PPUG SEMINAR "PUBLIC PROCUREMENT AUDIT"

Lisboa, 14-15 October 2010

Workshop on Performance Public Procurement Audit

Case: Concession for the operation of a container terminal

In 1984, following a public tendering procedure, a public enterprise, named as " PORT" and charged of managing the port of the city, signed a concession contract with a private company, named "TERM", for the operation of a container terminal in that port, to last for 30 years.

26 years later, 5 years before the end of the contract period, "TERM", the concessionaire, under its own initiative, proposed to the State (the sole shareholder of the above mentioned public enterprise) an investment plan of approximately 500 million €.

This investment would include an extension of the terminal front and the implementation of several facilities. The result would be to triple the terminal's initial capacity, from 280.000 to 840.000 TEUs[1] a year.

This ambitious investment plan was, at the time, justified by a supposed capacity shortage to occur in 2011, as well as by the need to improve the deep-sea ability of the terminal. Such reasons were considered as strategic to the port of the city by "PORT", the public enterprise charged of its management.

The investment plan was drafted to cover the following intervention areas:

- <u>Maritime</u> – The public enterprise, "PORT", would be responsible for the improvement of sea accessibilities through dredging, investing around 80 million €;
- <u>Terminal</u> – The concessionaire, "TERM", would carry out the extension of the terminal's front, making it suitable for the foreseen container traffic purposes;
- <u>Railways</u> – another state owned enterprise, manager of the national rail network, named as "RAIL", would improve the railway interface of the terminal, connecting it, through a railway tunnel, to the city's railway circular. The improvement of the railway interface project was technically considered highly complex, needing previous environmental approvals.

In April 2008, a memorandum of understanding (MoU) between the State, the two public enterprises ("PORT" and "RAIL") and the concessionaire ("TERM") was signed.

[1] Twenty-foot equivalent unit.

Through this MoU, it was preliminarily agreed the need of approving the investment plan and the need to compensate the concessionaire for the investment that he would make. The agreed compensations were:

- An extension of the concession period, adding 27 years to the initial period of 30 (making a total of 57 years);
- A tax exemption of 200 million €.

In April and in the following months, the concession amendment conditions were negotiated with commercial banks, since the investments would need a Project Finance. The model of Project Finance used implied, from the private shareholders of "TERM", an effort through loans instead of using their own funds (equity).

During these negotiations, financing conditions started to deteriorate due to the world financial crisis, whose effects included huge repercussions in the ports sector and container traffic.

In September 2008, the State approved by decree the new concession rules. As a result, more than 90% of the clauses were new, by comparison to those before the amendment.

Finally, after the banks due diligence, in October 2008, with the financial close, the contract amendment was signed.

Between April and October 2008, the changes that occurred in the financial model by its revision, allowed the shareholders internal rate of return (IRR) to rise from 11% to 14%. On the other hand, the banks decided not to assume any more demand risk (risk of container traffic variations).

****

Suppose that you are put in charge of a performance audit to address this situation.

Please prepare the scheme for this audit, drafting, on the basis of the identified risks, its objectives and main questions.

In that drafting, you are invited to consider the Public Procurement Working Group documents, mainly the Procurement Performance Model and the Checklists.