

Standardized PPP Contract in Korea and Its Implications for Latin America and the Caribbean

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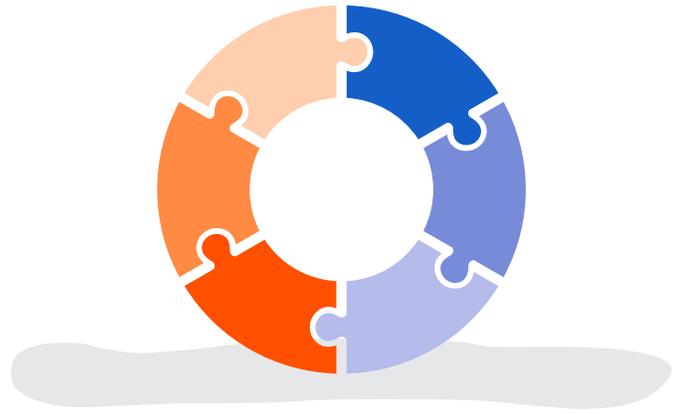
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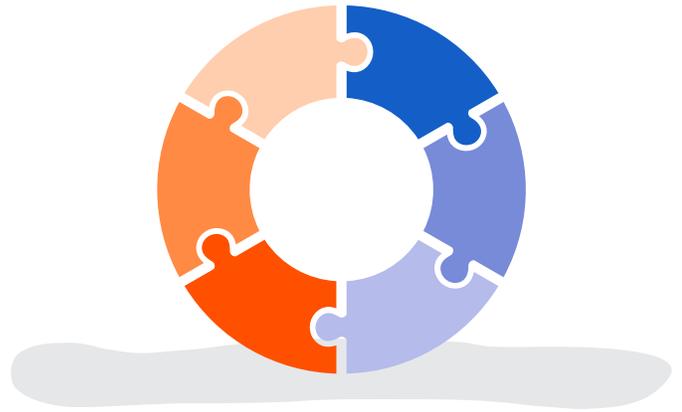




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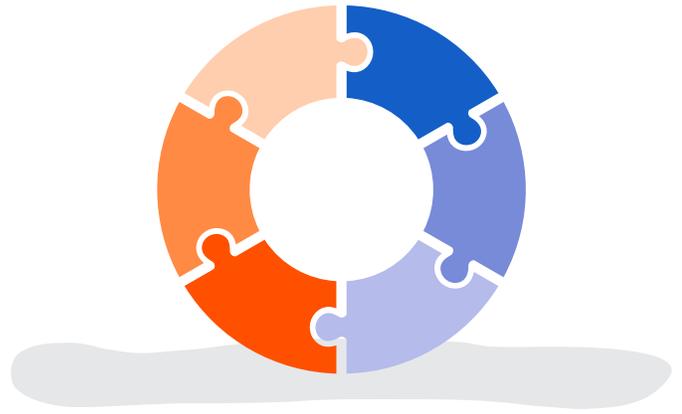
Abstract*

This note describes the Korean experience with the standardization of private–public partnership (PPP) contracts in the context of a civil law system and the lessons of this experience for Latin American and Caribbean (LAC) countries. Standardization strengthens the legal and institutional safeguards of long-term PPP contracts in civil law systems. To increase the reliability of PPP contracts in this setting, a standardized PPP contract was prepared by the statutory PPP agency under the approval of the Ministry of Economy and Finance, an influential ministry within the government. The standardized PPP contract has been of great utility for both the competent authorities and private partners. It has streamlined negotiations by giving the private partner greater confidence that the contractual assignment of risks regarding land acquisition, construction completion, operation and demand, and termination would be legally recognized and enforced. A survey of market and government PPP actors in Korea and the LAC region demonstrated similarities between the two that make Korean lessons particularly relevant. For example, most LAC countries have adopted the civil law system and developed similar payment types for PPP and risk allocation principles.

JEL codes: H0, H42, H54, H57

Keywords: standard PPP contract, risk allocation, PPP institutional frameworks, project financing, public-private partnerships

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Terms and Acronyms

BOO	Build-own-operate type of arrangement in which the ownership of an infrastructure facility vests in the concessionaire upon completion of the facility
BOT	Build-own and operate-transfer type of arrangement in which the ownership of an infrastructure facility belongs to the concessionaire during a specified period after completion of the facility vests in the central government or a local government upon expiration of the period
BTL	Build-transfer-lease type of PPP project; practically refers to government-pays model in Korea
BTO	Build-transfer-operate type of PPP project; practically refers to user-pays model in Korea
Competent authority	The public authority that enters into the PPP contract with the private partner (concessionaire)
Concessionaire	A private corporation that is designated as a concessionaire under the PPP Act and that implements a public-private partnership project
KDI PIMAC	The Public and Private Infrastructure Investment Management Center at the Korea Development Institute, a statutory PPP unit whose role includes support for executing concession agreements
LAC	Latin America and the Caribbean
MOEF	The Ministry of Economy and Finance (Korea)
MRG	Minimum revenue guarantee
PPP Act	Current Act on Public-Private Partnerships in Infrastructure, which has been revised since the Promotion of Private Capital into Social Overhead Capital Investment Act of 1994
RFP	Request for proposal
SC	Korea's standardized PPP contract published by KDI PIMAC
SPC	Special purpose company designated as concessionaire by competent authority
VFM	Value for money



Introduction

PPP refers to the procurement method of infrastructure that is funded, constructed, and operated by the private sector. The premise of the PPP scheme is that agreements made through negotiations between the competent authority and the private sector must remain stable for a long time.

Meanwhile, in civil law countries, governments have administrative authority to unilaterally reverse the effectiveness of contracts. Therefore, PPP policymakers in civil law countries need to primarily focus on creating an enabling environment for negotiation between the competent authority and the private sector on an equal footing, and to provide standardized contracts so that they can be accepted by all competent authorities.

In Korea, the contracts for more than 750 PPP projects in reference to the standardized PPP contract (Korea's standardized PPP contract published by KDI PIMAC, referred to here as SC) have been executed since the SC was enacted in 1998, and these projects are being constructed and operated reliably based on the contracts. The SC laid the foundation for the negotiation-based contract in procuring infrastructure facilities and contributed to the settlement of the

negotiation-based contract. Under the previous administrative procedure, there was little room for negotiation in PPPs. The SC, however, paved the way for smooth and proactive negotiations.

Many countries in Latin America and the Caribbean (LAC) accept the civil law system similar to Korea. However, there have been lots of cases of PPP renegotiation in LAC countries after the conclusion of PPP agreements, and it is understood that there are concerns about the situation in which PPP contracts are not maintained stably.

The Korean case of maintaining the stability of PPP contracts by standardizing them could be a reference to the establishment of the LAC system.

This paper aims to provide meaningful insights to LAC countries by expounding on the establishment process of Korea's SC and its contents. In addition, this paper includes some examples of the PPP schemes of LAC countries with PPP experience in the establishment of legislation and regulations for PPP contracts, the scope of payment type, and the recognition of key PPP risks. Finally, this paper proposes the key success factors of Korea's SC and its implications to LAC.



Overview of Korea's PPP Scheme

PPP FRAMEWORK

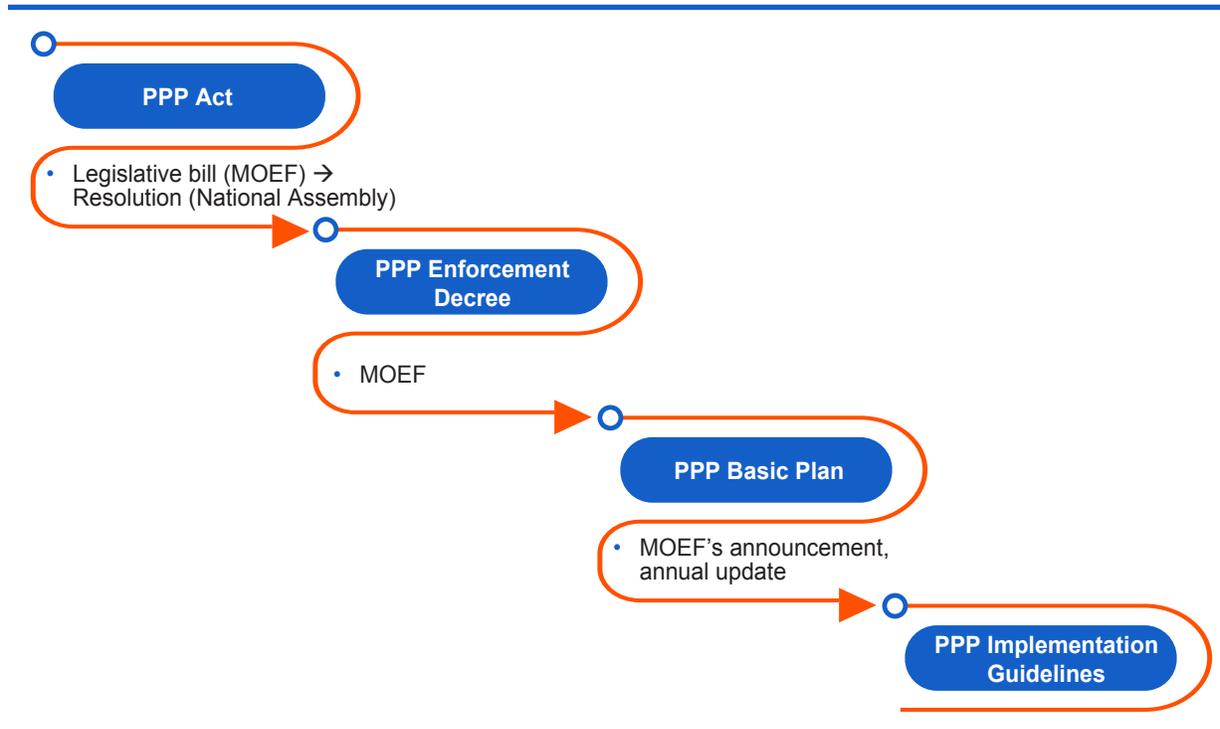
Institutional framework for PPPs

Korea's PPP scheme was structured and has been implemented in accordance with the PPP Act, the PPP enforcement, and the PPP Basic Plan (MOEF, 2020). Policymakers have achieved the completion of the institutional framework by taking legislative as well as administrative measures. As a legislative measure which strengthened the foundation of the PPP scheme, the PPP Act defines the concept of PPPs and provides the implementation procedures. As a supportive administrative measure within ministries, the Ministry of Economy and Finance (MOEF) announced and has annually updated the PPP Basic Plan, a government policy statement which elaborates supportive measures as well as key PPP principles. The MOEF has established these institutional frameworks, taking an independent stance from competent authorities. The MOEF, as the ministry in charge of the budget and fiscal management, has been playing a leading role in the creation of PPP policies and selection of PPP projects in line with the budget allocation process.

Also, since the MOEF is not the procuring authority in individual PPP projects and coordinates the various needs of the respective ministries, it is able to set policy objectives oriented toward national economic and social goals that are independent from those of each ministry.

Under the legislative authority, the practical guidelines for PPP implementation and management were developed by KDI PIMAC, official PPP unit of Korea, which has conducted comprehensive studies at the project screening stage and also extends its works to the contract management stage. While PIMAC's advisory work requires collaboration with the MOEF or other ministries, most work done by KDI PIMAC has been statutorily entitled and independently carried out.¹ KDI PIMAC's implementation guidelines cover

¹ KDI PIMAC is a government-funded organization that is operated independently. The competent authority that promotes a project does not directly contribute the funds. Internal decision making in developing a guidance study of PPP projects is carried out in accordance with the consultation of the MOEF, a policy department, but is not directly supervised by the administration ministries.

FIGURE 1 Korea's PPP Framework

the guidelines for feasibility and value for money (VFM) test, the guidelines for PPP's RFP, the standardized PPP contract, and the guidelines for refinancing gain sharing.

Payment type

The PPP projects' payment types are determined in accordance with Article 4 of the PPP Act. Briefly speaking, the payment type has evolved from user-pays type (concession), which had been adopted from the initial legislative framework in the mid-1990s, to government-pays type, which was adopted through the amendment to the PPP Act in 2005. As the PPP Act states, Korea's PPP project types are named BTO (build-transfer-operate), BOT (build-own and operate-transfer), BOO (build-own-operate), and BTL (build-transfer-lease), focusing on construction, ownership, and operation of the private sector.

BTO, BOT, and BOO—all of which are user-pays type—originally mean the structure in which the private sector can benefit from the operation

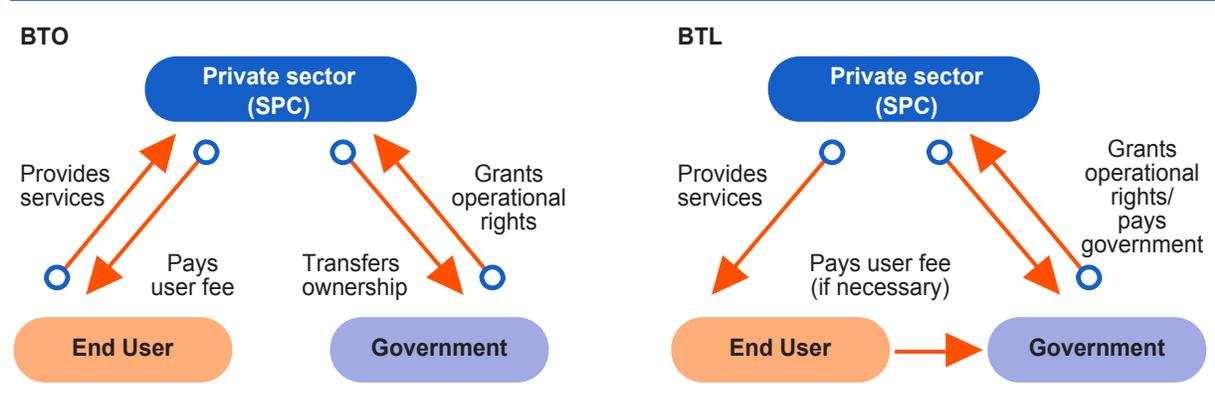
or ownership after completion of construction. In BTL, the lease relationship is created after completion of construction, which is beyond the original meaning of ownership and operation.

The main user-pays type is the BTO model, while BTL is the government-pays model.

Since BTL is widely accepted as a government-pays method, the PPP Act has provided special regulations, e.g., the National Assembly's decision on each year's total payment ceiling.

While BTL projects accounted for 66.7 percent of all PPP projects, amounting to 466 projects, BTO projects accounted for 69.3 percent of investments as of 2016 (KDI PIMAC, 2016). In the BTO structure, the private sector (special purpose company designated as concessionaire by competent authority, or SPC) provides the service directly to the end users who pay the user fees to the SPC. This structure has been used for toll road projects and railway projects. In the BTL structure, the SPC provides the service to the government who pays the rent fee

FIGURE 2 Comparison of BTO and BTL in Korea



to the SPC. This structure has been mainly used for school building projects or sewage pipe projects.

Procurement process

In a traditional procurement system for infrastructure, the construction or maintenance is individually procured by the competent authority. Contract management is simple because a particular construction work or maintenance service is procured through a short-term contract. On the other hand, a PPP scheme is a structure in which funding, construction, and maintenance works are all procured in batches. All aspects of funding, contraction, and operation in regard to the infrastructure shall be included in the PPP

contract and shall be managed for a long period of time. The project risks borne by the private sector need to be reasonably allocated with the competent authority.

PPP projects have been carried out in accordance with the procedures laid out in the PPP Act and the PPP Basic Plan, which are independent of the traditional procurement process and have been universally applied to every PPP project.

Unlike the traditional procurement process set forth in the Act on Contracts to Which the State is a Party, which has offered competitive bidding principles without indicating specific procedures, the PPP Act stipulates the mandatory procedure from project selection to contract award after a negotiation.

TABLE 1 Traditional Procurement and PPP Procurement

	Traditional Procurement	PPP Procurement
Law	Act on Contracts to which the State is a Party	PPP Act
Area	Public service works or construction works	PPP projects (projects' life cycle from construction to operation)
Analysis for Project Selection	Applicable in accordance with National Finance Act	Feasibility analysis required in accordance with PPP Basic Plan
Unsolicited Proposal	Not admissible	Admissible
Competitive Bidding	Competitive bidding process in principle, but in a special case, private contract is admissible	Request for Proposals is required even in unsolicited projects
Negotiation	Not required	Mandatory process

The procurement process of PPPs is pursuant to the PPP Act and is implemented as follows:

- Selection of PPP projects (solicited or unsolicited)
- Screening of PPP projects according to the criteria of feasibility and VFM test
- Announcement of RFP
- Evaluation of proposals and selection of preferred bidder
- Negotiation and contract award

The negotiation process is critical among these procedures in that the contractual terms negotiated between the parties, which are an essential part of PPPs, must be set during this process. Also, because the contract is the final stage to determine terms and conditions, the result of the negotiation should meet the VFM test. The PPP Act stipulates the essential aspects of PPP projects (i.e., a negotiation and consequential contract) and recognizes the legal binding effect of PPP contracts.

CONSIDERATIONS OF KEY RISK ALLOCATION

In establishing the PPP framework, the essential emphasis shall be placed on legal and political effort to affirm reasonable risk allocation between the public and private parties. The Korean PPP framework demonstrates how policymakers and legislators have set up the foundation of risk allocation principles. Based on a legal and political foundation, the SC was able to reaffirm the risk allocation agreement. The coordination between legislation and the MOEF's policy statement, the PPP Basic Plan, is evident in establishing the grounds for key risk allocation.

Land acquisition risk

Land acquisition risk is the risk of acquiring the title to the land to be used for a project, the

selection of that site, and the geophysical conditions of that site. It also is related to planning permission, access rights, and security (Global Infrastructure Hub, 2016).

In the risk allocation principle, the competent authority bears the principal risk as it is best positioned to select and acquire the title of the land required for the project. As a government support measure, the competent authority may need to use its legislative powers to secure the site (e.g., through expropriation/compulsory acquisition) (Global Infrastructure Hub, 2016).

The establishment of a firm legal basis to facilitate land acquisition for PPP projects became the foundation for the structure that allows the competent authority to bear the risk of land provision.

The legal grounds for facilitating land acquisition are set out as follows:

Exceptions to State or Public Property

- The PPP Act allows any national or public property located in an area designated for a PPP project to be sold to the concessionaire through a private contract without a competitive selling process (Article 19 (2) of the PPP Act)
- The PPP Act entitles the concessionaire (in a project in which ownership is transferred to the competent authority) to use free of charge and benefit from any national or public property located in an area designated for a PPP project until the date of project expiration (Article 19 (3) of the PPP Act)

Under the SC scheme, the land acquisition risk is borne primarily by the competent authority. Article 55 (Provision of Land for Project Site) declares that the competent authority shall provide the concessionaire with the land for the project without incurring any burden of tax, public charge, or security right. If the competent authority fails to provide the land, this is regarded as the competent authority's fault in accordance with Article 61.

Article 55 (Provision of Land for Project Site)

1. The competent authority and the Concessionaire shall make an agreement in advance on the plan for securing the land for the construction of facilities under this project, the time schedule of compensation therefor, and the time schedule for the conveyance of the land.
 - (1) The competent authority shall provide the Concessionaire with the land for this project as necessary for the Concessionaire's construction and operation of facilities under this project immediately upon completion of relevant procedures for the section for which compensation is not required and immediately upon completion of the compensation procedure for the section for which compensation is required.
 - (2) In providing the land for this project, the competent authority shall allow the Concessionaire to exercise the right to occupy and use the land, the right to use the land without consideration, and other rights recognized necessary for the Concessionaire to carry out this project under this Agreement during the project period without incurring any burden of tax, public charge, or security right.

Article 61 (Competent Authority's Faults and Countermeasures Therefor)

1. In interpreting this Agreement, the following events shall be deemed the competent authority's faults, which shall not be limited to the following events:
 - (2) Where the commencement or implementation of construction works is delayed due to the competent authority's delay in providing land for the project, carrying out works for compensation, or removing obstacles;

Demand risk

Demand risk is the risk that the project value, and project revenues, will be lower (or higher) than expected because demand for the output is lower (or higher) than expected.

The concessionaire's income is determined by price and demand, but it is virtually impossible to accurately predict demand during the next 30 years of the agreement. Therefore, there is a constant risk that the actual demand falls short of the pre-foreseen demand. If this risk is entirely borne by the concessionaire, it is exposed to risks such as bankruptcy if demand is significantly less than forecast.

Practices from developed countries have implied that demand risk should not be borne totally by a private partner, and in Korea sharing of demand risk has become a primary focus in evolving a user-pays PPP model.

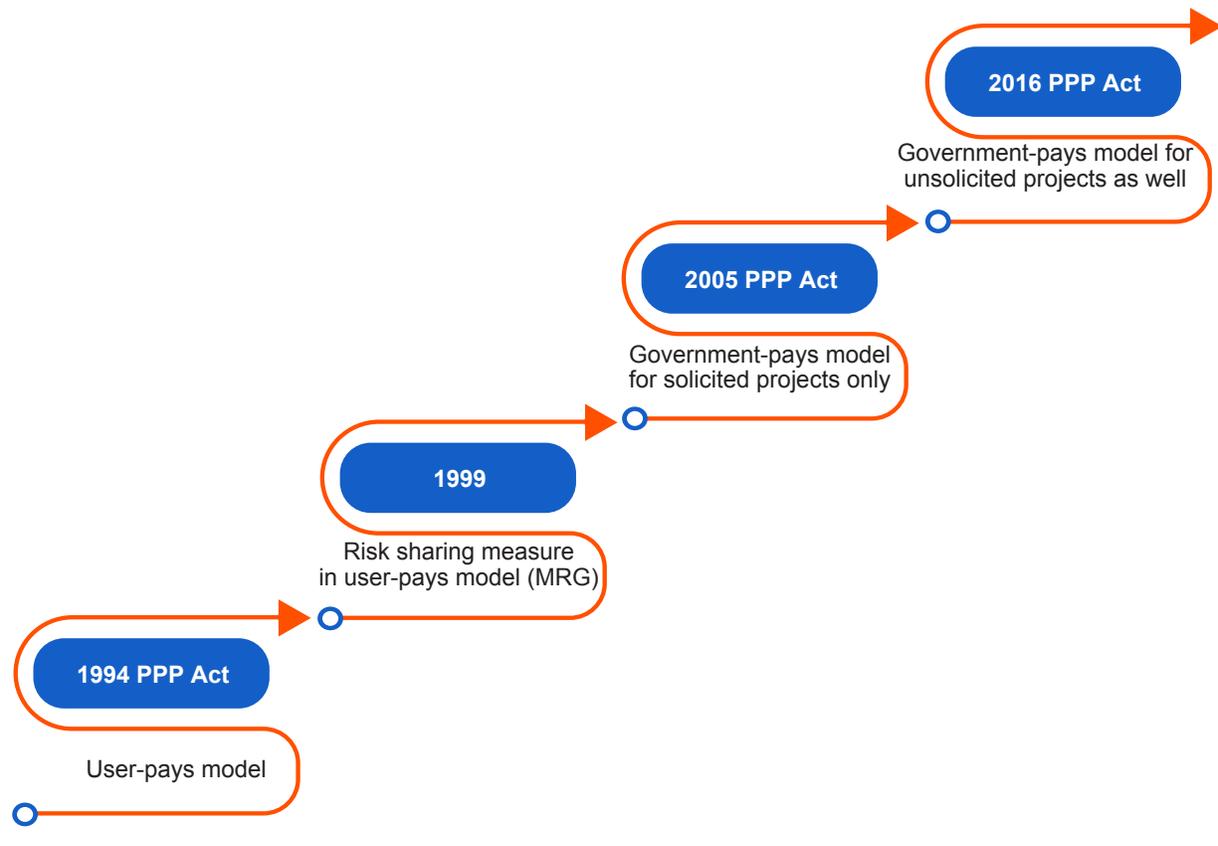
The risk allocation measures in demand risk were developed and have evolved in line with the legislation and policy to adapt the payment method in PPPs.

As shown in Figure 3, the payment type has evolved from user-pays type (BTO) to government-pays type (BTL) by legislation. Government-pays type was allowed in solicited projects only when it was first introduced in 2005. After 10 years' experience, it was also allowed in unsolicited projects through the amendment of the PPP Act in 2016.

Evolution of demand risk mitigation mechanisms

Historically, mitigation measures for traffic risk in the transport sector have been the focus for PPP policymakers. As already stated, a user-pays PPP model was initially introduced in the transport sector (notably, toll roads). The risk mitigation mechanism, which had been developed in Korea for user-pays PPPs, is the minimum revenue guarantee (MRG).

Under the MRG mechanism, the competent authority guarantees some portion of pre-estimated revenues. Also, in both lower and upper bands, the competent authority and the concessionaire share revenue risk.

FIGURE 3 History of Demand Risk Scheme

If in the given year the revenues fall below the bottom band, the government will have to pay the concessionaire the difference between the revenues guaranteed, which are based on the expectation, and the real revenues collected. If the revenues rise above the upper band, the concessionaire has to share a percentage of the extra revenues collected with the government. Since the introduction of the MRG scheme in 1999 until its abolition in 2009, the MRG agreements were included in actual transport projects.

In 2015, the MOEF announced a new risk sharing scheme through the PPP Basic Plan. This scheme (BTO-risk sharing model, BTO-adjustment model) aimed to mitigate the demand risk in the user-pays BTO model.

- BTO-risk sharing (BTO-rs): Government-pays model is applied to some portion of the private partner's costs of investment. The residual portion of the investment and its corresponding operation cost adopts the user-pay mechanism of typical toll road projects. By mixing the approach of a government-pays model and a typical toll road, this scheme aims to lower the private partner's requirements on the project rate of return in accordance with a decreased demand risk.
- BTO-adjusted (BTO-a): The government sets a risk sharing portion of the total investment cost and some portion of the operation cost. If the actual revenue falls below the shared investment cost, the government remunerates the shortfall.

Early termination and risk sharing

Early termination of a concession agreement may bring about considerable losses to both parties to the agreement (i.e., the competent authority and the concessionaire). From the perspective of the competent authority, if the concession agreement is terminated prematurely, social costs and losses are likely to be generated due to incomplete construction of infrastructure or unstable provision of public service. From the perspective of the concessionaire, as the investment cannot be recouped, it is highly probable that its property profits may be infringed upon. In the SC of Korea's PPP, a substantial portion of early termination risk is borne by the competent authority.

Clarification on the calculation standard for early termination payment

Early termination payment is clearly stipulated in the PPP Basic Plan, and the SC repeats the calculation standard included in the Basic Plan as is. The MOEF, the budgetary organization of the government, specifically sets forth the recipient and the amount of early termination payment in the policy document; therefore, the competent authority is able to provide the payment based on the unified calculation standard while excluding the arbitrariness in negotiations on early termination payment. The PPP Basic Plan's calculation standard for early termination payment is shown in Table 2.

TABLE 2 Calculation Standard for Early Termination Payment

1. User-pays BTO project

- The compensation on termination shall be based on the private fund invested during the construction period, but the level of compensation for the opportunity cost of the invested fund shall vary depending upon who is at fault for the termination.
- The compensation on termination shall be based on the present value of the accumulated depreciation and the expected return during the operation period, but the level of compensation shall vary depending upon who is at fault for the termination.

	Construction period	Operation period
Concessionaire's Default	Already invested private investment amount	Depreciated value of the amount on the left
Political Force Majeure	Already invested private investment amount $\times [1 + \text{standard debt interest rate}^{(1)}]$	Weighted average of the sum of the depreciated value of the amount on the left plus the future expected profit based on revenue result
Nonpolitical Force Majeure	Already invested private investment amount $\times [1 + (**)/2]$	Same as above
Competent Authority's Default	Already invested private investment amount $\times [1 + \text{nominal rate of return}^{(2)}]$	Same as above

¹ "Standard debt interest rate" is calculated by adding 2% to a value calculated by applying a weighted average to the average current yield of government bonds (maturing in five years) per year during the construction period according to the ratio of the accumulated amount of the private fund invested as of the end of each year.

² "Nominal rate of return" is calculated by reflecting the historical consumer price inflation rate during the construction period in the real rate of return for the calculation.

(continued on next page)

TABLE 2 Calculation Standard for Early Termination Payment *(continued)***2. Government-pays BTL project**

- The compensation on termination shall be based on the private fund invested (private investment cost - interest during the construction) during the construction period, but the amount of compensation for the opportunity cost of the invested fund shall vary depending upon who is at fault for the termination.
- The compensation on termination shall be based on the present value of the rent for facilities for the remaining period during the operation and shall vary depending upon who is at fault for the termination.

	Construction period	Operation period
Concessionaire's Default	(Private investment cost already invested at the time of termination) – (Paid-in capital already invested at the time of termination)	(Present value of the rent for facilities for the remaining period after discounted by the rate of return applied at the time of termination) – (Paid-in capital) = C
Political Force Majeure	(Private fund already invested at the time of termination) × (1+A ^a)	[C+(D-C)] × 1/3
Nonpolitical Force Majeure	(Private fund already invested at the time of termination) × [1+(A+B)/2]	[C+(D-C)] × 2/3
Competent Authority's Default	(Private fund already invested at the time of termination) × (1+B ^b)	Present value of the rent for facilities for the remaining period after discounted by the rate of return applied at the time of termination = D

^a Interest rate for treasury bonds specified in the concession agreement.

^b Interest rate for treasury bonds + spread in the concession agreement.



Overview of the Standardized Contract

BACKGROUND

Korea's SC has been drawn up and promulgated gradually. The Promotion of Private Capital into Social Overhead Capital Investment Act, the forerunner of the PPP Act, was established in 1994. At that time, the act did not stipulate that a concessionaire must be designated through a "contract procedure." The designation of a concessionaire was done not through a "contract" in which both negotiating parties need to agree the terms and conditions but through an administrative procedure classified as an "administrative action," which means the government's unilateral action. (Although there had been some cases of concession agreement at a working level, concluding a contract did not firmly take root as a "legal procedure" in those days.)

Despite the establishment of the Promotion of Private Capital into Social Overhead Capital Investment Act, PPP projects remained sluggish. In 1998, the Korean government set out to find out why and prepare countermeasures. The government conducted extensive interviews with foreign investors and set the following objectives to

facilitate private investment and to increase participation and effectiveness of the private sector:

- Establish institutions in accordance with international practices and rules
- Increase the transparency of and streamline institutions and procedures, thereby enhancing policy credibility
- Guarantee moderate revenue and sharing risks

PPP Act Article 13 (Designation of Concessionaire)

(3) The competent authority shall designate a concessionaire by making a concession agreement with the potential concessionaire designated under paragraph (2), including the conditions for project implementation, such as the total project cost and the concession period. Matters regarding the designation of a concessionaire who meets the requirements determined by Presidential Decree shall undergo a prior deliberation by the Committee.

- Strengthen the responsibility of private partners and publicize PPP projects proactively at home and abroad

As a result of the government's measures to facilitate private investment, the PPP Act went through an overall amendment in 1999. The revised act stipulated that a concessionaire shall be designated by "making a concession agreement," thereby making clear that the parties involved are legally required to define the arrangement in a contract.

ESTABLISHMENT OF THE SC

It was widely pointed out that the previous concession agreements had brought about distrust from domestic/international investors, particularly financial organizations, as the agreements failed to meet international norms and to clarify rights and obligations of the parties concerned, risk management methods, and more. There were no established criteria for the competent authority's reasonable allocation of demand risk, compensation in case of early termination, and stability of contracts over a long period of time.

The establishment and promulgation of the standardized PPP contract, therefore, was included in the government's measures to facilitate private investment in 1998.

In 2006, an SC draft was drawn up by KDI PIMAC that addressed the issues raised during actual negotiations. At last, the draft SC for the BTO user-pays model was made public for the first time in 2007. After several rounds of revisions that incorporated legal amendments, the SC took its current form.

PURPOSES AND FUNCTIONS OF THE SC

As outlined by KDI PIMAC (2006), the purposes of the SC are as follows:

- Swift implementation of projects by, for instance, shortening the negotiation period

- Eliminating disputes regarding matters that do not require consultation during negotiation
- Enhancing policy credibility and increasing the private sector's predictability by declaring the SC
- Inducing responsible decision-making by the people in charge

The SC contributes to enhancing the predictability of a project by stage and shortening the period needed for negotiations. In addition, it serves as one of the key reference points in the review process of a concession agreement. The predictability of contractual terms has been increased as the competent authority may, when notifying the request for proposal (RFP), append individual contractual terms which were written on the basis of the SC.

Moreover, during the negotiation process, the concession agreement is concluded generally based on the SC while also reflecting the points and issues specific to each distinctive project; the process for negotiation, therefore, is shortened. Even though there is no empirical confirmation, the period for negotiation on contractual terms is assumed to have been reduced. (Comparisons of overall negotiation periods may be imprecise as negotiations require consultations not merely on contractual terms but also on various procedures, costs, rate of return, etc.)

The PPP Basic Plan, a general guideline for competent authorities within the government,

PPP Basic Plan Article 71 (Attachment of Draft Concession Agreement)

The competent authority may draw up a draft concession agreement which includes terms for project implementation, such as management and operation and risk allocation of the project, by referencing the draft standard concession agreement prepared and promulgated by the Executive Director of the Public and Private Infrastructure Investment Management Center, and may attach the draft concession agreement when notifying the RFP.

PPP Basic Plan Article 86 (Review on Draft Concession Agreement by Public and Private Infrastructure Investment Management Center)

1. The competent authority shall request a review of the draft concession agreement from the Executive Director of the Public and Private Infrastructure Investment Management Center before the conclusion of a concession agreement. Provided that a project is not subject to the review of the Review Committee pursuant to Article 38, the review may be commissioned to a specialized organization. The competent authority shall cooperate with the specialized organization upon its request to submit documents (including financial model) necessary for the review.
2. The Executive Director of the Public and Private Infrastructure Investment Management Center or the specialized organization requested to review the project pursuant to paragraph (1) shall reply to the competent authority after examining whether the review is in accordance with relevant legislation, the PPP Basic Plan, the Detailed Guidelines, etc. within 30 days from the date of request unless there is a particular reason.
3. Notwithstanding paragraph (1), if the competent authority requests that the Executive Director of the Public and Private Infrastructure Investment Management Center carry out negotiations for the conclusion of or amendment to a concession agreement, the procedures for advice and review by the Executive Director of the Public and Private Infrastructure Investment Management Center may be omitted.

states that the competent authority shall request a review of the draft concession agreement from a specialized organization before concluding the concession agreement. KDI PIMAC conducts reviews on projects whose expense is larger than a set amount or which require government subsidies greater than a specific sum. In the review process, the SC functions as one of the key reference points for judging the fairness of contractual terms, particularly whether it is disadvantageous to the competent authority.

TYPES OF SC AND ITS DRAFTSMAN

The SC is written and promulgated by KDI PIMAC through consultation with the MOEF. The PPP Act

does not directly stipulate the drafting of the SC. The PPP Basic Plan (announced by the MOEF) mandates PIMAC to prepare and announce the implementation guidelines by task so as to maintain transparency and objectiveness of PPP projects and to carry out supportive works for PPPs. The SC is incorporated within the implementation guidelines.

There are three types of SC: BTO project in the road sector, BTO project in the environment sector, and BTL project. Because BTO and BTL are the most common PPP models in Korea, the SC was prepared for these models. Unique standards are being prepared for the road and environmental sectors because the level of performance of the concessionaire and the method of payment of user fees should be differentiated.

TABLE 3  Types of SC

Type	Sector	Major facility
BTO	Road	Highway
	Environment	Waste disposal, sewage treatment plant
BTL	None (common application)	National hospital, university dormitory, elementary school, military family housing

CHARACTERISTICS OF THE SC

The contractual terms and conditions in PPP projects are very complicated in that the PPP contracts need to last for a long time, up to 50 years. Also, PPP contractual terms need to cover the various aspects of design, construction, and operation of infrastructure as well as financial arrangements. The SC covers all aspects of PPP projects, as seen from the main table of contents of the SC for BTO projects included here (see the Annex for a more detailed overview of the contents of the SCs for BTO and BTL):

- Chapter 1: General Rules
- Chapter 2: Basic Agreements
- Chapter 3: Decision and Adjustment of Total Project Cost
- Chapter 4: Procurement and Injection of Financial Resources
- Chapter 5: Matters Regarding Design and Construction
- Chapter 6: Matters Regarding Management and Operation
- Chapter 7: Rate of Return and User Fees
- Chapter 8: Support from Competent Authority
- Chapter 9: Matters Regarding Risk Allocation
- Chapter 10: Termination of Agreement
- Chapter 11: Disposition of Rights and Refinancing
- Chapter 12: Resolution of Disputes
- Chapter 13: Other Matters

If these contractual terms and conditions are not consistent among the competent authorities, the contract management would tend to be vulnerable. The SC is a key factor to manage PPP contracts within the ministries.

The SC plays a key role in carrying through the policy goal. The SC reflects a substantial part of the PPP Basic Plan. Because the SC follows the PPP Basic Plan and updates according to the PPP Basic Plan, the SC serves to enhance policy conformity. The PPP Basic Plan specifically provides

standard contractual terms that are included in the SC (e.g., minimum equity ratio, procedure to change investors, refinancing scope, reasons for adjusting total project cost, general principles for risk allocation, etc.). In addition, the Basic Plan offers guidelines—reflected in the SC—for issues that are often raised at a working level but have not yet been dealt with in laws or decree.

THE MAIN CLAUSES IN THE STANDARDIZED CONTRACT THAT ADDRESS PROJECT RISKS

In both BTO and BTL models, construction and operation risks are basically borne by the concessionaire. It is agreed that construction of facilities shall be completed within the given construction period and fixed construction cost, and the concessionaire will take responsibility of operation, including the management of the facilities, within the confirmed operating cost during the operation period.

However, the SC provides for the competent authority to share the cost overrun risk by allowing user fees to be adjusted in certain circumstances (see Table 4). In this situation, the concessionaire may request that the competent authority allow the fixed total project cost to be increased so that the concessionaire can recoup the increased cost.

The SC provides the reasons, procedure, and effects of adjusting terms of a project confirmed by a concession agreement as shown in Tables 4 and 5.

Except for force majeure, these provisions of adjustment of total project cost and adjustment of operating cost are the main adjustment or compensation clauses to coordinate risk sharing between the concerned parties during the project. For the concessionaire, this provision could be a way to rebalance the contract in coping with the change of circumstances. The PPP Basic Plan prescribes the reasons by policy in advance, and the SC repeats the provision as is.

If the parties to the agreement have a consultation and agree that the situation corresponds to one of the reasons for adjusting total project cost (or operating cost), the effects of such

TABLE 4 Events for Adjustment of Costs in SC

Event for adjustment of total project cost	<ol style="list-style-type: none"> 1. If there is a change in construction cost, significantly higher or lower than price fluctuation rates during the construction period; 2. If the total project cost increases or decreases due to the competent authority's fault or a force majeure event; 3. If the total project cost increases or decreases due to the enactment or amendment of an Act or subordinate statute, or specifications that may directly affect construction cost, the design standards established by the Government, or design rules or guidelines (including design standards of the Korea Highway Corporation); 4. If the total project cost is increased or decreased with the competent authority's authorization in response to an environmental or traffic impact assessment, a request by an authorizing or permitting authority, consultation with a local government, or any civil petition; 5. If the total project cost is increased or decreased in response to the competent authority's demand.
Event for adjustment of total operating cost	<ol style="list-style-type: none"> 1. Where an Act, subordinate statute, or regulation related to the maintenance, repairing, operation, and management of facilities under this project is amended or the Government's policy is changed; 2. Where an increase or a decrease is caused by a change in the total project cost under paragraph (1) of Article 13 (Amendment of Total Project Cost) or the compliance with a demand from the competent authority; 3. Where the operating cost increases due to any other event recognized by the competent authority or an occurrence of a force majeure event.

TABLE 5 Change (Adjustment) of Project Terms

	Procedure	Effects
Change in Total Project Cost	<ul style="list-style-type: none"> • Occurrence of one of the reasons for change → Consultation between the parties to the agreement • The grounds for calculation of the adjusted amount should be confirmed by a specialized institution and approved by the competent authority. 	<ul style="list-style-type: none"> • Adjustment of construction subsidy, user fees, or the period for management and operation right (operation period) • Extension or reduction of construction period (Article 20 (2) of the SC)
Change in Operating Cost	<ul style="list-style-type: none"> • Occurrence of one of the reasons for change → Consultation between the parties to the agreement • Submission of the related documents at the request of the concessionaire → Approval from the competent authority 	<ul style="list-style-type: none"> • Adjustment of construction subsidy, user fees, or the period for management and operation right (operation period)

change will be demonstrated mainly through user-fee change in a financial model. In the case of an increase in total project cost, for instance, it is typical for both parties to agree on raising user fees, which commonly entails a combination of increase in construction subsidy and extension of the period for management and operation right.

IMPACT OF THE SC

The SC has a tremendous impact at a working level for a number of reasons. First, because the SC reflects a substantial part of the PPP Basic Plan, which itself has significant influence, it is widely accepted as one of the general standards of PPPs.

Second, the SC is highly influential due to the fact that it is utilized in each stage of the project. Because the competent authority should request that the MOEF-affiliated review committee evaluate individual contracts to be executed, the SC is used as an important reference to scrutinize whether the individual contract is properly written. Just as all other standardization has strengths and weaknesses, the powerful influence of the SC has brought about the positive outcome of ensuring coherence in contractual terms as well as exposing limitations, such as a certain amount of rigidity.

The SC also has a significant impact on individual PPP projects in areas such as the negotiation and review processes, as described below.

The SC's impact on negotiation

Under Korea's negotiation practice, the negotiation phase is the final stage for the competent authority to set the project conditions. Because unsolicited projects have been actively implemented in Korea, the role of setting project conditions more favorable to the government is more significant. In unsolicited projects, the private party proposed project conditions at the project selection stage. The government needs to scrutinize the project conditions before executing the contract through the negotiation stage.

From the private party's point of view, the negotiation results are enforceable and fixed during the entire project period and there is little likelihood of renegotiation. Because of this inflexibility of contractual terms, the parties often have a difficult tug-of-war over the project conditions. For example, the competent authority may seek lower fiscal burden or lower user fees while the potential concessionaire may pursue a high return on the project.

The negotiation team consists of the working-level and principal members from both the competent authority and the preferred concessionaire as well as outside experts as aides to the respective party. The working-level meetings focus on project condition details and are

held periodically on the specific terms (i.e., demand, cost, project IRR, user fee, contract period). After the working-level meetings finish, the principals from both sides meet and sign based on the results from the working-level discussion. Due to this time-consuming process, in most cases it tends to take a year or longer to sign the PPP contract. The parties can save time by making use of the SC in finalizing their own contract.

The SC provides the basic allocation of risks and sets out the relevant wording of the entire project. Once the negotiated outcome and the financial model have been finalized, the time to arrive at the signing of the agreement is shortened because the rest of the contract clauses just follow the SC.

The following case study will outline how use of the SC improved the negotiation process for a recently concluded road project.

Case study: Pyeongtaek, Buyeo, and Iksan Expressway

The express highway linking Pyeongtaek, Buyeo, and Iksan is the longest (total length of 138.3 km) among the roads constructed as PPP projects. The overview and timeline of the project is as follows:

- Project name: PPP project for the express highway linking Pyeongtaek, Buyeo, and Iksan (Seobu Naeryuk [west inland] highway)
- Project type: User-pays BTO
- Competent authority: Minister of Land, Infrastructure, and Transport
- Operation period: Stage 1: 40 years, Stage 2: 30 years²
- VFM test completion: November 2014
- Notice of RFP: December 2014
- Designation of potential concessionaire: May 2015

² The second stage of construction is scheduled to begin 10 years after the date of the commencement of the first stage.

TABLE 6 Contents of Negotiation for the Pyeongtaek, Buyeo, and Iksan Express Highway

Item	Contents
Demand risk	Borne by the concessionaire (same as the SC)
Land purchase and acquisition risk	Borne by the competent authority (same as the SC)
Reasons and payment of early termination	The reasons and procedure for early termination and the calculation standard for early termination payment are identical to those of the SC.
Handling of force majeure	Same as the SC (The concessionaires are entitled to be compensated 80% or 90% of additionally incurred costs.)
Cost overrun risk	Same as the SC (The concession agreement provides more detail.) <ul style="list-style-type: none"> Newly inserted as the reasons for adjusting total project cost are the cases that the competent authority requests construction or alteration of an interchange or junction or that taxes and the public utilities' charge increase/decrease due to a reason not imputable to the concessionaire.
Refinancing	Same as the SC and the PPP Basic Plan
User fees	Same as the SC (The concession agreement provides more detail.) <ul style="list-style-type: none"> The difference between initial toll charges determined in the concession agreement and the actual toll charges confirmed at the time of operation commencement will be reflected by adjusting future toll charges. Any decrease in toll revenues due to tax reduction/exemption vehicles or discount of toll charges pursuant to the laws relevant at the time of the RFP notification will not be financially supported.
Others	If the competent authority decides to implement a One Tolling System or Smart Tolling System, the concessionaire will abide by the decision and the total project cost and operating cost for the project will be adjusted accordingly.

- Negotiation: May 2015 to November 2016
- Concession agreement finalized: February 2017

Negotiations were held over 1.5 years, comparatively shorter than typical road projects. A total of 28 rounds of working-level meetings were held for this road project, and negotiations on the wording of the concession agreement were carried out in seven working-group meetings. Even though details of the project conditions were negotiated in these working-level meetings, the contract wording followed that of the SC. Without the SC, the competent authority would have hesitated to arrange and sign the individual contract. Shortening the time for wording of the contract reduced the negotiation time.

The SC's impact on the review process

The SC is also being utilized in the review process of each concession agreement. Concession agreements cover many issues and the review result may vary depending on the point of view. If reviewers did not have criteria for concession agreements, the review results could lose trust. The SC is stipulated to conform to government policy by statutory organization so that it can provide criteria for reviewing whether the individual contract conforms to any given rule or principle.

When a concession agreement for a project is concluded through negotiation, the competent authority requests a review from PIMAC. This is a mandatory process for large-scale projects, and even in the case of a small- or medium-scale

project PIMAC may review the contract at the request of the competent authority.

In the review process, PIMAC mainly examines whether the provisions of a concession agreement are in accordance with those of the SC. If any provisions are different from the SC, PIMAC offers its opinion on them. If the provisions prescribed different from the SC are disproportionately advantageous or disadvantageous to either party to an agreement, PIMAC recommends rectification of such provisions.

Based on the review opinion of PIMAC, the competent authority may exert its effort to improve the concession agreement. By having the individual contract reviewed against the SC before signing the contract, the competent authority has an opportunity to learn whether the individual contract may cause greater legal and fiscal risks than the standardized risk allocation principles under the SC.

The following case study shows the impact of PIMAC's review of the concession agreement for a particular PPP project.

Case study: Dongbuk Light Railway

In the case of the Dongbuk Light Railway urban transit project, the competent authority (Seoul Metropolitan City) requested that PIMAC review the (draft) concession agreement, negotiation of which had been completed with the concessionaire. After reviewing the draft concession agreement and annexed financial model,

PIMAC mainly recommended rectification of the following provisions prescribed different from the SC:

- As to the provisions regarding civil petitions, handling of all civil petitions is prescribed as the concessionaire's responsibility; this may impose an excessive burden on the concessionaire.
- There is a high probability of contention in the future as (i) the concession agreement does not provide specific procedures for determining toll charges and (ii) the provision on the competent authority's financial support in case a toll increase is not carried out in a timely manner remains obscure.
- The provisions stipulating that renegotiation is required if the competent authority changes the policy on toll charges, etc. weaken the concession agreement's binding force.

In this case, the competent authority did not fully accept PIMAC's recommendations. Instead, the competent authority explained to the committee members why they used contract clauses that were different from those in the SC. The specific provisions of the contract took into account the experience and policy decisions acquired in the negotiation and construction of previous projects, particularly in enhancing the competent authority's policy decision on charges.



Overview of PPP in LAC

In order to understand the implications of Korea's PPP case for LAC countries, it is necessary to look at the LAC countries' legal and institutional foundations for PPP. Depending on the legal and institutional foundations for PPP, the implications of the Korean approach to PPP may differ.

LEGAL AND INSTITUTIONAL FRAMEWORKS FOR PPPs IN LAC

In a general sense, there is a difference between the civil law system and the common law system in adopting public contracts and establishing the legislative and policy framework for PPPs.

Typical common law countries, such as the United Kingdom and Australia, have well-established PPP schemes without needing special legislation to recognize long-term PPP contracts because public contracts should be treated the same as commercial contracts without conflicting with the general law or principles. Thus, policy documents alone cannot hinder the full protection of PPP contracts, which are legally binding.

On the other hand, in civil law countries, public contracts including PPP contracts are recognized under the administrative law. The underlying principle of the administrative law may cause the

competent authority to be entitled to cancel or unilaterally adjust a public contract under the pretext of protecting the public interest.

These differences in countries' legal systems tend to lead countries to adopt different approaches to establishing the PPP framework. Countries with a civil law system are more likely to enact the PPP statute and detailed legislative and regulative measures for creating the enabling environment for PPPs.

Also, the different legal traditions interact with different PPP types. Table 7 shows the evolution of PPP payment types in both civil law and common law countries. Civil law countries have used concession contracts and similar arrangements for the private provision of public services for over 200 years. In contrast, most common law countries do not have a tradition of concession contracts, instead using fully private ("investor-owned") companies to provide infrastructure services, generally under government regulation.

Considering the above-stated differences in the legal systems surrounding PPPs, it is necessary to identify the legal systems of each country in order to then draw some implications and lessons from the other country's PPP frameworks. Korea's PPP frameworks developed under the civil law system can give meaningful implications especially to LAC countries that also have a civil law system.

TABLE 7 Legal Traditions and PPP Types in Civil and Common Law Countries

Legal tradition (PPP types)	Civil law	Common law
User-pays PPPs (concessions and similar contracts)	Historically France, Spain, and other civil law jurisdictions	Later development of the framework
Government-pays PPPs (PFI-style contracts)	Later development of the framework	Historically UK and Australia

Source: APMG (2016b).

Note: PFI refers to public finance initiative.

To the best of our knowledge from the available resources, most LAC countries have adopted the civil law system except some English-speaking Caribbean countries that follow the common law system (Garcia-Kilroy and Rudolph, 2017). It is also recognized that many countries in LAC have unique statutes to be applied to PPP infrastructure projects.

FLEXIBILITY OF PPP CONTRACTS

A PPP contract is a long-term agreement which includes risk allocation and risk sharing between the parties. Since the PPP contract entails a long-term relationship between the parties and contractual terms, there might be conflicting views on whether a flexible or fixed contractual arrangement is advisable.

On the one hand, the fixed contractual agreement, where renegotiation or adjustment of contract terms is strictly limited, may be advisable because the fixed terms may secure the stability during the contract period. Furthermore, if the VFM is realized during the initial project identification stage, the VFM could be sustained through the project period through the fixed contractual conditions and terms.

On the other hand, the flexible contractual arrangement may enhance situational adaptability. Economic, political, and financial circumstances surrounding PPP projects tend to require the long-term relationship to be adjusted accordingly. Obviously, Latin American countries' experiences show that PPP contracts are very likely to be subject to renegotiations.

Table 9 shows that the majority of total projects with data in LAC have been renegotiated, and that the number of renegotiation events is markedly large in comparison with other regions.

It is notable that the majority of these renegotiations have been initiated by the private party due to events that significantly unbalance the financial equilibrium and for the purpose of seeking to maximize the net present value of the PPP contract (Guasch et al., 2014).

In considering the lessons learned from the frequent renegotiations and its fiscal side effects, LAC countries were motivated to introduce key changes in the PPP legislation (Peru in 2008, Chile in 2010, Colombia in 2011, and Mexico in 2012).

In Chile, the Concessions Law of 2010 provided the manner in which Chilean concessions are amended. According to the law, in exceptional circumstances and only in the construction phase in which variation exceeds 25 percent of the capital budget, the amendment agreement must be approved by the Ministry of Public Works and the Ministry of Finance.

Conditions for the amendment include that the facts and circumstances giving rise to the amendment occur after the awarding of the concession, and could not have been foreseen upon its awarding and that—for reasons including expertise, behavior, performance, social and environmental impacts, management economies, or economies of scale—awarding the new works to the original concession holder is more efficient than granting a new concession. (APMG, 2016a).

TABLE 8 Examples of PPP Law and Contract Type in LAC Region

Country	PPP law	Contract type
Brazil	Law 8987 of 1995, on the Concessions Regime and the Provision of Public Services in Art. 175 of the Federal Constitution (Lei No. 8987, Dispõe Sobre o Regime de Concessão e Permissão da Prestação de Serviços Públicos Previsto no Art. 175 da Constituição Federal, e dá Outras Providências)	<p>Only two types of contracts will be considered PPPs in Brazil: (i) sponsored and (ii) administrative concessions. Concessions not requiring government transfers are not considered PPPs in Brazil.</p> <p>The law also states that the concession must be at least five years long to be considered a PPP.</p> <p>The contract has a minimum term of 5 years and a maximum term of 35 years.</p>
Chile	No. 20410 of January 20, 2010, the Law of Public Works Concessions (Ley de Concesiones de Obras Públicas, Ley No. 20410) → Chile extended its Concession Law to include government-pays PPPs	The law specifies a maximum duration for concession contracts of 50 years.
Colombia	<ul style="list-style-type: none"> In 2012: Law No. 1508 establishes the legal regime of Public Private Partnerships and enacts organic budget laws and other provisions In 2013: Law No. 1682 of 2013 In 2015: Law No. 1082 of 2015 adopts a unique law for the administrative national planning sector. These laws specify, among other issues, that Act No. 80, the General Public Acquisitions Act, applies to PPP contracts. 	<p>PPP contracts must always make the private investor responsible for operation and management and must be for less than 30 years (if the project is longer, it will require approval from the National Council on Economic and Social Policy).</p> <p>PPPs must have a minimum estimated investment of USD1.5m.</p>
Mexico	<ul style="list-style-type: none"> In 2012: Mexico approved a new Law on Public-Private Partnerships (Ley de Asociaciones Público Privadas [APP]), followed by a new regulatory framework (Reglamento de la Ley de Asociaciones Público Privadas). 	The first government-pays PPPs in Mexico were called <i>proyectos de prestación de servicios</i> or service provision projects (PPS) and had to rely on two regulations (i.e., the concession regulations to grant the title to operate the asset economically and the leasing law [Arrendamientos]) since the concession contract as established did not contemplate the service payments as a revenue or compensation form to the private partner. APP legislation (both at federal government and state level) has solved this issue.

Source: APMG (2016c).

TABLE 9 Prevalence of Renegotiation by Region, Based on 146 Projects

Region	Projects with data	Renegotiation events	Percentage
East Asia	17	2	12
Europe	43	12	28
Latin America and the Caribbean	43	25	58
Middle East and North Africa	8	1	13
North America	5	2	40
South Asia	14	5	36
South East Asia	8	1	13
Total	146	48	33

TABLE 10  PPP Type in Brazilian PPP Law

Sponsored concession	Administrative concession
The sponsored concession combines payments from the government and tariffs from end users. For instance, this type of concession is commonplace for toll road projects that are not able to fully pay back the investments with tariffs from end users, and sanitation.	The administrative concession serves to enable the delegation of public services or essential infrastructure for the provision of such services without the payment of tariffs. For instance, this type of concession is commonplace for public lighting projects, where the concessionaire is responsible for the operation, upkeep, and expansion of public lighting points without receiving any tariff from end users. Therefore, the concessionaire receives payment exclusively from the government.

Source: Freire, Sombra, and Dias dos Santos Neto (2020).

The new regulations set up a freeze for renegotiations for the first three or more years; clarify risk allocation, compensations, and rate of return; and state that any contract modification cannot alter the risk allocation matrix, etc. (Guasch et al., 2014).

PAYMENT TYPE IN PPP PROJECTS

In LAC countries with PPP experience, the payment types in PPP projects encompass both user-pays and government-pays models.

In Brazil, the Brazilian PPP law provides user-pays type as “sponsored concession” and government-pays type as “administrative concession.”

In Colombia, the PPP payment types under the Colombian PPP law range from user-pays type to government-pays type based on the following resources: “Concessionaire’s Remuneration comprises three things: government payments aimed at remunerating construction of the infrastructure; tolls; and commercial exploitation income of certain surrounding road areas (e.g., petrol stations, restaurants, hotels). On average, government payments will represent 40–70 percent of the total remuneration, and the remaining 60–30 percent will come from tolls and commercial income. Upon a concessionaire’s request, government payments may be denominated in US dollars, in which case the concessionaire’s remuneration will be a combination of income denominated in dollars and income

denominated in Colombian pesos” (Oxford Business Group, 2016).

In Mexico, the legal framework has provided the comprehensive PPP payment types. The PPP legal framework applies to projects that involve a long-term contractual relationship between public and private sector entities for the provision of public services to the public sector, intermediaries, or the end user, utilizing infrastructure provided, partially or totally, by the private sector. Under this legal framework, a number of types of PPP have been developed, as seen in Table 11 (Mexico Project Hub, 2020).

KEY RISK ALLOCATION EXAMPLES IN LAC COUNTRIES

A closer look at the legal and institutional frameworks in LAC countries tells us that the countries have already learned many lessons from formulating principles for reasonable key risk sharing and establishing institutions. It seems that the key risk allocation principles and mechanisms for reasonable sharing of public and private risks are being declared in LAC countries. In particular, the evolution of the demand risk sharing mechanism seen in Chile is quite pioneering.

Demand risk

In Chile, to mitigate the private party’s demand risk, the Chilean government devised three mitigation

TABLE 11  PPP Types in Mexico

Concessions	The private sector builds and operates a project. Generally, the investment is recovered through the fees paid by the project's users. This scheme is used mainly for roads, ports, and airports.
Financed Public Works	The private developer invests in a project, and once it is constructed, the public entity pays back the total investment. It is generally used in the electric sector.
Joint Ventures	Particular risk-sharing schemes, mainly for the hydrocarbon sector
PPP Contracts	Long-term contracts through which the private developer utilizes, partially or totally, infrastructure for the provision of public services. The public sector pays monetary consideration to the developer for these services. This scheme is mainly used for hospitals, road maintenance, penitentiary centers, and hydraulic infrastructure.

Source: Mexico Project Hub (2020).

mechanisms: Minimum Income Guarantee (MIG), Least Present Value of the Revenues (LPVR), and Revenue Distribution Mechanism (RDM).

Termination risk

In Colombia, upon early termination of the concession contract, a liquidation formula will apply

to calculate the termination payment for the relevant project. That payment is aimed at remunerating, in general terms, the invested capex (less fines and unpaid deductions). The government has insisted that termination payments for projects be sufficient to cover any outstanding debt of the concessionaire at any time during the life

Traffic Risk Mitigation in Highway Concession Projects: The Experience of Chile

- **Minimum Income Guarantee (MIG) mechanism**
Designed to mitigate risk and lower projects' financial costs through covering up to 70 percent of the investment cost as well as the operation and maintenance costs.
A lower band is defined every year, which triggers compensation if real revenues fall below. Similarly, if traffic is higher than the expected level, the private partners have the obligation to share the benefits—the obligation can be triggered if the IRR exceeds 15 percent in a given year or if the revenues are above a pre-defined level.
- **The Least Present Value of the Revenues (LPVR)**
The government is granting the concession for an infrastructure project to the bidder that requires the lowest Net Present Value (NPV) to cover its cost. This system reduces the likelihood of the renegotiation of the concession terms.
- **Revenue Distribution Mechanism (RDM)**
Guarantees that a pre-fixed amount of revenues—in present value—will be received by the concessionaire. Thus the duration of the renegotiated concession turns from being fixed to being variable. RDM causes the concession to finish earlier if average traffic growth is ultimately higher than the guaranteed level. If that happens, the concessionaire will ultimately fare worse than it would have if it had not obtained the RDM guarantee.
If the average traffic growth is ultimately the same as the guaranteed level, the concession will end in the year initially fixed.
If the average traffic growth turns out ultimately to be as forecast, the concession contract will expire some years later than the term originally established in the contract.

Source: Vassallo (2006).

of the project, even if the contracts are terminated beforehand due to an event attributable to those contractors. Obviously, each lending institution involved in a project will have to make its own financial analysis to check if, based on the debt-to-equity ratios of the relevant base case, the formula is sufficiently robust (Oxford Business Group, 2016).

Force majeure

In Brazil, recently, concession agreements have been establishing conditions for friendly rescission. For instance, the state of São Paulo's Piracicaba-Panorama Road Concession Project establishes that the concessionaire's failure to obtain long-term financing within 24 months, or force majeure events that compromise the operation of services, allows the concessionaire and the government to negotiate the agreement's extinction (Freire, Sombra, and Dias dos Santos Neto, 2020).



Implications and Lessons Learned

As stated earlier in “Overview of PPP in LAC,” we determined that there is a similar legal and institutional framework in Korea and LAC countries. As a result, the Korean SC experience could provide significant implications to LAC countries with a civil law system as well.

In Korea, where the civil law system takes effect, the SC has made a significant contribution to strengthening the stability of PPP contracts and creating an enabling environment for risk allocation agreement. It is expected that the use of a standardized PPP contract would be of great use in LAC countries

Also, we recognized during the course of this work some leading practices in LAC countries. The evolution of demand risk sharing in Chile, for example, would provide good implication to Korea.

ADVANTAGES OF THE SC

The SC may be able to facilitate the negotiation process by relieving the responsibility of public officials.

The standardized PPP contract provides the standard risk allocation model—that is, when the

government should compensate, how much early termination payment is paid, and how the government should mitigate the revenue risk of private sector. The standard financial model is also published to reflect all the financial terms and conditions. By citing this standardized model, the negotiating officials in the line ministries are able to establish the contract terms and risk allocation principles without having to use their own discretion. Without this standardized model, public officials may hesitate in negotiating these key risk allocation clauses due to the political responsibility that may result from the fiscal liability of the PPP risk sharing measures.

If the standardized contract is approved by influential ministry within the government, the reliability and trust from line ministries could be highly enhanced.

Even though the standardized PPP contract in Korea is prepared by KDI PIMAC, which is the statutory independent PPP unit, MOEF approves the standardized risk allocation principles and the standardized PPP contract. The MOEF has powerful influence on line ministries in that the MOEF is responsible for budget and finance.

The implications of Korea's case for LAC are as follows:

1. The PPP policy department announces the risk allocation frameworks to the market by announcing the policy direction in a timely manner.
2. The PPP unit or PPP specialized agency shall prepare and supplement standardized contracts to conform to the policy of the policy department.
3. The competent authority shall ensure consistency among individual projects by utilizing standard agreements approved by policy departments in negotiating and contracting individual infrastructure projects.

A standardized contract helps to elicit the private party's trust.

The private partners in PPP place the top priority in making an investment decision on whether return on their investment is sustained in a stable manner. They also first consider the safeguards in place to protect their investment even if unforeseen circumstances arise. Having all major risk allocation measures pre-announced through a standardized contract can elicit trust from the private party.

Private partners encompass contractors for construction and operation as well as financial investors. The private party can identify the risk allocation principles in advance because the standardized contract provides all provisions relating to construction, operation, force majeure, and termination confirmed within the legal framework and policy direction.

To the contractors for construction, the provisions of the standardized contract that may relieve concerns regarding risks of land acquisition, construction, force majeure, or early termination are meaningful. From the perspective of the contractors for operation and financial investors, confidence in securing stable revenues during the operation period and recouping investment in the case of early termination is of great importance. Therefore, the measures to mitigate demand risk and the force majeure or early termination of

a project should be a primary consideration. From the lenders' point of view, the security or collaterals which the private party may set without the competent authority's interference is a main concern. The standardized contract provides that the competent authority consents to the concessionaire's provision of collateral to lenders. The full contract clauses which encompass the PPP risk allocation measures during the PPP project cycle could be a gesture of welcome to private investors.

LESSONS LEARNED: RECOMMENDATIONS TO LAC

Recommendation #1: The strong legal and policy framework for risk allocation could enhance the reliability of the SC.

The experience of the Korean SC framework can provide lessons and implications particularly to the LAC countries that have similar legal systems to Korea. The legal system surrounding the PPP contract is directly related to how binding the agreement of key risk allocation is, which should be a core of the SC. In such countries where a negotiation-based contract between authority and private sector may not be wholly protected, like civil law countries, the SC affirmed by strong legal and policy framework could be a fundamental lesson from Korean experience.

If the risk allocation principle, which is the core of the SC, complies with the legal and policy framework, the contracting parties would readily adopt the standardized contract.

Some risk allocation principles need to be handled with great care as to whether they are acceptable within the legal environment. Some risk allocation principles need to be confirmed and declared by the influential ministry within the government. The institutional and legal framework for land acquisition and revenue risk are good examples in handling key risks in Korea.

Firm legal basis for land acquisition risk

Land acquisition risk is a key risk which private partners encounter in economic infrastructure

(toll roads and railway). Also, even in social infrastructure which is built in the designated area, normally within publicly owned land, the land acquisition cost could be a barrier to a private partner. If the competent authority doesn't take this risk, the private partner is not able to handle the risk due to their weak land expropriation right.

The legal framework has been established so as to allow the competent authority to provide the publicly owned property for free to the private partner for PPP projects where the ownership is transferred to the competent authority. Also, the private party is entitled to take the privately owned land under the PPP Act. If the private partner wants to entrust its land expropriation right to the competent authority, the competent authority may take the privately owned land for the sake of the private partner as a trustee. The authority's risk taking in land acquisition under the legal framework is not a target of negotiation. The standardized contract need not articulate a different scheme.

The role of policy framework for the SC

The risk allocation in demand or revenue risk is an example of a powerful policy framework for the standardized contract.

Demand risk is a key risk in the user-pays PPP (concession) model. The private partners are keen to make sure the revenue is guaranteed up to their investment and expected rate of return. On the other hand, the public authorities' concern is that the guarantee of future revenue could lead to a fiscal burden on the government or could result in a higher user fee.

Strong policy direction for mitigation of demand risk is required so that both parties can rely on it. The MOEF in Korea plays the role of coming up with a compromise for both competent authority and private partner. Through the announcement of the PPP Basic Plan, the MOEF has declared some major risk sharing methods for user-pays PPP.

Once these risk-sharing devices are established in a policy direction, the risk sharing method is reflected in the PPP contracts. Without

this policy direction, it is very difficult to devise a unique demand risk sharing in the standardized contract. Also, it is highly unlikely that the parties would accept the unapproved risk allocation principles.

Another example of strong policy framework can be found in articulating the early termination compensation criteria.

The PPP Basic Plan provides the early termination payment calculation method. Because the MOEF has a budget allocation and financing power, these criteria could be binding to the competent authority. The standardized contract also follows the same approach as the PPP Basic Plan. In an individual negotiation, there is not much room for a different scheme.

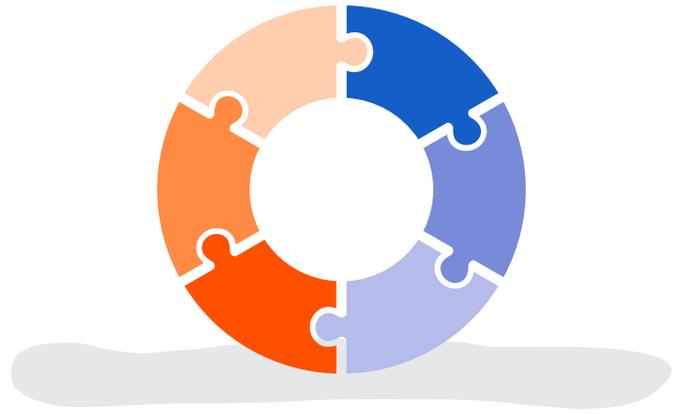
Recommendation #2: The establishment of a PPP unit could promote the standardization of PPP contracts.

A standardized PPP contract encompasses various aspects of PPP projects. Construction, operation, and financing issues as well as legal aspects are all incorporated into the contract. Professionals from the technology, financing, and legal fields can play a key role in producing a standardized contract and financial model.

PPP contracts continue to be managed for a long-term period. Because new issues continue to be raised through contract management, the standardization of a PPP contract is not a one-off project; it needs constant updates and management to incorporate these new issues.

It's also important to note that public officials in the line ministry or budget ministry are subject to personnel transfers, which means they may not be fully specialized in PPP contracts, whereas the professionals in a PPP unit tend to have a deep understanding of the PPP market.

All these factors highlight how an independent PPP unit which comprises experts from various sectors can play a key role in establishing and managing the standardized contract. If these experts work well with policymakers, the outcome will be a satisfying one for both the government and investors.



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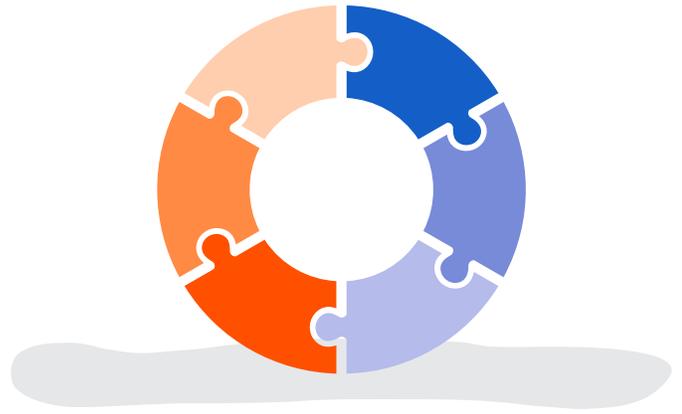
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Annex: Details of the Standardized Contract

This annex briefly outlines the contents of the SCs for BTO and BTL. As stated earlier, the BTO type is generally referred to as a user-pays type while BTL type is government-pays type in Korea.

CONTENTS OF THE SC FOR BTO

Chapter 1: General Rules

Chapter 1 elucidates the purpose and scope of a project, the size and scope of project facilities, and the implementation methods depending on characteristics of the project. For instance, if a project includes a supplementary/ancillary project, the contents of that project (e.g., an expressway service area) will also be specified.

The provisions with regard to the terminology, the principles of interpretation of the agreement, and the order of priority of documents are commonly applicable to all projects. Hence, they are not key points of contention during negotiations.

Chapter 2: Basic Agreements

Chapter 2 covers basic matters regarding a concessionaire's rights and obligations. The company

designated as the concessionaire of a project must establish a corporation for the implementation of the project before applying for approval of the detailed implementation plan. If the company fails to establish the corporation, the designation of concessionaire will cease to have effect. Such a strong consequence for noncompliance with this requirement is attributable to the PPP Act, which directly mandates the potential concessionaire to set up a corporation before applying for approval of the detailed implementation plan (Article 14 (3) of the PPP Act). In addition, the concessionaire should secure a loan commitment as outlined in the detailed implementation plan and submit it to the competent authority before applying for approval of the detailed implementation plan.

The SC stipulates that the rights to design, construction, management and operation, and levying of user fees are accorded to the concessionaire. It also provides that the competent authority may approve the concessionaire to use any national and public property in an area designated for the project free of charge until the expiration date of the management and operation

Article 7 (Concessionaire's Rights)

(2) Unless the Concessionaire breaches this Agreement or this Agreement or any relevant Act or subordinate statute otherwise so provides, the competent authority shall not revoke, cancel, deprive of, or alter the qualification, authority, or rights of the Concessionaire under paragraph (1) during the period of this project.

right. This stipulation is founded upon the special provisions regarding the use of national and public property free of charge, which aims to facilitate implementation of projects, in the PPP Act (Article 19).

Moreover, general provisions to protect the rights of the concessionaire are also included in Chapter 2 of the SC.

The “period for the management and operation right” stipulated in the SC practically means the time given to the concessionaire to maintain and operate the relevant project facility. And the “management and operation right” signifies a “real right,” which is made into a law to better ensure the concessionaire’s right (contractual right), in exchange for design, construction, and management and operation of facilities by the concessionaire.

Chapter 3: Decision and Adjustment of Total Project Cost

Chapter 3 states the amount of the total project cost (consisting of the construction subsidy and the total private project cost) and the grounds for an exceptional adjustment of the total project cost. In principle, the total project cost decided in the concession agreement according to the PPP Act cannot be adjusted. It is allowed exceptionally through mutual consultation between the parties to the agreement based on the reasons defined in the concession agreement or when construction costs markedly exceed or fall short of the price fluctuation rate. The SC stipulates the reasons for an adjustment as follows:

Article 13 (Amendment of Total Project Cost)

(1) If deemed necessary to adjust the total project cost fixed in this Agreement because any of the following events has occurred, the total project cost may be amended by a mutual agreement between the parties;

1. If there is a change in construction cost, significantly higher or lower than price fluctuation rates during the construction period;
2. If the total project cost increases or decreases due to the competent authority’s fault or a force majeure event;
3. If the total project cost increases or decreases due to the enactment or amendment of an Act or subordinate statute, or specifications that may directly affect construction cost, the design standards established by the Government, or design rules or guidelines (including design standards of the Korea Highway Corporation);
4. If the total project cost is increased or decreased with the competent authority’s authorization in response to an environmental or traffic impact assessment, a request by an authorizing or permitting authority, consultation with a local government, or any civil petition;
5. If the total project cost is increased or decreased in response to the competent authority’s demand.

The SC provides that in the case of an adjustment of the total project cost through consultation between the parties to the agreement, the variations in the cost shall be reflected by adjusting the construction subsidy, the user fees, and the period for management and operation rights.

Chapter 4: Procurement and Injection of Financial Resources

Chapter 4 defines the minimum equity ratio and the timetable for equity/debt financing, both of which the concessionaire has to comply with.

Article 13 (Amendment of Total Project Cost)

(6) If the total project cost is amended in accordance with paragraph (1), the parties to the Agreement may request the adjustment of construction subsidies specified in Table X (Time Schedule for Payment of Construction Subsidies), and the competent authority shall pay construction subsidies as adjusted: Provided, That if it is concluded by the parties to the Agreement as a result of a review that it is possible to eliminate the cause at issue by an adjustment of user fees or an adjustment of the effective period of the right to manage and operate, the parties may adjust user fees or the effective period of the right to manage and operate by an agreement. In such cases, if the parties fail to reach an agreement on an amendment of the total project cost, the dispute shall be settled in accordance with the procedure for the dispute resolution in Chapter X.

Moreover, the concessionaire has to apply for approval of the detailed implementation plan and finance equity/debt in accordance with the financing plan of the concession agreement. In addition, Chapter 4 imposes certain obligations on the concessionaire so as to provide security to lenders. First, if the concessionaire intends to establish a security right of the management and operation right, it has to obtain prior approval from the competent authority. Second, when securing the financial arrangement (credit agreement), the concessionaire should include in the financial arrangement that consultation with the competent authority must take precedence in order for the creditor to exercise the right to collateral security.

Chapter 5: Matters Regarding Design and Construction

General requirements and cost-bearing

Chapter 5 includes matters mainly regarding project procedures during the construction period. After concluding the concession

agreement, the concessionaire has to prepare a design and obtain approval of the detailed implementation plan from the competent authority according to the PPP Act. In principle, if objects that may cause danger or hindrance are found during the construction period, the cost incurred should be borne by the concessionaire. Exceptionally, if the objects that may cause danger or hindrance are found unexpectedly in spite of the concessionaire's faithful fulfillment of the duty to take caution, the cost incurred shall be borne by the competent authority on the grounds of nonpolitical force majeure. If cultural assets are found within the project area, the cost incurred is reflected to the total project cost in principle. However, if the cost was foreseeable through a conventional and reasonable survey, only 80 percent of the cost incurred shall be borne by the competent authority on the grounds of nonpolitical force majeure.

Penalty on delay

Neither the Act nor the Enforcement Decree on Private Participation in Infrastructure specify compensation for delays. The PPP Basic Plan and the SC likewise provide that penalty on delay shall be calculated at the rate defined in the general law on public procurement.

Civil petition

In Korea, there are many cases of civil petitions filed against PPP projects before and after the conclusion of a concession agreement. In particular, road projects encounter various civil petitions such as opposition against the route of a project, request for additional construction or alteration of an interchange, or request for changing the construction method to reduce noise pollution. Particularly in road projects, a civil petition is one of the key risk factors for delaying a project. Therefore, the SC classifies the types of civil petition into (i) a petition that falls under the concessionaire's responsibility, the cost of which should be borne by the concessionaire, and (ii) a petition that is handled under the competent

authority's responsibility. It also stipulates the party responsible for each type of civil petition. Article 33 serves as a reference point for negotiations on cost-bearing between the parties to the concession agreement when additional expense (e.g., extra construction cost for noise control) is needed to handle a civil petition.

Chapter 6: Matters Regarding Management and Operation

In Chapter 6, the provisions and reasons for operating cost adjustments are most importantly dealt with at a working level. The SC allows the concessionaire's request to adjust operating cost only when the operating cost confirmed by the concession agreement "dramatically increases/decreases" owing to the reasons listed in the concession agreement. Other than that, if there are variations of corporate tax rate due to an amendment to the Corporate Tax Act, the party to the agreement may demand adjustments of user fees, operation period (period for the management and operation right), or subsidy.

Documents on the details for management and operation are drawn up by the concessionaire every year and then finalized in accordance with the management and operation plan confirmed by the competent authority. Among the documents, reports on the status of annual traffic volume, toll revenue, revenue and expenditure of ancillary projects, and operating performance must be submitted to the competent authority.

In addition, the SC states the methods for sharing profits from an ancillary/supplementary project with the competent authority.

Chapter 7: Rate of Return and User Fees

In Chapter 7, the provision on user fees is one of the most important considered during negotiations. Because user fees in BTO projects are the only (and major) way for the private sector to recoup its investment, the concessionaire naturally intends to increase user fees every year, fully reflecting the consumer price index (CPI).

Article 33 (Settlement of Civil Petitions)

(1) Civil petitions raised in relation to this project shall be classified as follows:

1. Civil petitions on the project: Civil petitions raised in relation to the purchase of, or the compensation for, the site for this project or an obstacle or civil petitions raised in response to a violation of a right or an interest of a third party, excluding civil petitions under subparagraph 2;
2. Civil petitions on construction or operation: Civil petitions raised directly in connection with construction works or operation of this project, such as noise, bad odor, vibration, dust, traffic hazard, or any other impact on the surrounding environment.

(2) The competent authority shall take responsibility for the settlement of civil petitions on the project.

(3) If a civil petition on the project, which is raised in connection with the implementation of this project and to which the competent authority's regulations on compensation are not applicable, impedes the implementation of this project, the competent authority and the Concessionaire shall discuss a scheme for the settlement of the civil petition, and if it is agreed as a result of the discussion to settle the civil petition by amending the total project cost, the competent authority shall reflect costs actually spent by the Concessionaire for the settlement of the civil petition additionally in the total project cost.

(4) The Concessionaire shall be liable to settle civil petitions on construction works and operation at its own expense. The Concessionaire shall prepare measures for the prevention of civil petitions on construction works and operation and shall report them to the competent authority.

(5) The Concessionaire shall bear costs and compensation required for the settlement of civil petitions raised against the Concessionaire's activities conducted in violation of an Act, a subordinate statute, or a regulation related to the implementation of this project or the authorization, permission, or approval of a related agency.

As infrastructure is public property, however, the fees paid by users need to be kept in balance with the charges of government-financed toll roads. Therefore, the SC provides the procedures for negotiation between the concessionaire and the competent authority when deciding the initial user fees after the commencement of operation and yearly user fees from then on; at the same time, it clarifies the concessionaire's right to user fees. First of all, the initial user fees are determined after reflecting the price level in the user fees that are predefined as a constant price in the concession agreement. The adjustment of user fees can be made once a year within the variation of the price index through negotiations between the parties to the agreement. It is also stipulated that any discount or exemption of user fees pursuant to the relevant laws on roads (e.g., for compact cars, electronic vehicles, etc.) shall be applied to PPP projects. Accordingly, the concessionaire should plan the project in consideration of the possible decrease in revenues from user fees.

At the same time, in Chapter 9 (risk allocation) the SC strongly protects the concessionaire's right to impose user fees by stipulating, "Provided that the loss caused by imposing user fees lower than the ones decided in the agreement, at the request or as a result of policy of the government, shall be attributable to the competent authority" (Article 62 (1) 4 of the SC).

Chapter 8: Support from the Competent Authority

Support from the competent authority is classified into financial (provision of the construction subsidy and land compensation) and nonfinancial. The SC specifies the timeline and conditions for providing the construction subsidy. Also, in PPP projects, the SC stipulates that the competent authority is tasked with providing the project area as well as land compensation. It is not a legally binding obligation but a reflection of a common practice in which the competent authority conducts and bears the cost of land

Article 50 (Determination and Adjustment of User Fees)

(1) The initial user fees for this project shall be determined as set out in Table X (Standard User Fees for Each Type of Vehicle) but may be adjusted by consultation between the parties to the Agreement.

(2) In order to determine initial user fees, the Concessionaire shall submit the following documents to the competent authority by no later than X days before the commencement date of operation:

1. The method of using facilities under this project and the actual initial user fees applicable from the commencement date of operation onward;
2. Basic data on the calculation of user fees;
3. The method of collecting user fees;
4. Full or partial exemption from user fees, surcharge rates, and the eligibility for such exemption or surcharge;
5. The level of user fees for similar facilities, etc.;
6. Other matters necessary for user fees.

(3) In principle, user fees for each year, excluding initial user fees, shall be adjusted only once a year as at (Date) each year, and the Concessionaire shall calculate the user fees applicable each business year within the fluctuations in consumer price index, shall submit the calculation to the competent authority by the end of (Month) each year, and shall determine the final user fees following consultation with the competent authority.

(4) User fees may be adjusted additionally if additional costs or losses are incurred due to a force majeure event, the competent authority's fault, or any other cause specified in this Agreement and the parties to the Agreement agree to settle the portion borne by the competent authority by adjusting the user fees. In such cases, if the parties to the Agreement fail to reach an agreement on the appropriate adjustment of user fees, the parties may request a specialized institution designated by an agreement between the parties to evaluate the reasonableness of the adjustment of the level of user fees, and the parties shall be bound by the results of such a requested evaluation.

expropriation in road projects.³ Nonfinancial support includes matters regarding various kinds of approval and licensing.

Besides the forms of support set forth in the SC, the competent authority's support for matters including tax reduction and exemptions is provided in conformity with individual laws (e.g., the Corporate Tax Act).

Chapter 9: Matters Regarding Risk Allocation and Chapter 10: Termination of an Agreement

Force majeure

The SC directly classifies the causes of risk into force majeure, the competent authority's fault, and the concessionaire's fault. Such a direct stipulation has two benefits: first, it determines the party that will bear the cost incurred. Second, it confirms the conditions for early termination of the concession agreement.

Matters regarding risk allocation can be fine-tuned by project. However, there are few cases where the matters regarding risk allocation are determined to be different from the SC. In this regard, the provisions in Chapter 9 are considered as part of the PPP scheme rather than a subject for negotiation. First of all, force majeure is defined as follows:

Article 3 (Definition)

47. Force majeure event: refers to an event specified in Article 62, for which neither of the parties to the Agreement is liable, which creates a circumstance or a cause (or a combination of circumstances or causes) that neither of the parties to the Agreement can reasonably foresee and renders either party unable to perform obligations under this Agreement or adversely affects either party's performance of obligations. The burden of proving a force majeure event is on the party who asserts a force majeure, and a force majeure event means a direct and significant situation that a party is unable to overcome in spite of the party's reasonable efforts or preventive measures;

Force majeure is classified into political and nonpolitical force majeure.

Article 62 (Force Majeure Events and Countermeasures Therefor)

(1) In interpreting this Agreement during this project period, the following events shall be deemed nonpolitical force majeure events and events regarded as equivalent to such events (hereinafter referred to as "nonpolitical force majeure events"), among force majeure events:

This clause shall be applicable only where the competent authority owes such obligations under the Agreement.

1. A disaster caused by an earthquake, a flood, a tidal wave, a fire, a volcanic eruption, a landslide, a typhoon, an aircraft collision, or any similar event;
2. A nationwide, society-wide, or industry-wide strike;
3. Where a sudden change in the country credit rating, interest rate, or exchange rate, a similar sudden change in economic environment, or a rapid change in the environment for this project makes it impossible to execute a loan agreement or adversely and seriously affects the Concessionaire's profitability of this project;
4. Where an amendment to the PPP Act, the Enforcement Decree of the said Act, the Basic Plan for PPP Projects, or a change in the policy on public-private partnership for infrastructure has a direct, serious, and unfavorable impact on the Concessionaire: Provided, that the competent authority shall be liable for losses incurred as a consequence of collecting user fees less than the user fees stipulated in this Agreement due to a demand or policy of the Government;

(continued on next page)

³ In spite of the fact that the law entitles the concessionaire to the right to land expropriation, conventionally the competent authority handles tasks regarding land expropriation in view of possible resistance from the private sector.

Article 62 (Force Majeure Events and Countermeasures Therefor)

5. Other events not specified as force majeure events under paragraph (2) and events regarded as equivalent to such events but similar to those under subparagraphs 1 through 3.

(2) In interpreting this Agreement, the following events shall be deemed political force majeure events and events deemed equivalent to such events (hereinafter referred to as “political force majeure events”), among force majeure events:

1. A war, a civil war, an enemy invasion, or any other similar event;
2. Contamination of the project site by nuclear waste, a chemical, or radioactivity;
3. A riot, terrorism, or any other similar event;
4. Control of money exchange or overseas money transfer, or any other similar event.

The methods to deal with force majeure are as follows:

- Extension of time for performance: The commencement of construction shall be delayed or the period for construction shall be extended.
- Compensation: If the total project cost increases or the operational loss is incurred, the competent authority shall bear a certain portion of the cost incurred. In case of non-political force majeure, 80 percent of the cost incurred shall be borne by the competent authority; and in case of political force majeure, 90 percent of the cost incurred shall be borne by the competent authority (excluding the cost covered by insurance). The cost borne by the competent authority can be directly paid in the form of money. However, it can also be provided through an adjustment of the user fees or the period for the right to management and operation

based on consultation between the parties to the agreement.

Causes attributable

The SC lists events that are considered the competent authority’s fault and the concessionaire’s

Article 60 (Concessionaire’s Faults and Countermeasures Therefor)

(1) In interpreting this Agreement, the following events shall be deemed the Concessionaire’s fault, which shall not be limited to the following events:

1. Where the Concessionaire seriously violates an Act, a subordinate statute, or this Agreement or violates the competent authority’s disposition or order under Article 46 (Countermeasures against Violation of Acts, Subordinate Statutes, etc.) of the PPP Act;
2. Where it is concluded that continuing the project does not contribute to the public interest due to seriously poor performance of works for facilities under this project;
3. Where the Concessionaire is declared bankrupt by a court’s final and conclusive judgment;
4. Where it is resolved at the Concessionaire’s shareholders’ meeting to dissolve or liquidate the Concessionaire (excluding a merger);
5. Where it is found impossible to continue this project because the funds necessary for this project (equity capital and borrowed capital) have not been raised and injected due to any cause other than the competent authority’s fault or a force majeure event;
6. Where it is found impossible to continue this project because the Concessionaire fails to commence construction works without a justifiable cause within the deadline specified at the time of approval of the implementation plan or delays or evades the implementation of the project after it commences construction works.
7. Where the Concessionaire fails to file an application for approval of the implementation

(continued on next page)

Article 60 (Concessionaire's Faults and Countermeasures Therefor)

plan within the period specified in paragraph (1) of Article 18 (Approval of Implementation Plan);

8. Where it is found impossible to continue this project because the Concessionaire delays the commencement of the maintenance, management, and operation of facilities under this project under this Agreement without a justifiable cause for not less than X months or evades the maintenance, management, and operation for not less than X months during the effective period of the right to manage or operate.

(2) It shall not be allowed to change the total project cost on the ground of an additional cost or losses on revenue incurred to the Concessionaire as a consequence of an occurrence of any event specified in paragraph (1).

fault respectively as below. If either party is imputable to the fault, the other party has the right to early termination of the concession agreement.

The SC prescribes which party has the right to early termination and the timetable for exercising the right in case of force majeure, the competent authority's fault, and the concessionaire's fault. When a cause to terminate the agreement occurs, the party with the right to termination should request consultation for cure from the other party after notifying the other party of the occurrence of the cause for termination and determining the cure period which does not exceed 90 calendar days. If the cause for termination is not cured within the cure period and if both parties fail to reach an agreement for cure, the party with the right to termination may give the other party a notice of termination (Article 65 (5) of the SC).⁴ In addition, the SC provides that the calculation standard for early termination payment shall be

Article 61 (Competent Authority's Faults and Countermeasures Therefor)

(1) In interpreting this Agreement, the following events shall be deemed the competent authority's faults, which shall not be limited to the following events:

1. Where the competent authority confiscates facilities under this project or the right to implement this project without the Concessionaire's fault or a force majeure event. The confiscation or the revocation of designation of the Concessionaire under paragraph 1 or 2 of Article 47 (Dispositions for Public Interest) of the PPP Act shall be included herein;
2. Where the commencement or implementation of construction works is delayed due to the competent authority's delay in providing land for the project, carrying out works for compensation, or removing obstacles;
3. Where the competent authority fails to perform or breaches its explicit obligation provided for in this Agreement or any relevant Act or subordinate statute without a justifiable cause, such as a delay in an administrative action, including its obligation to consult on authorization and permission related to the approval of the implementation plan of this project or a modification thereto.

(2) If any event under paragraph (1) occurs, the competent authority shall postpone the commencement of construction works or extend the construction period by the period necessary for cure and recovery from such an event during the construction period, reimburse the Concessionaire for the costs actually incurred, and compensate the Concessionaire for losses incurred during the effective period of the right to manage and operate.

⁴ Separate from the right to termination pursuant to the concession agreement, the concessionaire has the right to request the buyout of the project from the competent authority in accordance with the PPP Act.

TABLE A1 Risk Allocation and Early Termination Right

	Who Bears Incurred Cost	Early Termination Right
Force Majeure	Political force majeure: competent authority 90% Nonpolitical force majeure: competent authority 80%	Either party
Competent Authority's Faults	Competent authority 100%	Concessionaire
Concessionaire's Faults	Concessionaire 100%	Competent authority

predetermined in the concession agreement. The standard is not specified in the SC but stipulated in the PPP Basic Plan.

Chapter 11: Disposition of Rights and Refinancing

Chapter 11 prescribes that the competent authority's prior approval is required for the concessionaire to establish a security right and the necessary procedures when investors of the concessionaire are to be changed. It also sets forth that the minimum equity ratio shall be complied with. If the concessionaire hopes to push ahead with refinancing, the competent authority's prior approval is necessary, and refinancing gains shall be shared in the ratio of 50:50 between the parties to the agreement. In fact, the scope of refinancing, the calculation standard/methods for refinancing gains, etc. have to be confirmed specifically so as to share refinancing gains. In Korea, specific matters related to refinancing, other than those provided in the SC, are defined by the PPP Basic Plan and the Detailed Guidelines for Refinancing. It is prescribed in the SC that refinancing gain sharing shall be done in accordance with the PPP Basic Plan and the Detailed Guidelines for Refinancing. (At a working level, not only gain sharing but also the definition and scope of refinancing, calculation of gains, etc. are confirmed on the basis of the abovementioned PPP Basic Plan and Detailed Guidelines.)

Chapter 12: Resolution of Disputes and Chapter 13: Other Matters

The SC states that disputes may be resolved primarily through the arbitration procedures

and the organization, the language, and the proper law of arbitration shall be defined in advance through the concession agreement. Such arbitration agreement, however, is not conclusive and compulsory. The SC provides that litigation procedures shall be taken when arbitration is rejected by either party to the agreement.

As to an amendment to the concession agreement, the SC sets forth the general principles. If either party to the agreement judges that an amendment is needed due to a change in circumstances after the signing of the agreement, the party may request the amendment to the concession agreement and the other party is obliged to faithfully consult on the matter. The SC does not specifically explain what type of change in circumstances may require an amendment to the concession agreement.

CONTENTS OF THE SC FOR BTL

As the basic composition and contents of the SC for the BTL model are analogous to those of the BTO model, the following will mainly touch upon the differences between the two.

Determination and provision of government payments

In the BTL model, the concessionaire can recoup its investment by receiving government payments. Government payments are determined by aggregating (i) the rent for a facility, which is compensation for the concessionaire's investment in the facility, and (ii) operating cost.

PPP Basic Plan Article 15 (Determination of Government Payment)

Government payments for a BTL PPP project shall be determined by aggregating the rent for a facility, which is compensation for the investment cost invested by a private-sector entity in the facility, and operating costs, which are to be compensated for costs spent by a private-sector entity while taking charge of the operation of the facility, including maintenance and repair.

PPP Basic Plan Article 16 (Determination of Rent for Facilities)

(1) The rent for a facility shall be determined in the following formula by equally dividing the principal and interest, calculated by reflecting the rate of return in the total private project cost invested by the concessionaire, to pay the principal and interest in equal installments during the term of lease.

The rent for a facility is calculated based on the following formula:

$$\text{Rent for a facility} = \frac{\text{Total private project cost} \times \text{Rate of return}}{1 - (1 + \text{Rate of return})^{-\text{(Term of lease)}}$$

The total private project cost, which serves as the basis for determining the rent, is calculated by adding the interest during construction and price fluctuations to the total price cost that is stipulated as a constant price in the concession agreement.

- The total private project cost shall be agreed as a constant price, and the total private investment cost shall be recalculated by reflecting actual price fluctuations when the construction is completed.

- Interest during construction (IDC) refers to the interest being generated during the construction period and it is determined by applying the spread to the base rate.
 - (Base rate means the average interest rate of a three-year non-guaranteed corporate bond [AA-] per business day from the date of notification of RFP until 120 days prior to the conclusion of a concession agreement.)
 - The spread is defined by project through consultation.
- The rate of return is determined by adding the spread α to the reference rate (yield on a five-year treasury bond). The spread α cannot be adjusted during the operation period. The reference rate, however, is adjusted

PPP Basic Plan Article 17 (Determination of Rate of Return)

(1) The rate of return on a BTL PPP project shall be determined through a competition between project proponents for each project, based on the pre-tax internal rate of return, taking into consideration financing costs, the level of risks in the project, etc., but shall be calculated by adding the spread (α), in which the premium on long-term investment, the risk premium on construction and operation, etc. are reflected, to the interest rate of treasury bonds maturing in five years, which serves as a reference rate.

(2) The initial reference rate shall be determined by applying the average interest rate of treasury bonds maturing in five years for five business days immediately preceding the date on which the right to manage and operate a facility is created, but the reference rate applicable subsequent to the initial reference rate shall be adjusted every five years by applying the average interest rate of treasury bonds maturing in five years, for five business days immediately preceding the date of adjustment.

(3) The spread (α) shall be fixed at the time the concession agreement is executed and shall not be adjusted thereafter.

PPP Basic Plan Article 23 (Evaluation of Performance of Services)

(1) The competent authority shall prepare guidelines for the proper inspection of performance and shall include the guidelines in the concession agreement so that the performance of services can be evaluated in as objective and fair a manner as possible.

(2) The evaluation shall be mainly focused on the utility and durability of a facility and the level of satisfaction with services, and further details and the allocation of marks shall be determined in view of the nature of each facility.

(3) The competent authority shall operate a committee for the evaluation of performance that shall be composed of public officials in charge, concessionaires, experts in relevant areas, facility users, etc.

PPP Basic Plan Article 24 (Deductions from Government Payments)

(1) The competent authority shall divide actual government payments payable during an operation period into payments for rent, as adjusted by applying the results of the evaluation on the availability of facilities, and payments for operating costs, as adjusted by applying the results of the evaluation of the performance in comparison with

output specifications, but further details and the method of deducting payments in each category shall be stipulated in the RFPs:

1. Rent payments: Such payments shall be deducted according to the degree of unavailability of a facility, if the facility becomes totally or partially unavailable for use due to the concessionaire's fault;
2. Payments for operating costs: Such payments shall be deducted according to the results of the evaluation on performance, such as the utility, safety, and durability of a facility and the level of satisfaction with services.

(2) If a concessionaire regains the level of services, as agreed to provide, after it has had government payments deducted pursuant to paragraph (1), the competent authority may restitute part of the deducted amount.

(3) Article 54 (Composition of Committee for the Evaluation of Performance)

The committee for the evaluation of performance consists of the chairman of the committee, X number of public officials in charge, X number of concessionaires, X number of experts in relevant areas, facility users, etc.

every five years so that the government shares the burden of interest rate change. The SC technically defines the followings of the PPP Basic Plan in more detail.

Operating cost is determined by aggregating all general expenses incurred by providing operation services, including maintenance/repair costs for a facility and project management cost, which are invested by the concessionaire during the operation period after the completion of the facility. Annual operating cost is defined by converting operating cost, which is predefined as a constant price in the concession agreement, into current prices by reflecting actual price

fluctuations. According to the SC, government payments (rent and operating cost) shall be provided evenly every quarter.

Inspection and evaluation of performance

In the BTL model, the procedure for evaluation of performance of services is stricter than that of the BTO model. For the precise and systematic evaluation of performance, the SC provides that “the guidelines for output specifications” shall be written and annexed as an essential addendum for a concession agreement. The guidelines for output specifications include specifications and service details of a facility, which the competent authority intends to lease, by each stage

of design, construction, and operation. Quantitative scores are given according to the criteria set forth in the guidelines, and government payments are provided based on the result of evaluation.

In order to facilitate performance evaluation, the SC prescribes the provision that enables the competent authority to request a tour of inspection, monitoring of works, and submission and explanation of documents from

the concessionaire; it also stipulates the concessionaire's obligation to fully cooperate. Furthermore, in case it is deemed that "the performance agreed upon in the concession agreement cannot be achieved due to noncompliance of the concessionaire despite a certain number of correction requests from the competent authority," the competent authority may terminate the concession agreement by reason of the concessionaire's fault.

