Public Private Partnerships – An Overview

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1. WHAT DOES 'PPP' MEAN?

1.1 The PPP concept

The need

Australia faces a number of major challenges over the next decade in relation to the development of our infrastructure. Governments need to provide infrastructure (of all types) does not always coincide with the availability of funds from the public purse to make such projects feasible. Government faces the challenge of how to develop infrastructure and deliver infrastructure related services to the Australian community in a timely, cost effective and sustainable manner. The private sector has had an involvement in the delivery of infrastructure through a number of traditional contractual models (for example, the Build, Own, Operate ('BOO'), Design, Build, Finance and Operate ('DBFO') and Build, Own, Operate and Transfer ('BOOT') models). With the introduction of the Private Finance Initiative ('PFI') in the UK, governments have begun to look at different ways of providing infrastructure and, more specifically, infrastructure services in partnerships with the private sector. This model has been utilised in Australia (although notably with some adaptations) first by the Victorian Government, through the 'Partnerships Victoria' model and more recently by the release of policies by the Queensland and New South Wales governments on the issue. The Australian model is called Public Private Partnerships ('PPP') and the goal of the model is to assist the public sector to deliver infrastructure in a more cost effective manner (whilst retaining control of the 'core' services) with significant input from the private sector. This new model creates some exciting challenges for both the public and private sectors alike.

PPPs have rapidly found favour with the public sector (based upon the generally good results PPPs have had in the UK, Ireland and Portugal). They will have a significant impact on infrastructure projects both now and in years to come.

This article will provide an '*introduction*' to the manner in which PPPs operate and the sorts of issues that are likely to be relevant in a PPP project. The article will also make some comments in relation to the management of the '*relationship*' under the PPP structure (as such relationships are likely to be over the long term). In terms of dispute resolution options under

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PPPs it will be noted that whilst the construction and services agreements may nominate an arbitral process for the resolution of disputes, the model also lends itself to less '*adversarial*' dispute resolution options – such as mediation, the mediation/arbitration model and '*dispute review boards*'.

A working definition

The most 'basic' definition of a PPP might be 'PPPs can be described as a model for the procurement of public infrastructure services by government from the private sector under a performance based contract with a private party in a manner which provides value for money for the government and safeguards the public interest.'

Traditionally governments (via public works programmes) contracted with the private sector for the purposes of procuring the construction of physical infrastructure assets (eg, power plants, water treatment plants, railways, roads, ports, hospitals and prisons). The essence of the PPP model and the critical distinction between it and traditional contracting is that under the PPP model the government purchases 'services' rather than assets. Those services are, in turn, dependent on underlying infrastructure. This means that during the term of a PPP contract (30-35 years) the government is largely relieved of responsibility for physical assets. Instead, it is engaged in a contract which focuses on the timely delivery of quality services to the government or the community. Accordingly, a PPP deal is somewhat more complex territory than contractors and the public sector has faced in the past. The challenge of the model is that the relationship between government and contractor under a PPP will need to be managed over a much longer period (and within a very different dynamic) than perhaps under more traditional models.

Elements

The key elements of the PPP model are:

(a) the achievement of outputs benchmarked against KPIs;
(b) the provision of business opportunities for the private sector;
(c) assuring value for money for the government;
(d) protection of the public interest.

PPPs are not models for private sector financing of public infrastructure. While a capital investment component is required, PPPs are essentially the procurement by government of infrastructure services. This distinction is a subtle but important one.

Efficiency in the delivery of infrastructure services

There is no presumption in the PPP model that the private sector can necessarily construct and operate infrastructure assets more efficiently than government. Conversely, there is also no presumption that government is more likely to be able to do those things better or more cheaply than the private sector. The issue of whether the public sector or the private sector can provide the required services more efficiently is largely dealt with in the PPP model by a 'Public Sector Comparator'. Ensuring the right 'Public Sector Comparator' is vital for both public sector principals and private consortia tendering for PPP projects.

Government policies

The PPP model is a response to governments' need to accelerate the development and provision of infrastructure services in an environment where funds are not necessarily available to do so from Treasury. On this basis the PPP model has been investigated by a number of state governments to examine whether it is appropriate for their particular circumstances. The Queensland Government has also issued its policy on PPPs which is broad framework and draws from the Victorian model. The New South Wales government is also in the process of developing a model. Whilst all of these models draw from the UK model there are some regional differences.

1.2 Key features

Uniqueness

The PPP model in many respects is very similar to commonly used, well established project delivery models, particularly the BOO(T) and DBFO models. There are, however, some key features of the PPP model which are unique and innovative.

'Core services' and the public interest

Government cannot divest itself of statutory responsibilities and accountability to the public. The PPP model recognises that 'core' services should be retained under the direct control of government (depending on the nature of the project in question). For example, a PPP project for the delivery of education services would leave the provision of teaching personnel to the government and require the private sector to provide the other infrastructure services such as accommodation, administration and teaching equipment. The prospect of government service providers working alongside private sector service providers in respect of the same project is a unique feature of the PPP model.

Public Sector Comparator (PSC)

Another unique feature of the PPP model is the process of comparing the cost of private bids to a hypothetical, risk adjusted cost of public delivery for the same services (the Public Sector Comparator). The PSC is a unique cornerstone feature of the PPP model. The PSC provides a benchmark against which the government can decide whether it is obtaining value for money from private sector bids.

The PSC is a contentious issue. Government must ensure that the PSC is 'right' for the particular project to ensure that their analysis of whether it is a project which is appropriate for delivery using a PPP model. That said, the PSC is merely a tool to assist government in its decision making and is not necessarily determinative of whether a project will be delivered as a PPP.

For contractors, knowing what the PSC is, is of great assistance when bidding for the project. Whilst some state governments have experienced a reluctance to disclose the PSC to bidders, the UK experience has been one where the PSC is generally disclosed (at least in part) to tenderers to assist them with their bids. This sharing of appropriate information is a

more efficient way to engage with the private sector in PPP projects.

Safeguarding the public interest

The public interest is of paramount importance in any public sector project. The PPP policy documents produced by the Victorian and Queensland Governments clearly state this. The 'public interest factor' means that any proposal to implement a project by using a PPP model will be assessed against a public interest test to ensure that the project protects the interests of the community, no community group is unreasonably disadvantaged and that the usual requirements of probity and transparency of process are adhered to.

Performance contracting

Another feature that lies close to the heart of the PPP model is that the PPP contract entered into between government and a private party for the provision of infrastructure services will be a performance based contract. The contract will invariably require the private party to meet specified performance standards and will contain bonus and penalty provisions for achievement and non-achievement of those standards by the private party. This aspect of the PPP model will manifest itself mainly in the payment mechanism under the contract. Contractor's are unlikely to be entitled to a fixed payment irrespective of performance. The payment mechanism will be linked to the availability, performance and usage of the services or a mixture of any or all of those requirements. Thus the contractors 'risk' is spread over a considerable period of time and their payments are staggered over the life of the PPP.

This, in turn, introduces new risks for contractors who are looking at the model as their payments are by no means certain and will be dependent upon their long term performance of the 'services' portion of the contract. This can be measured in 2 ways. The first is the 'actual usage' of the services (where the contractor assumes the 'usage risk') and the other option is that of 'availability', where the 'usage' risk lies with government. Often the measure is a mixture of both.

1.3 Context – Comparison with other project delivery models

Degree of private sector responsibility

The PPP model involves the private sector significantly more than in the past in the delivery of infrastructure services. The 'traditional' approach is where infrastructure services are provided wholly by the Government pursuant to its public works programmes. PPPs still involve government – but also involve the private sector and do not go as far as to hand over responsibility to the private sectors under the BOOT or privatisation models. Under the privatisation model, none of the project responsibilities are assumed by government. PPPs are, in some respects, very similar to the more commonly used BOO(T) model. The BOO(T) model is closer to privatisation than PPPs as the PPP model includes more government participation. There are common features and overlaps between the PPP and BOO(T) models. Generally the BOO(T) model is a subset of each PPP model in the sense that the BOOT model

is used for that part of the PPP model which requires construction or upgrading of the hard asset infrastructure necessary to produce the infrastructure services the subject of the PPP project.

The key distinctions between the PPP and BOOT models are:

(a) Under the PPP model, the Government assumes significant usage risk in respect of the infrastructure services being procured;
(b) Under the PPP model, some core services essential to the public will be retained by the Government;
(c) The PPP model uses a Public Sector Comparator, where the BOOT model does not.

Cost

PPP models will involve considerable tendering costs for contractors. As the model develops there may be some scope to assist contractors with those costs. The UK experience has been that there are also, initially, high transactional costs in negotiating and documenting deals for the public sector principals. These costs have however reduced significantly as much of the 'basic' UK documentation has been developed. One would expect a similar situation in Australia.

1.4 Practical applications

Examples

Examples of the application of the PPP model in practical terms are:

(a) Public schools – This project may take the form of the Government procuring school room accommodation services from the private sector. The private sector would take responsibility for design, construction, maintenance, administration and provision of school equipment. The Government would provide the school teachers;
(b) Public hospitals – This project may involve the provision of hospital accommodation services by the private sector to the Government. Once again, the private sector would take responsibility for the design, construction, operation, maintenance and administration of the hospital. The Government would provide the doctors and nurses;
(c) Railways – The PPP model could involve the provision by the private sector of railway passenger services on a specified section of track. The private sector would take responsibility for the design, construction, operation and maintenance of the track and stations, signalling equipment, ticketing and perhaps the railway staff. The Government would provide rolling stock and scheduling timetables;
(d) Power stations – The PPP project could involve the delivery of energy services (the supply of electricity to the grid) by the private sector. The private sector would take responsibility for the design, construction, operation and maintenance of the power station used to generate the electricity and the provision of relevant staff. The Government would provide facilitation of project approvals, interconnection facilities to the main grid, and perhaps provide some financial guarantees or take or pay commitments to take the usage risk away from the private sector to some extent.

Land tenure and Government policy

In all these types of projects, the Government would normally provide the necessary land tenure. It would also insist on the services being provided in accordance with Government Policy and strictly in accordance with the availability, performance and usage standards required under the contract.

Often property related issues are at particular importance and complexity in major infrastructure projects which may be delivered under the PPP model (for instance 'shadow' toll roads in Portugal). In other projects (ie. schools, hospitals, police stations) these issues will remain important but will not have such a major role.

Threshold issues

There are 3 key considerations that government will have when considering the use of a PPP delivery model:

(e) Core Services – the Government will examine whether the infrastructure services in question should be retained and delivered wholly by the Government;

(f) Value for Money – the PPP project will not proceed unless the Government determines that the private party bid represents value for money in comparison with the Public Sector Comparator.

(g) (c) Public Interest - the issue of safeguarding the public interest is an important threshold issue for the Government's assessment of any PPP project. The projects would be assessed against public interest criteria including accountability, transparency, public access issues, consumer rights, privacy, etc.

2. MANAGING RELATIONSHIPS IN PPPs

The risk allocation under a PPP arrangement is very different to that at most '*ordinary*' construction arrangements. It is likely that there will be a number of key relationships within the PPP structure which will be governed by different contractual arrangements:

Key contractual documents in a PPP may include:

(a) infrastructure services agreement;
(b) concession agreements;
(c) credit agreement(s);
(d) arrangements between the sponsor – equity participants;
(e) design and construct contract;
(f) operation and maintenance contract; and
(g) various financial/performance guarantees.

3. THE PUBLIC/PRIVATE INTERFACE

Unlike more traditional arrangements the public and private sector will need to work together over a longer period of time and far more closely than ever before. In this

environment having a '*standard*' escalation process (ie. meetings between various levels of management and then ultimately involving a third party arbitrator) followed by reference to the courts or through an arbitration process – is not ideal.

Because the nature of the services contracted for (between the provider and government – not necessarily relating to the arrangement between the parties making up the contractor's consortia) is over a long period of time and, perhaps more importantly involving social infrastructure (schools, hospitals etc) it is worthwhile considering more '*radica*l' approaches to managing the relationship with a minimum of disruption.

4. THE MEDIATION/ARBITRATION MODEL

There has been significant debate about the merits of the mediation/arbitration model for dispute resolution. This is where the arbitrator can, during the course of the arbitration (and with the consent of the parties) put the arbitration into abeyance and endeavour to reach a mediated outcome.

The critics state that the tension lies in the very different nature of the roles of arbitrator and mediator and the fact that any ordinary person would have differently reconciling the two roles. Certainly in situations where (within the context of a mediation) information was provided to the mediator which may be detrimental to the disputant's case, how can the mediator then ignore that information when stepping back into an arbitral role if the mediation is unsuccessful? Important issues such as natural justice need to be addressed. The mediation/arbitration approach is often advocated by very '*interventionis*t' arbitrators although it can produce good results for the parties.

This article suggests that perhaps a mediation/arbitration model may be useful where the resolution of the dispute needs to be expedited and, furthermore, a consensual outcome (ie. a mediated one that preserves the relationship) is the preferred one.

Dispute resolution clauses under PPP arrangements usually call up site/management meetings, mediation and then arbitration or litigation. Given the complex nature of the model (and the importance of resolving issues quickly to ensure that the service continues being provided to the public) the mediation/arbitration model is worth closer examination for use in projects of this type. Indeed, the mediator/arbitrator could even consensually be appointed at the outset of the project and act as a '*facilitator*' for the relationship during its life (on an as-needs basis). The person would need to be both trusted and respected by the parties and understand the issues involved in the project from its outset. Obviously, issues such as '*capture*' of that person would need to be considered, however, the model is one that could maximise the possibility of the rapid resolution of any disputes by a third party all participants have respect for and who already understands the issues (at least in a general sense).

As project delivery gets more complex, so too do the options for dispute resolution demanded by the market. It is no longer the case that relationships can afford to be '*burnt*'.

The mediation/arbitration option may not be the answer but it is worth considering.

Another option which has found favour overseas involves using dispute review boards ('DRBs') on projects of this type. The DRB is involved from the outset of the project and comes in on an '*as needs*' basis.

5. CONCLUSION

PPPs have had significant success overseas and have found favour with a number of governments throughout Australia. The PPP model is a complex one and one that will not be suitable for every infrastructure project. PPPs will involve government and contractors 'thinking differently' about both the project and their relationships more generally. This article has given an overview of the PPP model and suggested that the model demands a more innovative approach to its peculiar dynamic. The '*dispute resolution*' clause now needs to provide for '*relationship management*' and not simply provide for an absolute outcome of a particular dispute but recognise and support the commercial objectives that the participants set out to achieve at the beginning of the project. ❄

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