THE PPP PROGRAMME AND CHANGING BOT REGULATIONS

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Ladies and Gentlemen,

Following Mr. Cem Galip Ozenen's[1] extremely informative and comprehensive presentation, I would like to give the lawyer's perspective on the Turkish PPP program and the latest amendments to the BOT Law and Regulations. As seen also in Cem Galip Ozenen's presentation, the BOT – build operate transfer – model is the most commonly used form of PPP; so in the very limited time available for my presentation, I will focus on the BOT form of PPP (BOT as per Law No 3996, as amended in 2008 and Council of Ministers Resolution No: 2011/1807; dated 11 June 2011: together the **"BOT Regulations"**).

Starting with the Turkish PPP program: I would like to start by stating what we all know, that Turkey was actually one of the first Countries in the world to develop the concept of public-private partnership ("**PPP**") through the various BOT and BO legislation in the mid-90s, almost 20 years ago. Why then are we still today talking of developments and improvements to the Turkish PPP program?

Well, if I focus on BOTs and try to summarise key problems that were experienced in the past, I would group them under 4 key headings;

1) The lack of harmonisation among the various laws addressing PPPs – as Mr. Cem Galip Ozenen has explained in his presentation there are more than 8 or 9 laws and many more regulations which deal with PPPs, depending on which form of PPP is at stake (whether it is BOT, BO, Build-Lease or TOR) and in which sector the project takes place (whether it is in the energy, motorways, airports or health sector for example), and depending on these, the relevant authorities can be as varied as the Privatisation Administration, the Ministry of Transportation, or Health or the Ministry of Development under its new name (formerly known as the State Planning Organisation).

2) The long authorisation process – focusing on BOTs; two High-Planning Council approvals were necessary; one at the beginning of the process and are at the end of the process

1 Head of the PPP Unit at the Ministry of Development.

3) The numerous legal challenges to the relevant tenders –

and finally, last but certainly not least,

4) The lack of unity of approach and lack of real "private law spirit" in the Implementation Contracts ("IC") – [The IC is the key contract setting out the relationship between the Administration and the Project Company in charge of the BOT project]: Some projects (ie; TOR) were developed under an administrative (concession) law framework, whereas the BOTs were supposedly developed under a private law framework since the Constitutional Law amendments and consecutive amendments to the BOT Law made it possible in the late 90s. Why did I say "supposedly", because for a long time, even though the BOT Law made it clear that the BOT related ICs were "private law contracts", the BOT contracts were drafted with an administrative law mind-set simply because the BOT Regulations did not sufficiently "empower" the administration in terms of the risk-sharing principles that could be agreed. (We have to remember that Turkish law, contrary to the Anglo-Saxon approach is a legal framework where the Administration cannot do, unless it is authorised to do).

As a firm, we have put a lot of thought into this matter, and even have about 1,5 year ago, at the request of the Investment Support and Promotion Agency of Turkey, near the Prime Ministry, prepared a very detailed recommendation report and proposed draft amendments to the Draft PPP Law, which have been presented to the Ministry of Development. And I wish to congratulate the Ministry of Development for having dealt with many of the issues we raised in a very wise manner in the latest the latest BOT Regulation of 11 June 2011.

While the lack of unification among various Laws stands in most respects (and we would continue to recommend that thought is given to bringing more PPP models and sectors under the umbrella of the BOT Regulations), we believe that tremendous improvements have been achieved on the other fronts. And I will try to explain in my presentation how key improvements have been brought to the BOT Regulations in these respects and how all this has been reflected in the most recent BOT ICs.

- **Unification/Harmonisation:**

Though, as mentioned earlier, a proper legal harmonisation for all forms of PPPs and sectors, is still lacking, at least for the BOT form of PPP, its scope of application has been largely extended in the latest amendments and its provisions can now be applied to larger variety of sectors/areas: electricity, motorways, railways, tunnels, dams, seaports, airports, water, wastewater, waste treatment, projects etc.

Another very important aspect of harmonisation is "standardisation": We have always advocated the creation of a strong central PPP Unit which would carry the Standardisation task and help guide unification of implementation, specifically for authorities which are less equipped to develop complex BOT contracts (like Municipalities or less experienced

Ministries): we trust the PPP Unit, led by Mr Cem Galip Ozenen at the Ministry of Development will achieve this important task and be empowered to do so. It is a critical aspect of a good development of BOT projects.

- **Long authorisation process:**

A key impediment to the development of BOT projects used to be the very long authorisation process. The most problematic area being having to go twice to the High Planning Council (HPC), which is basically a mini-Cabinet. The Administration wanting to develop a BOT project had to go to the HPC first to get an authorisation for the project, and a second time to get the approval of the IC. The new BOT Regulations reduce this now to a single HPC step; only for the initial authorisation of the Project. The relevant Ministry can now approve the IC.

Additionally, the new BOT Regulations introduce important time limits to prevent any delay during the authorization phase at the HPC. The formalities to be carried out before the HPC renders its decision on the authorization request of the relevant administration have to be completed within 60 days. Furthermore, the authorities (i.e. Ministry of Finance, Ministry of Development and Undersecretariat of Treasury) from which the HPC may seek opinions during the authorization process have to respond to the HPC within 30 days.

- **Legal challenges to Tenders:**

Turkey has always been known in the past for the many legal challenges brought to public tenders. We see that this problem has very substantially diminished in most recent months/years. One reason is certainly the increasing professionalism in the way tenders are carried. We believe however that the new BOT Regulations will go much further in reducing this risk for the future. Indeed, the main cause for legal challenges was the lack of clarity of the regulations on what the Administration “can do”, and secondly there used to be too large a discrepancy between what was in the tender specifications and what was ultimately agreed to in the contract. The latest BOT Regulation includes very important improvements on these fronts; it lists in much further detail the minimum issues to be addressed upfront, in the BOT Tender Specifications. The list is quite extensive, but to name a few; the parameters for the determination of the price of goods/services provided by the project company, the “shadow tolling” principles if any, the amount and duration of Demand Guarantee if any, and whether any Treasury guarantee will be given to the project. The Tender Specifications will therefore address all the key points of the final documentation and thereby seriously reduce the risk of any meaningful challenge once the tender is awarded and the IC signed.

And as I said at the beginning of my presentation; the last but certainly not least of the key problematic areas was the contractual framework. We see now a strongly:

- **Improved Contractual Framework:**

In a complex BOT project, this is obviously a key area: as we know, BOT projects involve a considerable number of parties (i.e. the relevant public authority; the project company;

sponsors; lenders; the construction company; the O&M company; insurers; suppliers and eventually, the consumers); and a wide range of project risks (i.e. environmental/historical findings risks, design risks; construction risks; operation risks; market and revenue risks; financing risks; force majeure; political risks (i.e. change in law, competing projects, expropriation, change of tariffs, etc.). The optimum sharing of these risks between all these parties will make the success of a BOT project and enable its financing at optimum terms and conditions. And most importantly, the BOT contract must address all these risks over a long period of time which could be anywhere from say 25 to 49 years!

Bankable ICs must be very sophisticated and detailed in addressing these risks and their outcome. In the past many BOTs were concluded on the basis of very simplistic contracts relying mostly on general principles of law to resolve any situation that may arise in the future. The latest BOT Regulations bring a very important improvement: they provide a long and detailed list of issues which can be addressed in an IC. Turkish law being based on a need to authorize the Administration, this improvement is very important and indicates that the Administration is (i) now more willing to structure BOT projects based on the principle of "risk sharing", and (ii) mindful of the fact that ICs should be prepared in sufficient detail aiming to address all project risks and pointing out which party will bear these risks. This will of course enable the parties to conduct a more precise risk analysis and thereby hopefully reduce financing costs. This, again, was one of our important recommendations and we strongly support the changes made.

I would like to highlight a few items which have been "permitted" by the recent BOT Regulations and have already been reflected in some of the most recent BOT Implementation Contracts:

Definition and Allocation of Risks: The ICs now include a detailed list of what constitutes a Force Majeure (FM) or other "Risk Events". These F.M. and Risk Events will include pretty much all risks outside the Project Company's control; from archaeological/historical findings, to change of law, from severe economic crisis to future competing projects (except certain carved-out ones). Basically, any Act of God, or any Act of the Administration (whether a breach of contract or failure to issue a license) which would adversely affect the Project. Depending on certain thresholds, these FM and Risk Events are mostly dealt with through (i) an extension of the Contract term, and/or (ii) an adjustment to the price of the goods/services produced by the Project Company to safeguard the Company's interests. Above certain thresholds, the matter can lead to Termination of the Contract, however, in such cases, besides the assumption of the loans (which I will touch upon later); the Administration will also compensate the Project Company for the Equity which it has not yet recovered through the Project.

Demand Guarantee/Shadow Tolling: The new BOT Regulations stipulates that the Administration is entitled to grant demand ("off-take") guarantees in relation to goods and services provided by the Project Company and to establish a system of "shadow tolling". In such cases, ICs must stipulate how the excess will be shared between the Project Company and the Administration if the actual demand exceeds the guaranteed portion. Important to note

that the demand and shadow tolling guarantees and the pricing of the goods/services provided can be made in foreign currency, and escalated and revised/reviewed at certain intervals.

Treasury Support: Provisions have been introduced to clarify and expand the scope of the possible Treasury's support. In a nutshell, Treasury guarantees can be given with respect to the relevant Administration's supply and off-take guarantee, for the repayment of bridge loans, and for the repayment of outstanding senior loans in case of buy-out of the project by the Administration. Obviously, the Cabinet and the Treasury will decide which projects require or justify such support and there is no doubt that it will not be available for all projects, nor should it be required. A Draft Law waiting imminent ratification by the President brings public authorities with "private budgets" within the scope of projects which can be eligible for Treasury Guarantees. This also ensures that the General Directorate of Highways developed projects are brought back within the scope of eligible projects.

Step-in Rights for the Lenders and Direct Agreements: As we all know, this is no doubt one of the key elements to have a "bankable" project. Over the years, certain forms of step-in rights have been developed (both through regulation, in the energy sector, or mostly contractually in certain recent TORs for ports for example). The latest BOT ICs however, supported by the new BOT Regulations have gone one fundamental step further and have provided for a real/complete step-in right and even for Direct Agreements with Lenders. This is a major development.

In terms of step-in, certain recent BOT ICs have provided for a very detailed step-in procedure: if the Company defaults and does not cure the default within the contractual remedy period, the Administration will ask the Project company or directly the Lenders to submit a Corrective Action Program. If the Lenders are asked for the Program, the Lenders will also need to propose a replacement to the Project Company, to take the project forward from then on. The Administration will enter into a direct agreement with the Lenders in relation to this "step-in right" as part of the various conditions subsequent to the signing of the IC, and this direct agreement will be a requirement for the IC to enter into force.

Assumption of the Senior Loans by the Administration: As we know, whether it's due to FM or a Risk Event occurring or due to a breach by the Project Company which has not been cured or corrected under a corrective program; the Administration may terminate the IC and take over the project. The basic rule in the latest BOT Regulations is that the Administration will take over the senior loans at least for the part of the financing which has been used to date for the Project, and the Administration will reserve its rights to early repayment or to seeking refinancing for the part which has not been used.

Once again, certain recent ICs have provided that this matter is dealt with tripartite/direct agreement which will also be a condition subsequent to the signing of the IC. All the Loan Agreements, including these direct agreements will be Appendices to the IC.

Finally, the matter of:

Settlement of disputes is always extremely important in a contract: The old BOT Regulation stated that the parties could agree to resolve disputes arising out of an IC by way of arbitration provided that the arbitration would take place in Turkey and be subject to Turkish laws. The new BOT Regulations now only refer to "arbitration" (without stating that the seat of the arbitration must be in Turkey) and refer to only the "substantive law" of the IC being Turkish law. It means therefore that IC can be settled through international arbitration. While I do not expect that any IC will provide for an arbitration outside of Turkey, some IC provide for arbitration subject to international rules of procedure (such as ICC rules for example).

I have tried to highlight some of the key issues in the contractual framework for BOT projects, helped by the latest BOT legislative/regulatory amendments, and I believe that tremendous progress has been achieved on these contracts and that they are now appropriate for the projects envisaged, and bankable.

A final word to state that the current Government's strong support for these projects is also evidenced in a new draft law which has passed the parliamentary votes and is now awaiting imminent Presidential ratification; the draft law brings a very important VAT Exemption for all goods/services purchased during the development/construction phase of a BOT project (the exemption is brought both for projects developed under the BOT Regulations and also for the Health sector PPPs, which are subject to a different legislation/regulation). It is also stated that already awarded projects, with signed IC, can also apply for this exemption.

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