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Public Procurement & Government Contracts 2022

Spain: Trends & Developments

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Trends and Developments

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Financial Liability of Public Administrations in the Early Termination of Concession Agreements following Recent Spanish Supreme Court Rulings

The right of the concessionaire to be compensated by the contracting authority in the early resolution of the concession agreement is one of the most relevant elements to procuring the financing, construction and operation of public infrastructure by the private sector, especially during times of economic uncertainty.

Admittedly, an efficient public concessional system and recourse to private finance for the construction of public infrastructure ultimately rely on a predictable and clear legal framework setting out the game rules that apply in the early termination of public concessions. Tenderers and lenders should be able to accurately assess the risks arising from the operation of the infrastructure, especially under the early termination of the concession.

One of the best-known precedents in Spain in recent years is the case of several toll road concessionaires going bankrupt as a result of a sharp decline in traffic demand compared to what was estimated in the bidding offers, among other reasons. This insolvency situation led to the early termination of the toll road concessions and the subsequent return of the underlying assets to the granting authority. This, in turn, triggered the obligation of the contracting administration to compensate the concessionaire by means of what is known as the financial liability of public administrations (*Responsabilidad Patrimonial de la Administración* – RPA).

In these circumstances, the Spanish Supreme Court recently ruled on the appeals filed by dif-

ferent toll road concessionaires and lenders against the Spanish government's criteria for determining the RPA. Aside from the particularities of these concessions, the Supreme Court has set out important precedents that will certainly have a notable impact on future concessions and disputes.

Some of the key elements of the Spanish RPA regime considering the recent rulings of the Supreme Court are reviewed below.

Termination Events in Which the Concessionaire is Entitled to RPA Compensation

The contracting authority is obliged to pay the concessionaire the RPA only if the concession agreement is terminated early; the RPA regime will not be triggered when the contract is terminated due to the expiration of the term agreed by the parties. However, in such a case, it will be necessary to apply the contract specifications, which may provide, for example, for compensation in favour of the concessionaire for the underlying assets returning to the contracting authority that have not been fully amortised upon the termination date.

In the event of the early termination of the concession agreement, the value of the RPA differs depending on the following:

- whether the cause of termination is attributable to the contracting administration, to the concessionaire or to any of the parties;
- the legal regime applicable to the concession agreement, which depends on the date on which the concession was awarded; and

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- the regulation provided under the contract specifications applicable to the concession agreement.

In this vein, it is worth noting that the legal regime governing the RPA in Spain was amended on 22 October 2015, so the applicable RPA regime depends on whether the relevant concession agreement was awarded before or after such date.

The general regime applicable to concessions awarded before 22 October 2015 provides that the concessionaire is entitled to compensation consisting of the value of the unamortised investment made by the concessionaire, regardless of the cause of early termination. In addition, when the termination cause is attributable to the contracting administration, the concessionaire is also entitled to indemnification for loss and damages (as provided, where relevant, under the contract specifications).

Under the general regime applicable to concessions awarded after 22 October 2015, the RPA is strongly limited if the termination is not attributable to the contracting authority (this is when the early termination occurs for reasons attributable to the concessionaire or not attributable to any party). In these cases, the concessionaire is only entitled to compensation equal to the “value of the concession” resulting from a new awarding procedure via price auction.

Therefore, the date on which the contract was awarded is key to determining the value of the RPA to which the concessionaire will be entitled upon early termination of the concession agreement.

RPA Content and Calculation Criteria

As already noted, the value and mechanism to determine the RPA differ according to the causes of termination.

Early termination attributable to the contracting administration

When the concession agreement is terminated early due to reasons that are attributable to the contracting administration, the concessionaire is entitled to compensation comprising the following.

- The value of the investment made by the concessionaire in the expropriation of lands, the execution of the works and the acquisition of facilities that are necessary to operate the concessions, considering their depreciation, will be calculated for compensation purposes. For this purpose, a straight-line depreciation criterion will be applied. The Supreme Court has recently resolved some of the doubts and discrepancies that usually affect the determination of each of these concepts, as follows:
 - (a) in relation to the investment made in the works and the acquisition of facilities necessary for the operation of the concession:
 - (i) only the works and facilities that have been approved by the contracting authority through the corresponding initial or modified projects (and that have been effectively executed) should be considered;
 - (ii) the net asset value of the works will be that which results from the contract budget (which integrates the material execution budget plus industrial profit and general expenses) included in the corresponding initial or modified projects approved by the contracting administration; and
 - (iii) the works and facilities that are to return to the contracting authority should be in a condition of “proper” maintenance and operation. The concessionaire is not obliged to return these works and facilities in a “perfect” condition as if they were new. If such works and facilities are

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- not in a proper state of operation and maintenance, the contracting authority will reduce the investment amount by the cost necessary to bring them to such state;
- (b) in relation to the investments regarding the costs of land expropriations:
 - (i) fair compensation paid by the concessionaire to the expropriated parties should be considered in order to determine the investment value. However, fair compensation paid by the contracting authority to the expropriated parties should not be considered for these purposes; and
 - (ii) interest accrued due to delays in the payment of fair compensation to expropriated parties shall also be counted as investment, provided that such interest has been paid by the concessionaire and is not attributable to the concessionaire. Interest paid by the contracting authority should not be counted;
- (c) in relation to the straight-line depreciation of the investment made by the concessionaire:
 - (i) the starting date of depreciation shall be the commissioning of the concessions, except for those works finalised at a later date, for which the date of commissioning shall be taken into account; and
 - (ii) the end date of depreciation shall be the date on which the infrastructure effectively returns to the contracting authority and, therefore, the administration takes over the operation of the infrastructure.
- Upon the early termination of the contract for causes attributable to the contracting administration, the concessionaire shall also be entitled to compensation for damages caused by such termination. The following elements

shall be taken into account in determining the amount of such damages:

- (a) in the event of termination that is attributable to the contracting authority, the loss of profit indemnified will be quantified using the average of the pre-tax profits for a period equivalent to the years remaining until the termination of the concession. If the remaining time is longer than the elapsed time, the latter shall be taken as the reference; and
- (b) the loss of value of those works and facilities that are not to be returned to the contracting authority, considering their depreciation.

Early termination not attributable to the contracting administration

According to the legal regime currently in force, when early termination of the concession agreement is not attributable to the contracting administration, the value of the RPA will be strongly limited as the concessionaire is only entitled to the amount resulting from a new award of the contract via the following procedure:

- the contracting authority is obliged to initiate a new award procedure via an ascending-price auction, in which the sole award criterion is the price;
- the auction price will be set as follows:
 - (a) the starting price will be set considering the cash flows expected to be obtained in the period remaining until the termination of the concession, brought to present value by applying the discount rate of the interest on ten-year Treasury Bonds plus 300 basis points; future net cash flows shall be quantified as the average of the cash flows obtained over a period equivalent to the years remaining until termination, without including payments and receipt of interest, receipt of dividends and payments or receipt of profit tax; and

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- (b) if the works have not been completed when the concession is terminated early, the starting auction price will be 70% of the amount equivalent to the investment made by the concessionaire;
- if the first auction is unsuccessful, the starting price for the second auction will be reduced to 50%; and
- if the second auction is also unsuccessful, the value of the concession to be received by the concessionaire will be the starting price of the second auction.

As opposed to the regulation in force before 22 October 2015, the current legal regime states that, in the event of early termination for reasons not attributable to the administration, the final amount of the RPA to be received by the concessionaire may vary substantially and the value of the RPA will therefore be less predictable. This should be considered in particular when designing the financing scheme.

Time Limit for the Contracting Administration to Quantify and Pay the RPA

The time limit for the contracting administration to quantify and pay the RPA to the concessionaire will depend on the date on which the relevant concession agreement was awarded. Therefore, it is critical to determine which legal regime applies to each concession contract. According to the legal regime currently in force, the time limit is determined as follows:

- if the termination is attributable to the contracting administration, the RPA should be quantified within three months of the administration's resolution by means of which the concession was terminated, unless otherwise stated in the specifications governing the concession; the contracting administration should pay the RPA to the concessionaire within 30 days of the date on which the RPA

was quantified. Any delay in payment will accrue moratory interest (currently 8%); and

- if the termination is not attributable to the contracting administration, the RPA should be paid to the former concessionaire within three months of the date upon which the concessions were awarded to the new concessionaire or, when relevant, of the date in which the second auction was declared unsuccessful.

Pledge over Credit Rights Arising from the RPA

A pledge over future credit rights arising from the RPA is one of the key elements that has allowed the private financing of most concessions awarded in Spain in the last few decades. Indeed, according to a standard project finance scheme, once the concession agreement has been terminated early, the pledging of the RPA would allow the lenders to collect their credit rights (or part thereof) without having to share the operational risk of the concession.

The current regulation allows the concessionaire to pledge the rights arising from the early termination of a work concession agreement (the so-called RPA) to secure payment obligations, provided that they are related to the contract and that the pledge has received prior authorisation from the contracting authority. The same regulation applies to service concession agreements, provided they are compatible with the nature of the relevant agreement.

In any case, as has already been pointed out, the current regulation does not offer certainty in quantifying the RPA when the contract is terminated early for reasons not attributable to the contracting administration, which will normally lead to the lenders operating in the worst-case scenario and requiring additional guarantees to be provided (eg, sponsors' additional guarantees).

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Insolvency Ranking of Credit Rights Secured by Means of a Pledge over the RPA

Credit rights secured by means of a pledge over the RPA grant the creditors a “special privilege” in the insolvency of the concessionaire company, provided that:

- the credit rights arise from contracts or legal relationships executed prior to the declaration of insolvency;
- the pledge is executed in public document form, or has been duly registered with the relevant public registry in the case of a pledge without a transfer of possession; and
- the pledge was granted before the declaration of insolvency to secure credit rights related to the concession contract, and the pledge received prior authorisation from the contracting authority.

Actions of Pledges Regarding the Determination of the RPA Before the Contracting Administration and Before the Courts

It is worth noting that the concessionaire is entitled to receive the RPA and is therefore the holder of this future credit right vis-à-vis the contracting authority. This contractual position of the concessionaire is not altered if the credit rights arising from the RPA are pledged. From this point of view, the legal regulations do not provide the pledgees with a specific or more favourable position in the administrative procedure aimed to quantify the RPA.

However, given the fact that the pledgee creditors have a legitimate interest in the quantification of the RPA (since this will determine whether they may collect the outstanding secured debt), in practice, secured lenders are “interested parties” in the administrative procedure for determining the RPA. The Supreme Court has also recognised the standing of pledgee creditors to

intervene in the judicial proceedings related to the RPA quantification.

Conclusions

In Spain, there are co-existing RPA regimes that depend on the date on which the relevant concession contract was awarded, which differ significantly. Given the importance of the RPA in the financing schemes of this type of contract (normally linked to the construction and operation of the public infrastructure), it is crucial to identify the applicable legal regime and, consequently, what the lenders could expect in the event of the early termination of the concession.

The general regime applicable to concession contracts awarded before 22 October 2015 (notwithstanding the particularities that may affect each contract) provides that – regardless of whether or not the early termination cause is attributable to the administration – the concessionaire is entitled to compensation consisting of the value of the investment made in land expropriation, the execution of works and the acquisition of facilities necessary to operate the concessions, considering their depreciation value. In addition, when the termination cause is attributable to the contracting administration, the concessionaire is also entitled to indemnification for loss and damages.

This same RPA scheme is substantially maintained under the legal regime currently in force, but only for those cases in which the early termination of the concession is attributable to the contracting administration.

However, under the current legal regime, when the termination clause is not attributable to the contracting administration, the concessionaire is only entitled to compensation equal to the “value of the concession”, as detailed above. Therefore, in this case, the value of the RPA will be less predictable, and the final amount will typically be lower.

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GTA Villamagna is a market-leading Spanish firm that is well known by all market agents for providing creative and ground-breaking solutions for critical situations regarding major public matters, such as the early termination of complex PPP contracts for large public infrastructures. The public law department is currently formed of three partners, two seniors and ten associates. It is involved in the most notable cases concerning the awarding, construction

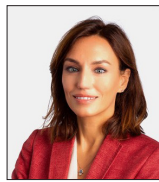
and operation of public infrastructure, such as national toll roads and public ports terminals, including advising the most important Spanish construction companies (v.gr. FCC, Acciona, Ferrovial, Sacyr, OHL). The team handles some of the largest, most complex and demanding public litigation disputes in Spain, like the recent takeover of several bankrupt toll roads by the Spanish government.

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Ernesto García-Trevijano has been a legal counsellor for the “Consejo de Estado” (the supreme advisory body of the Spanish government) since 1984, rendering his services in

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