

United Nations Economic Commission for Europe

**GUIDEBOOK**

**ON**

**PROMOTING**

**GOOD GOVERNANCE**

**IN**

**PUBLIC-PRIVATE PARTNERSHIPS**



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## FOREWORD

Public-private partnerships (PPPs) in the delivery of public services have become a phenomenon which is spreading the globe and generating great interest. But why is a concept, barely mentioned a decade ago, now attracting such interest? Overall, the answer is that PPPs avoid the often negative effects of either exclusive public ownership and delivery of services, on the one hand, or outright privatization, on the other. In contrast, PPPs combine the best of both worlds: the private sector with its resources, management skills and technology; and the public sector with its regulatory actions and protection of the public interest. This balanced approach is especially welcome in the delivery of public services which touch on every human being's basic needs.

There are lots of good reasons, therefore, why governments in the UNECE region and around the world favour PPPs and plenty of evidence that they work well. But they do present a severe organizational and institutional challenge for the public sector. They are complex in nature, requiring different types of skills and new enabling institutions and they lead to changes in the status of public sector jobs. To work well they require well-functioning institutions, transparent, efficient procedures and accountable and competent public and private sectors, i.e. 'good governance'. To address the challenge, the UNECE has elaborated this Guidebook for policymakers, government officials and the private sector. We hope that all the parties to PPPs will benefit by examining closely the principles contained in the Guidebook and ensuring their implementation.

It is widely recognized within the UN system that there is a need to increase the capacity of governments at all levels to implement PPPs successfully. The Guidebook is a beginning. The UNECE will use it as a basis for the elaboration of training modules that will contribute further to the capacity-building task. We hope in this way that the Guidebook will be of practical help in realizing the UN goals in economic and social development.



Marek Belka  
Executive Secretary  
United Nations Economic Commission for Europe

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## ABBREVIATIONS

BBO	Buy – Build – Operate
BLOT	Build – Lease – Operate – Transfer
BOO	Build – Own – Operate
BOOT	Build-Own-Operate-Transfer
BOT	Build – Operate – Transfer
DB	Design – Build
DBFO	Design – Build – Finance – Operate
EBRD	The European Bank for Reconstruction and Development
EIB	European Investment Bank
EIA	Environmental Impact Assessment
IDA	International Development Association
IFC	International Finance Corporation
IPP	Independent Power Producer
IRP	Independent Review Panel
O&M	Operation and Maintenance
PFI	Private Finance Initiative
PPP	Public-Private Partnerships
PPTA	Public-Private Transportation Act, State of Virginia, USA
PSC	Public Sector Comparator
SEA	Strategic Environment Assessment
STB	State Transportation Board
UNCITRAL	UN Commission on International Trade Law
VDOT	Virginia Department of Transportation

## Preface

The Public-Private Partnership (PPP) Alliance of the United Nations Economic Commission for Europe (UNECE) was established in 2001 to improve the awareness, capacity and skills of the public sector in developing successful PPPs in Europe. To this end, the Alliance prepares guidelines on best practices in PPPs, as well as preparing other PPP-related educational and training materials, and sponsoring PPP conferences and workshops. At its last meeting, the PPP Alliance agreed, in light of the lack of information available on the topic, to prepare guidelines on the subject of good governance in PPPs.

Following UNECE reform, a new Committee on Economic Cooperation and Integration has been established to promote competitiveness. This Committee takes over the previous work of the former Alliance. The Guidelines were reviewed at an International Conference organized by UNECE and the Government of Israel with the participation of experts from different countries to provide their experience and best practice in creating good governance conditions for PPPs<sup>1</sup>. A network of experts has also been established, incorporating the experts from the former Alliance group, to implement a work programme on PPPs. The Committee has requested the Secretariat to prepare a Guidebook on Promoting Good Governance in PPPs and to use this to undertake PPP capacity-building programmes especially in the transition economies.

## Avant Propos

Over the past fifteen years governments have been struggling to achieve economic development and competitiveness through improving their basic infrastructure. Increasingly governments are turning to the private sector for the financing, design, construction and operation of infrastructure projects. Once rare and limited, these public-private partnerships (PPPs) have emerged as an important tool for improving economic competitiveness and infrastructure services. They are increasingly being considered as a mechanism to fill an infrastructure 'deficit' in many UNECE countries.

## Challenges and Key Questions

One of the challenges all governments face in promoting PPPs is instigating the procedures and processes involved in delivering successful PPPs and establishing new institutions. Moreover, PPPs require a new type of public expertise that facilitates projects and monitors their performance. The key questions asked in the Guidebook are:

- (a) What does governance mean in PPPs?
- (b) How can governments improve their governance?
- (c) What technical, financial, legal, and other challenges must be overcome to build capacity?

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<sup>1</sup> "Knowledge Sharing and Capacity-Building on Promoting Successful PPPs in the UNECE region", Tel Aviv, Israel, 5-8 June 2007.

- (d) How can PPPs improve efficiency and achieve social, economic and environmental objectives simultaneously?

## Purpose of the Guidebook

The purpose of this Guidebook is twofold:

1. To demonstrate how governments and the private sector can improve governance in PPPs; and
2. To create a basis for the elaboration of training modules for PPPs.

*This Guidebook is organized as follows:*

**The Introduction** defines PPPs, the various models and the benefits. Highlighting the fact that PPPs are still in their infancy in most countries, it is argued that the lack of processes, procedures and enabling institutions, i.e. “governance”, is the main barrier to extending their use.

The next parts describe governance in specific areas, looking at the main challenge, the ways of addressing it and concluding with some specific action points and case studies (Part III).

Part II consists of 8 Chapters.

**Chapter 1** stresses the importance of good governance in PPPs. It identifies some key principles and the main arenas where PPPs are found. The chapter discusses the primary governance objectives in PPPs, and the economic benefits. Noting that these objectives are not being promoted enough, it describes how the UNECE Guidebook on Promoting Good Governance in PPPs can be used to integrate the principles into PPP processes.

**Chapter 2** explains the need for a PPP policy to set out a ‘roadmap’ that fixes clear objectives. It discusses the importance of reaching consensus, identifying the right PPP projects, setting realistic targets and establishing procedures for consulting key stakeholders.

**Chapter 3** discusses how to build the capacity within governments to implement PPPs. It argues for a combined approach using at the same time external advisers and internally establishing enabling institutions and training. It recognises the need to build specific PPP skills and to establish national PPP units, where multilateral cooperation can help.

**Chapter 4** argues that a clear framework of law and regulation is vital for PPPs and sets out the principles and priorities for the construction of this framework. What is required, it is argued, are fewer, better and simpler laws.

**Chapter 5** elaborates on the importance of risk by showing how governments should manage risks. It discusses the need for governments to take on their own share of risk responding to private sector concerns over ‘red tape’ and changing agreements. However, it warns against the use of guarantees that nullify the influence of incentives in boosting private sector

performance.

**Chapter 6** demonstrates the importance of transparency, neutrality, and non-discrimination in procuring PPPs. The specific cases of the Netherlands, the United Kingdom, and the United States are provided as examples of these principles in action.

**Chapter 7** shows why putting people first in PPPs can help meet the public interest objectives in PPPs. It discusses how this can be done.

**Chapter 8** presents the Green Case for PPPs, arguing that greening and private finance in PPPs is not mutually exclusive. It shows how governments can give incentives in PPP contracts to deliver public services in a more environmentally sensitive way.



# **PART I**

## **SETTING THE SCENE**



## **1.1. NEW OPPORTUNITIES, DISTINCTIVE FEATURES, AND THE NEED FOR GOOD GOVERNANCE**

### **What are PPPs?**

Public-Private Partnerships (PPPs) aim at financing, designing, implementing and operating public sector facilities and services. Their key characteristics include:

- (a) Long-term (sometimes up to 30 years) service provisions;
- (b) The transfer of risk to the private sector; and
- (c) Different forms of long-term contracts drawn up between legal entities and public authorities.

They refer to ‘innovative methods used by the public sector to contract with the private sector, who bring their capital and their ability to deliver projects on time and to budget, while the public sector retains the responsibility to provide these services to the public in a way that benefits the public and delivers economic development and an improvement in the quality of life’.

### **There are different types...**

There are various types of PPPs, established for different reasons, across a wide range of market segments, reflecting the different needs of governments for infrastructure services. Although the types vary, two broad categories of PPPs can be identified: the institutionalized kind that refers to all forms of joint ventures between public and private stakeholders; and contractual PPPs.

### **...With a strong upsurge recently of the contractual type consisting of the concession model where the ‘user pays’...**

Concessions, which have the longest history of public-private financing, are most associated with PPPs. By bringing private sector management, private funding and private sector know-how into the public sector, concessions have become the most established form of this kind of financing. They are contractual arrangements whereby a facility is given by the public to the private sector, which then operates the PPP for a certain period of time. Oftentimes, this also means building and designing the facility as well. The normal terminology for these contracts describes more or less the functions they cover. Contracts that concern the largest number of functions are "Concession" and "Design, Build, Finance and Operate" contracts, since they cover all the above-mentioned elements: namely finance, design, construction, management and maintenance. They are often financed by user fees (e.g. for drinking water, gas and electricity, public transport etc. but not for “social PPPs” e.g. health, prisons, courts, education, and urban roads, as well as defence).

### ...And the Private Finance Initiative (PFI) Model where the -‘public sector pays’...

Another model is based on the UK Private Finance Initiative (PFI) which was developed in the UK in 1992. This has now been adopted by parts of Canada, France, the Netherlands, Portugal, Ireland, Norway, Finland, Australia, Japan, Malaysia, the United States and Singapore (amongst others) as part of a wider reform programme for the delivery of public services. In contrast to the concession model, financing schemes are structured differently. Under PFI schemes, privately financed contracts for public facilities and public works cover the same elements but in general are paid, for practical reasons, by a public authority and not by private users (public lighting, hospitals, schools, roads with shadow tolls, i.e., payments based on traffic volume, paid by the government in lieu of tolls).

The capital element of the funding enabling the local authority to pay the private sector for these projects is given by central government in the form of what are known as PFI "credits".<sup>2</sup> PFI is not just a different way of borrowing money; the loans are paid back over the period of the PFI scheme by the service provider who is at risk if the service is not delivered to standard throughout. The local authority then procures a partner to carry out the scheme and transfers detailed control, and in theory the risk, in the project to the partner. The cost of this borrowing as a result is higher than normal government borrowing (but cheaper when better management of risks and efficiency of service delivery is taken into account). Currently, it does not always appear as borrowing in public accounts; although how it appears in public accounts may be changing as well.

### ... Based around different types of contract and risk transfer.

There are a range of PPP models that allocate responsibilities and risks between the public and private partners in different ways. The following terms are commonly used to describe typical partnership agreements:

***Buy-Build-Operate (BBO)***: Transfer of a public asset to a private or quasi-public entity usually under contract that the assets are to be upgraded and operated for a specified period of time. Public control is exercised through the contract at the time of transfer.

***Build-Own-Operate (BOO)***: The private sector finances, builds, owns and operates a facility or service in perpetuity. The public constraints are stated in the original agreement and through on-going regulatory authority.

***Build-Own-Operate-Transfer (BOOT)***: A private entity receives a franchise to finance, design, build and operate a facility (and to charge user fees) for a specified period, after which ownership is transferred back to the public sector.

***Build-Operate-Transfer (BOT)***: The private sector designs, finances and constructs a new facility under a long-term Concession contract, and operates the facility during the term of the Concession after which ownership is transferred back to the public sector if not already

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<sup>2</sup> This however will often not be used as a contribution to the capital expenditure of the project, but may be invested by the public sector party and used to pay the monthly unitary charge.

transferred upon completion of the facility. In fact, such a form covers BOOT and BLOT with the sole difference being the ownership of the facility.

***Build-Lease-Operate-Transfer (BLOT):*** A private entity receives a franchise to finance, design, build and operate a leased facility (and to charge user fees) for the lease period, against payment of a rent.

***Design-Build-Finance-Operate (DBFO):*** The private sector designs, finances and constructs a new facility under a long-term lease, and operates the facility during the term of the lease. The private partner transfers the new facility to the public sector at the end of the lease term.

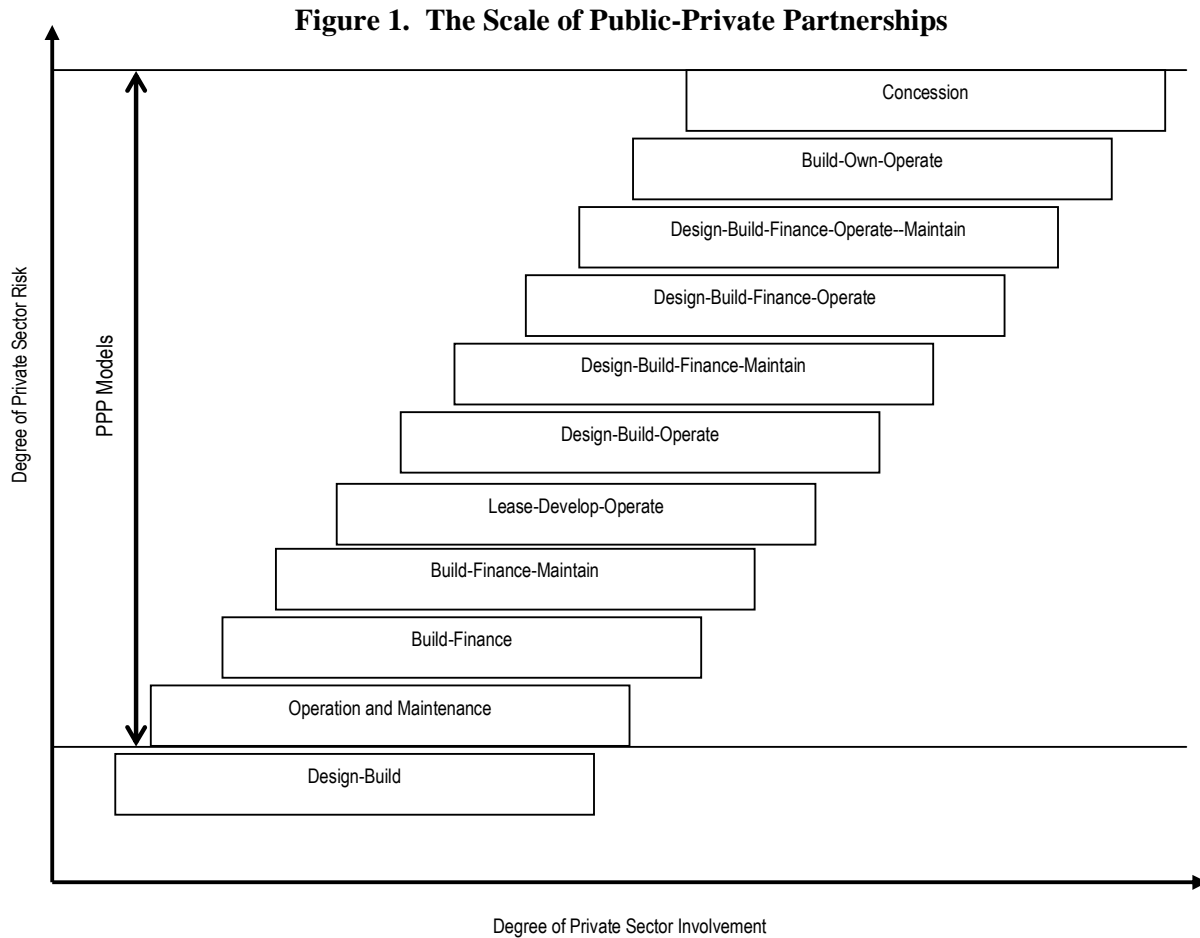
***Finance Only:*** A private entity, usually a financial services company, funds a project directly or uses various mechanisms such as a long-term lease or bond issue.

***Operation & Maintenance Contract (O & M):*** A private operator, under contract, operates a publicly owned asset for a specified term. Ownership of the asset remains with the public entity. (Many do not consider O&M's to be within the spectrum of PPPs and consider such contracts as service contracts.)

***Design-Build (DB):*** The private sector designs and builds infrastructure to meet public sector performance specifications, often for a fixed price, turnkey basis, so the risk of cost overruns is transferred to the private sector. (Many do not consider DB's to be within the spectrum of PPPs and consider such contracts as public works contracts.)

***Operation License:*** A private operator receives a license or rights to operate a public service, usually for a specified term. This is often used in IT projects.

The options available for delivery of public services range from direct provision by a ministry or government department to outright privatization, where the government transfers all responsibilities, risks and rewards for service delivery to the private sector. Within this spectrum, public-private partnerships can be categorized based on the extent of public and private sector involvement and the degree of risk allocation. A simplified spectrum including the above models for public-private partnerships follows.



*Source: The Canadian Council for Public-Private Partnerships*

### **PPPs should not be confused with privatization...**

PPPs are not privatization. Under PPPs, accountability for delivery of the public service is retained by the public sector whereas under a privatization, accountability moves across to the private sector (the public sector might retain some regulatory price control). Under PPPs, there is no transfer of ownership and the public sector remains accountable.

### **...Nor public procurement.**

PPPs differ also from public procurement. Public procurement refers to the purchase, lease, rental or hire of a good or service by a state, regional or local authority. Procurement is chosen because of the simplicity of goods or services desired, the possibility to choose from numerous providers, and the wish to contain costs. PPPs are more complex, frequently larger in financing requirements, and are long-term as opposed to one-off relationships. PPPs frequently provide the developer with the right to operate over an extended term, to charge fees to users and to assume key responsibilities e.g. design, construction, finance, technical and commercial operation, maintenance, etc.

However, PPPs are related to traditional public procurements in that PPP providers are often selected on the basis of public procurement procedures.

### **PPPs have emerged as an important tool to bridge the ‘infrastructure deficit’...**

Many citizens around the world and especially in transition economies face an ‘infrastructure deficit’, as evidenced by congested roads, poorly-maintained transit systems and recreational facilities, deteriorated schools, hospitals, and water and water treatment systems, and other infrastructure assets which are either non-existent or in urgent need of repair. These problems in turn impose huge costs on societies, from lessened productivity and reduced competitiveness, to an increased number of accidents, health problems and lower life expectancy.

Many governments have come to realize that the tax base alone cannot fund the huge needs for infrastructure. In some countries there is an acute need to rehabilitate existing infrastructure that was built decades ago. Furthermore, there is a critical challenge to find the funding for so-called ‘greenfield projects’ specifically the huge social projects required from rapidly growing economies and ageing populations. PPPs are one option to meet this challenge.

### **...Which can provide a number of specific benefits to the public**

**Better value:** The decision by government to pursue PPP delivery is often based on analysis to determine that the PPP approach will deliver value to the public through one or more of the following:

- (a) Lower cost;
- (b) Higher levels of service; and
- (c) Reduced risk

**Access to capital:** PPPs allow governments to access alternative private sources of capital, allowing important and urgent projects to proceed when otherwise they may not be possible.

**Certainty of outcomes:** Certainty of outcomes are increased both in terms of ‘on time’ delivery of projects (the private partner is strongly motivated to complete the project as early as possible to control its costs and so that the payment stream can commence) and in terms of ‘on-budget’ delivery of projects (the payment scheduled is fixed before construction commences, protecting the public from exposure to cost overruns).

**Off balance sheet borrowing:** Debt financing that is not shown on the face of the balance sheet is called ‘off balance sheet financing’. Off balance sheet financing allows a country to borrow without affecting calculations of measures of its indebtedness.<sup>3</sup>

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<sup>3</sup> As of 11 February 2004, Eurostat defined the treatment of Design, Build, Operate and Finance (DBOF) projects as being eligible for off balance sheet borrowing, which was clarified in the February 2005 report ‘Standing Committee on the impact of Investment on the GGB’.

**Innovation:** By combining the unique motivations and skills of both the public and private sectors and through a competitive process for contract award, there is a high potential for innovative approaches to public infrastructure delivery with PPPs.

### **PPPs offer new financing models...**

The private sector brings financing to PPPs, which provides specialized financing that is different from both public finance and corporate finance. As noted above, PPPs are often funded through government budgets but may also be partially or completely funded by the users of the service (e.g. toll road). Project finance is for the most part the means by which PPPs are funded.

The objective of using project financing to raise capital is to create a structure that is bankable (of interest to investors) and to limit the stakeholders' risk by diverting risks to parties that can better manage them. Project finance is based on the following characteristics:

- (a) **'Stand-alone' project:** the funding raised is for only one project;
- (b) **Special purpose Project Company as the borrower:** an independent legal vehicle (Project Company) is created to raise the funds required for the project;
- (c) **High ratio of debt to equity** (Gearing or leverage): the newly created project company usually has the minimum equity required to issue debt for a reasonable cost, with equity generally averaging between 10 to 30 per cent of the total capital required for infrastructure projects;
- (d) **Lending based on project specific cash flow not corporate balance sheet:** the project company borrows funds from lenders. The lenders look to the projected future revenue stream generated by the project and the project company's assets to repay all loans; and
- (e) **Financial guarantees:** the government does not provide a financial guarantee to lenders. Developers may provide guarantees often limited to their equity contributions.

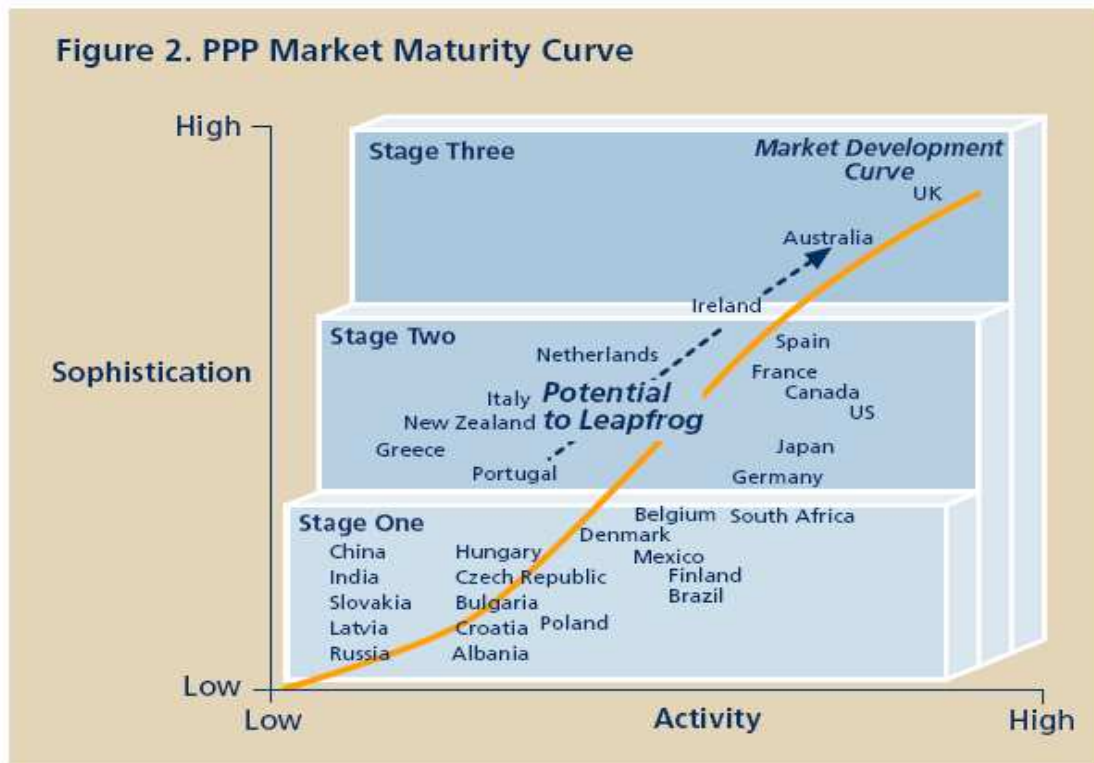
The private financier receives its payment from the income generated from the project or from the government.

### **The growth of PPPs in countries occurs in distinct phases ...**

As seen in the table below, countries tend to go through a number of distinct phases before a PPP programme becomes fully operational. Most countries are at a first stage where the development of actual projects is still numerically small. Only at the third phase, where relatively few countries are currently situated, does the programme become significant. At this stage countries will have developed the required institutions, e.g. the PPP unit, the capital markets as well as the know-how and expertise and can therefore turn their attention to more sophisticated projects and financial arrangements.

**Table 1. Three stages of PPPs development**

<b>Stage One</b>	<b>Stage Two</b>	<b>Stage Three</b>
<ul style="list-style-type: none"> <li>• Define policy framework</li> <li>• Test legal viability</li> <li>• Identify project pipeline</li> <li>• Develop foundation concepts (PSCs etc)</li> <li>• Apply lessons from earliest deals to other sectors</li> <li>• Start to build marketplace</li> </ul>	<ul style="list-style-type: none"> <li>• Introduce legislative reform</li> <li>• Publish policy and practice guidelines</li> <li>• Establish dedicated PPP units</li> <li>• Refine PPP delivery models</li> <li>• Continue to foster marketplace</li> <li>• Expand project pipeline and extend to new sectors</li> <li>• Leverage new sources of funds</li> </ul>	<ul style="list-style-type: none"> <li>• Fully defined, comprehensive “system” established</li> <li>• Legal impediments removed</li> <li>• PPP models refined and reproduced</li> <li>• Sophisticated risk allocation</li> <li>• Committed deal flow</li> <li>• Long-term political consensus</li> <li>• Use of full-range of funding sources</li> <li>• Thriving infrastructure investment market involving pension funds and private equity funds</li> <li>• Well-trained civil service utilises PPP experiences</li> </ul>



*Source: Deloitte and Touche USA LLP*

One of the purposes of this diagram is to demonstrate that countries need to move up the ‘maturity curve’ gradually and resist the temptation to take on projects in areas where they are not ready. While PPPs hold benefits, they also present formidable challenges, and there is a risk that too fast a turnover of assets to the private partner, without the public sector providing the necessary scrutiny, may put in jeopardy the delivery of essential services to the general public. Indeed, governments should be wary of a headlong dash into projects without full knowledge of what has worked and what has not, which puts themselves at risk of repeating earlier mistakes in other countries.

### **... And presents institutional challenges...**

The diagram also shows that the vast majority of governments are still at early stages in PPPs where their use is infrequent and uncommon. Indeed moving up the maturity curve is not automatic and PPPs have proved difficult to implement in many countries. The main reason for this is the need to develop institutions, processes, and procedures to deliver PPP projects. The lack of well performing institutions in many countries is reflected in several things such as the protracted length of negotiations between public and private partners, the slowness of reaching closure, the lack of flexibility in risk-sharing, and the cancellation of many projects with all the resultant waste.

Institutional ‘certainty’ moreover is critically important in success, as private investors will readily shy away from an opportunity where they are asked to take on a project that contains unforeseen risks. These ‘institutions’ consist of two types: the ‘formal’, meaning the legal

and regulatory frameworks and policy coherence, the ‘enabling institutions’ for PPPs, such as PPP units, and the ‘informal’, such as the ‘forums’ where public and private sectors meet to smooth over the misunderstandings and frictions that can arise on specific projects.

The challenge in PPPs then is developing the institutions, procedures and processes for effective PPP delivery.<sup>4</sup> This can be defined as building ‘governance’. If governments are to move up the maturity curve they will have to devote considerable effort to improving governance.

**...Along with building public sector expertise.**

The challenge is not just to create new institutions but also to develop the public expertise to administer projects. PPPs demand a strong public sector, which is able to adopt a new role with new abilities. In particular, strong PPP systems require managers who are not only skilled in making partnerships and managing networks of different partners, but also skilled in negotiation, contract management and risk analysis. Indeed, asking private partners to deliver government services places more, not less, responsibility on public officials.

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<sup>4</sup> Looking back to when countries were being assisted to establish PPP programmes at the start of transition in the 1990s, it was assumed that once a single viable PPP project had been implanted in a country that further deals would flow automatically. However, even while many individual projects were started, these single projects never translated into a deal flow. The reason for this disappointing performance is that other actions and processes need to be developed. It is now clear that a holistic approach is required, which involves the integration of policies and institutions surrounding the project.



## **PART II**

### **GOOD GOVERNANCE IN**

### **PUBLIC-PRIVATE PARTNERSHIPS**



## 2.1. PRINCIPLES OF GOOD GOVERNANCE IN PPPS

### GOVERNANCE CHALLENGE

The interests of the stakeholders are not always fully taken into account when developing PPP projects.

#### Good governance matters...

As stated in Part I, governance matters in PPPs if governments are to climb the maturity curve. This process requires putting into place the enabling institutions, procedures and processes surrounding PPPs in order to fully benefit from PPPs. This means also helping governments to play a critical role in the process and involving citizens as well as other stakeholders. Many governments, regional, international organisations and NGOs now recognize the importance of governance for economic development.<sup>5</sup>

#### ...Even while it is not an easy concept to define.

Governance refers to the processes in government actions and how things are done, not just what is done. It covers the quality of institutions and their effectiveness in translating policy into successful implementation. Institutions are in general understood to be the bodies setting formal rules (property rights, rule of law etc.) while taking into account informal constraints (beliefs, traditions and social norms) that shape human interactions.

#### Good governance involves some key principles...

Good governance is open to much interpretation but overall six core principles have become widely accepted:

- (a) Participation: the degree of involvement of all stakeholders;
- (b) Decency: the degree to which the formation and stewardship of the rules is undertaken without harming or causing grievance to people;
- (c) Transparency: the degree of clarity and openness with which decisions are made;
- (d) Accountability: the extent to which political actors are responsible to society for what they say and do;

“Political will must be mobilized to increase developmental assistance, including for capacity building for good governance.”

Ban Ki-Moon  
United Nations Secretary-General

<sup>5</sup> Amongst the bodies include: International Monetary Fund (IMF), World Bank Institute (WBI), Organisation for Economic Co-operation and Development (OECD), the International Centre for Not-for-Profit Law (ICNL).

- (e) Fairness: the degree to which rules apply equally to everyone in society; and
- (f) Efficiency: the extent to which limited human and financial resources are applied without waste, delay or corruption or without prejudicing future generations.

### **...That are played out in different arenas...**

There are also a number of governance arenas where these issues play out:

1. Government: executive stewardship of the system as a whole;
2. Public administration: where policies are implemented;
3. Judiciary: where disputes are settled;
4. Economic society: refers to state-market, public and private sectors;
5. Political society: where societal interests are aggregated;
6. Civil society: where citizens become aware of and address political issues; and
7. Sustainable development: where environmental concerns are included.

### **...While taking into account the following objectives.**

Taking these elements we can say that good governance objectives in PPPs refer to the following:

- (a) A fair and transparent selection process by which governments develop partnerships;
- (b) Assurance that value for money has been obtained;<sup>6</sup>
- (c) An improvement of essential public services especially for the socially disadvantaged, and adequate training for those to be involved in the new partnerships;
- (d) Fair incentives to all parties and fair returns for risk takers, combined with the achievement of commercial success;
- (e) Sensible negotiation of disputes that assures continuation of services and prevents the collapse of projects and consequent public waste; and
- (f) Enhanced security in the face of the new threats and for a general improvement in the safety of services provided under PPP arrangements.

### **Observing these objectives and principles will lead to economic benefits...**

Good governance in PPPs also matters from an economic perspective:

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<sup>6</sup> “Added value”, also ‘value for money’, means higher quality for the same money or the same quality for less money. See, *Public-Private Comparator*, PPP Knowledge Centre, at The Netherlands Ministry of Finance, p. 113.

- (a) An effective procurement regime means that government institutions are able to buy goods and services of higher quality at lower prices;
- (b) Mechanisms that secure well-governed projects will heighten the support of society for PPPs and give policymakers the confidence to provide the necessary political support for the PPP process;
- (c) Projects which are well planned and are based on the full agreement of all parties engaged, following a proper and ongoing consultation, have less of a chance of unravelling, thereby avoiding costly litigation;
- (d) A public administration that conducts its purchasing in an open manner contributes to the increased confidence of suppliers in the reliability of the administration as a business partner; and
- (e) Good governance and efficient institutions are strongly linked to increased competitiveness and faster rates of economic growth and development.<sup>7</sup>

**...But governance objectives are not being promoted enough...**

Initially the PPP was considered to be a financial mechanism to place expenditures off the balance sheet. As a financial and technical issue, there was also a tendency not to consult the public and other stakeholders.<sup>8</sup> More recently a shift can be detected from using PPPs for financial reasons to using them for greater efficiency or to create added value. Indeed, as 'value for money' objectives have become increasingly commonplace, it becomes increasingly clear that much more can be done so that PPPs can increase social, economic, and environmental development.<sup>9</sup>

**...And a new initiative is needed to integrate good governance criteria into PPP processes.**

Based on these observations, along with the need to bring the stakeholders back into PPPs to maximise their social, economic and environmental impact, the UNECE took an initiative to:

- (a) Organize a series of consultations with stakeholders including trade unions and businesses on good governance in PPPs;

<sup>7</sup> Douglass C. North (1990): *Institutions, Institutional Change and Economic Performance*, Cambridge University Press.

<sup>8</sup> It has been observed that good governance has not been a main priority of Governments in PPPs, given their primary goal in using PPPs is for budgetary factors. Indeed, the Build-Operate-Transfer (BOT) Group of the Economic Commission for Europe, in analysing the early experiences with the private financing of infrastructure in the 1990s, noted that most advisers tended to ignore the importance of good governance, and specifically the need to take into account the wishes of the stakeholders (local citizens, NGOs, employees/trade unions, civil society, media, etc.) in PPPs.

<sup>9</sup> See Guidelines on PPPs, prepared by the UNECE Build-Operate-Transfer (BOT) Group, Geneva, 2001.

- (b) Explore through cases studies of PPPs concerns related to corruption, limited consultations with stakeholders, lack of participation of members of the public in the decision-taking on PPPs, etc.;
- (c) Discuss ways that PPPs could be made more accountable; and
- (d) Prepare several drafts of the Guidebook on Promoting Good Governance in PPPs and hold major international forums to discuss and finalize these principles.<sup>10</sup>

### **This led to the UNECE Guidebook on Promoting Good Governance in PPPs ...**

Out of this process involving dialogue and widespread consultation in many different forums, the UNECE has prepared the good governance principles in PPPs, which focuses on:

- Policy
- Capacity-Building
- Legal framework
- Risk-Sharing
- Procurement
- Putting People First and
- The Environment.

### **...Based on good governance principles.<sup>11</sup>**

In each of these areas, governments can integrate the following good governance standards into their PPP practices:

- Participation
- Decency

<sup>10</sup> A set of recommendations on good governance in PPPs was elaborated by the UNECE PPP group a draft of which was reviewed and endorsed at the International Conference (Tel Aviv, Israel, 5-8 June 2007).

<sup>11</sup> The aforementioned good governance principles for PPPs are bolstered by **The UN Global Compact**, which encourages substantive action in regard to the following ten principles:

#### **Human Rights**

1. Businesses should support and respect the protection of internationally proclaimed human rights.
2. Businesses should make sure that they are not complicit in human rights abuses.

#### **Labour Standards**

3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining.
4. Businesses should uphold the elimination of all forms of forced and compulsory labour.
5. Businesses should uphold the effective abolition of child labour.
6. Businesses should uphold the elimination of discrimination in respect of employment and occupation.

#### **Environment**

7. Businesses should support a precautionary approach to environmental challenges.
8. Businesses should undertake initiatives to promote greater environmental responsibility.
9. Businesses should encourage the development and diffusion of environmentally friendly technologies.

#### **Anti-Corruption**

10. Businesses should work against corruption in all its forms, including extortion and bribery.

- Transparency
- Accountability
- Fairness
- Efficiency and
- Sustainable Development.

### **Sources and Further Information**

- (i) ECOSOC, Environmental Policy and International Competitiveness in a Globalizing World: Challenges for Low-Income Countries in the UNECE Region, 2007.
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- (iii) ODI Briefing Papers, Governance, Development And Aid Effectiveness: A Quick Guide To Complex Relationships, March 2006.
- (iv) OECD, Conference on Improving Governance and Fighting Corruption: New Frontiers in Public-Private Partnerships, 14-15 March 2007, Brussels, Belgium.
- (v) OECD, OECD Guidelines for Managing Conflict of Interest in the Public Service, 2005

## 2.2. POLICY

### Objectives, Projects and Communication

#### GOVERNANCE CHALLENGE

Some governments undertake PPPs without an overall PPP policy, which leads to ill-defined goals and a greater likelihood of problems with the projects.

*Principle 1 – The PPP process requires coherent policies that lay down clear objectives and principles, identifies projects, sets realistic targets and the means of achieving them, with the overall aim of winning the support of the population for the PPP approach.*

A PPP policy is needed to set a ‘roadmap’ for implementation. Without it, there will be no mechanism to enable aspirations to materialize into concrete projects.

#### **The PPP policy should begin by fixing clear economic objectives...**

Governments should have clear goals and objectives in their PPP policies - but what should they be? Some governments have tended to argue that whether a given service should remain in the hands of the state, or be turned over to other private organizations, should be a pragmatic decision. Often by ‘pragmatic’ it is meant economically the most efficient method and one that offers the best ‘value for money’.

#### **...With strong social objectives...**

However, such efficiency criteria alone can be insufficient to convince members of the public and other stakeholders that the PPP approach is best fitted to deliver public services that are basic to human well-being, such as electricity, heating, lighting, health and education. Public services are not commercial products and as a result they tend to be heavily dependent on taxpayers money. Moreover, those who work in public services tend to do so out of a public service ethos, a commitment to the community, and while commercial criteria can be used to deliver public services they cannot substitute the public interest goals enshrined in public services.

Public interest goals include: social equity, inclusiveness, accessibility, transparency and accountability, etc. These goals are particularly important to stress in low-income countries, which want to both increase the efficiency of their services and increase accessibility of basic services to citizens, especially those who are economically and socially disadvantaged.

#### **...That is linked to core values and principles.**

Governments also need to link their policy with ‘core values and principles’ that will be employed when implementing their goals. Here it is important to mention those principles that need to be safeguarded in PPP schemes – the typical key concerns of the public. At every

stage of the process from initiation to the ongoing management of partnerships, government officials may wish to ask key questions such as:

- What are the core values government must protect?
- How can public officials maintain the integrity of these values?
- In what ways can PPPs serve the public interest in a manner that is both equitable and sustainable?

Answering these questions will touch on a number of important issues, such as access to services, cost to citizens, fairness and equity, conflicts of interest, financial accountability, stability and quality of services provided.

### Means of achieving the goals

Once the objectives and principles have been set governments will need to examine how these should be implemented. For example, each of the following should be taken into account by governments:

- The forms of PPPs it will consider;
- The degree of risk it is prepared to accept;
- How it intends to manage risk;
- The risks it is not prepared to accept;
- The criteria for determining whether PPPs are a viable method of service delivery; and
- Its policy on the involvement of stakeholders.

### PPP Policies should incorporate the possibility of change...

PPP policies should be open to change as mistakes will inevitably be made and refinements needed. The UK is a good example. The UK government initiated a PPP policy, learnt from the mistakes and, rather than backing down, revised its policy and moved forward. The policy process became one of continuity but with an inherent ability to innovate and take on new models of cooperation.

### ...And reach consensus both within government...

The elaboration of PPP Policies should involve all relevant government departments. It is important to start with an initial dialogue, bringing together representatives from

### Governments should look at the sectors where PPPs have been especially successful in other countries:

*United Kingdom:* schools, hospitals, prisons and defence facilities and roads.

*Canada:* energy, transport, environment, water, waste, recreation, information technology, health and education.

*Greece:* transport projects: airport and roads.

*Ireland:* road and urban transport systems.

*Australia:* transport and urban regeneration.

*Netherlands:* social housing and urban regeneration.

*Spain:* toll roads and urban regeneration.

*United States:* projects, which combine environmental protection, commercial success and rural regeneration.

different Ministries (transport, finance, housing, energy, health, education, etc.) to discuss the use of PPPs so that some common position can be found for implementation. Coordination and cooperation within the government is a good basis for effective policy implementation. If there are municipal or sector-specific policy frameworks, care should be taken to avoid contradictions and overlapping.

### **...And outside government.**

An important consideration in preparing the policy is the need for considerable consultation with most relevant stakeholders. Given that the policy may impact various existing policies and arrangements, it is essential that stakeholders affected by the new policy be given the opportunity to be involved in its preparation.

### **It is crucial to identify the right PPP projects ...**

The challenge is to select the right projects and sectors where the possibility of achieving success is realistic. In this regard:

- (a) The project must be one for which there is plainly a social and economic need, while its delivery is recognized as important to most political opinions;
- (b) It should involve known and tested technologies, while cultivating an environment conducive to a marketplace of potential suppliers with whom to enter into partnership;
- (c) The project payment stream must be clearly affordable by the sponsoring ministry or agency (and/or supported by Ministry of Finance issued guarantees). The project should be of a sufficient size to interest international financiers and concession companies; and
- (d) The payment stream must not only be affordable but the public authority responsible for payments must also be creditworthy (or suitable credit enhancing mechanisms put in place).

#### **A Useful Model to Get Started**

One model that can be used to develop the PPP market is transport / urban renewal projects. Under such a scheme a government releases underused assets such as real estate around a transport hub such as a railway station and allows the private sector to commercialize the area through the building of shops, offices and recreational areas. The private developer can unlock value from an underutilised asset and use it to raise revenues. The government gives over the asset so that the developer becomes responsible for rebuilding and then operating and maintaining it. Such innovative deals have transformed small cities in Spain. In the U.S. as well, this approach has been used to renovate ageing railway stations in inner cities, while promoting transit-oriented development.

**...Which have realistic targets...**

It is important to encourage governments to prioritize and identify realistic goals for their PPP policy. Governments should start with those projects that are most likely to succeed and which are relatively simple and straightforward.<sup>12</sup>

**...And establish procedures for consultation ...**

Misunderstanding and even conflicts can develop between governments and the private sector, and so it is important to establish an informal mechanism and opportunities for dialogue between the public and private sectors to smooth out problems. By creating a forum in which government officials and stakeholders can discuss their concerns openly, conflicts can be resolved and friction between the different parties can be diminished before more serious problems emerge.<sup>13</sup>

**...While simultaneously communicating the benefits of PPPs...**

A strategic communication plan should be part of policy that explains the benefits of the programme and can prevent the discussion from being defined by PPP critics, within the media and elsewhere. By taking a proactive stance, PPP advocates can shift the focus to topics like congestion relief, the economic benefits that will result, and the greater service access provided to those in need, especially socially and economically disadvantaged groups.

**...And building market interest.**

PPP policy frameworks must provide guidelines and confidence to the investor community. Information must be provided on the types of support which government can give to increase the incentives to investors. In addition, there should be an appropriate number of projects coming into the market at the right pace to ensure that constructors and facility management firms have the capacity and financial ability to keep pace with the potential projects.

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<sup>12</sup> The country can realise a host of benefits from this innovative model:

- The railway station / port / harbour / etc. can be built quickly, spurring economic development faster than would otherwise have been possible;
- Long-term maintenance risks are shifted to the private sector; and
- And the country releases greater value from the land than would be possible under government ownership – all with reduced or no expenditure of tax revenues.

<sup>13</sup> For example, when the Netherlands initiated its first highway PPP, ‘alignment meetings’ were held between the public and private sector to solve cooperation problems. These meetings, which provided an informal setting for open dialogue, allowed for the key team members of both sides to de-escalate problems even before they became serious concerns.

**ACTION POINT**

PPPs are new and there is still no international forum where governments can cooperate in shaping effective PPP policies. In the light of the growing importance of PPPs, governments should promote the creation of international forums to exchange best practice and engage in policy discussions on this topic.

**Sources and Further Information**

- (i) Croatian Government: Guidelines for Purely Contractual Public-Private Partnerships, September 2006.
- (ii) Deloitte and Touche, Closing the Infrastructure Gap, Global Addition, 2006.
- (iii) Lithuania: Workshop on Establishing Public-Private Partnerships (PPPs) in the Transport Sector, Vilnius, 30 June 2005.
- (iv) PriceWaterhouseCoopers LLP, “Developing Public-Private Partnerships in New Europe”, 17 May 2004.
- (v) United Kingdom, HM Treasury, The Private Finance Initiative, Key Policy, March 2006.

## 2.3. CAPACITY-BUILDING

### Skills, Institutions and Training

#### GOVERNANCE CHALLENGE

PPPs involve complicated structures that require new skills, which are found more in the private than the public sector. How can Governments find the necessary skills to develop PPPs?

*Principle 2 – Governments can build the necessary capacities in a combined approach which establishes new institutions and trains public officials while at the same time using external expertise.*

#### **Developing skills inside governments presents a major challenge ...**

There are a number of new skills that must be developed for PPPs, such as negotiation, contractual and financial skills. One of the key challenges is that instead of the traditional approaches, which focus on inputs, PPPs require skills that can identify the outputs of projects.

This involves fixing specifications and targets that the private partner has to attain in order for the payment to be made and to monitor the performance of the partner and foresee any risks that threaten the delivery of the project. Civil servants furthermore will need to understand the industry from which the government will seek partners.

These skills are generally not found within governments and it is therefore best to bring private sector experts into the government.

These new financial and legal skills may be acquirable, but there also needs to be acceptance and willingness by the public sector of the added value which private companies running public assets can bring. This is even more difficult as these new arrangements can be perceived as a threat to job security by public sector employees.

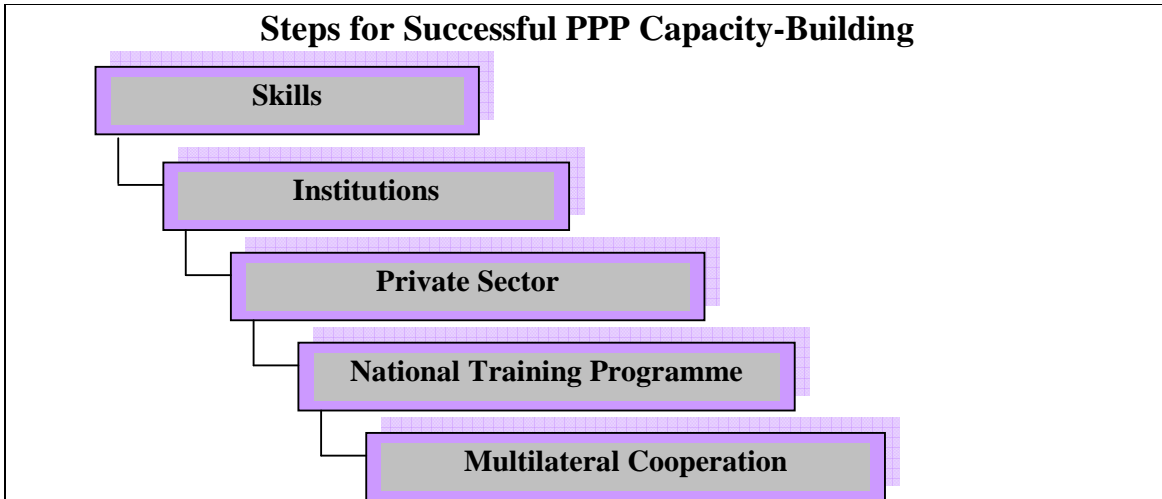
#### **...As ways must be found to put the skills into new institutions.**

It is extremely difficult for a government department to switch virtually overnight from the status quo where it has acquired an asset through traditional procurement to managing a network of different agencies involved in the building of and design of a project over a long period of time – the characteristic features of PPPs.

**PPP Units / Task Forces** should be established to house the new skills. This concentration in

one body will increase the impact of the acquisition of these skills.<sup>14</sup>

**Table 2. Steps for Successful PPP Capacity-Building**



**This must be done by establishing a project pipeline...**

The key role of the PPP Unit is to help develop and intelligently support the management of the project preparation process – an area where most governments have little expertise. It is important to carefully prepare and develop projects, especially given the long-term contractual nature of many PPP deals and the scrutiny they will subsequently be subject to by lenders' credit committees and the public.

**...Supporting regional PPP units...**

Typically, in larger countries the national PPP units will not undertake the projects but rather provide the policy, technical, legal and other support mechanisms to local authorities and government ministries that have the responsibility of putting the project together. Practically, it can help the relevant procuring authority (particularly one that is new to PPP or if the project is particularly new or complex) more confidently manage the whole process (including external advisors) from the development of the initial project design through to the bid evaluation process and post financial close. Units can achieve this by, for example, providing experienced people to sit on the decision-making boards for individual projects and supporting the public sector at key decision-making points.

<sup>14</sup> PPP Units can also be located within special ministries, e.g. Transport, Health, and Education etc., sometimes functioning in coordination with a central unit under the auspices of the Ministry of Finance. In the UK, for example, a number of operating ministries, such as in health, have their own PPP units.

**...Facilitating the PPP process...**

The National PPP Unit should also reduce bid times and costs and improve the quality of the PPP procurement process with standardized contracts and procedures, while ensuring national-level consistency. It can consult with investors and communicate to line ministries their concerns regarding legal and institutional bottlenecks to the implementation of PPP projects. It can furthermore develop the market for PPPs which can provide a consistency of approach across a wider range of projects – thus limiting the chance that the private sector might play one part of the public sector off against another (e.g. the development of the standardized contract in the UK, with sector specific standard derogation, which has helped significantly here). This also reduces the time and cost incurred by private sector bidders to learn/accept new rules for each separately administered market (another benefit of standardization).

**...And providing leadership of the PPP programme.**

The national PPP unit needs to be in a position to lead the programme from the front, while also having its own clear ideas on programme management. It must also have developed its approach to managing advisors, and for engaging with the contractors, service providers and providers of long-term debt and equity finance.

To provide this leadership capacity it is important to be able to recruit highly qualified staff and to take the steps necessary to keep them. Because of the higher salaries it offers, the private sector can drain the public sector of its best personnel. Hence, to ensure that the PPP unit can provide the leadership, government should design structures to counter the risk of an internal brain drain and ensure that PPP programmes will receive resources to be run properly. The consequences of not doing so can be much more costly in poorly prepared and managed projects.<sup>15</sup>

**It is also essential to build capacity by developing the market...**

PPP units should maintain a strong dialogue with all players in the market. This often starts purely as a need to liaise over PPP technicalities and to provide the private sector with information. The role usually develops because the unit reports to colleagues and Ministers the key findings about market attitudes and companies' responses to public sector actions and statements, in addition to reporting details and views about the private sector's capacity.

Moreover, the PPP unit can hold regular seminars for the commercial advisers – legal, technical and financial. Advisers play a central role and they can facilitate dialogue between the public and private partners in accordance with government policies and technical guidance. They also give the unit considerable support and advice informally. The PPP unit will be invited to speak at events sponsored by various players – construction companies,

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<sup>15</sup> A key point is that Governments can often find it hard to recruit and retain PPP talent (compared to the private sector) because of: (i) rigid or formal recruitment systems (with limited secondment from the private sector, and limited lateral entry into civil service positions); (ii) frequent intra-departmental transfers and lack of specialists; (iii) salary differentials with private sector (which not only hinder recruitment of experts but also lead to departure to the private sector of public officials with valuable PPP experience and expertise).

banks, etc. – to provide information. The PPP unit will invariably invite all the main players to ‘one-to-one’ meetings for discussions about their strategies and plans.

**...But doing so at arms length...**

However, while it is important that the PPP unit engages with the business community in establishing partnerships, it is important that the PPP unit retains its neutrality and independence from the private sector and ensures that it projects the public interest and operates according to the values and principles of the public sector.

**...And keeping the programme accountable for its performance.**

The institutional infrastructure requires bodies that can independently scrutinize projects after they have been signed in order to determine whether or not policy objectives have been met. This is not a role for a PPP unit but is vital as a source of independent and technically competent review of projects, which can be used to feedback into further development of policy and guidance.

**Partnerships UK (PUK)**

PUK is one example of a PPP Unit that encapsulates many of these principles. PUK was formed in 2000 to succeed the Treasury Taskforce in providing department-wide centralized support. This allowed the Treasury to concentrate on developing PFI policy, while setting up a separate centre with the expertise to help procuring authorities on more specific transaction-related and day-to-day issues. Hence PUK has a specific public sector mission set out as: ‘to support and accelerate the delivery of infrastructure renewal, high quality public services and the efficient use of public assets through better and stronger partnerships between the public and private sectors’.

As a Public-Private Partnership itself, PUK has a 51% private sector equity ownership, with HM Treasury and the Scottish Executive making up the remaining share. PUK has around 50 professional staff, many retained for more than five years. With over 600 signed projects, the majority of which are moving into or already in their operational phase, the UK has also looked to provide greater support to projects as they make their transition from procurement to the operational stage. An Operational Taskforce acting on behalf of the UK Treasury was created within PUK to work to this effect. The Operational Taskforce is a source of support, guidance and advice for operational projects, advising on contract management strategy, market testing, contract variations and a host of other PFI related issues.

## **Developing national PPP training programmes can also bolster the development of PPPs...**

The PPP unit will establish national PPP training programmes to build the expertise of government officials. A national training programme that has a greater chance of success should include practical ‘on-the-job training’ as opposed to theoretical classroom lecturing. In addition, by taking an incremental approach, setting and then following international standards, perpetually pursuing new knowledge of PPPs and being trained by country-specific PPP educators, developing good governance best practices through case studies, and engaging in on-site project learning, national training programmes increase their chances of success. Overall, “training by doing” inside the operational environment may provide the best solutions for PPP education.

### **Examples of different types of national PPP training programmes:**

*Spain:* SEOPAN, the association of major Spanish contractors and concessionaire groups, has established with a local management-training institute an MBA programme that has produced students to work in the field of concessions.

*Netherlands:* Within the Ministry of Transport a number of large PPP projects have been brought under the supervision of a single management entity and a PPP Knowledge Pool was established on 1 September 2006. The purpose of this Knowledge Pool is to consolidate, develop and spread financial, economic, legal and contractual knowledge and expertise in the area of PPPs within the Ministry. The Knowledge Pool is dedicated internally to facilitate the key positions in the different PPP projects. The rationale is to build expertise on the basis of delivering a few successful pilot projects, which reflect the Ministry’s new orientation in PPPs towards reliable and predictable access of transport services.

*United Kingdom:* Partnerships UK runs one or two times a year a PPP Foundation Course specifically for public sector PPP task force officials involved with the development and management of PPP programmes.

### **...Foster multilateral cooperation...**

Multilateral cooperation is important in PPP training programmes because it saves resources and avoids reinventing the wheel each time a country launches a PPP programme. National PPP units in this regard have helped other governments to establish their own units and to help with training on a bilateral basis. Gradually, over time, a consensus has emerged that there is a need now to make such valuable *ad hoc* arrangements more formalized in a new multilateral framework of cooperation.<sup>16</sup>

<sup>16</sup> The European Commission, jointly with the European Investment Bank, is establishing a European PPP Expertise Centre (EPEC), to be a platform to exchange experience about PPPs and to help develop PPP policies where Member States or responsible public authorities at regional level require such support. It is proposed that this body will become operational in 2008.

**...And at the same time combine this with the hiring of external advisers to fill the skill gap.**

For countries getting started in PPPs, a key requirement is to provide the necessary skills, usually by hiring consultants and external advisers. As it stands today, certain countries issue guidance on the hiring of consultants as advisers to PPP projects and it is essential to bring advisers into the project early rather than incorporating them into the team at a later date. In particular, the right advisers can provide the following guidance:

- (a) Technical
- (b) Legal
- (c) Financial and
- (d) Project Monitoring/Due Diligence.

It is important to ensure that only credible advisers with relevant experience are hired, while setting clear and binding rules of project governance, putting sufficient control mechanisms in place, and developing standard contract guidelines in order to maintain a seamless integration of the external advisers within the relevant government department.

#### **ACTION POINT**

Training is a critical component for a successful PPP programme and following the dissemination of the Guidebook, it is proposed, at a next stage, to elaborate training modules for project specific PPPs such as in roads, hospitals and schools.

#### **Sources and Further Information**

- (i) Deloitte and Touche, Closing the Infrastructure Gap, Global Addition, 2006.
- (ii) PriceWaterhouseCoopers LLP, “Delivering the PPP Promise”, November 2005.

## 2.4. IMPROVING LEGAL FRAMEWORK

### ‘Fewer, Better and Simpler’

#### GOVERNANCE CHALLENGE

Legal processes in many jurisdictions are insufficient, overly complex and fail to provide sufficient security and incentives to investors in PPP arrangements.

*Principle 3 – Investors in PPPs need predictability and security in legal frameworks, which means fewer, simpler and better rules. In addition, the legal framework needs to take account of the beneficiaries and empower them to participate in legal processes, protecting their rights and guaranteeing them access in decision-making.*

#### A clear framework of law and regulation...

Countries need a secure, predictable, stable, consistent and commercially-oriented framework of law and regulation, so that PPPs can flourish.

#### ...Must be based on key principles and priorities:

- (a) Protection of rights of investors to dispose of their property and assets;
- (b) Promoting a better quality of legislation under the banner of fewer, better and simpler rules;
- (c) Making enforcement more business sensitive;
- (d) Improving the effectiveness of the judiciary in the enforcement of contracts; and
- (e) Developing the legal framework for PPPs on the basis of thorough consultation in those areas which most directly affect the start up of the project and its operation, including concession, tax, competition, procurement and company laws.

#### Fewer laws...

PPP legislation should not be prescriptive, but permissive focussing on achieving outcomes, while setting broad parameters in which partners can design and implement projects that they agree on. Dense legislation that seeks to micromanage the PPP process will only deter prospective investors. The emphasis should be placed on flexibility. It also means:

- (a) The removal of burdensome legal constraints on investors using public assets;
- (b) The use of assets by private partners can sometimes be challenged by reference to provisions in the constitution. In these cases, such laws should be revised;

- (c) The removal and streamlining of unnecessary approval procedures for construction and land use; and
- (d) The lifting of legal restrictions on the investors' rights to use the benefits of their investment, such as on the ability to dispose of their equity investment in the Project Company at market prices and to repatriate the profits out of the country.

### **...Better laws...**

Better laws are those that are knowable and secure, allowing investors to plan investment decisions and to adopt longer term as opposed to short-term perspectives when entering a market and this factor can attract a better quality of investment to a PPP. In PPPs better predictable rules have also some other more specific advantages, namely where the need to mitigate risk is such a central feature, predictability can allow lenders to better quantify the risk.

Lenders and investors will look for a predictable and reliable framework for PPPs for example, on investment laws, tax, security, corporate law, and contracts, and dispute resolution law in the project country. Bearing in mind the limited recourse nature of most concession based financing, funders look mainly to the legal and contractual framework for protection and need to be reassured as to its long-term stability and predictability. Here the predictable conditions for investments will include such things as no restrictions on foreign or private ownership, deductibility of construction and other expenses, double tax treaties with investors' countries, no withholding tax on interest or dividend payments and the offer of other suitable tax incentives.

Better also means better quality legislation that clarifies rights and obligations in PPP processes. One such case – the public sector's legal ability to grant concessions – is in many jurisdictions the most critical uncertainty faced by lenders and investors and it is best removed by a fully-fledged concession law.<sup>17</sup> It is far more difficult to change a law than it is guidance, directives and other lesser rulings. It is also important to bear in mind that private investors prefer generic legislation as opposed to sector-specific rules, dealing with, say, transport or education, as the former involves numerous lenders and investors while specific legislation on sectors has a smaller constituency and is perceived as more vulnerable to change at the hand of the host government.

### **...And simpler laws will all lead to successful PPPs.**

Many PPP processes are often very complex and this raises the cost and excludes all but the wealthier partners. Simpler procedures will improve competition, which will also increase the range of partners governments can choose from.

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<sup>17</sup> The requirements and extent of any PPP law will also depend on the nature of the legal system. Under common law systems, the need for an extensive PPP law is often not nearly as great as in civil code systems. In the UK and Australia for example, PPPs have been successfully implemented with very little PPP law. In civil code systems this is less likely.

To improve efficiency in the legal processes surrounding PPPs, governments can standardize contracts. This approach promotes a common understanding of the main risks, allows consistency of approach and pricing across a range of similar projects and reduces the time and costs of negotiation by enabling all parties concerned to agree a standard approach without extended negotiations.<sup>18</sup> Another practice is bundling projects, that is contracting with just one partner to provide several small-scale projects and incremental partnerships, which allow a partnership to grow by stages rather than in one ‘big bang’. All these practices use economies of scale, lower costs to boost incentives for investors.<sup>19</sup>

Another practice that is becoming commonplace is the ‘Competitive Dialogue’. In complex contracts where a contracting authority is not objectively able to define the technical means capable of satisfying its needs or objectives, or specify either the legal or financial make up of a project or both, a new form of arrangement – competitive dialogue – is often used by governments. It involves working with bidders to develop technical and commercial solutions. While this approach leads to solutions that overcome the inherent complexity of PPPs, the contracting authority must still work to ensure fairness in the tendering procedures and avoid discrimination.

### **Improving legal processes means better arbitration processes...**

Lawsuits in PPP cases can be expensive and burdensome. Governments can improve the framework in which commercial disputes are solved. Overall, the investor needs to have confidence that the judiciary will enforce the laws and enforce contracts. In addition, the necessary administrative documents (such as authorizations and licences) to implement the PPP project must be obtainable.

Judicial enforcement is also a concern in arbitral judgements. Disagreements during the course of a PPP contract are common. Arbitration typically is performed on the basis of an agreement, explicit or tacit, prior to, or after, the dispute arose. Most countries have a law on commercial arbitration, some of which are based on the UNCITRAL Model Law on International Commercial Arbitration. Often, arbitration takes place with an institutional arbitration tribunal.

#### ***Recent trends in arbitration***

Use of foreign courts to deliver arbitration settlements

Increasing interest in the use of mediation

The concern of the investor is that local courts favour the local public partner. This concerns firstly the obligation for arbitration to take place in local courts. If the judgement is held outside the country there is often the further concern that the local judiciary will not enforce the decision. Arbitration needs to be widely recognized and generally not obstructed.

<sup>18</sup> In the UK, the Government decided to standardize PFI contracts: The Standardization of PFI Contracts was developed (SoPC 4 see UK Government, 2007). In the UK all PFI schemes must be SoPC4 compliant. To avoid uncontrolled sector-specific derogations from the model contract, at the time of writing all derogations from SoPC4 require specific prior approval from HM Treasury.

<sup>19</sup> In Australia, bundling sometimes takes the form of grouping hospital construction with ancillary structures and commercial activities, thereby creating enough revenue generation to balance against building and procurement costs.

In order to improve countries' dealings with regard to arbitration, governments may wish to familiarize their judiciary with the various international bodies dealing with international commercial arbitration, like the ICC. In addition, governments should also consider, if they have not already done so, the ratification of the New York Convention on the enforcement of arbitral awards. In considering arbitration rules for PPPs, it might also be helpful to refer to dispute resolution procedures set out, for example, in the UK's SPOC4.<sup>20</sup>

**...Together with fair and consistent enforcement...**

The way regulations are applied and enforced is just as important as the content. Governments need to make enforcement and implementation more business-friendly by putting emphasis on helping business to comply with rules and become real partners.

**...As well as fuller consultations.**

In drafting rules on PPPs as well as on continuing improvements it should be considered that drafting and detailing content are likely to benefit from public consultation. Improvement can also be made in writing legislation that is clear and user friendly.

**It is important to train lawyers and judges, particularly about lenders' rights to 'step in'...**

Many legal issues in PPPs will be new. For example under concession contracts lenders ask to be given 'step in' rights. This allows the lender to take over the project, and if necessary bring in a substitute concessionaire, in order to forestall a termination of the concession agreement following the concessionaire's default. The main purpose of 'stepping in' is to avoid a collapse of the agreement of the concessionaire and the basis by which the lender is repaid. Given this threat to its repayment, the lender is likely to ensure that it or a substitute project company appointed by it, has an opportunity to cure the default. This in effect allows the private entity to halt the government exercising its right to terminate. This right, however, can prove controversial to government entities that have not encountered them before and can lead to a number of awkward questions related to when the lender can step in, duration of the cure period and so on.<sup>21</sup>

**...While empowering citizens to use the legal processes is also essential to creating good governance.**

Good governance also means the practice of extending the rule of law to groups who for various reasons do not have access to laws to protect their rights. Legal empowerment specifically refers to the socially and economically disadvantaged who need to improve their access to basic services. In many societies the perceptions of the legal and law-enforcement systems are not favourable among the economically marginalized communities. This has to be overcome if the benefits from PPPs are to reach a wider constituency.

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<sup>20</sup> Released in March 2007, UK.

<sup>21</sup> See Law in Transition, 2007 Public-Private Partnership, pp. 46-47.

One method of legal empowerment is to better inform people of their rights to access good services and to enable them to participate in decision-making, preferably while the project is still in the planning stage. Governments should create mechanisms for early public participation and build up the constituencies who will use them. Otherwise, this will become a right that is not used or implemented.

“Although regional in scope, the significance of the Aarhus Convention is global. It is by far the most impressive elaboration of Principle 10 of the Rio Declaration, which stresses the need for citizen participation in environmental issues and for access to information on the environment held by public authorities. As such it is the most ambitious venture in the area of environmental democracy so far undertaken under the auspices of the United Nations.”

Kofi A. Annan  
Former Secretary-General of the United Nations

A good example of the legal empowerment of people that is relevant to PPPs is the UNECE Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters (the Aarhus Convention). This Convention promotes the principles of good governance and the rule of law by recognizing that better access to information and increased public participation improve the quality of decision-making, while enabling public authorities to be more responsive to public demands and concerns. It also provides access to a review procedure before a court of law or another independent and impartial body established by law to members of the public whose rights of access to information and public participation have been impaired.

The Convention is therefore not only an environmental agreement, it is also a treaty about government accountability, transparency and responsiveness. The Convention’s main contribution in promoting good governance is in setting standards for government performance that are applicable throughout the UNECE region and beyond.

#### **ACTION POINT**

Governments and international organizations may wish to work together to complete a pan-European legal framework for PPP legislation that can serve as a model for governments in the region, taking into account existing recommendations, and providing for fewer, better and simpler approaches.

## Sources and Further Information

### EUROPEAN COMMISSION

The European Community ("EC") lays down a number of specific rulings covering PPPs which can be consulted in drawing up national PPP legislation:

- Directive on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts of 31 March 2004 ("Public Contracts Directive") defines and regulates precisely "public contracts";
- The Interpretative Communication on Concessions of 29 April 2005 ("Communication on Concessions") defines the characteristics of concessions and general rules to be respected in the concession granting process;
- Guidelines for Successful Public-Private Partnerships (March 2003) ("PPP Guidelines");
- The Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions (April 2004), ("PPP Green Paper"). The PPP Green Paper provides that, "In general, the term [PPP] refers to forms of cooperation between public authorities and the world of business which aim to ensure the funding, construction, renovation, management or maintenance of an infrastructure or the provision of a service";<sup>22</sup>
- Communication on Public-Private Partnerships and Community Law on Public Contracts and Concessions (November 2005);<sup>23</sup>
- Public Contracts Directive: Public contracts (supply, works and service contracts) are contracts for pecuniary interest concluded in writing between one or more economic operators and one or more contracting authorities and having as their object the execution of works, the supply of products or the provision of services (Public Contracts Directive, art. 1). It defines also "public works concession";<sup>24</sup> and EU Procurement directives: In developing PPP legislation reference might also be

<sup>22</sup> It specifies furthermore that the following elements normally characterize PPPs:

- Relatively long duration of the relationship;
- Funding, in part from the private sector (public funds, "*in some cases rather substantial*", may be added);
- Important role of the economic operator (participates at different stages of the project: design, completion, implementation, funding); and
- Distribution of risks between the public and the private partner; risks generally borne by the public sector are transferred to the private operator (not necessarily all or major).

<sup>23</sup> The term concession is defined indirectly in the Communication on Concessions, by defining the scope of application of the Communication and by distinguishing concessions from public contracts: "This communication therefore concerns acts attributable to the state whereby a public authority entrusts to a third party - by means of a contractual act or a unilateral act with the prior consent of the third party - the total or partial management of services for which that authority would normally be responsible and for which the third party assumes the risk. Such services are covered by this communication only if they constitute economic activities. "

<sup>24</sup> A public works concession is distinguished from a public works contract in that the works concession involves the transfer of the risks inherent in operation. A privately operated toll motorway is an example of a public works concession. However, if public authorities guarantee reimbursement of the financing, this would be considered as a public works contract. The distinction between a services concession and a public service contract is based on the same criteria: transfer of risks inherent in operation.

made to the EU procurement directives introducing competitive dialogue procedures.

## **UNCITRAL**

The main international standard on legal best practice is provided by UNCITRAL:

- The 2000 UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects. This was followed in 2003 by the approval of the Model Legislative Provisos for Privately Financed Infrastructure Projects. The guide provides guidance and best practice, explanatory materials and recommendations.

## **EBRD**

- The EBRD using the UNCITRAL Guidelines to benchmark the performance of the transition economies in meeting best practice legal standards. See Law in Transition, April 2007.

## 2.5. RISK

### Cooperative Sharing and Mutual Support

#### GOVERNANCE CHALLENGE

Theory in project finance suggests that risks should be borne by the party best able to manage them, but many PPP projects often fail because the parties cannot agree on the allocation of risk, with each side trying to shift the risk to the other. It is also difficult to calculate risks, especially in transition economies when the rate of economic growth is sometimes less predictable, which makes forecasting demand especially in transport projects a difficult exercise.

*Principle 4 – PPPs allow risk which is most able to be managed by the private sector, to be transferred to them. However, governments also need to accept their share and help to mitigate those allocated to the private sector in mutual support.*

#### **Balancing risk is of crucial importance to PPP development...**

The main benefit from PPPs arises from the transfer of risk to the private sector. But such a transfer and the degree to which the private sector is ready to assume it sometimes impairs the feasibility of projects. The lenders tend to be highly risk averse and will turn down even the most socially desirable project if they perceive it to have too many risks – a fact which disappoints and frustrates the public sector.

#### **... And governments should identify risks at the start of projects...**

A good starting point may be to use a checklist of the risks, which typically apply to infrastructure service projects.

#### **...Establish a risk matrix...**

A useful tool to both government and the private sector is the risk matrix, which should be applied to each project phase, setting out the government's preferred position on allocation. During the pre-tender and tender phases, it can assist government practitioners in listing all the relevant project risks and their proposed allocation. During negotiations it can act as a checklist to ensure all risks are addressed, and after signing of the contract it can be a useful summary of the risk allocation effected by the contract.

#### **...And be prepared to mitigate the risks...**

Governments can use a number of tools such as insurance to mitigate the risk of a force majeure event, which could damage a state-owned network essential to the private component of the project. Such systems may be insurable by undertaking research before issuing tenders and specifying desired outcomes of the project (while taking into account government policy). Since the project is in the public interest, it is also essential to provide transparent regulatory

procedures, especially at the bidding stage. Once the project starts, the government will have to establish a risk monitoring system to ensure that services are delivered according to contracted performance specifications. Accordingly, this will allow for payment for services to be appropriately verified while ongoing surveillance will monitor that the project is progressing as planned.

**...While taking on their own share of risk within the areas where they have influence...**

Governments need to address political risk, including the concern that governments will come in unilaterally and change the rules (the swing from a positive approach to PPPs to a negative approach and cancellation of PPPs after an election is commonplace in some countries).<sup>25</sup>

**...While also responding to private sector concerns over ‘red tape’...**

A further challenge the private sector faces concerns the difficulties in obtaining the needed planning and other approvals to start projects, since red tape and unnecessary interference can delay the project. With respect to ‘red tape’, Governments can intervene to smooth over such problems in order to facilitate the project to start on time.

**...And changing agreements, but only in the right way.**

Governments can change the conditions of the agreement because of the long duration of projects. Yet, it is important before the change is made, that the private partners are fully consulted. Similarly, a government can ‘step in’ or terminate the contract if it perceives the project to be going awry. Here the private sector’s anxieties can be addressed by contractual clauses, which make termination and ‘step in’ measures of last resort.<sup>26</sup>

There ‘is a general perception that a private sector provider is “contracting with the umpire” which creates a general unease about changes to all areas of legislation and policy’.

*Source: Partnerships Victoria*

Attention must also be paid to the potential effects of lengthy cure periods and particular defaults, while also taking into account the government’s capacity to deliver core services and its ability to deliver or procure the delivery of replacement ancillary services that the private party is unable to provide.

**At the same time, it is also crucial that the government provides necessary support...**

<sup>25</sup> In some cases, however, the PPP can survive. For instance, the A1 road project in Poland survived eight changes of government during its negotiation process.

<sup>26</sup> In the case of a step in, relate only to emergency access and where there had been a material service default (which includes continuous or repeated non-material defaults); and in the case of termination, seek to ensure that ‘cure periods’ are fair and that as far as possible, the conditions under which termination or government step-in may occur, are clearly specified and limited to material defaults so as to avoid hair trigger termination events.

Many projects, especially in transport, require massive private sector investment and here the private sector may not accept one of the various commercial risks for these projects.<sup>27</sup> The public sector must provide support to a project and lower the risks sufficiently to stimulate the desired levels of private sector investment.<sup>28</sup>

There are various forms of support which the government can give to a project in order to mitigate the risk to the private sector (See Annex). To take one such example, guarantees may be an appropriate form of government intervention, in particular to shield the private sector from risks that it cannot anticipate or control. Indeed, many PPP contracts provide for minimum revenue guarantees that limit the private sector's exposure to demand risk.

**...However these types of guarantees and supports by governments must be provided with care...**

It must be noted that under this scheme, governments take on liabilities which have important fiscal implications. There is a risk too that inadvertently the governments create a 'guarantee culture' where the private sector seeks guarantees as an alternative to managing the risk themselves. Governments must stay focused on the fact that the whole point of the PPP is to improve performance of the project, which is done by using the risk to its investments as an incentive to the private sector to perform well.

Because guarantees are valuable to beneficiaries and are provided at the discretion of government, this can undermine governance. In reviewing this issue, government officials may wish to follow IMF Guidance on National Accounting. These guidelines argue that such guarantees do not count as part of a sovereign guarantee ceiling calculation, provided that they are being given to commercially viable entities, and it is unlikely at the outset that they will be called absent in the occurrence of an unforeseen event.

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<sup>27</sup> These include: the risk that in the promotion and development stage of the project, there is still no guarantee that the project will take place; the high-risk construction phase due to the likelihood of cost overruns throughout the lifetime of the project; and the uncertain revenues once a project starts operating and the potential for policy changes to undermine the viability of the project.

<sup>28</sup> For example, if the public sector does not plough enough resources or fails to offer other ways of lowering commercial risk, then projects such as TENS, which require massive private sector investment to be completed, will not be realized.

### **Flexibility is important in risk allocation**

#### *Case of Spanish Toll Roads*

Every situation is unique and there are no hard and fast rules or models for risk allocation. Often governments can introduce less orthodox and flexible tools in risk-sharing, which can have welcome benefits. For example, over thirty years ago the Spanish government, in an effort to upgrade its roads around its coastal seaside resorts to boost tourism, made a brave decision. It assumed the exchange rate risk on the project, something that, according to common practice, may have been considered to be ill-judged. Exchange rate protection continues up to the present day. However, based on a calculation of the costs of taking on such a risk and not taking into account the externalities of the benefits from tourism flowing from the improvement in the roads, it appears that over this period the government lost nothing in accepting this risk.

#### **...Because the risks and the benefits should both be shared.**

After a PPP project such as prison, school, or hospital is built, the level of risk falls substantially. This is because with the facility built, the risk that the facility may not be completed on time disappears. As a result, banks become receptive to review the interest rates it charges and to cut the cost of the loan. This leads to the creation of financial surplus and raises the question of who should gain from the success, bearing in mind that it has been typically the private sector that has taken on the construction risk in the first stage of the project?

Current practice suggests that all parties, rather than one exclusively, should share in the gains and that gains could be shared out by a formula agreed by the various parties before the agreement is signed.

#### **ACTION POINT**

PPPs afford both the public and private sector with a unique opportunity to share risk while providing complementary support in order to ensure that the project leads to mutual benefits to both sectors.

#### **Sources and Further Information**

- Partnerships Victoria, Risk Allocation and Contractual Issues, June 2001.
- IMF, PPP and Fiscal: International Seminar on Strengthening Public Investment and Managing Fiscal Risks from Public-Private Partnerships, Hungary, 7-8 March 2007.

## ANNEX TO SECTION 2.5.

### Public Authority Support for PPPs

#### **Rationale of public authority support**

- (a) A decision to support the implementation of a project is based on an assessment by the government of the economic and social value of the project and whether it justifies particular government support (certain projects cannot be financed by the private sector alone at an acceptable cost, others cannot materialize without government support, given the appreciation of an overall investment climate in the countries).
- (b) Three distinct justifications are generally presented in favour of government support: (i) the existence of uninsurable political risks; (ii) a policy decision that certain services should be provided at below real cost and thus subsidized to reduce user fees; and (iii) the theory that the government has a lower cost of risk bearing than private investors.
- (c) Political risks traditionally include the risk of expropriation, the risk of political violence (war, terrorism, etc.) and convertibility and transfer risk. However, the definition of political risks can extend to modifications of legal framework, unfavourable regulatory decisions or failure by publicly-owned enterprises to uphold their obligations to the project
- (d) Government financial support can be provided through three basic instruments (i) subsidies; (ii) financial instrument (debt, equity); or (iii) guarantees.
- (e) When defining public authority support, care should be taken *inter alia* (i) not to breach international/regional obligations of the country; (ii) to choose the most appropriate methods for estimating the budgetary costs of support measures, taking into account the present value of future costs or loss of revenues; and (iii) to ensure transparency (timely communication to all bidders).

*e.g. M5 Toll Motorway project in Hungary: for the first six and a half years of commercial operations, the government provided the private sector consortium with compensation in the form of a subordinated loan facility, repayable after discharge of project indebtedness to senior lenders, in the event that the consortium's actual revenues, for whatever reason, were below certain levels.*

## **Different forms of public support**

### **Public loans and local guarantees**

#### **Public loans**

- (a) Interest free or low interest loans in order to lower the project's financing costs.
- (b) Subordinated loans provided by the Government may enhance the financial terms of the project by supplementing senior loans provided by commercial banks.
- (c) Available to all project companies in a given sector or temporary assistance to the project company in the event that certain project risks materialize.
- (d) *Limitation:* to a fixed sum or to a percentage of the total project cost.

#### **Loan guarantees**

- (a) Public guarantees by the Contracting Authority or other government agency for the repayment of loans (can be limited to certain events) by such a company. Such guarantees usually have lower costs than loan guarantees provided by commercial lenders.
- (b) Loan guarantees are generally not recorded as expenses until such time as a claim is made, but may represent a substantial contingent liability (significant exposure in the event of total failure by the Project Company).
- (c) *Limitation:* to a fixed sum or to a percentage of the total project costs/defined circumstances under which guarantees can be extended (e.g. prior exhaustion of all other remedies available to lenders under the project agreement, the loan agreement or a direct agreement with the Contracting Authority).

#### **Equity participation**

- (a) Direct or indirect equity participation in the project company assures public involvement in and support for the implementation and operation of the projects and helps achieve a more favourable ratio between equity and debt (by supplementing equity provided by the project sponsors when other sources of equity capital such as investment funds are not available).
- (b) *Limitation:* care should be taken to distinguish public equity participation from a total public guarantee.

#### **Subsidies**

- (a) Tariff subsidies to supplement the Project Company's revenue when the project income falls below a certain minimum level; conceived as an alternative to the full commercial freedom to determine tolls, tariffs, etc.

*e.g. Perpignan-Figueras Rail Concession between France and Spain: state subsidy covering 57 per cent of the construction costs.*

- (b) Subsidy support can be provided by the government to cover the difference between the full commercial price and the actual user charge so as to retain incentive for private sector efficiency.

- (c) Subsidies usually take the form of direct payments to the project company (lump sum payments or payments calculated specifically to supplement the project company's revenue): audit and financial disclosure provisions in the projects agreement required. An alternative to direct subsidies may be to allow the project company to cross-subsidize less profitable activities with revenue earned in more profitable ones.
- (d) *Limitations*: (i) requirements of competition laws (many countries prohibit the provision of subsidies not expressly authorized by legislation), and (ii) requirements of international/regional agreements.<sup>29</sup>

### **Sovereign guarantees**

Pursuant to sovereign guarantees, the State, or sub-sovereign entity, does not guarantee the Project Company or the lenders the repayment of the loans but rather the 'proper behaviour' and the respect of the commitments of the Contracting Authority and/or of the other concerned public authorities. It should be noted, however, that a failure to respect such commitments will give rise to the monetary obligation to pay damages, which could include, *inter alia*, costs incurred to lenders under acceleration of loans in case of default.

### Performance guarantees

- (a) Guarantees issued by the host governments to cover the breach of obligations assumed by the Contracting Authority under the project agreement.
- (b) Performance guarantees are useful instruments to protect the project company and the lenders from the consequences of default by the Contracting Authority or other public authority assuming specific obligations under the project agreement.
- (c) Performance guarantees are used where the Contracting Authority is a separate legal entity that does not engage the responsibility of the government itself. However if a Contracting Authority is a truly corporatized entity, the performance risk cannot easily be considered as a political risk, but rather as a commercial risk.
- (d) Central government cannot provide guarantees against risks related to the behaviour of other entities (e.g. decentralized political authorities). To add credibility to the government's own commitment, other instruments may be needed, such as government's performance guarantees or guarantees by multilateral institutions counter guaranteed by the government. Performance guarantees can also be issued in the name of a public financial institution of the host country.
- (e) The legislation should enable the government to efficiently manage and assess the project risks and determine the level of direct and contingent liabilities it can

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<sup>29</sup> For more information on this topic, see EBRD risk-sharing reports on the Perpignan-Figueras Rail Concession between France and Spain.

assume, e.g. *Off-take Guarantee*: Government guarantees payment of goods and services supplied by the Project company to public entities.

In the scope of “power purchase agreements”, resources (or cash flow) are provided to meet (i) debt service, (ii) operation and maintenance costs, and (iii) return on investment.

Supply guarantees protect the parent company from the consequences of default by the public sector entities providing goods and services required for the operation of the facility (e.g. fuel, electricity, water), or to secure payment of which the Contracting Authority may become liable under the supply agreement

General guarantees: provided to protect the Project Company against any form of default by the Contracting Authority rather than default on specifically designated obligations. General guarantees are not very frequent, but can be used when the obligations undertaken by the Contracting Authority are not commensurate with its credit worthiness (e.g. municipal concession).

#### Guarantees against Adverse Acts of Governments

Guarantees that the Project Company will not be prevented by the Government from exercising certain rights that are granted to it under the project agreement or that derive from the laws of the country:

- (a) Foreign exchange guarantees: guarantees (i) convertibility of local earnings into foreign currency, (ii) the availability of the required foreign currency to meet all foreign debt-service obligations, foreign dividend and management payment, and (iii) the transferability abroad of the converted sums.
- (b) Expropriation guarantees: assures the company and its shareholders that they will not be expropriated without adequate compensation (includes confiscation and nationalization).

#### **Tax and customs benefits**

Legislation on foreign direct investment often provides special tax regimes to encourage foreign investments (tax exemptions, reductions, benefits). Such regimes should be carefully analysed and provided only when they benefit the Project or are needed to attract investors. Examples of such benefits include:

- (a) Exemption from corporate tax of the concession period (tax holiday);
- (b) Exemption from income tax for foreign project staff/lenders;
- (c) Exemption or reduction from real estate tax;
- (d) Exemption from or reduction of import duties on equipment, raw materials and components of the construction and operation and maintenance of the project;
- (e) Tax concessions on royalties;
- (f) Tax refund for foreign investors reinvesting their profits in new infrastructure projects in the country;

- (g) Deductions from taxable income for the cost of certain expenses such as electricity, water and transport; and
- (h) Capital/allowances in the form of depreciation or amortization.

### **Protection from competition**

- (a) Assurance given by the host government to the Project Company that no competing infrastructure projects will be developed for a certain period and within a certain perimeter, up to a defined threshold (e.g. traffic, consumption, etc.) and that no agency of the government will compete with the Project Company, directly or through the concessionaire. This may be particularly important for toll roads projects, where an additional road could undercut the revenue flow. Such provisions must be carefully reviewed by the Public Sector, however. Given the long-term nature of PPP contracts, population growth or other factors may render such provisions problematic.
- (b) Limitations: (i) requirements of competition laws (risk of monopolies that put national customers at a disadvantage), and (ii) requirements of international /regional agreements.
- (c) Ancillary revenue sources.
- (d) Allowing the Project Company to diversify its investment through additional concession for the provisions for ancillary services or the exploitation of other activities (e.g. right to collect tolls on an existing bridge, or the right to charge fees for the use of a facility built by the Contracting Authority).
 

*e.g. Sydney Harbour Tunnel Project: sponsors obtained the concession to operate the existing Sydney bridge as one of the incentives and the bridge toll was increased to the same level as the toll for the tunnel.*
- (e) Necessity of legislation allowing the right to use property of the Contracting Authority for purposes of charging fees for the use of a facility built by the Contracting Authority.

### **Possibility to create, perfect and enforce reliable security instruments:**

In the context of non-sovereign transactions, lenders look to the cash flow and assets of the project company to secure payment of their loans. In this respect, lenders will pay particular attention to how much and how fast they can recover their unsatisfied claim through realization of charged assets, and how simple the whole process will be.

Creation, perfection and enforcement of lenders' security instruments (see examples below) require that the legal system does not contain legal or regulatory impediments. Examples of such impediments include:

- (a) For the creation of a security: necessity of precise identification of the cadastre for mortgage or pledge or other attachment on movable or immovable assets;
- (b) For the perfection of a security: difficulties to verify the existence of prior ranking claims (poor state of corresponding registries) unclear, thus costly, procedures for registration, impossibility to attach public property, immunity;
- (c) For the enforcement of a security: difficulties in repossession and selling of collateral.

**Security interests in property assets:**

- (a) Mortgages over land, buildings and other fixed assets (floating) charges over movable assets, including project inventory and receivables production/work in progress, intangibles. And other personal property and interests.
- (b) Pledge on shareholders equity participation on the borrower's interest in the major projects agreements.
- (c) Assignment of rights underlying major project authorizations.

**Escrow accounts:**

- (a) Control and retain cash flow relating to the project.

**ACTION POINT**

The experience and key learnings from PPPs to date underscore the importance of building institutional and human capacities in PPPs and the need to improve governance in PPPs.

**Sources and Further Information**

- (i) British Columbia Ministry of Municipal Affairs, Public-Private Partnership: A Guide for Local Government, May 1999.
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- (iii) Deloitte and Touche, Closing the Infrastructure Gap, Global Addition, 2006.
- (iv) DLA Piper Rudnick Gray Cary, European PPP Report 2005.
- (v) Invest Japan, Japan's Private Finance Initiative on the Move, 2003.
- (vi) Vladimir Varnavskiy, Public-Private Partnerships: Types, Projects, Risks; Moscow, 2005.

## 2.6. PPP PROCUREMENT

### Transparent, Neutral and Non-Discriminating Selection

#### GOVERNANCE CHALLENGE

There is a gap in capacity to organize competitive tenders, especially at the local level, and a public perception of inadequate transparency in awarding PPP deals, and the lack of adequate administrative procedures for competitive tendering that, for example, exclude SMEs.

*Principle 5 – The selection of the bidder should be undertaken following a transparent, neutral and non-discriminatory selection process that promotes competition and strikes a balance between the need to reduce the length of time and cost of the bid process and, acquiring the best proposal. Along these lines, corruption should be penalized as well.*

#### Transparency, Neutrality and Non-Discrimination Defined

Transparency refers to the openness of procurement policies and practices. The basis for proposal evaluation should be made public.

Neutrality refers to clear, specific and predictable rules that do not provide scope for discretion and prevent any conflict of interest and provide a means of complaint and monitoring the implementation of the rules.

Non-Discrimination refers to all fair and equal treatment of all economic entities, public and private, foreign and domestic in the competition for PPP contracts.

#### Transparency can be achieved by information sharing...

Transparency in PPP procurement means ensuring that information about the PPP procurement and contractual administration regime and individual PPP opportunities are made available to all interested parties (and particularly to potential suppliers and service providers). It also entails the right of access to that information. At the same time, transparency calls for procurement policies and practices that are seen to be fair in all respects, with full information openly provided. Transparency encourages open and competitive procurement regimes thereby helping the government agency and the private sector entity achieve economic benefits. Supplier evaluation and contract award criteria should be made known to all interested competitors in advance for each individual project. Any changes relating to individual PPP opportunities should be made known to all participants.

**...Details of procurement decisions should be made known after the contracts have been awarded...**

Detailed records of individual contract award processes should be kept. Interested parties such as the media, individual citizens, trade unions, investors, etc. should be able to become acquainted with the contents of the contract. This will improve the involvement of stakeholders and make monitoring of the procedures possible.

**...And the method of procurement chosen should be the most transparent possible.**

In general, the fundamental guiding principle is to ensure that principles and objectives are established to maintain transparency in the procurement process. There is, however, a need to ensure secrecy of the bid, especially as certain information contained in the bid could benefit a competitor. It may also be important to maintain secrecy in some cases where the procurement involves the protection of patents and copyrights, or for national security reasons.

In Canada, the use of ‘fairness and process auditors’ – third party independent experts – provides a level of assurance to government sponsors, bidders and the public that the procurement process was fair, equitable, and appropriate.

**It is important that the operation of the entire procurement and award process is, and is seen to be, both neutral and fair...**

For example, enough time must be given to potential suppliers and service providers to prepare and submit their bids. Selection and award criteria must be neutral and non-discriminatory and should eliminate any scope for discretion. Thus, any technical specification relating to the service being procured should be drafted so as not to favour particular projects.<sup>30</sup>

**...While at the same time recognising that providing only this framework of rules is insufficient.**

There must also be a means to enforce the rules and hold the parties accountable:

- **Firstly**, the potential supplier should have the right to complain to an independent domestic tribunal if they believe that the PPP procurement has been handled inconsistently

For example, a small local authority in Denmark implemented a new PPP financing system where public assets were sold to private enterprises and then rented back. No Danish community up until that time had been able to offer such high standards of service through public funds. However, following a newspaper investigation it was alleged that companies had given money to the soccer club in return for obtaining contracts from the local authority – and the mayor was a shareholder of the company and chairman of the soccer club set to play in the new soccer stadium.

<sup>30</sup> Under a neutral system, evaluation of tenders is usually done in two stages (which may nevertheless take place concurrently). First, tenders are checked to assess whether they meet all the eligibility requirements. Does the project provider have any required qualifications? Also, do they have the financial and technical capability to fulfil a contract? These eligibility requirements must have been made known in advance and should not be changed during the course of the tender. Then all the eligible candidates are evaluated according to the criteria, which have been set down in the tender notice or documents.

with the law. That tribunal should have the authority to order the correction of an infringement or compensation for the loss or damages suffered by a supplier. And pending the outcome of the challenge, it must be able to provide rapid interim measures, including the suspension of the tender process, to correct infringements and preserve commercial opportunities.

- **Secondly**, an independent monitoring authority – with powers to self-initiate investigations into the PPP procurement practices – can play an important role in monitoring the implementation of the rules by individual procuring entities. The institutional framework should differentiate between those who carry out the procurement function and those who have oversight responsibilities. In this regard it is now generally advisable to establish an agency, which has responsibility for overall procurement policy formulation in the PPPs and the authority to exercise outright oversight regarding the proper application of the procurement rules and regulations.
- **Thirdly**, the independent auditor must have no ties to either the public or the private parties involved. It should get involved early on so that it can develop a thorough understanding of the project in order to maintain a complete and unbiased audit of the programme.
- **Finally**, there must be no conflict of interest in the selection procedure. The contracting authority should be completely independent of the projects and the companies involved in the bidding, in order to avoid a conflict of interest. These issues may be under the surface and not readily apparent during the selection procedure; but since any instance of corruption can tarnish both the public and the private sectors' reputations, it is crucial to be as cautious as possible regarding conflicts of interest.

**Moreover, non-discrimination also plays an important role...**

It is very important that procedures offer opportunities for all companies irrespective of the country of origin. Non-discrimination is usually achieved through the creation of rules specific to this issue, as well as more general requirements not to act in a manner which could reduce competition. A sign of success of the operation of this principle is apparent in the extent to which foreign companies win bids. At the same time, while governments should welcome bidders from other countries, this openness should be on the proviso that other countries are correspondingly open in their approach. Additionally, it is not just foreign bids that should not be discriminated against. Bids from SMEs should also be encouraged and treated in a non-discriminatory fashion.

**...While sanctions against corruption must also be considered within the context of international rules.**

There are numerous models of best practice in creating open procedures for tendering, based on international and regional agreements. In 1994 the UN Commission on International Trade Law adopted the UNCITRAL Model Law on Procurement of Goods, Construction and Services. The objectives of the UNCITRAL Model Law include promoting competition

among suppliers and contractors, providing for fair and equitable treatment of all suppliers and contractors and achieving transparency in procurement procedures.

Within the European Union (EU), strict rules for open government procurement apply. Several European Commission (EC) directives deal with public procurement of supplies and works, including the construction and the telecommunication sectors. The EC has the authority to impose sanctions for breach of EU competitive tendering rules in public sector procurement and construction. In addition, beneficiaries of EU funds must comply with EU competitive tendering rules when contracting third parties for the performance of projects financed under such funding. The main purpose of the EU directives is to set a standard procedure for the award of public sector contracts in order to stimulate competition. Under EU legislation, in principle, public tendering is mandatory for contracts with a value over EUR 200,000. Within the EU, such directives must be transformed into national legislation.

The World Trade Organization's General Agreement on Trade in Services is the first multilateral agreement, which establishes rules regarding trade in services. Currently, the question of whether rules on government procurement should be added to the General Agreement is under discussion. An Agreement on Government Procurement is already available but it covers only a limited number of services, including construction, environmental services, computer services and value-added telecommunications services.

**...And national best practices in PPP Procurement should be considered.**

The following describes in detail the practices of three countries, the Netherlands, UK and the US in PPP procurement:

## **THE NETHERLANDS**

### **Guiding principles in PPP procurement and regulatory framework**

In the Netherlands, the key principles that should be met in government procurement in general are the principles of non-discrimination and transparency. This means that any authority procuring an object or service cannot discriminate amongst candidates offering the same quality, whether from domestic or international origin, and that the procurement process should be announced publicly. These principles are laid down in the Treaty of the European Union.

The Dutch national authorities are subject to EU regulation on open government procurement. These rules have been transposed into even stricter national legislation. The legislation offers different procedures, which can or should be applied, depending on the characteristics of the project to be procured. Furthermore, projects in all domains are subject to obligatory public consultations in different stages of the project, either within the framework of the Track Act and/or a spatial planning procedure.

Furthermore, additional principles applied by Dutch authorities in procuring a PPP contract are:

- (a) Outcomes of public consultations concerning the project should be taken into account;
- (b) Intellectual property rights of candidates should be protected, cherry picking should be prevented and confidentiality should be warranted; and
- (c) The costs of bidding for candidates should stay within reasonable limits.

### **Procuring PPP contracts in infrastructure development**

For every infrastructure project valued higher than a certain amount of estimated costs, the Ministry of Transport carries out a comparative analysis of different contract options, amongst which PPP. This is part of Dutch PPP policy. The PPP option under consideration generally consists of a contract for the design, construction, financing and maintenance of an infrastructure segment, including its artworks, for a long duration. In case the PPP option turns out to offer highest value for money as compared to the other options, the PPP approach will then be pursued.

When it has been decided to use a PPP approach for the implementation of a project, the next step is to determine what procurement procedure suits best the characteristics of the project, taken that the requirements for application of the procedures posed by legislation can be fulfilled. Even though PPP reflects partnership and cooperation, it is assumed very important that the selection of the preferred private sector partner takes place in a competitive environment.

Up until 2007, two types of procurement procedure have been used by the Dutch transport Ministry in selecting the preferred partner for a PPP contract: the negotiated procedure and the competitive dialogue. The negotiated procedure has been used to procure the contract for the high-speed rail link connecting Amsterdam with Brussels; the competitive dialogue has been used for several road infrastructure projects. The competitive dialogue procedure is specifically designed for the procurement of PPP contracts.

In the table below both procedures are described in terms of general steps to be taken towards final selection of the preferred partner.

**Table 3. Procurement Procedures used by the Dutch Transport Ministry**

<b>Negotiated procedure</b>	<b>Competitive dialogue</b>
Public announcement and call for candidates, including selection criteria	Public announcement and call for candidates, including selection criteria
Application for candidacy by interested parties	Application for candidacy by interested parties
Procuring authority selects candidates to be submitted to the procedure	Procuring authority selects candidates to be submitted to the procedure
Procuring authority issues a programme of requirements, including publication of the award criteria and invites candidates to submit their offer	Procuring authority issues a descriptive document hence initiating the dialogue phase, which usually consists of three rounds of consultation: <ul style="list-style-type: none"> <li>(a) A presentation of the general</li> </ul>

	<p>approach of each candidate</p> <p>(b) A consultation round to optimize tender documents per candidate</p> <p>(c) Final dialogue</p> <p>The dialogue between procuring authority and candidates takes place at bilateral level. The result of the dialogue phase is a solution per candidate, which meets the needs of the procuring authority.</p> <p>Procuring authority then invites candidates to make an offer based on the solution resulting from the dialogue</p>
Candidates submit their offer	Candidates submit their offer
Procuring authority selects the best offer based on criteria	Procuring authority analyses the bids based on the award criteria and enters the final stage with the preferred bidder
Procuring authority negotiates with the preferred candidate in order to optimize the offer	
Contract signature N.B. In case no agreement can be reached during negotiations, the procuring authority can negotiate with the second best candidate.	Contract signature

As can be noticed in both procedures, selection of the preferred bidder in fact happens in two stages. First of all, candidates have to comply with selection criteria to be submitted to the procedure. These can include criteria on financial solvability, track record, etc. Second, a preferred candidate is being selected by analysis of his offer as compared to other offers, based on award criteria, which have been made public in advance.

The award criterion used in the competitive dialogue is the most economically advantageous tender. In the Dutch practice this is determined by the net present value (NPV) of the offer, the value of the risks left with the procuring authority and the value of the demands, which cannot be met by the candidate’s offer. The bid with the lowest sum of these three factors offers the most economically advantageous tender.

The lessons learned from procurement of PPP projects up until now in the Netherlands can be summarized as follows:

- (a) A good PPP tender process requires careful and extensive preparation by the procuring authority; this includes reserving enough time and capacity to organize the tender and to maintain a strict control and planning during the process.
- (b) A clear and unambiguously defined objective of the project and procurement procedure, which is regularly updated, is of vital importance for a successful tender procedure.
- (c) Special care should be taken to guarantee confidentiality where relevant, because this is key to a transparent and non-discriminatory procedure. This also includes aspects of integrity within the procuring authority itself.

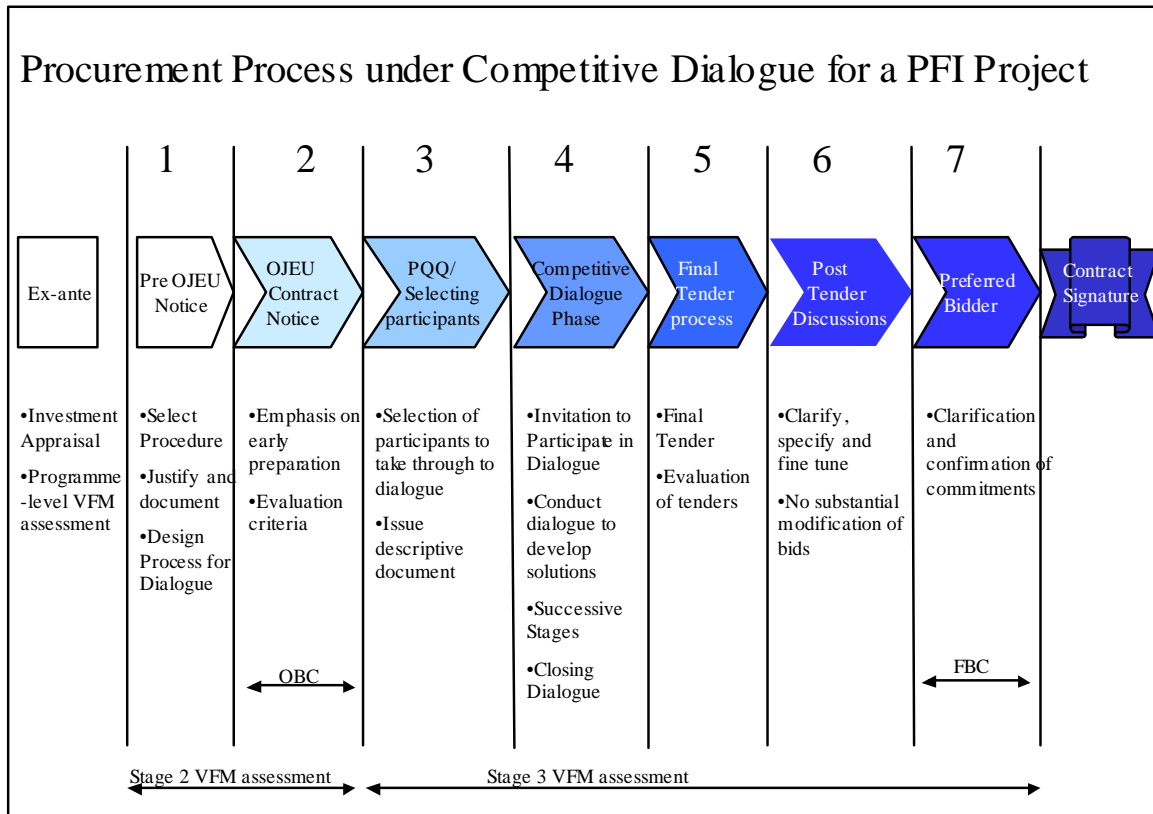
- (d) The elaboration of the criteria for selecting candidates and awarding the contract requires special consideration. The criteria should be formulated as objectively as possible, in order to maintain equal treatment of candidates during the procedure.
- (e) Since procuring a PPP contract is a complex matter, it pays off to offer a clear explanation and guidance to candidates during different stages of the procedure. This helps them to be efficient in composing their offer and also creates an atmosphere of trust which is needed to reach an optimal solution.

### **UNITED KINGDOM**

The decision to use PFI for the procurement of public infrastructure and services follows a rigorous investment decision process. The latter involves individual Departments deciding upon a capital investment strategy, with specific investment options being appraised using the UK's Green Book guidance. Capital projects are then prioritized within a Department's overall capital programme, and following that those project areas which may be suitable for the asset and service requirements to be procured through PFI, are identified.

A three-stage value for money assessment - covering both qualitative and quantitative assessment - is then initiated to ensure projects selected for PFI procurement are only chosen where this represents value for money. The Competitive Dialogue procedure is a new procurement procedure introduced in the EU Public Sector Procurement Directive (2004/18/EC). This was implemented into UK law via the Public Contracts Regulations (SI 2006/5) with effect from 31 January 2006. Following the incorporation into English Law of the EU Public Sector Procurement Directive, it is considered that the competitive dialogue process will be the relevant procurement procedure for the majority of PFI projects. The diagram below details how the competitive dialogue procedure is envisaged to work for a PFI project:

**Figure 3. Procurement Process under Competitive Dialogue for a PRFI Project**



**The first three phases**

During these early stages contracting authorities should plan in detail how the different stages of the procedure will be conducted, particularly the structure of the dialogue phase, as an Outline Business Case is compiled. The OBC sets out details on potential costs, management of risks and timelines involved in the projects. Contracting authorities are also required to publish a contract notice setting out their needs and requirements, which are defined in the notice itself during this stage. The prequalification of participants, following the expression of interest, is carried out in accordance with the relevant provisions of Articles 44 to 52 of the directive. It aims to identify bidders with the capacity to fulfil the contract. Qualified candidates are then invited to participate in the dialogue phase of the procurement.

**The dialogue phase**

Under competitive dialogue procedure, the competitive stage or dialogue occurs before the final tender process, and consequently there are strict rules on the conduct of discussions at the post tender stage. For this stage it is important for authorities to define at the outset how they plan the dialogue phase will be conducted and on what basis bidders will be excluded at progressive stages of the dialogue. The dialogue ends once the authority identifies a

procurement solution, which meets requirements. The authority then declares that the dialogue is concluded. Final tenders are then submitted: all commercial issues of substance must be finalized in advance.

### **Post-tender discussions**

In post-tender discussions after the submission by bidders of final bids, authorities can ask tenderers to clarify, specify and fine tune, as long as it does not change the bid in a way that distorts competition or has a discriminatory effect.

### **Preferred bidder**

On selection of the preferred bidder, the contracting authority can ask the preferred bidder to clarify aspects of the tender or confirm commitments contained in the tender as long as this does not have the effect of distorting competition or imposing additional burdens on the bidder.

### **Alcatel standstill and contract signature**

On selection of the preferred bidder, the authority notifies all who submitted final bids stating its decision and the preferred bidder. At this point, the Alcatel mandatory standstill period requirement means the authority must allow a 10-day standstill period before contract signature. This affords bidders the opportunity to request the reasons their particular bid was not selected and the authority must respond three days before the end of the standstill period. If there are no challenges during this period, the authority may proceed to contract signature.

## **UNITED STATES OF AMERICA**

The United States differs from the previous examples in that it has no central PPP unit at the national level, and no overarching standard methodology for developing and implementing PPPs. At the federal level, legislation providing authority to establish PPPs is enacted on an agency-by-agency basis, so that the procedures for implementing a PPP to provide, for example, electricity for a national park, would differ in their specifics from the procedures for providing power to a military installation. At the state level, enabling legislation is developed on a state-by-state basis. However, at all levels there is a focus on the principles of open competition. To demonstrate how this functions in practice, this paper will discuss two PPP initiatives, one at the federal level and one at the state level.

The U.S. Department of Defense (DoD) has a policy of relying first on the private sector to provide housing for its 1.5 million active duty servicemen and women, and their families. This is done by paying the military personnel a housing allowance, which they can use to rent the housing of their choice in their local community. However, many U.S. military installations are located in remote rural settings, with little commercially available housing, or in high-cost urban areas, with little quality housing affordable for a military family. Where there is a deficit of acceptable housing available, based on cost, commuting time, and other established criteria, DoD traditionally financed, designed, built, and maintained government-owned housing on the base. By the mid-1990s, DoD owned and operated approximately 300,000 family housing units.

Amidst competing budget priorities, it proved difficult for DoD to obtain the construction and renovation funds necessary to keep the housing inventory up-to-date. In 1995, on-base housing had an average age of 33 years, and more than 60%, approximately 200,000 units, was regarded as substandard by then-current DoD standards.

Assessing this situation in 1995, DoD estimated that US \$16 billion in supplemental funding would be required to bring the existing housing inventory to acceptable levels through a combined programme of replacement and renovation. A funding increase of this magnitude was simply not attainable. In response to this problem, DoD approached the U.S. Congress, and requested statutory authority to enter into Public-Private Partnerships for provision of family housing.

Congress recognized the need for action, and the National Defense Authorization Act for Fiscal Year 1996 (Public Law 104-106) provided DoD with a number of new capabilities. These included the ability to:

- (a) Form limited liability partnerships with developers, and invest directly in military housing through stock or bond purchases, or other debt or equity instruments;
- (b) Sell, convey, or lease DoD property to the private sector and use the proceeds to finance a housing-related partnership; and
- (c) Provide direct loans to developers to help them acquire or build housing; and other authorities.

To encourage the creative application of these new authorities, DoD created a DoD-wide initiative. Under this programme, DoD granted each of the military services, the Army, Air Force and Navy (to include the Marine Corps), the power to determine which of these new authorities they would apply in any given situation. DoD did, however, establish two mandatory requirements:

- (a) Each Service must eliminate all of its inadequate housing by 2010; and
- (b) In any given transaction, the developer must provide at least two-thirds of the total capital investment.

The success of this programme has exceeded DoD's expectations, and the replacement and renovation of the substandard housing will be completed in 2008, two years ahead of the original goal. The entire \$16 billion backlog will have been eliminated in 12 years from the start of the DoD initiative. The majority of installation-specific projects have required no government capital investment. In addition, the benefits transcend the avoidance of capital investment: the U.S. General Accounting Office reviewed the first dozen partnerships and concluded that the life-cycle cost of these agreements would be 11% less than the cost of equivalent government-built housing units.

The programme's success can be attributed in large part to the open competition practices employed by the military services. While the specific partnership structures employed varied

from service to service and installation to installation, open competition was universally practised.

Pre-procurement. Each installation performs a detailed business case analysis of its housing requirements and potential partnership approaches. A key consideration is whether one partnership for the entire installation is feasible, or whether multiple PPPs should be established for geographically-dispersed housing areas.

Procurement. All partnership opportunities are publicly announced in the U.S. government's Internet-based procurement portal (early opportunities were announced in print, then in print and web-based media; current announcements are posted only via the Internet). Requests for Tender for each installation are performance-based. The government identifies the required number of units, the mix two-bedroom, three-bedroom, and other units, community standards, and certain material standards, and the developers are free to propose their own design solution and community amenities. Draft requests for proposal are released for public review and comment. Pre-proposal conferences are held, to further address questions and comments, and responses to questions and amendments to the Request for Tender are posted on the Internet. The Request for Tender also identifies the evaluation criteria to be used for tender evaluation purposes.

Typically, a two-step tender process is employed. In the first step, firms (and/or teams of firms) submit conceptual overviews of their partnership proposal, together with past performance data, and information on corporate capacity and financial stability. These firms with the highest evaluations are asked to submit comprehensive proposals. This two-step process helps to encourage broad participation from the developer community, because it reduces the cost of testing a design concept.

Evaluation. Tender evaluations are conducted by an independent board of reviewers, who use a Tender Evaluation Plan and evaluation criteria developed specifically for the individual acquisition. Each evaluator documents their rankings, with supporting rationale, so that the evaluations can be reviewed for consistency and objectivity.

Award and Appeals. Contract award decisions are publicly announced on the Internet, with direct notification of unsuccessful bidders, who can receive briefings on the evaluated strengths and weaknesses of their proposals. In addition, there is an established appeals procedure, based upon standard processes in the Federal Acquisition Regulations.

Contract Monitoring. Contract performance is evaluated based on the criteria in the Request for Tender. Contract administration staff are assigned at each installation. Dispute resolution is based upon the procedures established by the Federal Acquisition Regulations.

At the state level, the State of Virginia has one of many established programmes. The State of Virginia's Public-Private Transportation Act (PPTA) of 1995 is a legislative framework enabling the Virginia Department of Transportation (VDOT) to enter into agreements authorizing private sector entities to develop and/or operate transportation facilities. Private sector entities may identify a need, such as a new connector highway or light-rail system, and submit an unsolicited proposal to VDOT. Alternatively, VDOT may identify a requirement

which may be appropriate for a Public-Private Partnership solution, and issue a Request for Tender. Proposal/project evaluation is then a six-phase process:

1. *Quality Control.* Does the proposal address needs identified in the appropriate local, regional or state transportation plan? Will it provide a more timely, efficient or less costly solution than the public sector? Is there appropriate risk-sharing?
2. *Independent Review Panel (IRP).* The proposal is reviewed by an Independent Review Panel with members from the State Transportation Board (STB), VDOT, transportation professionals, academics, and representatives of the affected jurisdictions. The review is based either on the basic criteria established by the law (which is available on the Internet) or on a modified version of these criteria, as provided in the State's published Request for Tender. Public Meetings and input are part of the process.
3. *State Transportation Board Recommendations.* The STB reviews the proposals and recommendations of the IRP and recommends to VDOT whether to proceed with the project. A decision to proceed means that VDOT will advance to a public request for detailed proposals. Such requests are advertised on the State's procurement website and are open to participation by any responsible party. The Request for Tender will identify the State's evaluation criteria.
4. *Submission and Selection of Detailed Proposals.* VDOT forms a proposal review committee and requests detailed proposals. Based upon its review, VDOT may select none, one, or more proposals for further negotiation.
5. *Negotiations.* If the quality of proposals merits, VDOT will negotiate for the interim and/or the comprehensive agreement which will, among other things, outline the rights and obligations of the parties, set a maximum return of rate of return to the private entity, determine liability, and establish dates for termination of the private entity's authority and dedication of the facility to the State.
6. *Agreement.* The negotiated agreement undergoes final legal review, and is then submitted for signature and implementation. State law also provides for debriefings of unsuccessful bidders and an appeals process.

This process has been successful in generating effective partnerships. The first project to be completed as a result of this law was the Pocahontas Parkway, in 2002. This is a 14.1 kilometer, four-lane road, including a high-level bridge over the James River, which connects two major commuting routes in the Richmond, VA area. The business model was based on the premise that commuters would be willing to pay a modest toll to reduce their commuting time. After one adjustment in the toll price, in 2004, due to traffic volume being slightly under projections, this project is now performing well.

### **ACTION POINT**

Each country uses its own unique approach to soliciting and evaluating partnership proposals. The examples show that each country has its own distinct procurement regulations, e.g. in the United States of America there are such regulations at both the federal and state levels. Yet a common factor, uniting all of these PPP programmes, is their commitment to the principles of open competition, which is reflected throughout the procurement process. This commitment must be maintained wherever PPPs are to be successful.

### **Sources and Further Information**

- (i) British Columbia Ministry of Municipal Affairs, Public-Private Partnership: A Guide for Local Government, May 1999.
- (ii) Deloitte and Touche, Closing the Infrastructure Gap, Global Addition, 2006.

## 2.7. PUTTING PEOPLE FIRST

### Information, Accountability and Support

#### GOVERNANCE CHALLENGE

Members of the public are often insufficiently consulted in the PPP process and their interests and needs are not addressed. This lack of transparency and accountability has led to a governance challenge that must be confronted in order for PPPs to move forward.

*Principle 5 – The PPP process should put people first by increasing accountability and transparency in projects and through these improving people’s livelihoods, especially the socially and economically disadvantaged.*

#### People are important in PPPs...

PPPs need to put people first. Initially, PPPs were proposed as a financial mechanism to place government expenditure off the balance sheet. While this proved a useful financial strategy, it failed to convince people that they were at the heart of PPPs, as the main beneficiaries. For example, there were concerns that the government sector was losing control over the delivery of essential services - such as health, water and education - when PPPs were used.<sup>31</sup>

#### ...And so it is paramount to define the public interest...

To address these concerns the government will want to put in place mechanisms to assure the public that they are the main beneficiaries of projects. In this regard, Governments will wish to define how PPPs can promote the ‘public interest’ and what this means in terms of PPPs. It can decide for example that there are certain core services which should not be delivered at any price by the private sector. Often the services performed by doctors and nurses within public hospitals, teachers within government educational facilities and judges within courts, are regarded as core services which is the function of government to provide while the supporting infrastructure and ancillary services within those services can be delivered by the private sector.

#### ...Consult the people on policy...

<sup>31</sup> Best practice policy to address the concerns and ensure that the public interest is protected in undertaking PPPs is presented below. It is based on the practice of Partnerships Victoria in Australia. Under their practice the decision as to whether or not a service should be delivered as a PPP project depends on three questions:

- Which if any part or parts of the proposed service is a service that the government itself should deliver to its citizens? (The core services question.)
- For all other aspects of the service and supporting physical infrastructure, what is the project model that delivers the best value for money? (The value for money question.)
- Do the outcomes of the value for money question satisfy the public interest criteria articulated in the policy? If not, can the public interest criteria be satisfied by either building safeguards into the contract or through regulatory measures (and at what costs), or should the project be reconceived to ‘reserve’ further areas of service for provision directly by government? (The public interest question.)

It also makes sense for Governments to consult the key stakeholders on policy. An early and consistent involvement can manage the fear of change and the unknown by providing an open, transparent process. Furthermore, by bringing in end-users and those involved in providing the service, their objectives, needs, and concerns can be identified and addressed in the PPP. In Ireland, prior to the launching of its PPP legislation, both social partners were fully consulted and this achieved a consensus which allowed the programme to be implemented successfully.

In all countries the consultation process needs also to include full information on what PPPs are. Many people are not familiar with PPPs and consider them another form of privatization.

**...And ensure that PPPs provide value for money.**

Before a project begins, it is important to undertake a full cost/benefit analysis. Often when the government approves the project where it seeks to involve the private sector through a PPP, private sector bids are assessed against public sector benchmarks to determine value for money. The quantitative benchmarking tool is the Public Sector Comparator (PSC).<sup>32</sup>

**Governments must also make sure that the public is well informed...**

The Government can enforce delivery of services by strict conformity to the contract with the private entity. Although contracts are complex and not easily understood by the general public they can nevertheless provide a strong instrument for achieving accountability especially if the targets and performance indicators are clearly identified and understood.

Private organizations however may seek to establish that certain aspects of their operations are commercially confidential. This puts limitations on accountability, which could present a challenge to local authorities and national governments. Consequently, the contracts ought to include accountability requirements where structures exist in which the organizations delivering the service are open to such accountability. Increasingly, PPP contracts are stressing such a feature.

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<sup>32</sup> Value for money is maximized by allocating risk optimally. The PSC is used to estimate the hypothetical risk-adjusted cost to government of delivering the proposed project using the most efficient form of government delivery. The PSC is then compared against private bids. Care should be taken however to ensure that the comparison is between genuinely comparable items. There is a strong possibility that bids will not be identical to the proposed service specifications, and risk allocation outlines in the bid documentation on which the PSC is based. To compare such a bid with the PSC without appropriate adjustment would be therefore misleading. If the bids are higher than the PSC, and the level of service delivery and the risk allocation in the bids is similar, in the absence of other offsetting qualitative benefits, the project would be best delivered as a public project. This decision should be based on the total cost of each alternative, i.e., considering not only the estimated contract cost, but also the cost to the government of contract monitoring and administration.

**...And that these obligations can be overseen by an objective third party...**

Monitoring performance in meeting targets set out in contracts is a major task to ensure accountability of services. There needs to be good performance assessment and measurement in the public services and this work is best accomplished by independent bodies, set up to monitor performance in specific sectors, with responsibility to put their findings into the public arena and to make that information readily available to the public. This information will also help the public improve the choices they make in the use of public services.

Increasingly, the number and differences amongst the suppliers of public services to governments continues to grow: not just public entities, but also fully private, NGOs, charities and also social enterprises are becoming engaged. The principle of monitoring performance to ensure that members of the public receive value for money should be the same for whatever entity is providing the service - public, private or some other type of entity.

A key challenge is not just to establish the auditors and independent bodies to monitor performance; it is also to define targets in such a way that they can be effectively used in practice. For example, how to audit data on outcomes and productivity in hospitals? Another case is prisons, a sector where PPPs have been quite successful but where setting performance standards and designing outcome-based performance requirements is particularly complicated due to the risk of unintended consequences. One example: tough financial penalties for escapes from prisons might cause unintentionally a climate in which prisoners' maltreatment increases.

Furthermore one of the features of the PPP is that the public sector is contractually linked to a private entity for a considerable period of time, i.e., for 25 years or more. This can be a burden for future generations of taxpayers, for example, when paying for hospital configurations which have been designed for today's era. While the contracts usually allow for changes over time, this will have to come at a price. The challenge here is that those who monitor will not know whether these long-term contracts represent long-term value for some years to come. Accordingly, the monitoring must, in a sense, anticipate these emerging problems and deal with them before they become a drain on the taxpayer.

**...Thus giving citizens more choices and more power.**

Accountability can go even further. Increasingly the providers – be they public or private – must take into account what the beneficiaries want and need. Yet by increasing choice, governments can create incentives to providers to improve services and performance as funding will follow the choices the beneficiaries make. This policy will in turn ensure that providers begin to increase their use of customer services and consultations, which can score how well services are responding to customer demands. Increasingly, the UK local authorities, for example, publish tables, which present the performances of providers in health and education. Instead of services being scored

In overall state systems of health for example, patients are being offered choice as to the hospital, the time of treatment and even the doctor that is best able to treat them. Until recently it was assumed that the only persons who should have choice in health and education were those who could afford it.

purely by top down inspections they would be scored by the users themselves. By applying these mechanisms to providers of PPP services and ensuring that they consult with the customers in these ways, the acceptability of PPPs will increase amongst members of the public.

### **By placing safeguards that ensure ongoing public access to essential services...**

Another important concern is that the transfer of management of service to the private sector risks increasing the tariff and thus excluding the socially and economically disadvantaged. One of the challenges is that when some projects are retransferred to the private sector they are already subsidized services, which do not reflect the true costs. But tariff increases are not often necessary and governments can step in to protect those who are at risk from higher charges. Governments, for example, can increase the aid to the project (see above) so as to ensure the continuity of existing and new services to socially and economically disadvantaged groups is not jeopardized.

A good example of subsidy with the intention of both making accessible the service to the poor and making the overall price affordable to poor and vulnerable groups was the Pamir power project in Tajikistan. The project established a special social protection tariff scheme. The tariff will increase gradually over ten years with additional flexibility but the key objective is that the tariff and the especially mobilized funds will ensure that those who cannot afford the current prices will nevertheless receive electricity. This power project in Tajikistan shows that it is possible to attract the private sector into a scheme that improves social welfare in one of the poorest countries and one of the poorest regions in Central Asia.<sup>33</sup>

### **...Governments can provide assurances that community health and safety will be secured...**

The issue in PPPs is not that the private entity saves profits by failing to pay the extra costs that ensure safety. The issue is rather whether the private entity complies with the safety standards set out in the contract. Failure by the private entity to comply with health and safety requirements will lead to a variety of penalties including abatement of its fee, penalty charges and potentially ruinous litigation of termination of the PPP contract. But often there is the concern that turning a public asset over to the private sector corrodes at the same time the ethos of public service.

The answer lies in selecting precisely where the private sector can contribute to safety and security. These areas may be in using new technologies which directly and indirectly enhance safety.

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<sup>33</sup> Although the prospects outlined for this project appear promising, it should be noted that they must be linked to an overall programme of income generation and increased livelihoods so that the project will itself become sustainable when the subsidy runs out. In general, certain risks come with very large PPP projects in countries where knowledge gaps exist. For example, to fill this gap countries will often require the import of experts, labour force, materials, and the like for the PPP project to progress at an optimal rate that satisfies both the public and private partners.

In Ontario, for example, the local government in an effort to meet the demand faced by a dual driving test system contracted with Serco, a firm from the United Kingdom, driver examination services, while a new road in the same country reduced fatalities by 70%.<sup>34</sup>

**...All while adopting an even-handed regulation to ensure fair public accountability.**

While public accountability in PPPs needs to be enhanced to ensure that people are put first, it should not go too far in over-bureaucratic control, providing ‘poor’ as opposed to ‘good’ regulation. Generally, an even handed approach to providers of services needs to be adopted, with the same rules for entry to the market for providers, whoever they are and wherever they come from. Governments must achieve the right balance in opening up the PPP process to outside scrutiny and the need to deliver an effective and efficient stream of projects.

**ACTION POINT**

Putting people first must be not only the organizing principle behind PPP development, but also be the guiding principle at every step in a PPP programme’s development. Accordingly, governments must take steps to enhance public accountability without micromanaging the system – which would thus stymie the benefits afforded by the private sector’s involvement.

**Sources and Further Information**

- (i) Canadian Council for Public-Private Partnerships, Project Finance: An Introductory Manual for Canadian PPP Project Managers and Advisors, November 2006.
- (ii) Deloitte and Touche, Closing the Infrastructure Gap, Global Addition, 2006.
- (iii) PriceWaterhouseCoopers LLP, “Delivering the PPP Promise”, November 2005.
- (iv) UK National Audit Office, PPP in Practice, 2003.

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<sup>34</sup> In the 195 km highway project in Canada between Moncton and Fredericton. Construction was completed in less than four years compared to the 15 years it would typically take under traditional methods. Since the new highway replaced a dangerous section of road, the rapid construction of the highway, meant that lives were saved more than ten years sooner than would otherwise have been the case. Moreover, the attention given to designing a highway that would improve driver safety has had impressive results. The highway has seen a 70% reduction in fatalities on the road between Fredericton and Moncton. This is a greater safety improvement than expected from the conventional wisdom that upgrading major arteries from two to four lanes will reduce fatal accidents by a third. It is believed to be the first time that driver examination services across an entire jurisdiction have been delegated to a single private company. Serco paid the Ministry of Transportation a concession fee of Canadian Dollars 114 million, and retains the driver examination fees charged. The Ministry retains control over examination standards and the amount of fees charged through a prescriptive concession agreement. Since the partnership began, wait times to take a driver’s test have been significantly reduced from up to 15 months to an average of six weeks and overall customer service has improved. The project demonstrates that it is possible to improve customer service and value to the taxpayer without compromising public safety.

## 2.8. THE ENVIRONMENT

### The Green Case, Government Role and Delivery of Benefits

#### GOVERNANCE CHALLENGE

PPP projects must contribute to sustainable development and protection of the environment as a key priority. This must be achieved by balancing the public's current needs with the responsibility towards future generations. Responsibility of PPP projects often rests with the economy, finance and transport ministries, rather than the environment ministries. These ministries tend not to be well versed in environmental issues, whilst the environment ministries often lack the understanding of the economic and business basis of PPP projects.

*Principle 7 – The PPP process should integrate the principles of sustainable development into PPP projects, by reflecting environmental considerations in the objectives of the project, setting specifications and awarding projects to those bidders who fully match the green criteria.*

#### The Green Case for PPPs

##### **Greening and private finance in PPPs are not mutually exclusive...**

Inserting environmental considerations into projects not only achieves environmental objectives, it also lowers the costs of the project for the private contractors. For example, whilst requiring materials such as timber to come from legal and sustainable managed sources is a good aim in itself, an efficient heating system for an office building can both help to reduce carbon dioxide emissions and energy usage and result in lower life costs for the contractor.

##### **...As PPPs give incentives to deliver public services in a more environmentally sensitive way...**

Private companies have an incentive to consider which design features and construction materials will generate optimum whole life costs across the life of the contract. This might mean that a contractor chooses to invest in higher cost design features if those features will be offset by lower maintenance and running costs during the operational life of a contract and beyond.

##### **...And environmentally friendly technologies are not more expensive...**

There is a problem of perception that environmental technologies are a luxury that governments cannot afford. However PPP projects have demonstrated that investing to deliver environmental improvements can lower running costs, reduce waste and have health and social benefits, such as better working conditions.

### **...Thus making the private sector often amenable to adopting green criteria...**

Investors in PPPs have a financial motivation as seen above, for taking environmental considerations into account because the effective use of resources and reduction of waste both in design and construction means lowered whole life costs and hence higher margins. The private sector, in addition, can be a willing partner in advancing true and integrated sustainability principles in PPP programmes based on a company's internal core policy. Corporate social responsibility and sustainable development strategies are increasingly integrated into the operations of the company. Many companies indeed voluntarily include sustainability criteria into their project bids and schemes.<sup>35</sup>

A strengthening and further promotion of corporate social responsibility and global business social and environmental accountability will facilitate the consistent incorporation of sustainability in PPPs.

### **...And this is particularly true because failure to act can be costly.**

Failure to consider green issues when developing a PPP project, means that a once in a lifetime chance can be missed to reduce the whole life costs since the contract may run for 25–30 years and potentially even longer given the asset life.

## **The Role of Government**

### **Governments need to be diligent in promoting the green criteria in PPPs...**

Before making the decision to undertake a project or programme, public authorities need to evaluate and take into account the environmental and health factors. In some cases, at the project level they will undertake Environmental Impact Assessments (EIAs) as a part of the preparation of plans, programmes, policies and legislation that are likely to have significant environmental effects.<sup>36</sup> They may also undertake Strategic Environmental Assessments (SEAs) towards these ends as well.

As the contracting authority, the burden for ensuring compliance of PPPs with green criteria rests with the government. They must fix clear objectives and specifications in contracts. They should identify some environmental factors as the key performance indicators, as well as environmental risks and the party that should manage them.

### **...By bringing the environmental national policies into line with the project's goals....**

<sup>35</sup> Achieving value for money for the taxpayer means looking beyond initial price to take account of whole life costs and quality. A low cost design may result in high maintenance and operating costs as negative environmental impacts.

<sup>36</sup> Most countries have national legislation on environmental assessment. In the European Union, these processes are regulated through the EIA Directive 2003/35/EC and SEA Directive 2001/42/EC. In the UNECE region, two international treaties have been negotiated in order to harmonize standards and procedures for these processes: the Convention on Environmental Impact Assessment in a Transboundary Context (Espoo, 1991) and the Protocol on Strategic Environmental Assessment (Kiev, 2003).

Public bodies are increasingly scrutinized by environment Ministers and stakeholders, NGOs and the public to determine if their policies are in line with environmental standards. Government departments involved in PPPs will have therefore to benchmark their strategies against their own Government's environmental policies. This will also include the EU rules on environmental considerations in procurement. See European Commission Interpretative Communication on Green Procurement (2001).

Projects are sometimes undertaken with the express objective to achieve environmental goals. In Canada, for example, the Vancouver Landfill Cogeneration Plant, undertaken as a PPP, was designed to reduce carbon emission in line with that Government's support of the Kyoto Agreement.<sup>37</sup>

### **...And bringing environmental 'champions' and advisers into the process...**

Sustainable development advisors need to be consulted in order to help the contracting authorities ensure that sustainability considerations will be consistently included in PPPs. It is important to consistently interpret value for money based on whole life costing, and not a cheapest-bid-wins scenario. This would be aided by expert sustainability advisors, in compliance with national and international legal obligations.

### **...While putting sound practical environmental objectives into the project...**

In considering PPP projects the government should explore whether more environmentally-friendly methods would achieve the same goals. For example, localised satellite offices with hot-desking and telecommuting may be a more cost effective, environmentally preferable and socially beneficial alternative to a large office in a prime inner city location. Also, exploring opportunities to reduce unused space and maximise the use of brownfield land across the public sector's land could be a solution for some projects. If new buildings or relocations are planned, preference should be given to sites which are already well served by public transport in order to reduce car emissions.

### **...And into the contracts....**

Governments can build into the contracts environmentally preferable products, such as avoiding ozone depleting chemicals, choosing low maintenance materials with low embodied energy and made from recycled materials when possible. They should also specify types of building, such as energy efficiency buildings, which can be designed from the outset for disassembly and recycling. They can also favour use of brownfield as opposed to greenfield sites that minimize car dependency.

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<sup>37</sup> The environmental aspect was taken into account by the City of Vancouver and Maxim Co for the Vancouver Landfill Cogeneration Plant. Under this arrangement Maxim, a private company, has financed, built and is operating a world-class cogeneration facility to convert waste to energy. It raised 83 per cent of the Can dollars 10.3 million project cost through debt financing arranged by Corpfinance International – principally a 20 year 7.8 per cent fixed interest rate, non recourse loan for 7.6 million – and provided equity for the balance. Under matching 20 year agreements, the facility uses landfill gas collected by the City to generate electrical and thermal energy.

### **...When picking bidders...**

The contracting authority must send a clear signal to the private sector that sustainability will be rewarded in evaluation bids and in the award of a contract. The selected bids should demonstrate that they have understood the needs of the site and that they have the ability to develop appropriate solutions which meet environmental requirements to conserve resources, minimize waste and reduce pollution both during construction and during the lifetime of the project. The final evaluation of tenders should not be based on price alone. The requirement in the public sector to achieve value for money for the taxpayer means looking beyond the initial price to take account of the whole life costs and quality. A low cost design may result in high maintenance and operating costs and negative environmental impacts.

### **...While being especially careful of what is specified and what is being offered by the bidder.**

The evaluation team will need to ensure that the claims made by bidders make sense, satisfy the specification and assess as well whether they offer more than is expected. Answers to these questions can be found by reference to various guidance materials such as the Green Claims Code.

#### **The Green Claims Code**

The Green Claims Code provides advice about environmental claims made by contractors which are not substantiated as well as claims for products or environmental marks which have no formal recognition. Some typical examples to watch out for include:

*Contains no X*

Where products of this type no longer contain X, or where X is prohibited by law.

*Biodegradable*

Meaningless if not explained. An item might be biodegradable in five days or may take several years with the right conditions.

*Environmentally friendly or Made with care for the environment*

Meaningless if not explained. Does not necessarily qualify the whole product as being environmentally preferable if it applies to only one aspect of production.

The Green Claims Code can be found at:

<http://www.defra.gov.uk/environment/consumerprod/gcc/index.htm>

### **Delivery and Benefits**

Greening of PPPs does not stop with the award of the contract. Government departments will need to work with the contractor to ensure environmental performance throughout the life of the projects.

**An effective payment mechanism is crucial....**

PPPs are not procurements and require a real partnering relationship with the contractor. In this regard an effective payment mechanism should be put in place to ensure compliance with environmental criteria.

It is important that environmental requirements are not considered a politically correct add-on to a contract, which can be discarded at a later date through lack of understanding. In this regard it is necessary to ensure that the contractor knows the requirements behind the environmental specifications.

**...Especially when paired with ways to bring companies together with governments to work out how to improve environmental performance...**

As well as having the appropriate payment mechanism, there are further opportunities for exploring how the environmental aspects of a PPP contract are being handled. There should be reviews of performance after certain periods. It is also likely that the environmental rules will be strengthened during the lifetime of the contract. In this case it is important that governments work with the private partner to promote green PPPs. Companies often have a comprehensive understanding of environmental sustainability and this is an opportunity for mutual learning.

**... But more dissemination of best practice in Green PPPs is still required.**

While some companies maintain that there is a strong business case for sustainability, others in the private sector perceive it to be too risky. There needs to be a much wider dissemination of best practice case studies, and a sharing of information among private sector PPP professionals, in order to incorporate sustainability principles into PPP bids and operations. This would bridge the existing perception gap and contribute to a more consistent implementation of environmental sustainability criteria in public-private partnerships.

**ACTION POINT**

In order to integrate sustainable development into PPPs, a two-fold approach may be taken. The first step is to disseminate best practice case studies as to the reality of incorporating sustainability principles into PPP bids and operations, which would bridge the existing perception gap. The second step is to improve the policy coordination between the economic and finance ministries that have responsibility for a relevant PPP project or programme, and environmental ministries, in order to maximize the contributions of PPPs to sustainable development.

**Sources and Further Information**

- (i) United Kingdom Department of Transport, Green Public-Private Partnerships Guidance Note, 2003.
- (ii) European Commission Interpretative Communication on Green Procurement, 2001.

## **PART III**

# **DEMONSTRATING SUCCESS**



## CASE STUDIES

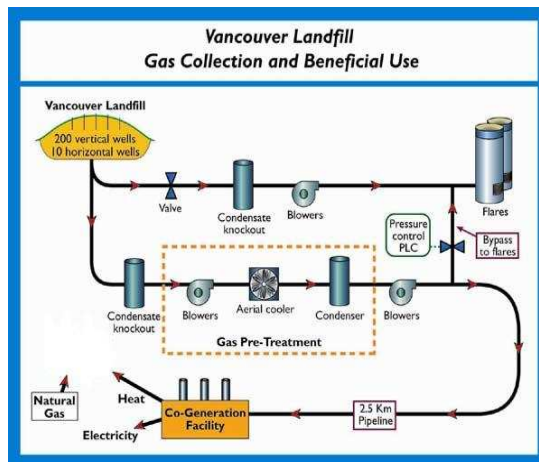
It is argued that governments which implement these good governance principles are more likely to be successful in PPPs. The following case studies show in detail that well-governed projects that are applying the principles mentioned in the Guidebook achieve significant benefits. The following case studies have been taken from different sections (transport, energy, etc.) and from different countries around the world.

<i>Canada:</i>	The Vancouver Landfill Project
<i>France:</i>	The Centre Hospitalier Sud Francilien
<i>Israel:</i>	The Cross-Israel Highway
<i>Tajikistan:</i>	The Pamir Power Project
<i>USA:</i>	The Chesapeake Forest Project

### 3.1. CANADA

#### ENERGY SECTOR

#### THE VANCOUVER LANDFILL PROJECT



The City of Vancouver, British Columbia, decided to bring in the private sector in an agreement to transform a landfill site producing gases (including methane, a greenhouse gas that contributes to global climate change) into beneficial commercial uses. Under the approved PPP structure, the private partner designed, financed and constructed a cogeneration plant, which uses the landfill gas as fuel to generate electricity, which is sold by the private partner to a local utility. Waste heat from the power generation process is recovered as hot water, which is sold by the private partner to a large greenhouse complex for heating purposes. The private partner and the City share the revenues from the sale of electricity and thermal energy.



#### Main players

The City of Vancouver is the public partner. The City owns and operates the landfill, which is located on public land. The private partners consist of a Canadian power company, which established a wholly-owned subsidiary, as a stand-alone project company, to design, finance, build, and operate the cogeneration facility, and sell the electricity and thermal energy. BC Hydro, a British Columbia Crown Corporation reporting to the Minister of Energy and Mines, purchases and distributes the electricity produced by the cogeneration facility. The final partner from the private sector is an agribusiness, which purchases the heated water produced by the power production process, and uses it to heat its greenhouse complex.



## **Selecting a partner**

In 2001, the City issued a competitive Request for Tender to select a partner which would finance, design, build, own and operate a beneficial use facility. Although the City had considered building a power plant itself, it decided to solicit private proposals in order to evaluate a broader array of project concepts and maximize the economic, environmental, and social benefits to the City. Five proposals were received, each based on a different approach to landfill gas utilization. The concepts submitted using the gas to dry sea urchin shells to make fertilizer, upgrading the gas to pipeline quality, and direct use in a cement kiln. Following a detailed and structured proposal evaluation and negotiation process, a 20-year Public-Private Partnership contract, based on the most highly evaluated proposal, was approved by the City Council in February 2002.

Under the approved PPP structure, the City continues to operate the landfill, and a 2.9 kilometre pipeline was constructed by the private partner to take the gas from the landfill to a nearby agricultural complex, where they built the cogeneration power plant. The private partner selected by the City designed, financed and constructed the cogeneration plant, which uses the landfill gas as fuel to generate enough electricity (7.4 MW per year), to supply 4,000 to 5,000 local homes. The power is sold by the private partner to a provincial utility, BC Hydro.

Construction of the power plant was completed in September 2003, and it was operating at full capacity by November of that year. (Initial capacity was 5.55 MW per year, increasing to 7.4 MW per year with the installation of a fourth engine in late 2004.)

Waste heat from the power generation process is recovered as hot water, which is sold by the private partner to a large (32 acre) tomato greenhouse complex adjacent to the plant, where the water is used for heating purposes. Using the landfill gases in this manner, rather than burning them, results in further reduction of greenhouse gases, equating to the removal of 6,000 vehicles from Canada's roads.

## **Risk Allocation**

The City of Vancouver makes no payments to the private partner, but guarantees provision of landfill gases for the twenty-year duration of the agreement. The City thus assumes the supply risk associated with the project, but it minimizes this risk by retaining responsibility for the management and operation of the gas collection system. The private partner's total investment was approximately \$10 million. The private partner signed a power purchase agreement with BC Hydro, and a twenty-year thermal energy sales agreement with the owner of the greenhouse complex. Proceeds from the sales of power and thermal energy go to the private partner, minus a 10% royalty paid to the City. The City's operating costs to capture and provide the landfill gases are approximately \$250,000 per year, and the royalties it receives are approximately \$400,000 per year.

## **BENEFITS**

### **Private sector added value**

The private sector has the knowledge and technology, often lacking in the public sector, to transform waste into energy on a commercial basis.

### **Social and economic benefits**

- (a) It will help support approximately 300 jobs in Delta.
- (b) Vancouver will receive about \$300,000 a year in revenues from the project that will be used to help offset operating costs.
- (c) The PPP has transformed an expensive environmental programme into both a more effective environmental programme and a net revenue generation for the City.

### **Environmental benefits**

- (a) It reduces greenhouse gas emissions by approximately 200,000 tonnes per year of carbon dioxide equivalents (the emissions of about 40,000 automobiles).
- (b) It captures approximately 500,000 GJ of energy a year, the energy requirements for 3,000 to 4,000 households.
- (c) It will reduce CanAgro's annual natural gas use by about 20 %.

### **Efficiency**

An efficient model in that it makes beneficial use of the products of natural decomposition processes, i.e. methane and other landfill gases, to provide both environmental and economic benefits for the community.

### **Applicability to other countries**

Other countries can benefit from the technology and the model is being used successfully around the world.

## 3.2. FRANCE

### HEALTHCARE SECTOR

#### THE CENTRE HOSPITALIER SUD FRANCILIEN



After launching a two-year tender process in July 2004, the Centre Hospitalier Sud Francilien (CHSF) was awarded to a special purpose company created by Eiffage, Europe's seventh largest construction and concession group. This deal followed a competitive tendering process in which Eiffage beat out French rivals Bouygues and Vinci – largely due to Eiffage's previous experience in PPPs, which included a contract for a four-prison programme that eventually became the first major French PPP to reach a financial close in February 2006.



The prison deal served as a blueprint for the CHSF, which abetted the entire process and allowed for the programme to be expedited as well. Whereas the prior deal took four months to close, the CHSF took just six weeks after the contract was initially awarded. While France had seen other hospital projects in recent years, this deal had a total construction cost of € 315 million – by far the largest deal of its kind.



The project was planned to last 30 years from the commercial operation commencement date, which is anticipated for early 2011 with construction lasting four years. When finished, the CHSF will cover approximately 110,000 metres – the equivalent of 15 football pitches.

#### Financing the CHSF

The deal was structured as follows:

##### *A Long-Term Facility:*

The repayment of this facility, which amounted to a € 268 million amortising senior loan totalling 80% of capital expenditures, will be made by an unconditional payment obligation

by the CHSF that is not subject to any deductions or penalties.

This section of the deal benefited in particular from the Daily PPP Ordinance of 17 June 2004, which allowed for the hospital to grant the irrevocable assignment of receivables, which receives further mention in the “Guarantees” section.

*B Long-Term Facility:*

A € 45 million amortizing senior loan was established to bear the project performance risk. Whereas the A facility had an average life of roughly 23 years and a 35 year maturity, the B facility was set up to have a 24 year average life and a 33 year maturity.

*VAT Facility:*

The VAT portion of the financing was set up as a €7 million revolving facility through cash advances, with the VAT amounts to be paid by the borrower. This facility is fully secured by the assignment of VAT repayments from tax authorities.

*Equity Bridge Facility:*

The three mandated lead arrangers provided a € 24 million equity bridge loan to pre-finance the injection of shareholders’ funds, thus improving overall shareholders’ returns. Eiffage guaranteed this facility and it was repaid with shareholders’ funds at the initial commercial operation date, both in the form of equity and the shareholders’ loan.

## **Guarantees**

At least in terms of financing, this transaction is unusual due to the level of guarantees that were granted by Eiffage during the construction period and then by the CHSF thereafter.

Eiffage granted the lenders and swap providers a guarantee that covered the construction risk involved in the project, since the private sector could bear the burden of the risk most effectively. This corporate guarantee isolates lenders from the construction risk, thus allowing the two long-term facilities to benefit from better pricing during the construction phase of the project. This worked well for the public sector since the French government aimed to transfer as many risks as possible to the private sector during this phase of the deal. As stipulated in the aforementioned Daily PPP Ordinance, the PPP grantors could now undertake to make specific payments to the project company in the PPP agreement itself. This revised French PPP structuring policy, coupled with the risk-oriented approach taken by Eiffage, allowed for some of the lowest financing conditions offered for this type of deal to date.

## **BENEFITS**

### **Efficiency**

The public sector benefited greatly from the record time in which the deal was closed and construction was begun, meaning that the hospital could be opened to the public sooner than was heretofore imagined. The efficiency created through completing the deal and devising a rapid construction schedule greatly benefited both the public and private sectors.

### **Private sector added value and construction risk guarantees**

Since the private sector was best able to take on the financial risk inherent in the construction phase of this deal, it took on a corporate guarantee that covered all such risk and isolated lenders from construction risk in all forms. Also, by choosing companies through a transparent and competitive tendering process, the public sector was able to select the right company for the deal, which had a great deal of expertise and expedited more than would have been otherwise possible.

### **Public policies created to encourage PPP deal making**

Realising that new legislation was needed in order to match the emerging opportunities presented by PPPs, the French government instituted measures that made it much easier for the public and private sectors to reach a deal.

### **Social and economic benefits**

By taking advantage of the benefits afforded by the private sector, both the public and private sectors benefited. In terms of economy, the deal was reached in record time with a fair risk allocation that maximized the taxpayer's money while also compensating the private entity. In terms of social benefits, hospital patients will now receive far better healthcare in a facility which will be built sooner than could have previously been possible if the deal were not conducted as a PPP.

### **Applicability to other countries**

Other countries can learn from the way in which the private sector chose to take on a great deal of the risk of this project – and all of the construction risk – based on the fact that it was most able to bear the risk burden. Moreover, the efficiency with which the deal was reached shows how PPPs can bring services like healthcare to the people sooner than ever before.

### 3.3. ISRAEL

#### TRANSPORT

#### THE CROSS-ISRAEL HIGHWAY



Highway 6, also known as the Cross-Israel Highway, is a 300km highway along the eastern part of Israel from south of Beer sheva to the Galilee in the north. The central section of the road, named after Yitzhak Rabin, stretched 86km from Hadera to Gedera, connecting Israel's northern and southern regions. It was constructed by Derech Eretz Group and included a fully electronic free flow tolling system. Road 6 constitutes a primary traffic passage from the central region to both the north and south and served as an alternative route to the existing roads, Road 4 (Geha Road) and Road 2 (the Coastal Road). Road 6 also diverts traffic to the central region of the country in order to reduce vehicle density and pollution in the Tel Aviv region. Costing a total of \$1.3 billion, Highway 6 is the largest infrastructure project in the history of the State of Israel.



#### Main players

The private sector firm Derech Eretz group was contracted to construct the road and oversee the operation of the highway. It has three shareholders: Africa-Israel, CHIC-Canadian Highways and Housing and Construction Limited.



Private sector firms Raytheon and Transdyn provided the electronic tolling and traffic management systems. By bringing the two companies together to integrate Transdyn's traffic management system and Raytheon's open road electronic tolling system, the two companies formed a unified electronic toll and traffic management system, which was a technological breakthrough as well as an

innovative initiative in public-private partnerships. At completion the highway will have in total 14 interchanges, 94 bridges and 50 aqueducts. Additionally, the road will have two 500m tunnels in Hadid. The project will integrate 100km of farm service roads and 44km of lateral roads. There will be a central operations and control centre at the Nachshonim interchange. The project involves 1,700 direct and approximately 10,000 indirect employees.

### **Toll pricing**

The pricing scheme for Highway 6 is based on the number of segments a driver passes in a given trip. Each “segment” is determined by the road span between two interchanges; and as of March 2006, the pricing for up to three segments is 15.04 NIS, 17.94 NIS for four segments, and 20.84 NIS for five or more segments. Prices differ for motorcyclists and trucks, but these prices are for drivers who register with the Highway 6 system and install the in-vehicle transponder unit to record their highway usage.

When a vehicle does not have a transponder, its license plate is scanned and the vehicle identified. If a license plate is not in the Highway 6’s database, the bill is sent to the owner of the vehicle based on records from the Israeli Ministry of Transportation. These users pay a rate that is forty to eighty percent higher than users who have registered with the system and have activated their vehicle’s transponder.

### **Financing the Cross Israel Highway**

#### **Debt**

The Cross Israel Highway transaction is the largest and only the second project finance transaction completed in Israel. The deal, structured on a build, operate and transfer model (BOT), was closed in October of 1999 with 90% commercial debt and 10% equity. The central section of the road was completed in fewer than five years, opening in May 2004.

The commercial debt was provided through a New Israeli Shekel (NIS) syndicated loan facility with a NIS equivalent of US \$850 million arranged by Bank Hapoalim and a note purchase facility for US \$250 million arranged by the Tyco Group. The NIS syndicated loan consists of two tranches and included a 6.5-year interest roll up based on a term of 28 years, with 29% of the facility repaid after 20-21 years. The facility was syndicated to domestic banks and an Israeli pension fund. The note purchase facility necessitated a rating of BBB by Standard & Poor’s. Prior to financial close, the fixed rate pricing of the facility had to be adjusted due to adverse conditions in the emerging markets. The term of the facility is 28 years.

#### **Equity**

The 10% equity contributed by the sponsors, which was based on the final actual construction costs, was originally contributed at financial close by way of \$120 million bridge loan to DEC backstopped by letters of credit from the sponsors. Proceeds of the letters of credit were used to repay the bridge loan essentially at construction completion.

As a result of various reserve requirements and a 10-year block on dividends, equity returns on the project were back ended. In addition, the sponsors were required to backstop certain performance securities for DEC under the Concession Agreement.

## **BENEFITS**

### **Value for money and accountability driven by the private sector**

In March 2006, Derech Eretz reported a profit of 89 million NIS for 2005, with about 500 000 registered subscribers, 1.36 million individual users, 21 million trips, and a remarkable bill collection success rate of 97%.

### **Increase in efficiency**

The Israeli government regards Road 6 as a crucial project that provides the nation with its main traffic artery connecting the periphery to the centre of the country. Running the length of Israel, this PPP has led to shortened travel time between the north and the south of the country.

### **Reduction in road accidents and air pollution**

This project has also led to an increase in the development of outer settlements, a decrease in road congestion – and a resultant reduction in the number of road accidents – as well as a decrease in the high level of air pollution presently produced by vehicular traffic in Israel.

### **Environmental awareness and historical preservation**

The design and laying of Road 6 took into account the preservation of the environment and archaeological sites. Derech Eretz set advanced construction criteria in managing environmental awareness and landscape development along Road 6, investing US \$70 million towards this end. Since the two tunnels nearby the Moshav Hadid and Ben Shemen interchanges go under an archaeological site called the Tel Hadid, the system's tunnels were excavated to preserve and prevent damage to the site, which is of great cultural and historical importance to the nation.

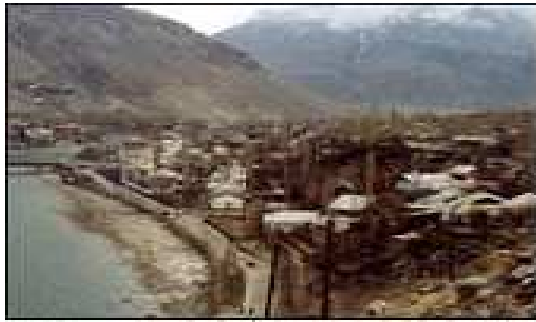
### **Applicability to other countries**

Many countries can take lessons from this project in regard to engaging the private sector effectively and for the mutual benefit of the public and private sectors.

### 3.4. TAJIKISTAN

#### *ENERGY SECTOR*

#### **THE PAMIR PRIVATE POWER PROJECT**



The Pamir Private Power project worked to restore a reliable electricity supply to the poor and isolated inhabitants of Eastern Tajikistan. Under the Soviet Union, 60% of Tajikistan's energy was provided by diesel-generated machinery running on imported fuel. Citizens did not have reliable electricity and power failures were widespread. The Pamir Project was designed to contribute to Tajikistan's poverty reduction strategy by providing basic services, as well as supporting economic growth.



#### **Financing**

The agreement for the ownership structure was a concession agreement in which the government remains the principal owner of all physical assets. Pamir Private Power is responsible for all existing electricity generation, transmission and distribution facilities through a privately owned special purpose company operating under a 25-year concession agreement. The total cost of the project was \$26 million, of which \$2 million was interest during construction.



The financing mix was 45% through equity and 55% debt, which was provided by the International Finance Corporation (IFC) and the International Development Association (IDA). IFC provided \$3.5 million in equity financing; the remainder, \$8.2 million was provided by the Aga Khan Fund for Economic Development (AKFED), the private sector partner in the venture.



## **Social protection**

A very important component of the project was the social protection scheme under which households (which account for 98% of all consumers) pay reduced tariffs consistent with their standard of living. The Government of Tajikistan agreed to take on the additional social protection costs. However, the funding provided by the Government was not adequate enough to cover all social protection costs. To address this issue, the IDA and the Swiss Government became involved. The revenues arising from the interest rate (5.25%) on the IDA credit proceeds were maintained in an Escrow Account to be used towards social protection costs. This provided the Government of Tajikistan with about \$4 million. The Swiss funds were to be maintained by the World Bank in a trust fund and disbursed to Pamir Energy.

## **Partnership Agreement**

Renegotiations in public-private partnerships have the potential to negatively impact the actors involved. These types of renegotiations are removed from the competitive environment and limit the decision making process to the government and operator. Often the ‘winner’ is not the most efficient operator, but the most skilled in renegotiations. In the case of Tajikistan, negotiations and renegotiations were addressed before the start of the project.

The primary agreement which was negotiated was the concession agreement. The Concession Agreement details the policy, regulatory, operational, and financial and the legal framework necessary for the project to commence and function. The IFC had a primary role in providing international legal counsel to draft the agreement.

The Government established a high-level working group including senior representatives from all relevant ministries and agencies to discuss and negotiate the Concession Agreement. Renegotiations had to occur due to the fact that originally, the venture was designed as an independent power producer (IPP) project. In this model, the private investor would only be responsible for the generation of electricity and the power would then be sold to the state-owned national electricity utility, Barki Tajik.

However, problems were noticed immediately. Such an arrangement would require the private venture to depend on revenues from a bankrupt state. The first change made was to the structure of the project, enabling the private investor to take over all operational functions. The second change ensured affordability by the customer base. The Government, as well as international institutions, mobilized additional funding to implement a social protection plan.

## **BENEFITS**

### **Successful risk mitigation**

The planning and development of the Pamir Power Project was a success because risks were assessed initially and mitigated before the project was implemented. The IFC and IDA provided needed equity as well as the regulatory and legal framework. The government agreed to share some of the risks and the Government of Switzerland and the World Bank provided the remaining funds to cover social protection risks.

### **Private sector added value**

Even in a relatively high-risk country, private provision of infrastructure services proved preferable since the private provider brings in the necessary commercial orientation and can be held accountable for service provision and quality.

### **Social protection**

Without credible social protection, private investments in a very poor and politically volatile region with little experience of private investment in infrastructure and which requires a significant increase in average tariff levels will not be sustainable. Therefore 'payment for results' in terms of output delivered to the poor is an attractive way to structure such social protection.

### **Applicability to other countries**

The example demonstrates that PPPs can work even in circumstances specific to a transition country with perceived high level of political risk, especially if supported by foreign development agencies and international financial institutions.

### 3.5. USA

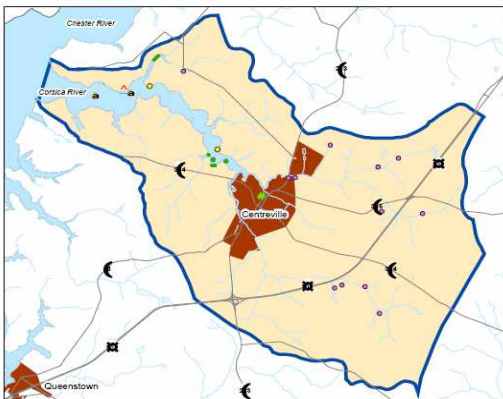
#### *NATURAL RESOURCES SECTOR*

#### **THE CHESAPEAKE FOREST PROJECT**



The Chesapeake Bay is the largest estuary in the United States, as well as a major area of both recreational and commercial fishing for the State of Maryland. The environmental quality of the Bay has been seriously threatened by wastewater discharges from growing population centres and minimal controls of agricultural run off (both fertilizers and animal by-products).

In response, area governments have made restoration of the Bay an environmental priority, including an increased interest in land and wetlands management. However, both state and local governments lacked the financial and personnel resources to fully address these issues. In this context, the Chesapeake Forest Project was created. A private lumber company sought to divest its land holdings in the State of Maryland, offering the State the opportunity to purchase this land - more than 58,000 acres in five counties. Much of this land bordered on existing State-owned parkland and forest, creating a unique opportunity to buffer a large area from deforestation and development.



However, the State lacked the funding to acquire the land and the personnel resources to manage the land once purchased – not to mention that the cessation of timber harvesting on the offered lands would have caused an unacceptable loss of employment in largely rural regions of the state. The State regarded the potential to safeguard these lands from development as a unique environmental opportunity. Recognizing its fiscal and personnel limitations, the State entered into a two-phase PPP to purchase and manage the land.



## Main Players

- (a) The State of Maryland Department of Natural Resources is the public agency with responsibility for oversight of the management of all phases of the project.
- (b) A major philanthropic foundation, which provides grants for projects “in the public interest” aided in the initial property acquisition.
- (c) A non-profit public interest group with a focus on the environment aided in developing the project’s Sustainable Forest Management Plan.
- (d) A for-profit forestry firm performed the forestry management under the implemented PPP.

## Selecting a partner

*Phase One:* the State worked with NGOs to acquire funding to help purchase the land and plan for sustainable management of the forest.

*Phase Two:* the State entered into a unique public-private partnership which required the private sector partner to manage the entire property according to environmental standards closely monitored by the public sector. In return, the private sector entity was allowed to harvest a sustainable level of wood products from specified portions of the lands. The revenues from the timber harvest generated the necessary income leading to revenue for all parties.

For the initial land acquisition that ultimately led to the partnership, the State provided \$16.5 million in order to purchase half of the 58,000 acres. The non-profit public interest group, acting on behalf of the philanthropic foundation, purchased the remaining 29,000 acres for \$16.5 million with the intent to later gift the land to the State. Since the initial phase in development of this partnership covered only this initial 29,000 acres provided by the non-profit group, a private environmental firm was contracted to manage the property in conformance with the State’s environmental standards and regulations. The terms of the final contract for this PPP between the State and the private company regarding the entire 58,000-acre forest tract were negotiated based upon the success of the PPP for management of the initial 29,000 acres. The unique aspect of this PPP, however, was that it was self-funded. The Sustainable Forest Management Plan included identification of areas in the forest where wood products could be harvested without negative environmental impact. The private partner managed the harvesting operations, the revenues from which pay for the contract and provide additional funds to both the State and local governments. In addition, controlling the continuation of timber harvesting activities addressed local communities’ economic concerns.

## Risk Allocation

Due to concerns about the viability of this model, the State agreed to cover any losses incurred by the private entity in the first two years; after that the private partner assumed the risks associated with the partnership’s profitability. However, the partnership succeeded in generating a profit in its first two years, as well as in each subsequent year. The contractor assumes a great deal of risk since there is no carry over of capital from year to year. No other source of funds is available to pay the contractor should it fail to generate sufficient income to

pay its fees – thus creating a strong incentive to keep the project economically self-supporting.

## **BENEFITS**

### **Private sector added value**

The private sector has the financial and personnel resources to address issues of land management and the sustainable use of natural resources.

### **Economic, Social and Environmental Benefits**

#### **The project:**

- (a) Provided a steady flow of economic activity and employment to support local businesses and communities;
- (b) Prevented the conversion of forested lands to non-forest uses;
- (c) Contributed to improvement in water quality, as part of the larger Chesapeake Bay restoration effort;
- (d) Protected habitat for threatened and endangered species;
- (e) Maintained soil and forest productivity health; and
- (f) Protected visual quality and sites of special ecological, cultural and historical interest.

#### **Efficiency**

- (a) Instead of hiring foresters and support staff, the State had its private partner manage these lands to its standards;
- (b) The State avoided expending public funds and, instead, generates revenue while ensuring the sustainable management of the forest; and
- (c) Since implementation, revenues have increased annually, thus giving strong incentives to the private sector as well.

#### **Transparency**

- (a) The project is a model of transparency that involves NGOs, local government, the public and private industry in the discussions of the need for the project, its financing and its structure.
- (b) The annual audits of the project finances, with full public disclosure, and performance monitoring by DNR, ensure accountability as well.

#### **Applicability to other countries**

This model may be applicable in conditions where the provision of services is combined with the sustainable development of natural resources.

## SUMMARY

There are seven main arenas where good governance in PPPs must be observed:

Governmental level: executive stewardship of the system as a whole;

*Principle 1 – The PPP process requires coherent policies that lay down clear objectives and principles, identifies projects, sets realistic targets and the means of achieving them, with the overall aim of winning the support of the population for the PPP approach.*

Public administration: where policies are implemented;

*Principle 2 – Governments can build their capacities in a combined approach that includes building skills, establishing new institutions and training public officials and using external expertise.*

Judiciary: where disputes are settled;

*Principle 3 – Legal processes in many jurisdictions are either insufficient or too complex and therefore fail to provide sufficient security and incentives to investors in PPP arrangements. As a result, lawmakers should aim to create PPP rules that are ‘fewer, better, and simpler’.*

Economic society: refers to state-market, public and private sectors;

*Principle 4 – PPPs allow risk to be transferred to the private sector, which are most able to manage them. However Governments also need to accept their share and help to mitigate those risks allocated to the private sector.*

Political society: where societal interests are aggregated;

*Principle 5 – The selection of the bidder should be undertaken following a transparent, neutral, and non-discriminatory selection process that promotes competition and strikes a balance between the need to reduce the length of time and cost of the bid process while selecting the best proposal. There should also be zero tolerance of corruption.*

Civil society: where citizens become aware of and address political issues; and

*Principle 6 – The PPP process should put people first by increasing accountability and transparency in projects and improving the quality of life, especially of the socially and economically disadvantaged.*

Sustainable development: where environmental concerns are included.

*Principle 7 – The PPP process should integrate the principles of sustainable development into PPP projects by reflecting environmental considerations in the objectives of the project, setting specifications and awarding projects to those bidders who fully match the green criteria*

## GLOSSARY

«**Buy-Build-Operate**» (**BBO**). Transfer of a public asset to a private or quasi-public entity usually under contract that the assets are to be upgraded and operated for a specified period of time. Public control is exercised through the contract at the time of transfer.

«**Build-Own-Operate**» (**BOO**). The private sector finances, builds, owns and operates a facility or service in perpetuity. The public constraints are stated in the original agreement and through on-going regulatory authority.

«**Build-Own-Operate-Transfer**» (**BOOT**). A private entity receives a franchise to finance, design, build and operate a facility (and to charge user fees) for a specified period, after which ownership is transferred back to the public sector.

«**Build-Operate-Transfer**» (**BOT**). The private sector designs, finances and constructs a new facility under a long-term Concession contract, and operates the facility during the term of the Concession after which ownership is transferred back to the public sector if not already transferred upon completion of the facility. In fact, such a form covers BOOT and BLOT with the sole difference being the ownership of the facility.

«**Build-Lease-Operate-Transfer**» (**BLOT**). A private entity receives a franchise to finance, design, build and operate a leased facility (and to charge user fees) for the lease period, against payment of a rent.

«**Design-Build-Finance-Operate**» (**DBFO**). The private sector designs, finances and constructs a new facility under a long-term lease, and operates the facility during the term of the lease. The private partner transfers the new facility to the public sector at the end of the lease term.

«**Finance Only**». A private entity, usually a financial services company, funds a project directly or uses various mechanisms such as a long-term lease or bond issue.

«**Operation & Maintenance Contract**» (**O & M**). A private operator, under contract, operates a publicly owned asset for a specified term. Ownership of the asset remains with the public entity. (Many do not consider O&M's to be within the spectrum of PPPs and consider such contracts as service contracts.)

«**Design-Build**» (**DB**). The private sector designs and builds infrastructure to meet public sector performance specifications, often for a fixed price, turnkey basis, so the risk of cost overruns is transferred to the private sector. (Many do not consider DB's to be within the spectrum of PPPs and consider such contracts as public works contracts.)

«**Operation License**». A private operator receives a license or rights to operate a public service, usually for a specified term. This is often used in IT projects.

**Bankability.** The ability of a project to generate sufficient cash flows, bearing in mind the risks associated with the project, to repay its financing.

**Concession agreement/contract.** An agreement or contract made between a host government and a project company or sponsor to permit the construction, development, and operation of a particular project, through which the government is delegating its monopoly or other unique rights.

**Concession period.** The duration over which the private sector will operate the service/asset. The asset is handed back to the government authority in a pre-agreed condition at the concession handover/reversion date.

**Consortium.** A group of companies wishing to act jointly as sponsors to a project.

**Construction cost.** Any of the cost types (appropriations, commitment, expenditure or estimate to complete) associated with the scope of the construction work.

**Construction risk.** Risk associated with the physical construction phase of project development.

**Currency risk.** The cross-currency and foreign exchange availability risks.

**DG TREN.** The directorate at the European Commission responsible for regional policy on transport and energy.

**Financial close.** The finalization of all arrangements and contracts pertaining to the external financing of a project.

**Financing agreement/contract.** The documents, which provide the project financing and sponsor support for the project as defined by the project contracts.

**Financing risk.** The risk of not being able to obtain the necessary funding of a project from the banking and capital markets. Whilst this is formally a risk for the project sponsors, it is also a major risk for the host government in delivering the project, and explains why financial close is such a major milestone.

**Infrastructure gap.** The difference between existing infrastructure and the infrastructure needed to promote economic development of a region.

**Operational risk.** The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events during the operational phase of a project.

**PFI.** Private Finance Initiative, the original acronym used to describe PPPs in the UK, sometimes used to mean a subset of PPPs based primarily on availability payments.

**Political risk.** The general term used to describe risks arising from factors that are determined or influenced by governments. External risks, such as currency convertibility, war, sanctions, etc., may be avoided, hedged, or insured against, and are significantly mitigated by

membership of the EU and EMU. Internal risks, such as taxation, terrorism, inflation, and strikes, are usually unavoidable and uninsurable, and particularly affect PPPs.

**Private funding.** Finance provided by a private party.

**Private sector.** The economic entities which are not controlled by the state, i.e. a variety of entities such as private firms and companies, corporations, private banks, non-governmental organizations, etc.

**Public Contribution.** The level of funding committed from the public sector to a project.

**Public Guarantee (or sovereign guarantee).** A government commitment of funds/actions under certain conditions, based on project documents.

**Public Sector Comparator (PSC).** The risk-adjusted, estimated full lifecycle cost of a project if it was carried out by conventional in-house means. It is expressed in terms of net present value.

**Return on equity.** Earnings before extraordinary items, less preferred-share dividends, divided by average common shareholders' equity; the rate of return on the investment for the company's common shareholders, the only providers of capital who do not have a fixed return.

**Revenue-generating (RG) projects.** A project involving an infrastructure, the use of which involves fees borne directly by users and any operation resulting from the sale or rent of land or buildings.

**Risk.** An event which can change the expected cash flow forecast for a project.

**Syndication.** The process of inviting other banks to participate in a financing by the underwriters of the financing.

**Sovereign risk.** The risk that a government will be unable to meet its external commitments. By definition, all governments are able to meet their obligations expressed in their own currency, so government bonds issued in their own currency are deemed to be risk-free for economic actors in that currency.

**Special Purpose Company/Special Purpose Vehicle (SPV).** A special purpose joint venture project company established by the sponsors which has, as its sole purpose, the delivery of a specific project.

**Sponsor.** A party wishing to develop and finance (with own equity or subordinated debt and other project finance) a project. Shareholders of project companies are known as sponsors.

**Step-in rights.** Rights relevant to both the private and the public sector. An entitlement to perform or allow a third party to perform the SPV's obligations under the concession contract in certain circumstances.

**Traditional Procurement.** Procuring infrastructural projects through a tender that encompasses only the construction of the relevant facilities.

**Traffic Risk.** A risk relevant to transport infrastructure projects, namely the chance that the number of users is not sufficient to meet established payback requirements.

**Trans-European Transport Networks (TEN-T).** A European Union designation for roads, railways, inland waterways, airports, seaports, inland ports and traffic management systems which serve the entire continent, carry the bulk of the long-distance traffic and bring the geographical and economic areas of the Union closer together.

**Underwriting of financing.** The commitment by a group of banks to provide the entire agreed financing, subject to certain restricted conditions.

**Underwriting of risks.** Formal agreement to take on a certain risk and reimburse the other party in the case of negative consequences ensuing from that risk.

**Value for Money (VfM).** A concept associated with the economy, effectiveness and efficiency of a service, product or process, i.e. a comparison of the input costs against the value of the outputs and a qualitative and quantitative judgment of the manner in which the resources involved have been utilized and managed.

**Whole life costs.** The full costs of a project including those incurred during the design, construction, operation and maintenance of the facility.

**Source:**

- (i) Hybrid PPPs: Levering EU funds and private capital, PricewaterhouseCoopers LLP and the World Bank, January 2006.