

# CONCESSION CHOICES

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**HFW's Joseph Botham detangles the complicated knot of port ownership models in common use today.**

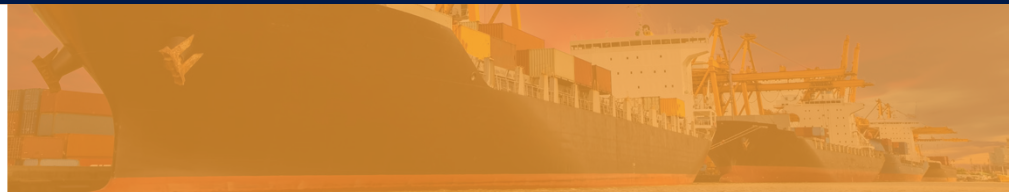
Port ownership models can vary wildly in complexity and have created their own set of terms and acronyms that would leave an industry outsider scratching his head.

Most port privatisations proceed by way of the grant of a concession by government to private entities, often joint ventures between a mixture of financial investors, port operators, construction companies and local interests.

Alternatives are the outright sale (freehold) of port estates, which are extremely rare, or some form of lease arrangement, which is a variation on the grant of a concession. The form of legal structure is usually dictated by local legislation, whether the general legal system, privatisation law or specific legislation granted to privatise specific assets.

Concessions are widely used in the port sector. A port concession is a contract in which a government transfers operating rights to private enterprise, which then engages in an activity conditional on government approval and subject to the terms of the contract. The contract may include the rehabilitation or construction of infrastructure by the concessionaire.

These characteristics distinguish concessions from management contracts at one end of the reform spectrum, and comprehensive port privatisation at the other. Concessions, by permitting governments to retain ultimate ownership of the port land and responsibility for licensing port operations and construction activities, further permit governments to safeguard public interests. At the same time, they relieve governments of substantial operational risks and financial burdens.



## Taking charge

One method used to involve the private sector in large-scale infrastructure investments is where the private sector is granted a concession from the state to build, finance, own and operate a facility, and after a specified time is obliged to hand it back to the state. This concept is variously described as BOT, BOOT or BOO, depending on the terms of the agreement granting the concession.

The acronym BOT stands for 'build, own and transfer' or 'build, operate and transfer' (these terms are often used interchangeably). The 'owning' is an essential element since the main attraction to a governmental entity or port authority is that the concessionaire's equity stake underwrites its commitment to a project's success.

Other variants include BOOT (build, own, operate and transfer) and BOO (build, own, operate). In BOO projects the concessionaire finances, designs, constructs and operates a facility over a given period, but it does not revert to the grantor as it would using the BOOT strategy.

Under the 'build' component, the concession will grant the concessionaire the right to design, construct and finance the project. A construction contract will be required between the concessionaire and a construction contractor. The contract is often among the most difficult to negotiate in a BOOT project because of the conflict that increasingly arises between the concessionaire, the construction contractor responsible for building the facility, and those financing its construction.

Banks and other providers of funds will want to be sure that the commercial terms of the construction contract are reasonable and that the construction risk is placed as far as possible on



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the construction contractors. The construction contractor undertakes responsibility for constructing the asset and is expected to build the project on time, within budget and according to a clear specification, and to warrant that the asset will perform its design function. Typically this is done by way of a lump-sum turnkey contract.

Under the 'own' component, the concession from the grantor provides for the concessionaire to own, or at least possess, the assets that are to be built and to operate them for a period of time - the life of the concession. The concession agreement between the grantor and the concessionaire will define the extent to which ownership (and its associated attributes of liability, possession and control) of the assets lies with the concessionaire.

## Making money

Under the operate component, an operator is to assume responsibility for maintaining the facility's assets and operating them on a basis that maximises profit or minimises cost on behalf of the concessionaire and, like the contractor undertaking

construction of the project, the operator may provide funds to finance construction and be a shareholder in the project company.

The operator is often an independent company appointed under an arm's length agreement. However, in some cases the concessionaire operates the facility directly through the concessionaire company.

Finally, the transfer component relates to a change in ownership of the assets which occurs at the end of the concession period, when the concession assets revert to the grantor. Transfer may be at book value or no value and may occur earlier in the event of failure of the concessionaire.

Concession agreements are often developed as a part of a BOT scheme and represent specific agreements between a government or port authority and a special purpose company (SPC) established by the concessionaire to carry out construction and operation of a port development project. Under concessions, the ultimate ownership of the affected assets is retained by the



national or local government, or by the port authority. At the same time, part of the commercial risks of providing and operating the assets is transferred to a private concessionaire.

The port authority may (depending on legal structures) hold a financial interest in the SPC created by the concessionaire. If the port authority chooses not to participate financially in the SPC responsible for developing the port assets under a concession contract, then its role as an independent and impartial public entity does not significantly change. The only real change is in the shift in responsibility for investments from the port authority to the concessionaire.

If a port authority not only enters into a concession agreement with the SPC, but also participates in the SPC as a shareholder, then the port authority's role changes more dramatically. By investing risk capital, the port authority becomes more directly involved in port operations. If the venture has a monopoly in the port (such as having the only container terminal), the situation might be acceptable, although a conflict of interest may arise between the roles of port authority as

an investor and as the regulator of the monopoly. If the venture competes with other terminals in the port, however, participation of the port authority in the SPC will give rise to a serious conflict of interest and will undermine its independent, neutral position.

#### Lease scheme

Other than granting concessions or transferring freehold ownership interests in relation to ports, governments may adopt a leasing strategy. Landlord ports derive a substantial part of their income from leases. Potential lessees include:

- Terminal operators.
- Vargo handling companies.
- Dedicated terminal operators and shipping lines.
- Forwarding agents.
- Inland transport operators.

Typically, only land or warehouse facilities are leased. Berths may be included or excluded from the lease. If excluded, the port authority collects and keeps all revenue derived from berthing fees.

Alternatively, governments may choose to transfer ownership to private enterprise and grant such companies freehold ownership of ports. Outright sale of port land combined with a transfer of traditional public port tasks, such as safety and environmental oversight, remains an exception, eg. DPW's London Gateway development.

Comprehensive port privatisation often requires the enactment of new laws, both to regulate the transfer of ownership and functions from the public to the private sector and to define the boundary between public and private responsibilities and tasks.

Privatisation legislation may include additional elements, depending on the local situation, the structure of the former port authority and the specific legal, institutional and socio-economic situation in the country concerned.

A number of maritime nations consider comprehensive privatisation to be incompatible with national and regional interests, and it has been argued that the UK experience has yielded very mixed results and provides few arguments in support of comprehensive privatisation (the sale of port land and transfer of all public functions to the private sector) when other, less radical reforms can achieve the same objectives.

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