

THE NEW ROAD CROSSING OVER THE TAGUS - A CASE STUDY

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INTRODUCTION

Lisbon is one of the few cities in Europe where the urban area is divided by a very wide river, which forms a powerful obstacle to the fluidity of traffic between both banks. During the 1960s the first road crossing was constructed under a public work scheme, and the bridge has been under state operation and maintenance since then. At the end of the 1980s the Government of Portugal decided to initiate studies on the location and operation of a new bridge and on the construction of the first train crossing over the Tagus in the Lisbon area. Later, by Decree Law 14-A/91 of January 9, 1991, it set-up a state agency called Gattel to conceive a new road crossing, to decide its location and to define the model for its construction and operation.

Environmental issues related to the nature reserve on the eastern part of the estuary, and to the urban density on the riverbanks, caused a long public debate on the choice of location and type of operation i.e. road, train or mixed crossing.

THE PRE-DEVELOPMENT PHASE OF THE PROJECT

With Decree-Law 220/92 of October, 15, 1992, the Government of Portugal decided that the new road crossing would be constructed between the eastern suburb of Lisbon Sacavém, on the north bank, and the small site of Samouco near the nature reserve on the south bank of the river. It

also decided to launch an international tender offer to be developed in three stages:

1. The first stage aimed at pre-qualifying the bidders under the criteria of financial capacity, technical experience in the design and construction of similar works, and credibility in terms of corporate, financial and relationship skills.
2. The second stage was intended to select the two best bidders, measured under criteria such as: quality of conception and of preliminary design; quality of construction; completion date; level of tolls; concession life; service and security levels; degree of acceptance of the risks related with the concession; level of private finance assured to the project.
3. The third stage was reserved as a "negotiation phase" where separate meetings could take place, granting each one of the bidders an equal opportunity to accept or to counter-propose any aspect of the concession before the award was made.

The project was defined under the following main characteristics:

1. It was to be developed under a BOT (building operation and transfer) scheme with a project finance model, by a project company with limited liability duly incorporated under the laws of Portugal.
2. Its development was to be regulated in a public works concession agreement (CA) with the nature of an administrative contract, submitted to the public laws of Portugal.
3. The specifications were not restricted to the usual terms of a BOT but included the conception and design of all related facilities, the expropriation of all real estate at the site and the execution of (and compliance with) an environmental impact assessment in order to qualify the project for subsidies from the EC Cohesion Fund.
4. The project finance model eliminated the use of the government's own funds or guarantees, the financing being provided by the share capital and the borrowings of the project company, together with a mixture of EC Cohesion Fund aid and toll funds from the existing bridge, of which the operation and maintenance was also included in the concession. All investments were to be repaid out of the toll revenue of both bridges during the concessions life.
5. Finally, all the risks of the concession were to be allocated to the project company, including: soil ground conditions; expropriations; environmental mitigation measures; construction operation and maintenance costs; financing risks (with the exception of those from abnormal turmoil in the exchange rate markets); and changes in law risk, excepting any change with a specific and direct impact on the outcome of the project. The grantor only retained the right to obtain the

EC Cohesion Fund aid for the amount to be agreed in the CA, beyond the risks legally non-transferable (force majeure for non-insurable events, etc).

THE AWARD

One of the peculiarities of the tender offer was its third stage, the "negotiation phase". This unusual phase was directed to provide the host government with the highest level of certainty on the feasibility of the project, and to provide the best possible assurance as to the capacity of the concessionaire to comply with its undertakings.

To this end the two groups of multinational bidders selected for the third stage, were asked to prepare and execute most of the contractual framework before the award of the concession, so that at the moment the concession was awarded each one's preliminary design was already discussed and approved, each one's project company was already incorporated, all the sub-contracts related to the design, construction and operation were discussed and approved, the financial undertakings of the sponsors were already secure under equity with additional contribution agreements entered into with each one's project company, and each one's borrowings were already structured and assured as far as possible, through term sheets and commitment letters from each one's bank syndicates.

With the above conditions complied with the Government of Portugal finally awarded the project to a private company founded by some of the leading Portuguese contractors in a joint venture with well known British, French and Brazilian conglomerates.

THE CONTRACTUAL FRAMEWORK OF THE PROJECT

The most important documents which form the contractual framework of the project are the following:

Concession Agreement. This is the basic contractual document, granting the concessionaire the right to construct and operate the new road crossing, to operate and maintain the existing bridge from January 1, 1996, and also granting sole rights to any new road crossing over the River Tagus for up to 20kms northwards.

The agreement is of an administrative nature, attributing to the grantor a set of rights and entitlements usually not permitted in private agreements or in agreements executed in countries where the common law system is applicable, namely the right :

- to apply fines for infringement by the concessionaire of any of its duties or obligations;
- to redeem the concession, under any grounds of public interest, by prior notice of one year and against the

payment of compensation equivalent to the actual value of the concession, calculated by a discount cash flow method using the internal rate of return foreseen in the agreed computer model of the project's economics (hereinafter the "base case");

- to sequester the concession, i.e., to step temporarily into the concession should the concessionaire seriously fail to carry out the project to the required standard;
- to introduce unilateral modifications in any condition of development of the activities comprised in the concession subject to compensation of the concessionaire. For the regulation of such compensation, which also would be applied in cases of, for example, relevant force majeure, exchange rate turmoil, or specific changes in law, a very extensive and complex "financial balance" clause was incorporated into clause 101 of the CA to ensure the restoration of the financial equilibrium of the concession.

Beyond those stipulations, the CA contains a list of provisions which are more typical of any CA, including those executed under common law, notably provisions relating to:

- the variable lifetime of the concession, depending on the cumulative verification of the payment of all loans made to finance the concession activities and the use of the two bridges by the number of vehicles estimated to be as sufficient to ensure the repayment of the capital invested by the sponsors and the IRR as foreseen in the base case;
- the obligation of the founding shareholders of the project company to maintain control of at least 51% of the share capital during the concession life, and to submit to prior approval by the grantor the constitution of any charge or encumbrance over any of the shares, except the ones to be executed as security to the banks that are financing the project;
- the duty to inform Gattel periodically, or on a case-by-case basis, of a long list of matters related to the activities of the concession;
- the right of the grantor to visit the site, to order tests and to have access to any documents of the project company;
- the right of the concessionaire to collect tolls from the users of both bridges at amounts precisely fixed in the CA, including a formula for the yearly adjustment of such tolls, subject to the control of Gattel;
- the right of the grantor to control sub-contracts or any kind of agreements related with the design and construction of the project, the operation and maintenance of its facilities, the financing of the project and its insurance;
- the prohibition of total or partial assignment of the concession without the prior authorisation of the grantor;

- the right of the grantor to terminate the concession in the event of serious, continuing, or non-remediable breach of any of the project company's duties, as listed.
- the transfer, free of charge, to the grantor at the end of the concession, of the assets and rights, including personnel and intellectual and industrial property, of any study, design and document related to the concession;
- the dispute settlement procedures, creating two permanent expert panels, one for technical matters and the other for legal and financial questions, both responsible for the issuance of non-binding opinions on any dispute, subject to arbitration in Lisbon under the rules of the ICC Court of Arbitration of Paris.

The concession agreement is likely to set a precedent for any future concession agreements under a project finance model in Portugal and possibly in other countries too.

Design and construction contract (DCC). The founding members of the project company, who are from companies directly or indirectly involved in the construction industry, decided to incorporate an ACE (*Agrupamento Complementar de Empresas*) permitted by Portuguese law (Law 4/73 of June 4, 1973 and Decree Law 430/73 of August 25, 1973) as a joint venture with a separate legal personality, whose members are jointly and severally liable for its obligations.

To ensure the independence of the parties and to improve the bankability of the project it was decided that the managements of the project company and the ACE should be made up of different persons under different leadership. Once formed, the ACE and the concessionaire entered into a turnkey construction contract for the conception, design and construction of the new bridge and its connecting roads, subject to the laws of Portugal. The negotiations of the construction contract were made "back-to-back" with the concession agreement as the grantor required that the CA had absolute priority over any other project agreement.

The DCC was executed for a fixed price, with a fixed date for the commissioning of the new bridge and a clear definition of the conditions to be met on acknowledgement of the completion of the works.

In addition to the usual terms of a turnkey construction contract, the contractor entered into a direct agreement with the grantor, setting out the consequences in the event of the grantor joining the concession under the terms foreseen in the CA.

Operation and maintenance agreement (O&M). In accordance with clause 74 of the CA, the operation and maintenance of both bridges, including the management of the service area to be located on the new crossing, have been attributed to a wholly-owned subsidiary of the project company.

Some of the most complex problems which faced the parties were related to the transfer of the existing bridge's

operation and maintenance which were entrusted to a state agency (JAE), and whose employees had been given the option to join the new private operator. These problems gave rise to articles 49 to 52 and 70 to 73 of the CA, which lay down the following rules:

1. The operation of the existing bridge, including all its equipment and the right to collect tolls at rates previously fixed in the CA, is to be transferred to the project company as of January 1 1996.

Such a transfer actually occurred, but on two different occasions the government introduced unilateral modifications by freezing the tolls at their 1995 level up to March 31, 1998, having thus executed two financial restoration agreements to compensate the project company for its loss of revenue (cl. 101 of the CA.).

2. The O&M company has to grant to all personnel who opted for the transfer all relevant labour rights including the ones due to seniority. However, none of the personnel took up the option, preferring to stay with the public administration.
3. The transfer of the existing bridge would be preceded by an inspection made by JAE, Gattel and the project company, to assess the physical conditions of the facilities and equipment and to detect any defects which JAE would be responsible for the repair of.
4. The implementation of the train crossing on the lower deck of the existing bridge and reinforcement work to withstand the enlargement of the road crossing to six lanes, is reserved for the grantor to carry out through an independent contractor, a system of co-operation having been established to avoid any negative effect on the current operation.
5. The maintenance of the structure remains JAE's responsibility, the project company having undertaken to pay an annual contribution; otherwise, the maintenance of the road, pavement and of all other relevant areas is the project company's responsibility.

Further to the above conditions, the O&M was executed back-to-back to the CA to be in force throughout the whole life of the concession, unless six months prior notice is given by any of the parties after the first seven years of the concession.

The O&M agreement passes all risks and obligations emerging from the CA in relation to the operation and maintenance activities to the operator.

Finance agreements. Despite the initial purpose being to eliminate the use of government funds or guarantees, it was quickly realised that the financial size of the project would prohibit the feasibility of a purely private financing for the project, with all the investment being repaid out of tolls. Therefore the Government of Portugal decided that the project should be partially eligible for subsidies from the European Cohesion Fund, and made an undertaking from the start to obtain a subsidy from the fund amounting to

approximately one third of the project's cost.

Furthermore, the Government of Portugal announced during the tender offer that the European Investment Bank (EIB) was prepared to lend money to the project, with each bidder responsible for the negotiation and the conclusion of his own loan agreement. The arrangement of equity, and of additional loans and security required by EIB and by the project, were also allocated to the individual bidders.

As possibly the biggest lender to the project, EIB provided all bidders with the relevant information required and, during the negotiation phase, granted equal opportunities to both competitors, issuing on each one's behalf the same kind of conditional commitments.

After the award was made EIB concluded negotiations with the project company, leading to the execution of the most important loan agreement for the financing of the project – the "EIB Facility Agreement". This is a long term EIB loan for an aggregate amount of the equivalent to the higher of ECU323.6m or PTE64bn, to be reimbursed within 20 years, following each drawdown.

In connection with this loan, and in order to implement the bank guarantees requested by EIB and to assure the various forms of bridging financing required, the project company has ensured the contribution of a syndicate of prestigious international and Portuguese banks with whom it has concluded a complex set of financial arrangements including the: escudo facility agreement; deutschmark facility agreement; bridging facility agreement; account agreement; forecasting agreement; security agreement; call option agreement; and intercreditor agreement.

Simultaneously, to complete the financing of the project, the founding shareholders executed a shareholders agreement and entered into an equity subscription agree-

ment and an additional shareholder finance agreement with the project company, whereby they have undertaken to subscribe to the company the proposed share capital and additional contributions subject to the legal regime of equity and to make available subordinated loans whenever certain previously defined risks should occur, or certain precise conditions are met.

Finally, the project company has entered, with its contractor, into a contractor's loan agreement, providing for a loan equal to a percentage of the construction price.

Repayment of the agreements between the founding shareholders and the project company, and of the contractor's loan agreement, remain subordinated to the repayment of bank loans under the terms of a subordinated agreement executed between all the interested parties.

All these finance agreements are subject to English Law and to the non-exclusive jurisdiction of the English Courts, with the exception of the escudo facility agreement, the security agreement and the contractor's loan agreement which are subject to the laws of Portugal.

The new road crossing over the Tagus is another example of finance agreements executed under the principles of common law, being used in a project finance whose main contractual framework is submitted to the laws of a country of civil law, where a strong public administration with a long tradition has given rise to the peculiarities of administrative law.

So far the development of the project is running smoothly and all the agreements are being executed free of dispute.

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