of investors, especially international investors.

On this point, LAC is relatively advanced, as contracts in the region usually include a detailed section on dispute resolution and almost all of them provide for international arbitration as a legally valid mechanism.

6.3. Information management and document management

On this particular matter, several points were discussed by the panel.

Information management includes mechanisms for capturing, handling and processing information (sometimes including upstream reporting) and then recording it properly so that the information is readily available as and when needed.

The information to be managed also includes communications “towards” the private partner, especially those bearing an official administrative title (notices of breach, imposition of penalties, etc.) and of course the documentation relating to the contract file (especially contractual amendments⁴⁴).

A good information system is an essential means of record-keeping when it comes to claims management as it allows the parties to properly document and then retrieve bid commitments, especially projected costs that the private partner had undertaken to meet.

It is also crucial for ensuring the proper monitoring and management of performance.

The first thing to bear in mind is the need to manage the information flowing between the public and private partners, which is the most directly important aspect of contract management. Here we are essentially talking about the flow of information and reporting from the private partner to the public partner and how that information should be recorded and treated. As discussed in the section on performance management, the contractor’s quality control systems lie at the heart of a good contract monitoring system.

In this connection, it is essential that the management systems to be implemented are compatible with those used by the private partner. This must be foreseen in the tender specifications right from the outset, either by specifying which type of software the public partner will use (and checking in the initial stages that it is indeed compatible with the software usually used by the private partner), or by insisting that the public partner eventually implement the same software that the private partner will use, who must guarantee at all times fluid access to the monitoring information in real time.

In the case of Mexico, it is worth noting that most of the Road Maintenance and Management Contracts based on Performance Standards insist on the use of specialized hardware and software (Road Management System, for monitoring compliance and historical record-keeping of the standards required under the contract), the logging of information on maintenance work effectively performed, as well as real-time surveying of incidents, automatic monitoring of response times and applicable penalties. The developer, government and external supervisor have immediate access to the data and can carry out any verification measurements they deem necessary to confirm the results recorded in the system.

Currently, there are more than 25 road contracts subject to this type of requirement, some of which have been in operation for over seven years, where all the relevant contract information is recorded in the Road Management Systems: intensive measuring of standards related to paving performance such as IRI, rutting, friction, surface deterioration, deflections measurements twice a year to confirm paving performance and response to the maintenance work carried out, as well as proper control and logging of incidents and penalties under the contract.

⁴⁴ In Spain, for example, a number of serious disputes have recently occurred in some contracts with ex-post claims for compensation made by a (later) government team on account of savings that the private partner had amassed in previous years under agreements that had not been formally signed.

In addition, the panel highlighted the role of information management in relation to the reporting obligations that should be incumbent on the contracting authority under a good framework.

This is linked to stakeholder management, whether internal — for example, reporting of risks and contingencies to the Ministry of Finance — or external — publication of reports available to the public on the performance of PPP projects and programs — usually through or subject to ex-post evaluation reports drawn up by supreme audit institutions.

In general, the group/panel of experts considers that the region “scores poorly” on this issue, as it does not pay due attention to the importance of having information and document management resources and tools/systems in place, in a general context in which digital information management is becoming increasingly important⁴⁵.

6.4. Contract management and early termination

Early termination events are extraordinary situations that require close scrutiny and management.

6.4.1. Preventive and proactive management

What matters the most? Preventing minimizing the risk of early termination. Seeking to ensure that the contract remains in effect.

In the first instance, this requires proper groundwork for the project prior to tendering (this being a stage prior to contract management, as we mentioned near the start of this document).

Let's take the case, for example, of contracts that must be terminated due to social pressure or opposition. These termination events qualify as “unilateral termination”. The underlying cause for termination is usually poor stakeholder management during the pre-investment phase, though it may also be due to poor communications management during the contract phase.

There are more examples of early termination (many, in fact) that stem from poor project preparation: insolvent/unqualified contractors, overly aggressive bidding on price, government inability to pay, etc.

Yet early termination can also occur due to an unforeseen event that cannot be resolved according to the rules of the contract: a supervening event of considerable magnitude that was not foreseen (or could not reasonably have been foreseen). An example? COVID-19. We address this matter at greater length in Section 7.

Let us not forget that one of the overriding objectives of contract management is to prevent the contract from having to be terminated early for reasons that could have been avoided in the first place.

⁴⁵ As one of our panelists pointed out, the trend is to establish a digital agenda (SDGs). For example, we have the commitment recently made by the governments of the Pacific League.

From a performance standpoint in particular, good management should be steered by the ultimate objective of “never reaching” the point where early termination is enforced due to breach of contract. This can be achieved by relying on the tools discussed in Section 3 (i.e. through good management of contractual incentives) and by allowing the banks or lenders to “step in” if needed in extreme situations⁴⁶.

6.4.2. Managing contract termination events

The situation is as follows: *“We’re going to terminate the contract. How should we proceed? What do we need to do? What things do we need to take care of?”*

Naturally, we will need to do what the contract says and also what the law says, as we (i) calculate the compensation payable, if any, or adjust the amount being sought by the private partner (it is of paramount importance to be clear and objective on how this is calculated); (ii) then pay the resulting amount of compensation; (iii) obtain the approval/budget appropriation; (iv) manage its effective payment; and (v) manage the dispute process, whether at arbitration or before the courts.

Yet beyond the process of calculation and liquidation, or rather as part of this process, we will need to analyze the possibility/opportunity for enforcing the performance bond under the contract. We must also determine whether the private partner is entitled to receive any insurance indemnities (this mainly occurs if the termination event is due to force majeure) and in certain cases there may be the right to seize (or deduct) reserves posted and not used for the maintenance of the assets. All of this should be provided for in the contingency plans.

Aside from the payment of any compensation that may be due, it is essential to have an “exit plan” as part of the necessary contingency plans mentioned in Section 4.

An exit strategy, in good international practice, is something that should be defined without fail for the first few years of the contract. Minimum protocols may also be put in place from the outset to respond to an unexpected event of early termination. What the parties need to do is decide in advance on whether they prefer to continue to manage the asset through the PPP or opt for another, more direct form management. There must also be protocols in place to enable a prompt succession of management, either by switching to direct management or by launching a new PPP contract tender. These protocols must regulate issues such as the hand-back of the assets⁴⁷ (necessary review of the state of the assets and possible existence of liability/damage due to poor or no maintenance), the

⁴⁶ Another key issue is the sound design of contracts as an initial element of contractual management: to benefit from a framework that commits us to certain obligations while also enabling and regulating possible step-in by the bank over a certain period of time in a bid to reverse the situation and hopefully avoid early termination. This is related to the definition of proactive/flexible frameworks for contract management, since in most countries it will be necessary to enable this mechanism through the law (as it collides to some degree with the principle of transparency and competition).

⁴⁷ Detailed plans should also be drawn up for the hand-back process, under the framework of the processes to be defined in the contract, including annual inspections over the last years, the obligation on the private partner to post a reserve so that the necessary investments can be made in order to meet the hand-back requirements, and the possibility of withholding payments if necessary so as to ensure that sufficient funds are available in the reserve. More on this point can be found in the CP3P Certification Program Guide in Chapter 8.

transfer of all pertinent operating documentation (operating and management manuals drawn up by the private party), the possibility of insisting that the private partner continue to manage the asset on a temporary basis, etc.

The aim is invariably to guarantee the continuity of the service and to minimize the damage caused to users.

- **Box 7: Early termination of PPPs: the Brazilian experience in the State of São Paulo**

During the contract performance phase, the parties may find that their concession-based arrangement is no longer viable. These cases usually result in lawsuits or arbitration proceedings and are ultimately detrimental to the effective provision of the service for the benefit of the public. Conflict situations signal to the market the state's attitude towards planning the economy, either attracting or driving away investments according to the security and predictability of the contracting authority's position.

Given the importance of signposting, the State of São Paulo has developed an innovative mechanism in its PPPs. Not only do the contracts here increasingly incorporate internal management mechanisms to ensure the continuity of the project, they also contain tools that allow for the arrangement to be terminated without this leading to litigation, which, in extreme cases, can result in the interruption of the service and put off future investors.

While we can find no specific provision in the Brazilian Federal Concession Law (Law No. 8,987/1995), Article 26 of the São Paulo State Concession Law (Law No. 7,835/1992) states that a PPP may be amicably terminated by the parties before it has run its course, provided that the contract explains how the termination should proceed.

Recent concession instruments have allowed for early termination bargaining. This can occur upon the occurrence of unforeseeable circumstances or force majeure events that are not insurable and whose effects persist over a certain period of time; where restrictions are imposed on the tolls that can be charged and received; where materialized tax risks excessively affect the cash flow of the project; or upon the occurrence of imbalance events that have an intolerable financial impact on the concession. What matters is ensuring dialog between the parties in response to events that cause damage to the parties and to the continuity of the contractual relationship.

Once an imbalance of positions has been confirmed, the parties can negotiate to put the contract back on the right course or otherwise move to terminate the project. The resulting situation might generate a severe tax impact, even in PPPs with freedom to set tariffs, the contracting authority can assume the financial burden and look to rebalance the arrangement. If the contract is terminated, the rules on compensation can vary, depending on whether the service is cancelled or nationalized, depending on the seriousness of the event.

7 COVID-19 and PPP Contract Management

The COVID-19 pandemic has had an undeniable effect on PPP projects in the pipeline or already up and running.

While the impact of the pandemic has been felt differently around the world, it has definitely slowed down international logistics by affecting the supply of inputs for projects. In many countries, a compulsory quarantine or lockdown has been imposed, which has had the effect of halting activity, while other areas of activity have been subject to specific measures.

Unquestionably this new state of affairs has forced us to reflect on PPP projects, and not only in relation to the construction or execution side, but also in terms of the lessons learned for those projects yet to be implemented.

There has been quite some debate as to whether COVID-19 qualifies as a force majeure event and how the contract clauses should operate, as this unprecedented situation was clearly not envisaged at the time.

If the government imposes a mandatory quarantine, lockdown or similar measure, this circumstance will cause many transportation projects to lose a significant volume of revenue. The basis for the contractor's claim in these situations would be something different: discriminatory regulatory change that generates damages, or the alternative concept of MAGA (Material Adverse Government Action).

The COVID-19 pandemic provides a perfect illustration as to how in most cases (as far as possible, always on a best-effort basis) a key vector when drawing up a contract (and, as the case may be, standards, laws or policies) is to foresee anything and everything that it is reasonably plausible, thus generating a suitable framework for the management of unforeseen events (which are not unforeseeable).

The aim here is to minimize the "risk of renegotiation", meaning the negotiation of a solution necessarily outside the framework of the contract. Normally, at least in countries with a civil code tradition (as is the case with most, though not all, of the countries within the region), this 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). See Box 9 in this chapter for the case of Spain.

In this context, the sharing of project risks acquires added substantive relevance and must be reconsidered in light of these new unforeseen circumstances.

The inevitable conclusion is that the force majeure clauses of PPP contracts must be reframed so as to ensure that they contemplate situations which, while perhaps not constituting "force majeure" (in its most abstract definition), may nevertheless warrant the adoption of appropriate measures so that the parties can overcome their difficulties and press ahead with the contract by striking a suitable balance for both sides.

Peru has wasted no time in adopting a protocol on how to respond in these cases.

Chile is another interesting case, which we succinctly explain below.

- **Box 8: COVID and its impact in Chile⁴⁸.**

The impact of the pandemic on PPP projects underway in Chile has varied, depending on whether or not the project is linked to demand-side revenues. For example, in projects immune to demand (subject to government subsidies instead), such as prisons or hospitals, there has been less of an impact than in those cases where the mobility restrictions led to a reduction in revenues, such as the Interurban Highways project. This particular project features a Minimum Revenue Guarantee, which covers the risk of a drop in demand.

One of the most affected projects has been the International Airport of Santiago de Chile. The claim risk had been passed to the private partner, who claimed that this was an unexpected event and asked for an extension of the contract term. One possible solution would be the revenue distribution mechanism and to mutate from a fixed-term contract to a variable-term contract.

In the case of urban highways, the discussion centered on congestion pricing. With the mobility restrictions in place, there was no longer any congestion and the state argued that the tariff should not be charged because it was tied to two conditions: time of day and actual flow of traffic. However, the private partner claimed that it was subject only to the time requirement and that it was therefore entitled to charge the tariff.

In any case, Chile has an amicable dispute resolution formula (in place since 2010) before the parties resort to renegotiating this type of contract. Under this solution, a Council and Panel of Experts reviews the situation and determines whether contract renegotiation is warranted. This Council liaises with the private partner in a bid to hammer out a solution. It is important to point out that the 2010 reform made arbitration at law the norm, as opposed to arbitration *ex aequo et bono* (in equity).

- **Box 9: COVID-19 and PPPs in Spain. A brief interview with a Spaniard.**

1. Has the government ever imposed a mandatory quarantine, lockdown, or mobility restrictions in your country? Yes, it has.

2. Has the pandemic ever been framed as a regulatory change that discriminates against or harms the interests of PPP contractors? There have been various claims lodged by concession companies, especially toll road co-operators. My understanding is that the arguments raised by the companies were either based on force majeure (which I do not believe to be the case for the reasons I will explain in due course), or actions attributable to the government.

3. Has anyone contended that it qualifies as force majeure? If so, was it set out in the relevant contract? A law was passed to regulate the right to claim for contract rebalancing, among other matters. In Spain, the law on state contracts provides a closed list of force majeure events and situations such as COVID-19 do not qualify. I also think it is unclear as to whether it constitutes a discriminatory rule as the enforced lockdown did not discriminate between sectors, except for those considered essential (health, army/defense, electricity production and water). As a result, most of the nation's industry and the entire services sector fell inside the definition.

In other words, it has been deemed necessary to enact a formal rule of law to enable the parties to negotiate their contract.

⁴⁸ Our thanks go out to our colleague Jorge Montesinos from Chile for his contribution, which we have attempted to replicate in the summary included in this box.

8 Matters Relating to the PPP Framework and Contractual Standards. Recommendations

In this section, we share some recommendations on two key concepts: contract standards and the general PPP framework (especially in its most fundamental dimension, namely the PPP law, where such a law exists) and their importance when it comes to contract management.

8.1. The need for a framework that “enables” and strengthens contract management

As we have already discussed, the existence of a good contract is necessary (though not enough in itself) and indeed a condition precedent for the sound management of PPPs. More precisely, they should provide a reasonably flexible framework to respond to the changes that will inevitably occur over the life of the contract. It is essential that they provide the contracting authority (who, it bears repeating, is the owner of the project) with a set of tools for the effective management of the various threats and risks that may affect the projects, in relation to all the matters discussed in this document and indeed certain relevant issues that we have not been able to address.

This flexible framework applies to various aspects, including stakeholder expectations, technological adaptation and dispute resolution, which may change over the life of the contract and require close attention in order to protect the contract.

The contractual relationship should be structured so as to align and harmonize the incentives of both the public and private partners on a case-by-case and project-by-project basis. As a result, the management of the project, as set out in the contract, should seek to regulate the duties and obligations of the parties and the way the services are provided and balance this with the need to maintain a certain degree of flexibility.

However, it will often be difficult for a contract to possess such flexibility and provide effective mechanisms for responding to change and threats unless there is already an adequate legal framework in place.

It is widely known and accepted that stable regulatory environments are a must. The heavy investments to be made by private investors must be supported by a stable institutional and regulatory environment so that they can reasonably sure of the risks and possible impacts that lie ahead. The institutional framework must ensure the necessary legal certainty so as to provide the parties with a degree of assurance on what to expect while the contract is being performed and certainty that their respective obligations will be honored, as well as the possibility of enforcing changes to the contract.

This clearly impacts the market by helping to attract investors and providing a certain environment for the delivery of high quality public assets and services for the benefit of the population.

Yet beyond the general legal system governing PPPs, there to ensure legal certainty when it comes to rights and obligations, the PPP frameworks themselves must enable those tasked with the design of the contract (who are none other than the project owners, namely the contracting authorities, who are then responsible for their management) to develop and then include in the contract the contractual management mechanisms needed for the proper management of any risks or threats that might emerge over the life of the project.

Following international best practices, there are often many issues to be addressed (in the contract) so as to ensure good contract management, and this can sometimes conflict with general principles of public procurement, such as transparency and competition. Naturally, these principles can affect aspects such as:

- direct negotiation of changes to the scope of the contract;
- transfer of the contract, or transfer of ownership of the operator;
- the “sudden” acceptance of a financial institution as a party to the contract, when it lacks the expertise required under the tender and is ultimately not the partner we chose at the outset.

Other matters governed by traditional administrative law, such as the government’s privilege to have disputes and other matters heard by the country’s own courts, conflict with the international trend for there to be freedom of contract between the parties (even though one of them is public and the other private) and for international arbitration to be the ultimate dispute resolution mechanism. It can also affect the way investors perceive country risk.

These are just some examples of the various key aspects of the PPP legal framework that need to be addressed in order to bring them in line with good practices and attract national and international infrastructure investors.

The panel of experts and indeed the author are largely of the opinion that the LAC region scores very well in all of these aspects.

8.2. The need to institutionalize the contract management function

It is essential to “unlock the value” of contract management as part of the PPP cycle, in the same way that it is common practice at the framework level to have handbooks and guides on how to manage a broad range of important aspects, particularly the preparation and evaluation of projects.

While national guidelines and best practice handbooks tend to focus on the phases of risk identification, assessment and allocation, we believe that certain aspects of contract management (most notably risk monitoring and reporting) should be clearly incorporated into existing risk management guidelines in many countries.

Another key aspect is the need to make the contract management function an actual profession by offering specialized courses or by fostering a culture of contract management within the line ministries to encourage officials to train and pursue a career in this discipline⁴⁹.

⁴⁹ While contract management is clearly a multidisciplinary task, it also requires a set of minimum skills when it comes to stakeholder management, risk management and of course project management.

It is also important to explicitly name the agents responsible for contract management at the institutional framework level and explain how the governance of these contracts works: What is the specific responsibility of the contracting authority and its decision-making authority? What is the role of the Finance/Treasury Department? What role do regulatory bodies or entities within the sector play, if any?

We would also underscore the need to implement the duly institutionalized dynamic of ex-post assessments of programs and projects, which is essential for encouraging good contract management through accountability.

Broadly speaking, there is still a long way to go in improving all of these aspects throughout the region.

8.3. The need to develop contractual standards

The first thing we need to make clear is that when we talk about contractual standards, we are not insisting on boilerplate clauses. It is more about having documents to describe and explain how this important aspect should be approached, including the rationale, available options (if there is more than one way forward) and only sometimes establishing a standard wording for a clause that should be used⁵⁰.

Contractual standards minimize the risk of errors occurring during contract drafting and generate consistency in the use of PPPs (consistent treatment of key issues in the various contracts that make up the program). There must always be room to accommodate the unique characteristics of each project.

Although there is a (positive) trend in the region towards standardization of risk allocation (e.g. Colombia, Peru) through the issuance of binding guidelines, this approach should be extended to include other relevant areas of contract design that have a big impact on project management.

Here we are talking about the need to standardize certain aspects that play a major role in making the contract an operational framework for its own management, such as:

- The treatment of shareholding changes at the contracting company and the approval process.
- Early termination events and consequences (how they are calculated).
- Dispute resolution processes.
- Aspects relating to contractual changes to project scope or requirements.
- Service monitoring and reporting.
- To name but a few.

⁵⁰ For some examples of sound contractual standards see, for example, Australia's "*commercial principles*" ("*National Public Private Partnership Guidelines Volume 7: Commercial Principles for Economic Infrastructure*" and "*Volume 3: Commercial Principles for Social Infrastructure*"), or the UK's "*Standardisation of PF2 Contracts*".

- **Box 10: Early termination in Uruguay.**

According to our expert from Uruguay, the country has a regulatory framework that sets out the termination events for PPP contracts and whereby events can be added or removed from the list. It addresses, among other aspects, the impossibility of performance due to measures adopted by the state, situations in which the contractor becomes insolvent, the existence of causes or events disqualifying the contractor from rendering the services, or the existence of force majeure events or acts of God. It is also worth noting that there is a mandatory mechanism for dispute resolution: arbitration. Contracts in the country typically set out termination events and explain how the asset will be handed back to the state. They also regulate powers to step in immediately in certain cases and to appoint an auditor and contain investment calculation formulas.

8.4. Key aspects to reinforce (or incorporate) in a PPP framework to enhance and institutionalize PPP contract management

To conclude, we now propose the following list of key aspects that should be present in the design (or review) of a good PPP framework in relation to the contract management function.

Earlier in this document we discussed how only some of these points seem to be relatively present in the region, while others have clear room for improvement or are rarely seen.

- Development of a contract management guide and institutionalization of the need for specific training and capacity-building on this subject
- Legal basis or foundation for having disputes heard through international arbitration
- Clear description of roles and responsibilities for contract management at framework/legal level
- Risk allocation standards
- Standards on upstream reporting obligations
- Risk management standards (after the contract is signed)
- Implementation of ex-post performance assessments of programs and projects for continuous improvement and lessons learned
- Standards on dispute resolution
- Standards on change management
- Standards on how to include risk allocation as part of the contract
- Standards and methodologies for addressing imbalances and rebalancing processes
- Standards on how to define force majeure events
- Standards on how to define termination events and processes for the financial settlement of contracts
- Legal basis/viability of step-in by banks

9 Some Key Observations as Way of an Epilogue

- There is much room for improvement when it comes to the management of PPP contracts in the region.
- The main problem is a general lack of awareness of the importance and magnitude of this function. Managing a contract is much more than just monitoring and control.
- It also involves relationship management, information management and stakeholder management, as well as the key activities relating to risks and threats (performance management, risk management, change management and dispute management).
- There must be a change in attitude, shifting from a purely supervisory focus to a more collaborative attitude.
- We have also observed a certain detachment from the asset, whereby the government falsely believes that it no longer owns the project, thus undermining the necessary accountability.
- We must understand the importance of institutionalizing the function:
 - integrating contract management into the overall governance of PPPs at PPP framework level;
 - making the function part of the institutional and operational framework of the larger PPP system, and bringing central and decision-making agencies into the contract governance process;
 - ensuring that the function is supported by national policy documents/guidelines and institutionalizing the figure of the contract manager as a meaningful professional profile.
- We must equip ourselves with the right skills and capacities:
 - visualizing and scaling the resources from the outset and determining the need for funding;
 - incorporating advisors not only to monitor and control, but also to provide meaningful management support when renegotiating and making changes to the contract;
 - proactively managing knowledge through the use of project management techniques and planning the continuous training and succession of team members.
- It must be made clear that contract management starts from the time the contract is structured and drawn up (sometimes even earlier), seeing as though the contract provides the operational framework for its proper management. This requires a reasonable degree of flexibility and must duly incorporate the main instruments for management (clear allocation of risks, system of penalties, regulation of not only changes in scope/obligations, but also financial changes and information and reporting obligations, among others).

- Yet contract management also calls for methodologies and tools that complement the contract itself, such as:
 - An operational management handbook;
 - protocols and internal procedures (for managing and responding to claims for risk, negotiating and implementing changes to the scope of the contract, reviewing performance and payment procedures, etc.);
 - risk control and monitoring system;
 - the payment mechanism model;
 - a comprehensive information and document management system;
 - appropriate communication strategies;
 - a knowledge management plan;
 - contingency plans.

Recommended Reading

We recommend the following bibliography for further reading on the subject.

- PPP Certification Guide (2016), chapter 7, on managing the contract and on management during the construction phase. <https://ppp-certification.com/ppp-certification-guide/strategy-delivery-and-commissioning>
- PPP Certification Guide (2016), chapter 8, on managing contracts during their operational phase through to hand-back. <https://ppp-certification.com/ppp-certification-guide/operations-and-handback>
- South African National Treasury (2004). National Treasury PPP Manual, Module 6: Managing the PPP Agreement. <https://www.gtac.gov.za/Publications/1160-PPP%20Manual.pdf>
- Contract Management Guide, Partnerships Victoria. <https://library.pppknowledgelab.org/documents/2377>
- EPEC Contract Management Guide, European Union. “Managing PPPs during their contract life.” https://www.eib.org/attachments/epec/epec_managing_ppps_en.pdf