

Guidelines for Government Support to Public–Private Partnership (PPP) Projects

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Committed government support is essential to the development of public–private partnership (PPP) projects and to attract private investors in a highly competitive market. The private sector participation in infrastructure through PPP models is no sleeping pillow for the government authorities. As the name “Public–Private Partnerships” indicates, PPP is a partnership arrangement where active support from public authorities to private sector development of infrastructure projects is required, in particular in the pre-construction phases of a project.

There is no general recipe for an active public support to PPP projects. Each government must assess realistically the country’s attractiveness to domestic and foreign private investment. As each government must decide by which active steps private sector investment and development of infrastructure projects can be encouraged and the negative impact of existing, country-related impediments can be reduced.

In general, however, a government may be expected, inter alia, to support PPP projects in the following ways :

1. An Adequate Legal Framework for Public–Private Partnership Projects.

A national legal/regulatory framework should provide for, inter alia :

- (i) The legal authority for awarding and approving PPP projects;
- (ii) Eligible PPP infrastructure sectors and authorised PPP structures ;
- (iii) Administrative coordination and services ;
- (iv) Selection and organisation of private sector partners/companies ;
- (v) Creation of customary forms of security in project assets and particular PPP security arrangements in favour of project lenders ;
- (vi) Minimum requirements as to the content of PPP contracts ;
- (vii) Mandatory protection of national interest against onerous terms in PPP contracts, including exclusivity terms, onerous risk allocation and one-sided termination terms ;
- (viii) Rights to exchange local currency into foreign currency and to remittance abroad of foreign currency to off-shore accounts(see below, sec. 9) ;
- (ix) Protection of investors against expropriation, negative effects of changes in law and other political interventions; and
- (x) Enforcement of rights and remedies under the PPP contracts and security documentation, including resolution of disputes through internationally recognized arbitral proceedings.

It is recommended to have such legislation in place before undertaking PPP projects. As demonstrated by the Nam Theun 2 project the PPP contracts are not appropriate as proxy to adequate legislation.

2. Selection of Projects Suitable for Public–Private Partnerships.

It is the government that identifies and selects the infrastructure projects considered suitable for a PPP approach. Two issues are particular critical for this selection :

First the government must estimate whether the infrastructure project in question can be made financially viable under a PPP arrangement.

This is particularly important under PPP concession/BOT arrangements, where the substantial debt of the private investors usually is repaid to the lenders from the revenue generated by the project only (“limited recourse” or “project financing”). To attract private investors and their lenders it must be demonstrated that the PPP project most likely can generate revenues over the projected concession term sufficient for repayment of estimated construction, operation and maintenance costs and for providing a commercially acceptable rate of return on equity.

The practice adopted by some governments to select the most viable and solid infrastructure projects for public development and leave the less attractive projects to private sector development is not to be recommended.

Second, the government must assess whether the customers are able and willing to pay for infrastructure service involving private participation.

If tariffs, tolls, fees etc. to be paid by consumers for electricity, road service or water supply are reduced by a PPP arrangement, this is no issue. If, however, this is not the case, the public demand and “willingness - to - pay” for a more expensive infrastructure service may be a key factor in the selection of a PPP project.

Experience has also shown that PPP arrangements can provoke political and social problems related to privatisation of infrastructure under foreign ownership, fear of workers lay off etc.

Such issues should be managed by the government and preferably before undertaking a PPP project.

3. Ensuring value for Money as an Objective; Not as a Requirement for Public–Private Partnerships.

According to the legislation or government policy of some countries PPPs should only be adopted as a procurement option if it is reasonably documented that the PPP approach will deliver enhanced value for money over traditional public procurement methods. Value for money assessments, carried out by governments, therefore become crucial in deciding the suitability of a project for PPP development in such countries.

While enhanced value for public money is an important objective for all governments in applying PPPs, it is, however, not recommendable to make this objective and value for money assessments a legal requirement for adopting PPPs.

Few developing countries have the luxury of an option between public or private financing of infrastructure projects, due to constrained public capital.

Value for money assessment techniques, including the use of financial comparator techniques as employed in particular in the UK, are complicated and time consuming and do not produce results with a higher degree of certainty than the quality of data on which the assessments are based. Value for money assessments should, therefore, only be used after careful reflection.

In particular value for money assessments should not be permitted to make the PPP selection process so complicated that public authorities shun away from PPPs. In other words: Theoretical perfection should not become the enemy of the practical good, as had happened in several developing countries whose PPP programmes never came to fly.

4. Transparent, Competitive, and Orderly Procurement Proceedings.

It is the government that decides the procurement method for PPPs, manages the procurement proceedings and defines the criteria for selection of private sector PPP partners.

Orderly and transparent procurement proceedings appear to be a basic condition for attracting private investment in infrastructure. Serious private investors are extremely reluctant to invest in countries where the procurement system is inadequate, resulting in lack of transparency, ineffectiveness and patterns of abuse. It should also be recognized that procurement of PPP projects differs in several aspects from traditional public procurement of works, goods and services.

It is recommended that governments promote specific procurement regulations for PPPs, preferably in accordance with established international principles and guidelines for procurement of PPPs.

Generally, a competitive (single-stage or two-stage) tendering process is preferred by private PPP investors and their lenders, including by the development banks. Competitive tendering also provides the best protection of the public interest, as value for money primarily is achieved through a competitive process based on the economically most advantageous offer principle.

According to conventional wisdom unsolicited PPP proposals is a way to open for the private initiative. This is not the case. Experience shows that the vast majority of unsolicited proposals are attempts to avoid competition. It is recommended that the PPP procurement regulations make such proposals subject to transparent and competitive tendering proceedings.

5. Streamlining of Public–Private Partnership Contracts.

It is common experience that the transaction time and cost for developing PPP projects can be significant, in particular in developing countries.

Part of the high transaction time and cost are caused by the cumbersome process for developing the PPP contracts.

The PPP contracts are usually drafted by law firms according to each law firm's PPP experience, and project by project. Contract proposals drafted by one law firm, typically as

part of the tendering documents, will be followed by mark ups and time consuming negotiations with the other party's law firm (and law firms engaged by project lenders), each law firm, naturally, promoting the interests of their clients.

The time and cost of this contract development process can be excessive. For example, it took 6 years to develop the contract package for the Nam Theun 2 project, with legal fees exceeding US \$ 30 million.

It is also questionable whether this bargaining contract process is suitable to produce the most adequate contracts for PPP projects. As stated in a royal commission report on PPP projects in the oil and gas sectors: " The basic contract terms, including terms on risk allocation are too complex and too important to be decided by tug of war negotiations and ad hoc solutions, roject by project" (NOU 99.11).

To reduce the high transaction time and cost for PPP projects and to promote more rational PPP contracts, the government is recommended to develop model or bench-mark PPP contracts following internationally recognized, commercial contract principles and structures. International contract principles, based on broad international experience, have generally higher legal authority and higher legal quality than contract terms made by bargaining law firms. As internationally recognized contract principles, generally, are considered to be fair and balanced to both parties.

This recommended contract methodology was applied, tentatively, to the contracts for the Chengdu Water B Plant BOT Project and later refined for PPP projects in Asia and Africa. The method cut down the transaction time and cost for the Chengdu project significantly and was one of the major reasons that the project received a number of international awards in 1999 - 2000.

The contract developing method applied to the Chengdu water plant PPP project is discussed in details in Appendix 1 to the Chengdu case study.

6. A Credible and Efficient Administrative Framework for Public-Private Partnership Projects.

The government must establish a credible and efficient administrative framework to support its PPP strategy. Complicated administrative procedures, lack of authority for administrators to make decisions and lack of consensus between ministries and local authorities are often cited as serious obstacles to PPPs.

There is no single perfect administrative framework for PPPs to be recommended. Each country has its own administrative system and administrative culture. Efficient administrative support to PPPs , however, may include :

- (i) Establishment of an administrative focal point to plan and coordinate suitable PPP programmes and PPP projects in cooperation with implementing ministries, government agencies and local authorities. First and foremost the administrative focal point must ensure consensus between all public authorities before a PPP project is undertaken. Public authorities must speak with one voice to private sector partners.
- (ii) Several countries, and most private PPP investors, prefer the so-called one - window system as an efficient and time/cost saving administrative support to PPP projects. Under such system the private PPP partner needs to deal with only one government office to obtain and renew approvals (see below, sec. 7) , to receive

country related information and to expedite solutions to problems inherent in the implementation of all large infrastructure projects.

- (iii) Some countries have created national PPP units dedicated to PPP projects. As experience and training is gained, the role of such PPP units will focus on assisting the selection of PPP opportunities, counselling procurement proceedings and drafting of tendering documents, assisting in negotiations with bidders, promoting value for money and maintaining political support.

Experience indicates that competent, national PPP units have played a key role in creating professional trust with private PPP investors, which in turn allows for the development of effective and sustained partnerships.

7. Assistance to Obtain and Renew Approvals, Licences, and Permits.

Governments are expected to support PPP projects by facilitating the availability of national approvals, licences and permits for the projects, provided the private partners have fulfilled their obligations. The government assistance may include :

- (i) Provision of complete information about which approvals, licences and permits are needed by the private PPP investor, including by his construction and O&M contractors, to implement the project ;
- (ii) To accelerate project implementation, the government may, to the extent possible, prepare and coordinate the obtainment of approvals, licences and permits for the project in advance, that is between the award and the final signature of the PPP contract ;
- (iii) Coordination and support to the PPP investor in obtaining later available approvals, licences and permits and their timely renewals.

For implementation of this government support, a one - window administrative system clearly is the most efficient approach.

8. Provision of Land Use Rights, Access to the Site, Services from Utilities, and Other Logistical Support.

A government usually supports the implementation of large PPP infrastructure projects by providing land use rights to the project site, and access to the site, energy and communication supplies and other logistical support.

It is strongly recommended to arrange for the site and access to the site ahead of undertaking the procurement process.

9. Legislation to Promote and Protect Foreign Investment.

Most developing countries have enacted foreign investment laws to encourage and facilitate direct foreign investment. Although the scope and approach of the foreign investment laws differ greatly, the laws all grant a broad range of incentives, taxation advantages and benefits to foreign investors. They need to be made applicable to investment in PPP infrastructure projects, which are simply a different form of foreign investment.

With regard to PPPs the government must further recognize that most infrastructure projects do not generate foreign currency revenues. This leads to two major issues for PPPs :

First, in countries with high political risk lenders will require local currency revenues exchanged into foreign currency and free remittance of such foreign currency into off-shore accounts. This is sometimes strongly resisted by national governments, as was, for example, the case in Turkey.

Second, the private PPP investor may be exposed to local currency revenues and foreign currency cost, usually in a high inflation/devaluation environment. This problem has been solved in many cases by governments agreeing to pay tariffs (revenues) in foreign currency, then taking the foreign currency risk itself. When a government is unwilling to do so, other techniques may be explored in countries with developed domestic financing markets, such as hedging or by funding part of the project cost in local currency.

10. Possible Government Support to Make Public–Private Partnership Projects Viable.

As mentioned above a PPP project must have a sound economic rationale. This means that the project must produce an acceptable return to the private PPP partner and meet the debt coverage/loan life cover of the lenders.

In order to make some PPP infrastructure projects viable, a government may consider to provide financial support to the project in the form of cash grants, loans or in-kind contributions. A number of PPP infrastructure projects in Southern Europe have been structured in this way, with EU grants and EIB funding making the projects viable for the private investors and commercial lenders.

Most governments, however, while wanting the infrastructure project to be provided by a PPP arrangement, will wish to distance themselves from the financial burden and risk of the project. Indeed, a major reason for a government to enter into long-term PPP arrangement for a project is to pass off the cost and burden of the development of the project.

Governments may also be requested to support PPP infrastructure projects by providing guarantees. There are a number of guarantee mechanisms available to a government who want to support the viability of a project in this way, such as guarantees for the performance of a public offtaker (quite usual), equity guarantees, debt guarantees and revenue guarantees. In general, governments should seek to minimize guarantees to PPP projects, learning from the experience of the Philippines.

Summary:

PPP infrastructure projects cannot be realised without substantial commitment and cooperation on the part of the government.

Experience suggests that a government's active commitment and partnership support are critical factors in the assessment of a PPP project by private investors and their lenders. Indeed, experience presented by a number of large, private infrastructure companies during the 4th European Congress on Private Sector Participation in Infrastructure (Frankfurt 2004) showed that a proactive and sustained government support to PPP infrastructure projects can be a decisive factor in the competition for foreign investment in such projects.