. . . as appeared in . . .

Published by *WorldTrade Executive, a part of Thomson Reuters*

LATIN AMERICAN Law & Business Report

THOMSON REUTERS

Volume 19, Number 9 **September 2011**

PPPs and Latin American Infrastructure Markets: *Focus on Colombia*

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In the first article of this series, we discussed the evolution of the public-private partnership ("PPP") model in Latin America with an overview of infrastructure markets in Brazil and Chile.[1] Here, we examine Colombia, a market with promising prospects for infrastructure investing. Colombia has been among Latin America's most active countries for transport concessions and has plans for growth as a major market for PPPs in a number of sectors. In addition to its encouraging investment climate and massive portfolio of infrastructure projects, Colombia is currently in the drafting stages of a comprehensive PPP law that could further improve infrastructure development frameworks.

Infrastructure Opportunities: The Colombian Market

Of Latin American countries, Colombia ranks fifth in the 2010 Infrascope index with a score of 53.7/100 (see 2010 Infrascope Chart on page 19).[2] Another infrastructure index, the World Economic Forum's Global Competitiveness Report 2010-2011 (the "WEF Report"), ranks countries by existing infrastructure competitiveness as opposed to the Infrascope's focus on investment conditions and internal frameworks for infrastructure development. The most recent WEF Report rated Colombia's infrastructure at 79th of 139 countries. Colombia fared especially poorly in transport infrastructure at 101st and relatively well in electricity and telecommunications at 68th.

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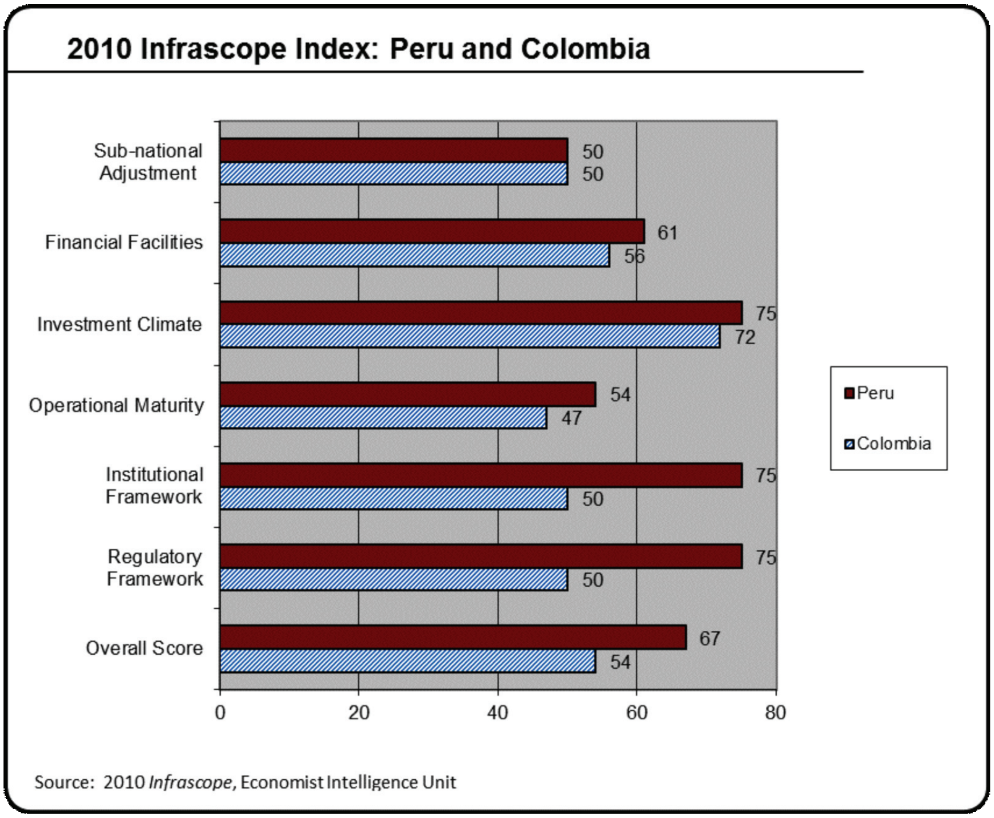
Combined with a distinct and challenging physical geography, Colombia's recent economic success and export-oriented industries have created substantial demand for infrastructure. Transportation bottlenecks and infrastructure deficiencies are major obstacles for continued growth. The Economist recently cited an estimate that resolving infrastructure deficits could increase annual GDP growth by a full percentage point.[3] Private investment is viewed as part of the solution to these problems and was identified among top priorities in Colombia's National Development Plan 2010-2014, which includes plans for major road, rail, urban transit, energy, port, airport, communications and information technology projects.

Private investment has played an increasingly important role in Colombia's infrastructure development since the early 1990s. Historically, infrastructure projects with private involvement have mainly targeted electricity and transport projects. As a percentage of GDP, Colombia's investment in transport infrastructure grew from 0.66% in 2002 to 1.73% in 2010.[4] Of those investments, around 35% came from the private sector. Despite recent growth, private participation in infrastructure projects and overall investments in Colombia's infrastructure continue to lag behind demand. The Inter-American Development Bank ("IADB") recommends maintaining infrastructure investment at around 4% of GDP.

Colombia has redoubled efforts to open its economy and to increase the ease of doing business domestically. In the last five years, Colombia jumped from 105th to 39th out of 183 countries in the World Bank's Doing Business 2011 index. Among other measures, Colombia upgraded investor protections, streamlined construction permits, and improved the sanctity of contract. In June, Fitch Ratings raised Colombia to investment-grade status, joining Standard and Poor's and Moody's as the third major ratings agency to upgrade Colombia to such status this year. All of the above are positive signs and accomplishments. At the same time, translating this progress into broader economic and social gains depends on the consolidation of internal peace and stability.



In May, Colombia's Transport Minister Germán Cardona Gutiérrez presented a ten year $56 billion USD infrastructure development plan, Infrastructure for Prosperity, of which $17.9 billion USD will be invested between 2011 and 2014. Urban infrastructure and roads figure to be the largest sectors for investment by volume with ports and rail seeing significant activity as well. Colombia's National Department of Planning ("DNP") has suggested that over half of the total investments might come from the private sector. More recently, the DNP unveiled details of a portfolio including eight transport megaprojects and four social infrastructure projects (see details in DNP Project Forecast Chart on right).[5]

If ratified by the U.S. Congress, the U.S.-Colombia Free Trade Agreement ("FTA") could strengthen key areas for infrastructure investment between the two countries. The Government Procurement Chapter of the U.S.-Colombia FTA could open Colombia's procurement market to U.S. firms with non-discriminatory rights and access to bidding opportunities at various levels and branches of government.

DNP Project Forecast 2011

Name of Project:	Notes:
Autopista de la Montaña	1,251km, $4.8 billion USD
Consolidación Corredor Bogotá	86km, $2.2 billion USD CAPEX
Proyecto Movilidad Bogotá	Urban transit projects including Bogotá subway system ($2.5 billion USD) and a suburban train (at $2.1 billion USD)
Transporte Multimodal Puerto Gaitán- Puerto Carreño	Waterway project 700km in length, $1.86 billion USD
Consolidación Corredor Bogotá-Buenaventura	503km road project, $1.79 billion USD CAPEX
Consolidación Corredor Bogotá-Cúcuta	568km road project, $1.60 billion USD
Atlantic-Pacific Rail Project	Rail project to develop and connect ports on Atlantic and Pacific coasts. Atlantic Phase: $2.52 billion USD. Pacific Phase $1.29 billion USD.
Popayan Bypass and Pasto Airport	$1.11 billion USD

(Source: *Infrastructure Journal*)

Colombia's Legal Framework for Infrastructure Development

The Constitution of 1991 opened the door to greater private participation in the provision of public services and infrastructure development in Colombia by permitting governmental entities to execute contracts with private entities for such activities. Article 339 of the Constitution established that a National Development Plan should be created every four years. Each National Development Plan identifies development goals and contains multiyear budgets that set the national agenda for infrastructure projects in Colombia.

The General Public Acquisitions Act (Law 80 of 1993) expanded on the possibility of private participation in public services allowed under the Constitution of 1991. Beyond Law 80, Colombia has created sector specific laws that further regulate infrastructure projects. Among the most important of the sector specific regulations is the Transportation Law (Law 105 of 1993).[6] Mechanisms for return on investments in road concessions, such as tolls and other collection instruments, are governed by the Transportation Law. Also of major significance, the Environmental Law (Law 30 of 1993) establishes environmental standards and requirements for projects.

In 2007, the Colombian government enacted Law 1150, which reformed key aspects of the General Public Acquisitions Act. Law 1150 modified the bidding and selection process, established additional guidelines for public disclosure and transparency, and set forth requirements for the various stages of the bidding process. Colombian law does not establish a time limit for project maturation; however, unlimited terms are prohibited. Under Colombian law, certain provisions are required in concessions, among them:

- the state entity may unilaterally modify, terminate or interpret the agreement to prevent the paralysis of the delivery of the public service to which the agreement relates; and
- all infrastructure built and the assets used by the concessionaire to perform the agreement are transferred to the state entity when the term of the agreement expires.

Private unsolicited proposals for infrastructure projects, iniciativas privadas, are expressly permitted in Colombia.[7] Article 32 of Law 80 provides requirements and basic parameters for evaluating projects such as project descriptions, technical and financial feasibility, and environmental impact studies. Decree 4533 of 2008 builds on the iniciativa privada provisions of Law 80, refining the criteria for analysis and adding flexibility for additional considerations. To date, Colombia's iniciativa privada has not been widely used by the private sector.

Historically, the most common structure for infrastructure projects in Colombia has been the concession model. Partnership contracts are more common for the exploration and production of oil and gas. While Colombia does not have a central PPP law, a legislative project for such a law is currently underway. Though the PPP legislative project is still in preliminary stages, our discussions with different stakeholders involved in the project have revealed potential for improvement in several key areas. Additional transparency measures, streamlining of the administrative process, greater flexibility in the assignment of risks, and the adoption of certain best practices and industry standards are among potential improvements.

At present, a number of statutes govern infrastructure projects and authority is allocated among various agencies. Compared to a highly centralized PPP framework—like the Chilean system, which has one primary PPP law and one ministry with nearly all the relevant PPP authorities—Colombia's framework is characterized by a disperse and multi-layered body of laws and regulatory agencies.

Furthermore, regulations are subject to specific terms contained in a particular contract and decrees issued by the Economic Council of Ministers (CONPES).[8] Complexities created by CONPES decrees, along with the different regulatory and contracting powers at various levels of government, result in a system that is relatively difficult to navigate. Until further reforms are enacted with the forthcoming PPP legislation, a greater degree of unity and standardization at even a basic level could aid Colombia in addressing some of these issues. For instance, boilerplate bidding terms and form contracts are options that could increase efficiency and transparency, reduce the cost of entry for bidders, and streamline the overall bidding process.

Colombia's regulatory landscape is currently undergoing changes at the agency level. The Ministry of Transport has initiated an internal restructuring, including the creation of a National Infrastructure Agency ("ANI") to replace the existing National Institute of Concessions ("Inco") with the goal of strengthening Colombia's regulatory capacity for large-scale projects and improving transparency. Officials at Inco have hinted that the ANI may borrow from the models established in the Peruvian PPP framework and from Colombia's own National Hydrocarbons Agency. The ANI is expected to replace Inco before 2012 and will oversee concessions for highway, port, rail and river projects.[9]

One critical problem in the Colombian legal framework is the set of strict prescriptions for risk allocation under traditional procurement mechanisms. Another disadvantage is that the Colombian system is cost-driven rather than value-driven. A value-for-money approach is based not only on the minimum purchase price (economy) but also on the maximum efficiency and effectiveness of the purchase. Under the current framework, the lowest bidder will be awarded the project, provided that it complies with other qualification requirements. If a project is awarded to a bidder that is not the cheapest, but offers the best value, such award would be subject to a challenge. This factor, coupled with the lack of coherent PPP legislation, limits the ability to structure and allocate risk to parties best suited to handle those risks and also increases the cost of the projects and their financing.

Law 963 of 2005 offers investors the option to enter into "legal stability contracts" with the government for a term of three to twenty years. These contracts allow investors to ensure that their investments will not suffer significant adverse effects due to changes in certain existing laws, regulations or rulings. A minimum investment of roughly \$2.14 million USD applies and the investor must pay the government a premium of 1% of the investment value each year during the term. The stability contracts are available for investments in manufacturing, agriculture, tourism, mining, petroleum, telecommunications, construction, electricity production and transmission, port and railroad development, and other activities as may be approved.

Financing Infrastructure Development in Colombia

Sources of funding for infrastructure projects include investment banks, pension funds, multilateral agencies providing prearranged credit facilities, and government sources such as export-import trade programs or political risk insurance coverage from the Overseas Private Investment Corporation. Common financial instruments include syndicated loans, bond issuances, mezzanine debt, and structured transactions in local stock markets. Colombia's recently attained investment-grade rating, the stability of the domestic market, and improvements with the forthcoming PPP legislation should provide greater flexibility in financing projects, not only with traditional end-user revenues but also with availability payments. These factors will continue to attract institutional investments from sovereign and local pension funds.

In June of 2009, the Andean Development Corporation and the IADB, with capital commitments from Ashmore Investment Management, Inverlink (a Colombian investment bank) and Macquarie, formed the Ashmore Colombia Infrastructure Fund. This private equity fund started with a target size of $500 million and is reported to have raised at least half of the target amount already. Also established in 2009, Brookfield Asset Management set up a $400 million USD private equity infrastructure fund in Colombia.

Colombia has improved the regulatory landscape for private equity by improving laws on fund formation and operation, minority shareholder rights, and corporate governance. Remaining challenges include delays in the process of fund formation, liquidity issues in local capital markets and a relatively complex tax environment. Structural issues such as perceived corruption and the strength of the judiciary are also works in progress, though both have shown improvement.

Colombia addressed various issues with the Financial Reform Act of 2009 (Law 1328), including reforms that eased regulatory restrictions affecting insurance for infrastructure projects. Prior to the reforms, problems with insuring large-scale infrastructure projects were a primary obstacle to funding major public works. The newer regulations allow for (i) the division of the guarantee into project stages, such as construction and operation, for projects exceeding a five-year term and (ii) greater flexibility in calculating insured values by stage rather than solely for the total value of the agreement.

In recent years Colombia has reformed rules for pension funds and insurers by lowering barriers to participation in private equity by institutional investors while liberalizing portfolio investment requirements. Institutional investors, such as pension funds, are permitted to invest as much as 5% of their overall assets in local private equity or venture capital funds. Because pension funds are the largest source of private investment in infrastructure and private equity in Colombia, these reforms have made a meaningful impact on infrastructure financing. Prior to the change, pension funds were restricted to more conservative options, such as government bonds and other fixed income investments.

Of the $108.7 billion Colombian pesos administered by pension funds in Colombia, about 17% is invested in infrastructure primarily through stocks, bonds, and private wealth funds.[10] The energy sector dominates pension fund investments in infrastructure and hydrocarbons lead the way at almost 50%, with notable investments in Canacol, Ecopetrol, Gas Natural, Pacific Rubiales and Promigas. Electricity is second highest at 31.6% with major investments in ISA, Isagén and Emgesa.

As the third largest coal exporter in the world, Colombia has received interest from China, including a project for the construction of a massive "dry canal" Atlantic-Pacific railway across Colombia (see details in DNP Project Forecast Chart on page 19). Colombia and China are reported to be in a discussion phase at this point. The project could be financed by the Chinese Development Bank and operated by China's state-owned China Railway Group and would provide a major avenue for East-West cargo across Colombia.

1 "PPPs and Latin American Infrastructure Markets: Brazil and Chile," Vittor and Samples, Latin American Law and Business Report, Volume 19, Number 7, July 2011.
2 The 2010 Infrascope is a study produced by the Economist Intelligence Unit and commissioned by the Multilateral Investment Fund, a member of the Inter-American Development Bank. The 2010 Infrascope is available at www.eiu.com/sponsor/LACInfrascope
3 "Colombia's Infrastructure: Bridging the Gaps," The Economist, 17 September 2011.
4 See "Bases del Plan Nacional de Desarrollo: Prosperidad Para Todos," Departamento Nacional de Planeación, available at http://www.dnp.gov.co/PND/PND20102014.aspx
5 "Colombia unveils megaprojects," Infrastructure Journal, 9 July 2011.
6 Other major sector specific laws include Law 37 of 1993 and Law 555 of 2000 for telecommunications and personal communication services, Law 143 of 1994 for electricity, Law 99 of 1993 for ecotourism, and Law 1 of 1991 for ports.
7 For a detailed discussion of the iniciativa privada process, see Vélez and Rodríguez, "La Iniciativa privada en las concesiones de infraestructura y servicios públicos," Revista Digital de Derecho Administrativo, N.o. 3, Segundo Semestre, 2009.
8 CONPES is authorized to conduct studies, approve projects and issue decrees in determining general infrastructure policy and private sector participation.
9 Luis Fernando Andrade Moreno was recently appointed as director of Inco. See, http://www.inco.gov.co/CMS/COMUNICADO-DE-PRENSA-No.-33.news
10 "La infraestructura del país está por hacerse" El Colombiano, 27 July 2011.

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