

# Paradigm

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# Public Private Partnerships in Developing Countries: Concept, Characteristics and Mechanisms for Implementation in Colombia

Public Private Partnerships (PPPs) or Public Private Associations (PPAs), are a mechanism by which the private sector delivers a public service (utilities, infrastructure, etc.) in alliance with the public sector, interested in fulfilling its goals by sharing risks, responsibilities and benefits.

Nevertheless the term “shared risks” usually means the risk is passed to the private sector rather than shared. To this point, one must bear in mind that the public sector in developing countries has, among other things, limited resources, unqualified human personnel and inefficient management systems. On the other hand, the private sector has know-how, experience, competence, innovation, and well-trained people.

In summary, PPPs are considered a useful tool to integrate and help the public sector fulfill its social functions and to attract foreign investment, thus improving the economy in developing countries.

The key elements according to author Peter Snelson<sup>1</sup>, to promote and implement PPPs in emerging economies, are as follows:

- **Maximizing value for money:** Delivery by the private sector is designed to maximize efficiency and innovation as well as minimize costs and time overrun.
- **Reducing public debt or off-balance-sheet financing:** Allows the reduction of public sector borrowing and enables the procurement of services that are consistent with policies to drive economic development; in this case construction or reconstruction of infrastructure triggers economic growth, which is a tool for poverty reduction.
- **Strengthening infrastructure and public utilities:** This can be achieved by providing services that would not otherwise be available within existing public budgets of developing countries.
- **Financing tool for emerging countries:** Becomes a suitable tool to finance their

development, establishing the legal mechanisms to secure the correct use of resources, whether public or private, to be invested in infrastructure, housing and utilities systems projects.

## PPPs under Colombian Law

PPPs are enshrined in Act 1508 of 2012, regulated by National Decree 1467 of 2012 and modified through Act 1682 of 2013.

Public Private Partnerships are defined, in Article 1° of Act 1508 of 2012, as follows: “*The Public Private Associations are an instrument to bind private equity, that materialize in a contract between a public/state entity and a natural person or legal private entity, for the provision of public goods and its related services, that involves the retention and transfer of risks between the parties and the mechanisms of payment, related to the availability and level of service of the infrastructure and/or service.*”<sup>2</sup>

Regarding the legal definition, it is possible to say that PPPs in Colombia are



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considered contracts between public and private sectors for building infrastructure or providing public utilities. Through this legal instrument, the Colombian Government expects to sustain the growth rate of the Colombian economy and promote and enhance private sector participation, trying to overcome infrastructure and public utilities deficiencies and gaps with respect to other emerging economies.

## Key Issues and Concerns before Undertaking a PPP Project

There are some key issues that must be analyzed and considered before any PPP is undertaken:

- **Project settlement:** The project must be justified and all real options must be evaluated.
- **Legal certainty:** Clear and fair rules for the parties involved in the PPP and its future contractors are essential for the project's success.
- **Technical viability and flexibility:** In order to achieve suitable and ideal value for money and innovation, it is necessary to ease the procurement requirements and permits to carry on the project activities.
- **Financial feasibility and investment attraction:** The project must be lucrative in order to facilitate the private sector participation which will allow the PPPs to have better financial conditions.
- **Public sector commitment:** The state, department or municipality involved in the project must be committed to carry out the aforementioned tasks during the entire process, working in harmony and joining efforts with the private sector in order to achieve the PPP's objectives.

## PPP Structure Challenges and Trust as an Ideal Solution

Today, the main challenges to PPP projects in Colombia are commercial risk and uncertainty.

The private sector is not in a position to undertake large investments without significant debt financing from financial institutions (usually 30 percent equity and 70 percent debt). Lenders generally have specific concerns, as they lend money against known commercial risks and usually are afraid of assuming legal and political risks associated with the project.

For the purpose of addressing these issues, trusts can be implemented as tools not only for the administration of the public sector resources, but also to control the way they are invested.

To control uncertainty, the PPP's trust can include the following provisions and regulations:

- **Framework:** Establish a strong legal framework for lenders regarding the use of resources by the person or people in charge of the project.
- **Guarantees:** Settle guarantees linked to the resources delivered – preference, payment and other kind of guarantees. Stipulate that it will be the trust, not the persons chosen by the government, who will be in charge of the development of the project, or the one who is going to own the goods required for its development.  
As a result, all the assets-rights of the contract and all the goods acquired to fulfil the obligations linked to it will be owned by the trust.
- **Government:** It is possible to create an internal organization in which banks and institutional lenders could have a seat. From there, they will be able to monitor the project and the way the resources are being invested.
- **Clear rules for dissolution or liquidation of the trust:** It allows the regulation of a complete framework to protect the investor's interests through the allocation of the trust assets in case of liquidation.

In Colombia it is possible to find good examples of such trusts. On one hand, some urban projects were implemented

by the private sector for the development of nearly 35,000 housing solutions where trusts were used to administrate the resources and to regulate the participation of the public sector. Additionally, during the last two years, the current government used trusts as a mechanism to administrate almost 2 billion dollars with the objective of building another 100,000 housing solutions; currently at least 30,000 of these housing solutions have been delivered to their final beneficiaries.

It can be concluded that to the extent a legal regime provides a cohesive and clear structure for the grant of concessions, lenders will be encouraged to provide financial support to PPP projects. The legal regime should recognize the lender's interest in establishing effective security over the project and in ensuring effective enforcement remedies. Trusts could play an essential role considering that within its internal regulation, investors, project managers and the public sector are able to create the necessary environment to enhance their participation, secure their rights and develop the projects effectively.

## Other References

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1 LAW IN TRANSITION (2007) Snelson P, <http://www.ebrd.com/downloads/research/law/lit071.pdf>. (Accessed on 30-05-14).

2 Free authors translation.