Out of focus

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Talks have resumed after the summer break among the Ministry of Infrastructure, CIPE, and ANAS over clarification of new regulations governing tariffs accruing to Italian PPP road concessionaires. Their focus is on reviving the promise of new toll road investment. Though the aim of the regulations is to clarify the legal procedures from tender to award, through to monitoring across the life of the concession, at present uncertainty and litigation are rife in the Italian road sector.

The new tariff regime is based on the Regulated Asset Based (RAB) model, a model commonly used in the regulation of utility companies to ensure that private companies do not profit unreasonably from the provision of a public good. A ceiling for tariffs will be determined depending on the capital expenditure of the project. It is the first time a profit cap has been used on motorway concessions anywhere. It is both innovative and highly controversial.

Given that CIPE, the government body responsible for financial planning, authorised the new tariff regime proposed by the Ministry of Infrastructure and Ministry of the Economy without – as is normally the case – a wider consultation with private parties, it is no surprise that the new regime has been met with bemusement by the wider market.

The situation is compounded by the fact that while talks are ongoing to flesh out the detail of regulations that have yet to be fully implemented, many of the large road schemes that have been in negotiations for years – such as the BreBeMi project – adopted the regime after it was published in February 2007.

However, in June CIPE asked the Ministry of Infrastructure to make sure that the RAB tariff only applies to projects that have yet to be tendered. At present it is uncertain whether the Ministry will accede to its wishes or let the negotiating parties continue their course.

There is also growing apprehension about what profit cap the regime will impose. It seems certain that the raison d'etre for the regulatory change is to divert more money into public coffers rather than incentivise the private sector. One lawyer that has been following the formation of the regulations is not optimistic about how the negotiations have been progressing: "From what I've heard of the tariff mechanism, it seems that they are going to set the tariff ceiling too low, which will limit constructors' IRRs."

The web gets more tangled. The new regulation would be implemented against the backdrop of a slew of litigation against the national awarding authority ANAS. Several concessionaires recently came to the end of their five-year regulation period, and applied to ANAS to increase the tariff on their concessions. The concessionaires could reasonably expect ANAS to enter into a dialogue, moderate or reject the requested increase. However ANAS did not respond to concessionaires within the stipulated 50-day window, but rather later sent letters saying that no increase was allowed. Litigation has thus ensued.

A regulation was passed in 2006 giving ANAS the power to terminate concessions if an agreement is not reached in renegotiation and contained provisions limiting the voting rights of sponsors to 5% of the company's capital when appointing the directors to the board of the concessionaire. These regulations caused Abertis, among others, to ask the European Commission to look at the regulations.

This was just one of a number of hurdles facing the Abertis-Autostrade merger. Given that Autostrade operates around 60% of the concessions in Italy, with some granted as early as the 1970's and up for renewal, uncertainty surrounding renegotiations of concessions would have seriously dented its enterprise value. A cynic may argue this was just another Italian protectionist block to prevent the merger.

Fortunately for the free market, both these provisions have been struck down by the Commission, which stated: "the Commission considers that the new rules do not give potential investors the specific, objective circumstances in which the renewal motorway concession will be granted or withdrawn with the result that such rules are liable to hinder or make less attractive the exercise of fundamental Treaty freedoms and must be regarded as contrary to the principle of legal certainty."

The uncertainty is heightened by the fact that negotiations for renewals are presently conducted on a bilateral basis with ANAS without many clearly defined rules. The market is waiting to follow the lead of Autostrade. Meanwhile, the proposed Abertis-Autostrade merger rumbles on. A final decision by Abertis about whether to proceed will be made between February and December 2008.

The new and the old

Despite the Italian authorities' capriciousness, it seems that investment will continue despite new regulations rather than because of them. ANAS in June launched a tender for four projects worth Eu4 billion ($5.55 billion): the connection with the Port of Ancona, Termoli-Saint Vittore Bojano highway, Catania-Ragusa highway and the Caianello-Benevento highway. These projects will be tendered under the RAB tariff regime.

The fundamental differences between the new and old regime is that there is no traffic risk exposure borne by the private sector and no upside potential. Both regimes are subject to five-yearly regulatory reviews where components of the tariff are renegotiated, and both comprise an inflation component set yearly by the government and performance criteria monitored by ANAS.

Under the old system the was no explicit provision for increases in costs or traffic save from a productivity recovery target that includes traffic increases, so that the concessionaire is incentivised to make savings and any savings are those for the concessionaire to keep. On the flip side of gaining any upside to the base case traffic projections, because there was no formal adjustment mechanism to change the standard cost for concessionaires, there was an efficiency risk they had to bear if the cost of maintaining the road went up unexpectantly.

The new tariff comprises a profit cap that maintains the difference between allowed costs and allowed revenues, with any surplus handed over to the public purse. It also comprises a yearly cost parameter allowing the concessionaire to recoup investments in the previous financial year.

Offsetting the profit cap, the new regime takes away traffic risk but places the cost of delays in construction on the concessionaire from the time of regulatory approval – a fairly sizable risk given the length of time to close these projects and EPC inflation. Any income from roadside services will be added into the allowed revenues, where it was potentially an additional source of profit under the old regime.

Impact

What impact will the RAB tariff regime have? It may ensure greater rigour on the part of promotores in the formation of their business plans. A highly placed public official who wished to remain anonymous says, "The new regulations will more clearly codify the efficiencies expected of sponsors so that they can receive commitment from the banks with a viable business plan."

Greater uncertainty will cause further delays with ongoing projects and dent confidence in the system. Its effect is more likely to be lukewarm neither stopping nor boosting dealflow to any great extent.

The legal framework for road concessions has followed a similar path to the general contractor (GC) provisions. Although

GC schemes are not PPPs in the strict sense of the phrase – since it is essentially construction financing based on factoring without an operating phase – the legal framework was tightened to minimise the risks to lenders.

The banks' position in Italy is protected by the lobbying strength of the Association of Italian Banks (ABI). The ABI was instrumental in negotiating clarification of the general contractor scheme, where the monies due from the public authority upon various milestones in construction (receivables) are now directly assigned to lending banks and insulated from clawback arising from poor performance – any benefit of pre-financing and retention would seem to be wholly undermined.

Similarly, concession projects are now more bankable. Lenders to concessions under the new regime are likely to still take on construction risks and performance risks through the life of the concession, but no longer have to shoulder any traffic risk.

ABI met on 12 September to discuss the progress of the Ministerial review of the tariff regime. The ABI is keen to address is the frequency of legal challenges by disappointed bidders. One possible solution is to provide a window of appeal, rather than the situation at present, where a legal challenge has no boundary in time. It is hoped that a clearer concession framework will lead to fewer legal challenges.

Potential sponsors will not desert the Italian road sector altogether, but one consequence of limiting profits is an increase in the agreed standard cost at the outset of projects as sponsors look to weigh up the reward relative to their risk. An increase in the cost of projects is less likely where the tariff regime symmetrically limits the costs to the concessionaires, balancing the risks and rewards, but the policy driver behind the regulations is widely accepted as placing more power with ANAS and more money into the public purse: private is the smallest 'p' in PPP.

Outlook

It is likely Italy will be waiting until 2008 for a significant PPP financing of a road concession, when both BreBeMi and the Asti-Cuneo highways are scheduled to close.

The Eu1.6 billion BreBeMi toll project is sponsored by an Autostrade-led consortium backed by Banca Intesa (www.brebemi.it). BreBeMi has been held up by delays in authorisation, permitting and the settlement of public contributions, with changes to the project schedule requiring unanimous approval by the state, regional and municipal administrations. Similarly delayed is the Eu1 billion Asti-Cuneo highway sponsored by SIAS and backed by Mediobanca and RBS.

These issues – where a highway cuts through various levels of administrative law – are the critical path to financial close on other projects, and where new legislation should be directed to improve dealflow. However there is unlikely to be any political appetite for new legislation that will usurp power from local and regional authorities by fast-tracking the authorisation procedure. The new regulations have no bearing on authorisations or permitting whatsoever.

In spite of the uncertainty, there is a pipeline of deals coming through. Dexia is arranging the Eu400 million refinancing of an Autostrade-led consortium's Rome-L'Aquila-Pescara highway that was initially signed in 2001. The deal has to date been financed by short-term corporate loans. An Autostrade-led consortium was named promotore in July on the Eu1.2 billion Cispadana highway in the Emilia-Romagna region. The project now moves to the second part of the tender procedure, where competing bids are invited.

Despite the pipeline, progress on PPP financings has been slow, yet there is a compelling need for road concessions in Italy. Italy needs new road infrastructure and PPPs offer a more manageable financial burden for the cash-strapped public sector over traditional forms of procurement and the general contractor scheme.

Usually in virgin PPP economies, the road sector is the first area PPP blossoms, because it does not suffer the same level of legal complications posed by the private provision of services such as those in the education and particularly healthcare sectors. But while there are now four PPP hospitals that have closed under Merloni Law, road concessions continue to be dogged by wrangling over authorisations, public contributions and an endemic uncertainty caused by political interference.