AN OVERVIEW OF THE LEGAL ASPECTS OF CONCESSION AGREEMENTS IN LATIN AMERICA

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Over the past decade, the method by which Latin American governments have implemented infrastructure projects has changed dramatically. In the past, a governmental agency would simply apply for a development loan with a multilateral lending agency which would then step into the project and impose its own rules for pre-qualification and the tendering process. In the early part of the 1990's, Latin American governments, in response to the changing global economic environment and their nations own increasing demand for improved infrastructure, began to open up their respective markets to attract foreign investment into the infrastructure development and operation sectors. In order to accommodate private investment for infrastructure development, a sector of the economy that has traditionally been undertaken by the government, many Latin American nations were required to modify and adapt their foreign investment and public works legislation. This presentation provides a general overview of the types of changes that have taken place in this field as well as an introduction concerning the issues that are most likely to arise for foreign investors interested in building and operating infrastructure in Latin America.

In many nations of Latin America, new legislation was enacted changing the scope of existing public works laws to accommodate private investment. The main legislative vehicle for attracting private investment is the granting of a concession by the government to an individual investor or a group of investors for the construction and operation of an infrastructure project or a specified period of time, thereby allowing the private investor to recoup its investment costs and a reasonable profit for the life of the concession. Due to the magnitude of these projects, the

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developer and the concessionaire rarely act alone in this process. They can normally count on the participation of the project designer, the contracting engineer, financial institutions, and equipment manufacturers and suppliers which in and of themselves require the negotiation and execution of several agreements.

I. THE EXAMPLE OF COLOMBIA

In 1993, Colombia enacted Law No. 80 (General Statute Regarding Public Administration of the Republic of Colombia), which contained the legislative framework for public contracting including the granting of concessions. While the law allows the government to extend concessions to private investors, it also guarantees to the project investors that economic equilibrium will be maintained throughout the long term of the concession. The concept of economic equilibrium is well established under the public works law of Colombia and other Latin American countries. This legal doctrine is one that applies to long term contracts wherein, during the term of the contract, circumstances change that alter the original agreement in such a way that to comply with the contract as originally agreed would result in a more onerous burden for one or both of the parties.

In Article 20 of Law 80, the government may modify a concession agreement where, in the public interest, it must maintain the economic equilibrium of the contract for both parties and respect the economic advantages that have been given to the contractor. In the event the contract does not maintain the required economic balance, the law provides that the parties shall take the necessary steps to re-establish the equilibrium.

Under Law 80, public entities entering into concession agreements with private investors are required to maintain annual reserves in their budgets to cover contingencies that may bring about an economic imbalance. Moreover, the law permits the government to extend certain guarantees on behalf of the private investor as an incentive for attracting private investment. This is particularly helpful when financing is required for the development of the project and the start-up of the concession.

As a result of this legislation, concessionaires developing and operating infrastructure over a long-term period are provided with a measure of protection for their investment. Should economic circumstances change that detrimentally impact the concessionaire, the developer may insist that the concession be modified to reestablish the economic balance of the agreement. Moreover, the law contemplates maintaining monetary reserves available to attend to any perceived imbalance.

II. THE EXAMPLE OF PANAMA

The law governing public contracting and concessions in Panama is found in Public Contracting Law No. 56, which was enacted on December

28, 1995. The doctrine of economic equilibrium is also enshrined in Law No. 56. The Panamanian statute includes provisions, whereby in case an extraordinary or unforeseen event occurs that materially affects the conditions upon which the contract was originally based, the parties may modify their contract in order to return the parties to their original contractual position. This law also permits the parties to execute the required agreements in order to re-establish the contractual equilibrium, including contract amounts, forms of payment, and for additional costs such as financing fees and interest.

Notwithstanding the fact that Law 56 clearly places the burden and risk of the concession squarely upon the concessionaire, the government has several mechanisms at its disposal to maintain the economic balance of the contract. In the case of a toll road concession, the government may reduce the tolls charged by the concessionaire to benefit the users of the service, but in so doing must offer the concessionaire a form of compensation to restore the economic balance. One of the unique features of Concession Law 5 of 1988, as amended by Law 36 of 1995, is that the government may grant state-owned property to the concessionaire. This includes granting the right to the concessionaire to fill in portions of the seabed from which the concessionaire has the right to develop and market such newly created lands for the benefit of the concessionaire.

III. THE CASE OF VENEZUELA

The Republic of Venezuela has also passed legislation whereby concessions may be granted to private parties. This legislation is found in Decree 138 of 1994 and contains the rules for granting concessions and for public works in general. The Venezuelan laws, like its other Latin American counterparts, have included the doctrine of economic equilibrium as a key element of the concession law. This is also unique since it allows the government to offer sovereign guarantees on behalf of the concessionaire to assist the concessionaire in arranging financing and for ensuring that the project remain financially viable during the life of the concession. As an additional inducement to attract private investment, the Venezuelan law contemplates certain tax benefits, international arbitration in the case of disputes, and financial assistance in the event a state of emergency is declared that affects the works.

IV. THE CASE OF MEXICO

For the past ten years Mexico has been in the process of reforming its domestic legislation to attract foreign investors. Under the terms of the Foreign Investment Laws of 1994 and 1997, markets that were once reserved either for the state or to Mexican nationals have been opened to foreign capital participation. These activities include: 1) Transportation and Distribution of Natural Gas and Electricity; 2) Oil Exploration and Operation of Secondary Petrochemical Plants; 3) Operation of Port

Facilities, Railroads, Airports and Highways; and 4) Telephone and Satellite Services.

One of the most recent examples of Mexico's attempt to attract private investment for infrastructure relates to the privatization of the Mexican airport systems. In 1995, the Mexican Congress enacted the Airports Law in order to privatize the existing airport system and to allow for the participation of foreign capital in the process. The most important aspects of the Airports Law include the creation of four regional airport concessions and the creation of their respective holding companies. The participation in the holding companies is to be initially shared between the federal government and a strategic partner to be made up by a qualified Mexican partner and one or more foreign investors. The strategic partner will initially be entitled to own 15% of the holding company and may increase its participation to 20% after five years. Once the concession of thirty years is awarded to the strategic partner, the government will then sell its shares in the holding company through a public offering through the international capital markets. Under this scheme, the Mexican government seeks to turn the running of the airport system over to private investors and world class airport operators.

Mexico's prior experience with the privatization of the railroad system paved the way for the airport privatization. Under the 1995 Railroads Law, the Mexican Congress authorized that the nation's railroad system be divided into three regions each having its own concession. Once the concession was awarded, the government sold off 80% to 100% of its participation in each railroad group allowing the concessionaire to retain the sole right to administer and operate the railroad for a year period.

Bidding for public works and concessions is highly regulated and transparent. Under the Law of Acquisitions and Public Works, the Mexican Congress has mandated that competitive bids be received from qualifying candidates. Although the law permits direct assignation of contracts without competitive bidding, said assignation is only permitted in time of emergency and is subject to review by the Comptroller General's Office.

V. CONCLUSION

As Latin America continues to respond to the growing needs of its population and the international pressures of globalization, infrastructure will continue to be a necessity. As such, the legal systems of these nations must be subject to increasing scrutiny, and changes must occur if they intend to attract private funds for infrastructure development. Many of the innovations referred to in this presentation are still being tested and challenged. Moreover, as development funds are most sought after, the nations of Latin America are competing with each other to affect legal changes to offer the most attractive investment opportunities. Based on these pressures to grow and to attract the necessary funds to propel much needed development, the legal systems of Latin America warrant close attention in considering future investment in infrastructure.