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Kuwait and see

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As investors target Saudi and Qatar, it is still possible that Kuwait may turn to a hybrid PPP model involving outsourcing and privatisation, write Paul de Cordova and Patricia Tiller at K&L Gates

While western economies blow hot and cold over the merits of PPPs, many Middle East countries are embracing this alternative to conventional government procurement. Kuwait is prominent among the first movers in this emerging sector.

Kuwait introduced its own PPP law in 2008, with guidelines administered by the Partnerships Technical Bureau (PTB) and developed in consultation with the World Bank. Kuwait is taking a professional approach to bringing projects to market. Unlike some of its neighbours who have announced PPP schemes with little advance planning, Kuwait is endeavoring to approach projects in a methodical manner. Every project must undergo a feasibility study stage and be approved by a ministerial higher committee under the chairmanship of the Ministry of Finance before entering the procurement stage. Furthermore, the PTB is required to engage professional advisers to ensure, as far as possible, that projects are structured to attract the international investment community.

Projects that are approved by the Higher Committee will be put out to tender in the manner prescribed by the PPP Law. Unfortunately, the law, the regulations and the Guidebook lack clarity when describing the features of the tendering process, which provides for both an auction procurement methodology and a competition procurement methodology. The Guidebook states that the “auction” process is most suited for commercial projects, such as shopping malls and parking schemes, where the bidder is in effect buying a development right and that the “competition” process should be adopted for technically complex infrastructure projects such as power generation, transport systems, desalination plants and wastewater treatment plants requiring the government to specify minimum technical parameters. It will be interesting to see how those tasked with bringing the first few projects to market interpret and apply the procurement models and rules.

Of particular interest to investors in Kuwait’s PPP market are the rules in the PPP Law governing investment structures for larger value projects. Article five of the PPP Law provides that projects with an estimated cost in excess of 60 million Kuwaiti Dinars (approximately US$220m), including the estimated market value of the project land or usufruct rights, are to be carried out through the auction of shares in a public joint stock company. The PPP Law prescribes mandatory share allocation in the company as follows:

- 50% by Kuwaiti citizens, via a public offering;
- 26 - 40% by the successful bidder/investor;
- up to 20% by the sponsoring public entity (with this allocation being taken from the public offering and bidder/investor allocations on a pro rata basis); and
- up to 10% held by an Unsolicited Proposer (as defined in Article 10 of the PPP Law), who fails to become the successful bidder.

The auction tender documents are to include evaluation criteria which will score not only the price offered per share, but other factors of a technical and financial nature, which may result in someone other than the highest financial bidder being awarded the project.

The share auction concept for a major PPP transaction involving a “pre-pack” legal, commercial and financial structure will be unfamiliar to and potentially off-putting for many investors and funders. Significantly, and perhaps understandably given the risk that the private sector may not take to a share auction process, the Council of Ministers, on the recommendation of the Higher Committee, retains discretion to grant an exception to Article five, whereby projects not exceeding KWD250m ($915m) may be awarded on a more conventional “competition” basis.In a further effort to make the Kuwait PPP market attractive and transparent the PTB plans to develop standardised contractual provisions for PPP projects, based on international best practice and the particular requirements of the PPP law. These standardised provisions are expected to appear in all draft PPP contracts that accompany a request for proposals issued by the PTB. The PTB also intends to introduce sector-specific standardisation of these terms.

There are issues flowing from the PPP Law and the associated regulatory scheme. Bidders may be concerned about the ownership requirements specified in the law and outlined above and about how the various stakeholders in the project delivery entity will co-exist. Bidders may also be concerned about the potential size of projects, with most involving ambitious infrastructure developments in sectors where there is currently no smaller, market tested, equivalent. Given recent disillusionment with the overall flexibility and cost of PPP schemes in other Gulf countries, including Abu Dhabi’s cancelled road PPP, it is possible that Kuwait may choose to adopt a hybrid model. A likely hybrid model would involve government investing in the core infrastructure for new schemes, supported by outsourcing of operation and maintenance functions. The eventual privatisation of these schemes, in line with the privatisation law approved by the National Assembly of Kuwait in 2010, is also likely.

Other issues are likely to arise in financing these schemes, as lenders will not be allowed to take conventional security over project land and assets and will have to rely on project revenues as their main source of security. When coupled with the questionable depth of capital and debt markets to support the large scale projects currently planned, there is likely to be a shortage of finance available for these PPP projects. The bureaucratic and political obstacles involved in the Kuwait market, in particular, the constant change in composition of the Kuwaiti government, may also hinder the progress of projects.

The overall response to Kuwait’s PPP initiative is positive. A number of projects have been identified as suitable for PPP and there is now a significant pipeline of schemes reaching the market or in the feasibility stage. These include:

- Expansion of Kuwait International Airport to increase its handling capacity to 20 million passengers, planned in five separate project packages;
- Construction and operation of 17 highway rest houses, each including a restaurant, supermarket, cafeteria, mechanical workshop and parking; and
- Four new power and desalination plants at Al Zour North, ranging from 800MW to 1,500MW installed capacity each.

The first wave of tenders has been issued and the international community is now awaiting news of the market response. The initial tender packages are of a comparable size to projects elsewhere in the Gulf region and have been well received by potential bidders. Investors and funders are no doubt waiting for the PPP Law to be clarified before embarking on major schemes, failing which, it will be difficult for interested parties to develop a predictable risk assessment.

In the event that Kuwait's PPP schemes do not receive the desired interest from the international community, the PTB will likely focus on more specific, lower cost schemes rather than being responsible for the government's benchmark procurement process. A "wait and see" attitude is clearly evident among international investors looking to enter the Kuwait market, who have shown a more active interest in conventional schemes on offer in Qatar and Saudi Arabia to date.

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