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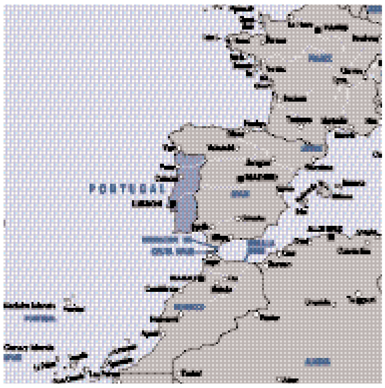

Law changes provide infrastructure finance opportunities

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A number of changes were introduced in 2002 in the area of corporate finance legislation. Some that will undoubtedly have significant impact and repercussions in Portugal were the development of legislation relating to private finance initiatives and public and private partnership, and the amendments to the securitization regime and the transactional context within which it arose.

Private finance initiatives and public and private partnerships (PFI/PPP)

Over the last decade, PFIs and PPPs have become useful tools in Portugal for the government to develop public infrastructure. The construction of the new bridge over the River Tagus represented the inauguration of the PFI/PPP and this was followed by a number of motorway and railway projects.

After the success of these infrastructure projects, the focus in 2003 switched to the construction of football stadiums for the Euro 2004 championship, hosted by Portugal. The football associations embraced the PFI/PPP concept, albeit with some fine tuning in relation to other PFI/PPP projects. The stadiums are now built and ready for Euro 2004.

In 2004 and 2005 the Portuguese government plans to procure 10 hospital projects as *design, build, finance and operate* (DBFO) PPPs. The first long-awaited hospital PPP tender hit the market on January 12 2004. These projects are ruled by the new legislation concerning PPPs and by specific legislation applicable to PPPs in the health sector.

It was during 2003 that the government decided to implement a decree law (86/2003 of April 26) known as the PPP law, which applies to existing and future PPP projects. PPPs are defined in the law as a contract or union of contracts, according to which a private entity agrees with a public entity to develop a long-term activity and cater to a public need, and where the financing and operation of such activities are partially or totally the responsibility of the private entity.

PPPs can be financed either in a project finance regime or not. Project finance concerns the financing of long-term infrastructures, industrial projects and public services based on a non-recourse or limited recourse financial structure, where project debt and equity used to finance the project are paid back from the cashflow generated by the project.

The private sector companies use project finance as a means of funding large projects off balance sheet. The private companies create a special purpose vehicle (SPV), which consists of the consortium shareholders and is created as an independent legal entity that enters into contractual agreements with a number of other parties necessary in a project deal.

The public entity – the state and other public entities, the funds and autonomous services, and other public companies or entities incorporated to satisfy public interests – awards the SPV an agreement (public works concession agreement or public service concession agreement) granting it an exclusive ownership of a specific facility or asset for a certain number of years. At the end of the agreement the asset is handed back to the public sector. The agreement usually entitles the SPV to build, finance and operate for a fixed period of time, although there are variants.

The new law has created other types of agreements, such as: (i) the services agreement (*contrato de prestação de serviços*) where the public entity continues to operate the public service and the private entity cooperates in certain services; or (ii) the management agreement (*contrato de gestão*) according to which the private entity manages a public establishment rendering services to third parties and is paid a fixed or variable amount periodically by the public entity (these type of agreements are used in the health sector); or (iii) the cooperation agreement, which relates to establishments or infra-structures owned by charities or other private solidarity entities.

The new law tries to avoid situations where risks, such as those in relation to the environment or expropriation of land, have not been measured by the public entities, or where the state assumes certain payment obligations without having created the required budgetary allowances (for example, highway SCUT concessions or virtual tolls, where the payments are made by the public entity and not by the user of the highway). The law clearly requires the public entity to measure the risks and avoid future compensations to the private entities or payments unforeseen when the agreement was negotiated. The public entity must negotiate a PPP with a reasonable assurance of the stability of such agreement.

It is clear that the public entities will only be able to attract private entities to these projects if the agreements are complied with and, moreover, if unilateral modifications by the state that change the financial balance of the agreement are exceptional and not the rule and the private entity is totally compensated for these modifications.

The legal regime that applies to securitization

Securitization operations in Portugal have received a boost in the last year. Apart from the execution of several asset-backed securities (ABS) operations in connection with bank and private company receivables, the first securitization of fiscal and parafiscal receivables was carried out by the Republic of Portugal and the Portuguese social security system.

This was a pioneer securitization operation, not only in Portugal but also in the EU. For the first time, a state assigned credit rights in relation to non-performing tax and social security claims. Previously only social security claims had been sold and securitized, a transaction that occurred about two years ago in Italy.

In the first phase of the transaction, the state transferred several tax and social security non-performing credits arising from tax enforcement procedures initiated between January 1 1993 and September 30 2003, with a nominal amount of €11.44 billion ($13.6 billion) and a price of €1.99 billion ($2.38 billion). This transfer was made to a Portuguese securitization vehicle controlled by Citigroup through a true-sale transaction.

The securitization vehicle issued bonds, which were asset-backed by the acquired tax and social security credits, for a private placement with an institutional investor. In the second phase, the securitization vehicle refinanced the operation by issuing new bonds, collateralized by the same credits (listed on Euronext Lisbon and the Luxembourg Stock Exchange) and repaid the institutional investor.

The most innovative aspect of this transaction is the type of assets that were securitized: outstanding tax credit and social security receipts. Under Portuguese law, these credits may be assigned as long as the protection of taxpayers is assured. Thus, the legal framework that allowed for the execution of the securitization operation was carefully prepared to ensure taxpayers' rights and legal guarantees were not jeopardized as a result of the assignment. A specific legal framework was designed for this purpose, dealing with several crucial aspects, such as the effect on pending litigation files, bankruptcies and payments in kind. To achieve this goal, among other measures, the state maintains normal relations with taxpayers; acting as servicer of the securitization vehicle for the collection of the credits. These obligations were assumed under a servicing agreement, subject to remuneration to be paid by the securitization vehicle.

This operation was also structured in order to comply with Eurostat rules in relation to securitization of receivables held by EU states, in particular by assuring that the assignment only involved credit rights that were already due and that their assignment was made on a true-sale basis, without granting any ancillary guarantees.

The need to enact new legislation was also an opportunity for the government to introduce some general improvements in the securitization legal framework, based on the experience of the market during recent years. In this area, three novelties should be highlighted:

- the securitization legal regime now applies not only to receivables but also to other types of securitizable assets;
- non-performing receivables are now an available asset for securitization; and
- securitization vehicles are no longer bound to keep a record (for withholding tax purposes) of the period during which their issued securities were held by investors.

Other important provisions were also reviewed, such as those that relate to the notification of debtors. In fact, subject to authorization from the Portuguese Securities Market Commission (CMVM), the assignment does not necessarily need to be notified to the assigned debtors if the receivables are serviced by the entity that maintains the relations with such debtors.

The legal regime that applies to UCIs

On October 17 2003, Decree-Law 252/2003 established the new regime for undertakings for collective investments (UCI) in Portugal, in compliance with Directives 2001/107 and 2001/108 of the European Parliament and Council, which amended Council Directive 85/611. This new legal framework introduced important amendments in two distinct areas concerning UCI development. On one hand, it has innovated the UCI management companies' regime, creating new market access rules, as well as a wider circle of managing operations. On the other hand, it created the possibility of the opening of undertakings for collective investment on transferable securities (UCITS) investment polices by broadening the variety of assets in which it is possible to invest.