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Law No. 93 of September 19, 2019 on Public Private Partnerships

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Panama’s National Assembly recently enacted Law No. 93 of September 19, 2019 on Public Private Partnerships (the PPP Law), in an effort to bolster infrastructure investment and job creation as well as address ongoing public infrastructure needs. The PPP Law will permit the State, autonomous entities, majority-owned State enterprises and municipalities (collectively, the Government Entities), other than certain excluded government entities, following a public tender process, to enter into agreements (the PPP Contracts) with private partners (PPP Contractors), for the design, construction, repair, financing, exploitation, development, operation and/or maintenance of public infrastructure or the provision of public services, previously identified by the Cabinet Council or that had been included in the Republic’s Five-year Investment Plan (the PPP Projects).

The following sectors or entities are excluded from the application of the PPP Law:

The State-owned water company (IDAAN), the Panama Canal Authority (ACP), the Superintendence of Capital Markets, the Superintendence of Banks, State-owned banks (Caja de Ahorros, Banco Nacional, Banco de Desarrollo Agropecuario and Banco Hipotecario Nacional), public health, security and education services and mining exploitation concessions.

Governance

The PPP Law creates the PPP Authority (Ente Rector), a body integrated by six ministers and headed by the Minister of Presidency, for purposes of, among other things, regulating the PPP Law and approving the projects to be developed under the framework of the PPP Law. It also creates the National PPP Secretariat (Secretaría Nacional de APP) as an administrative body in charge of performing technical studies and analyzing and recommending to the PPA Authority those potential projects proposed by the Government Entities that meet the criteria to qualify as PPP Projects. In addition, an Advisory Committee composed of 8 private sector representatives, is empowered to provide recommendations to the National PPP Secretariat regarding the implementation of the PPP Law.

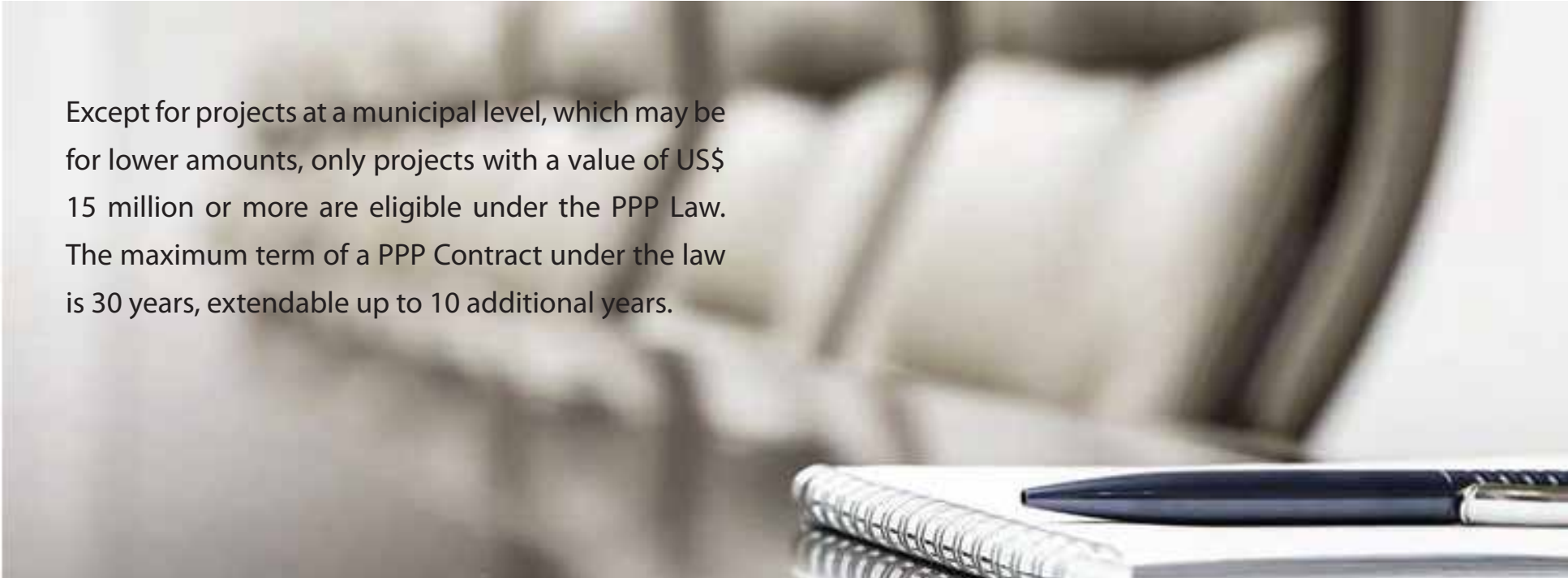
Each Government Entity is responsible for identifying potential eligible projects, performing the relevant studies and, if the project is approved by the PPP Authority, carrying out the public tender process for the selection of the winning bidder and the execution of the PPP Contract with the PPP Contractor.

The PPP Law mandates that the Ministry of Economy and Finance evaluates, assesses and records any payment obligation undertaken by the State or any the Government Entities under each PPP Contract to ensure that the fiscal limits described below are not exceeded.

By virtue of its design, the PPP Law aims to encourage the provision of public services with more effective risk allocation between public and private partners.

PPP Bid Process and PPP Contract

Once the project identified and presented by a Government Entity has been approved by the PPP Authority, along with the proposed tender documents, following the technical analysis and recommendations made by the National PPP Secretariat, the Government Entity is then authorized to launch a formal public tender process for the selection of the PPP partner. The PPP Law describes a standard bidding procedure for the selection of the contractor, the basic content of the PPP Contract among other matters. The winning bidder is obligated to constitute, within the timeframe established in the tender documents, a special purpose company, as the PPP Contractor. The PPP Contract is then signed by the PPP Contractor and the Government Entity, countersigned by the General Comptroller of the Republic and published in the Official Gazette.



Except for projects at a municipal level, which may be for lower amounts, only projects with a value of US\$ 15 million or more are eligible under the PPP Law. The maximum term of a PPP Contract under the law is 30 years, extendable up to 10 additional years.

The PPP Law permits both national and international financing of PPP Projects. From a financing perspective, the PPP Law envisions two distinct categories of PPP Projects: those which do not rely on direct government transfers or payment guarantees and are considered self-financed; and those which do rely on government transfers or payment guarantees issued by the government and are considered co-financed. The PPP Law places a limit on financing by Panamanian State banks of no more than 25% of the total investment in the PPP Project.

The PPP Law includes a series of measures designed to facilitate the bankability of PPP Projects such as

- (I) establishing the right of the PPP Contractor to collect fees, tolls and other revenues as well as the possibility of government support payments;
- (II) streamlining the constitution, perfection and enforcement of security interests; and (iii) establishing termination payments and other remedies designed to improve recovery in the event of termination of the PPP Contract.

a. Revenue Stream and Government Support Payments

- **Revenues.** The PPP Contract will grant the PPP Contractor the right to collect fees, tolls from users (with provisions which permit for toll increases).
- **Fixed or Variable Payments and Contributions.** When the PPP Project is co-financed payments made by the government in connection with a PPP Contract can take the form of either fixed or variable payment amounts. The Government Entity cannot provide financial guarantees, but can undertake contingent payment obligations. They may also include payments for the availability of certain services as well as shadow tolls based on projected use and demand. Government Entities can make contributions to the PPP Project either in the form of cash (or other payment instruments) or through the granting of exploitation rights over public assets.
- **Contractual Protections on Revenue Allocations.** Any PPP Contract must expressly state the budgetary provisions necessary for any government support payments. In addition, the PPP Contract must contain clauses obligating the Government Entity to include in all future budgets the necessary provisions for payment of its future obligations under the PPP Contract.
- **Fiscal Limits.** The PPP Law includes provisions designed to ensure that the Government Entities can meet, and continue to meet, the payment obligations set forth in the PPP Contract. These include an obligation for the Government Entities to include all fixed and contingent payment obligations set forth in the PPP Contract in their respective annual budgets and establish limits on government support payments, whether fixed or contingent.

More specifically, for central Government Entities, the PPP Law provides that the value of all PPP Projects (together with other concessions) contracted or awarded by the Government Entity cannot exceed the lesser of 30% of the investments made by a Government Entity during the previous fiscal year or 30% of the projected investments to be made the Government Entity under the most current Republic's Five-year Investment (with stricter measures for municipal governments).

Globally, the PPP Authority will be required to ensure that the aggregate total present value of all quantified fixed and contingent payment obligations undertaken by the non-financial public sector of the State under all PPP Projects and other government concessions does not exceed 7% of Panama's GDP (though this threshold may be revised every five years by the National Assembly in light of any public infrastructure needs). The National PPP Secretariat will also need to certify that any PPP Project complies with all of these fiscal limits prior to authorizing any contractual bidding process.

b. Streamlining the Constitution, Perfection and Exercise of Security Interests.

The PPP Law contains certain provisions that could potentially facilitate the granting and perfection of security interests of any financing contracted for the PPP Project.

- **Assets Held in Trust.** In those cases where a PPP Project is co-financed, all public assets and other assets managed in a project must be administered through a Panamanian trust with the Government Entity acting as settlor and beneficiary thereto. Such Panamanian trusts are also permitted to hold and maintain onshore and offshore bank accounts. The trustee for such a vehicle must be a locally authorized trustee that has also been approved by the PPP Authority.
- **Creditor Step-in Rights.** The PPP Law expressly recognizes creditor step-in rights and allows these to take priority in the event of any default by the PPP Contractor including during insolvency or liquidation proceedings. The PPP Law also provides for a thirty-day period in which creditors can post performance bonds or other guarantees required by the Government Entity as part of their exercise of substitution rights under the PPP Contract.



- **Special Pledge on the PPP Contract.** In addition to step-in rights, the PPP Law provides for a special pledge covering contract revenues, contracted Government Entity payments and any income belonging to the PPP contractor. These assets may be pledged permitting for the encumbering of these assets in favor of financial institutions. Any seizure of administrative control over the PPP Project will automatically trigger the pledge and it will be granted priority over any other credit obligation. Once the pledge has been triggered, the PPP Law allows the PPP Authority to authorize the transfer of these rights to any locally or internationally regulated financial institution or to any other person that meets the criteria of the original bid proposal.
- **Express Risk Allocation.** In addition to the holding of assets in trusts, all PPP Project contracts must provide for an allocation of risk between the relevant Government Entity and the PPP Contractor. The required risk allocation must be based on technical studies prepared by the Government Entity and the implementation of objective quality and efficiency standards registered (both approved by the PPP Authority). Pursuant to the PPP Law and except for extraordinary circumstances, the risk relating to design, construction, financing, demand, operation and maintenance should be borne by the PPP Contractor. The express division of risk within PPP Contracts may facilitate both diligence and the drafting of financing agreements to ensure that they properly track possible sources of project risk.

- Subordination of Performance Bond Issuer's Rights. The PPP Law expressly states that the rights of the performance bond issuer will be subordinated to those of any creditors of the PPP Project.

c. Termination Payments and Other Remedies

The PPP Law also provides for potential credit enhancements designed to improve recovery in the event of termination of the PPP Contract. These include:

- Seizure of PPP Contract (Rescate Administrativo). In the event that the contracting Government Entity seizes any PPP Contract, the Government Entity will be required to compensate the PPP Contractor. If the PPP Project is under construction, compensation will be equal to the present value of the investment in and maintenance of the physical assets developed, but not amortized, in addition to interests due at a rate established in the public tender documents. If the PPP Project is already in operation, the indemnification must also include a percentage of the net present value of the expected net profit, as measured relative to the investment and maintenance that were effectively carried out.

Possibility of Arbitration. The PPP Law permits controversies relating to PPP Projects to be submitted to arbitration proceedings conducted in Panama and in the Spanish language. Under the law, creditors of the PPP Project secured by the special pledge are awarded automatic standing to participate in these arbitration proceedings, as third parties. The inclusion of creditors in arbitration proceedings, and the reliance on arbitration as opposed to Panama's court system, appears to provide for a swifter conflict resolution mechanic than currently exists under Panamanian law.

In order to strengthen the effectiveness of these reforms, the PPP Law has made the PPP Authority and National PPP Secretariat responsible for providing oversight to the various Government Entities that will pursue PPP Projects. To that end, the PPP Authority and National PPP Secretariat will also work with the Ministry of Economics and Finance to ensure that the fiscal limits are not exceeded, while also creating and maintaining a registry of PPP Projects. Pursuant to the PPP Law, Government Entities and the National PPP Secretariat may also work together to engage consultants in order to improve its institutional capacity for the management of PPP Projects. These reforms are aimed at ensuring that Government Entities develop public private partnerships consistent with Panama's development plan, while providing each Government Entity with the tools and instructions to make investment and contracting decisions pursuant to what it has identified as a pressing need.

ARIFA expects the new law to create opportunities for contractors, infrastructure funds and other institutional investors, consultants, banks and financial institutions. These opportunities are expected to develop once the PPP Law regulations are approved by the Executive Branch and further ongoing reforms to the country's public procurement process are undertaken by the end of 2019 or early 2020.

