



**OECD International Transport Forum Roundtable:
Public-Private Partnerships for Transport Infrastructure
“Renegotiations - How to approach them and economic outcomes”,
George Mason University, Washington DC, USA, 27 October 2014**

Introduction from the Chair - Michael Burnett

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- **Chartered Accountant (c.20 years working in public procurement/PPP/contract management)**
- **Assistant Director, KPMG (7 years)**
- **Director, EIPA European PPP Forum (9+ years)**
- **Member, European Commission Stakeholder Expert Group on Public Procurement since 2012**
- **Member, Editorial Board, European Procurement and PPP Law Review since 2007**
- **Member, OECD Senior PPP Officials Group since 2012**

PPP contract renegotiation – Fundamental propositions

- **The core objective of an awarding authority in awarding a PPP contract is to secure value for money (VFM) for the public sector, irrespective of how the economic operator is remunerated**
- **VFM - “The optimum combination of whole-life cost and quality (or fitness for purpose) to meet the user’s requirement”**
- **The awarding authority has a potential weakness after awarding a PPP contract to a partner which *de facto* often has a supply monopoly**
- **This weakness is exacerbated where the awarding authority does not have an effective exit strategy or there is a high degree of short-term criticality to service continuation**
- **The approach to renegotiation of a given project is influenced by the territorial/sectoral market of the project i.e. there are particular risks in different territories, the transport sector as a sector and its sub-sectors**

PPP contract renegotiation and VFM

- **VFM in PPP award – Extensive experience and elements of good practice well understood**

“The awarding authority’s approach to the use of PPP will be influenced by the signals at territorial level (e.g. funding incentives, preference for “deals not rules” etc.)”

- **VFM in PPP execution – Still a relatively neglected subject in practice – in spite of availability of extensive guidance (e.g. OECD, EPEC, UK government, UK NAO reports, UK Parliament reports, Australian states of Queensland and Victoria etc.)**

“VFM in a PPP is not just the VFM secured in the award procedure – it is the VFM secured in the contract execution phase”

PPP contract renegotiation in the context of PPP contract management (1)

- **Contract renegotiation takes place in the context of the awarding authority's approach to PPP contract management, including measuring contract performance and checking delivery of contract objectives as well as managing contract change**
- **Effective contract management starts with the design of the contract management régime during the contract award process**
- **The signals sent by the awarding authority before and during the award process will influence how it is able to manage the contract (e.g. approach to project selection, approach to the PSC, approach to stimulating competition, appropriateness of timetable, competence in negotiation, process transparency, stakeholder consultation etc.)**

PPP contract renegotiation in the context of PPP contract management (2)

- **How the awarding authority addresses the “asymmetry of information” between the public and private sectors will influence how it can manage the contract (e.g. contract conditions giving it access to operational and financial systems of the economic operator, a mechanism to verify continuing VFM during contract execution such as rate of return monitoring etc.)**
- **How the awarding authority addresses the “asymmetry of skills” between the public and private sectors will influence how it can manage the contract (e.g. transferring procurement knowledge to contract management team, resources, skills, authority, remuneration of the contract management function, continuity in contract management function, senior management/politicians engagement post-award etc.)**

“If an awarding authority doesn’t take contract management seriously it is unlikely to manage contract renegotiation effectively”

Papers for discussion

- **Soft budgets and renegotiations in Public-Private Partnerships – Eduardo Engel et al.**
- **Renegotiation of transportation Public-Private Partnerships: The US experience – Jonathan Gifford et al.**
- **Institutional and political determinants of private participation in infrastructure – Gonzalo Araya et al.**
- **The renegotiation of PPP contracts: An overview of its recent evolution in Latin America – José Luis Guasch et al.**

PPP contract renegotiation – Questions specifically addressed by contributors

- **Do parties usually renegotiate simply because of a lack of compliance with contract terms and departure from them?**
- **Do renegotiations imply economic losses associated with efforts to evade contract terms?**
- **Do renegotiations reduce the strength of incentives for efficiency, leading to a loss of global surplus?**
- **Are renegotiations more often the result of a need to adapt contractual agreements to a changing environment, without any loss, following the reasoning of incomplete contract theory?**
- **Are renegotiations more often the result of perceptions of unfavorable outcomes (for example insufficient competition leading to high margins for the private partners)?**

“Contract renegotiation in the construction phase cannot satisfactorily be explained by incomplete contract theory”

PPP contract renegotiation – More fundamental questions (1)

- **Does contract renegotiations ever lead to better VFM for the public sector? If not, when should they be considered?**
- **What is the observed impact on the incidence/outcome of contract renegotiation in concession-type PPP (including shadow toll arrangements) as compared to availability-based PPP?**
- **What is the observed impact of different SPV gearing ratios on the incidence/outcome of contract renegotiation?**
- **Should awarding authorities ever consider a PPP project based on receipt of an unsolicited offer?**
- **What role should portfolio/territorial management play in contract renegotiation i.e. where an economic operator manages several facilities in the same geographical entity?**
- **Should concession-type PPP be awarded differently from conventionally procured infrastructure or availability-based PPP?**

PPP contract renegotiation – More fundamental questions (2)

- **How far is the incidence/outcome of contract renegotiation linked to specific aspects of the award procedure (e.g. the number of candidates short-listed, scope of negotiation, investigation of potentially unsustainably low offers, the nature of the award criteria, price and quality balance in the award criteria etc.)?**
- **Should territories set a statutory limit on the length of concessions contracts to limit market foreclosure?**

And maybe....

- **Does the incidence/outcome of contract renegotiation call into question the classic contractual PPP model (whether demand or availability based) as compared, for example, to alternatives such as wholly/partly public finance (including DBO/performance contracts), post-construction revenue securitisation, use of mixed capital SPVs, regulated utilities or other privatisation, finance via sovereign wealth funds, private equity funds, lower SPV gearing ratios etc.?**
- **Should there be a “mixed market” of delivery models at territorial level?**

Or even...

- **Given the existence of a historically low level of benchmark interest rates in some jurisdictions, should the public sector now be drawing up a list of PPP contracts which could be profitably bought out?**

PPP contract renegotiation – Supplementary questions at territorial level

- **Should territories give guidance on the appropriate level of resourcing for the contract management function?**
- **How should territories develop contract management capacity?**
- **To what extent can/should contract management become a professionalised/certified function?**
- **How should territories develop knowledge sharing within the territory on contract execution outcomes?**
- **Should territories apply a mandatory/statutory post award moratorium for a period of time on contract renegotiation?**
- **Could territories improve VFM in contract renegotiation by a requirement for *ex ante* and/or *ex post* independent verification (e.g. by external auditors, third party arbiter/independent panel, stakeholder participation etc.) or *ex post* transparency (e.g. EU obligation for a Contract Modification Notice for certain changes)?**

And maybe....

“The effectiveness of contract renegotiation is influenced by the context in which it takes place”

SO....

- **What are the immediate priorities for countries in facilitating an appropriate framework for contract renegotiation (e.g. legal constraints such as on the scope of contract change and for investor protection, economic constraints such as actions to prevent market domination in sectors/sub-sectors, financial management procedures, transparency obligations re PPP execution, anti-corruption measures such as conflict of interest procedures, asset disclosures by politicians and restrictions on donations to political parties by PPP investors or operators, the effectiveness of external scrutiny such as judicial, audit, parliamentary, civil society, IFI or media scrutiny etc.)?**

PPP contract renegotiation – Supplementary questions for awarding authorities (1)

- **What linkage is observed between contract renegotiation and attempts to transfer excessive/unmanageable risks (such as securing land use permits or environmental permits) to economic operators?**
- **How far should an awarding authority's response to requests for contract renegotiation by an economic operator be influenced by the causes underlying the request (especially if there is a risk of financial or operational failure of the economic operator)?**
- **What response is needed to address observed differences between post-renegotiation contract VFM for changes requested by the awarding authority and those of the economic operator?**
- **How far is VFM in contract renegotiation influenced by the existence in the contract of change protocols for foreseen and unforeseen change? If so, what procedural arrangements should be in place for such foreseen and unforeseen events?**

PPP contract renegotiation – Supplementary questions for awarding authorities (2)

- **How can the awarding authority ensure it can measure the contract's continuing VFM during/after contract renegotiation?**
- **Is there evidence that contract renegotiation is less likely to result in VFM if it immediately precedes or follows political change?**
- **What has been the impact of variable concession lengths (“the lowest NPV bid”) on contract renegotiation?**
- **Should awarding authorities require bidders to include a change contingency reserve in their offers?**
- **What impact does contingency planning for materialisation of risks play in securing VFM in contract renegotiation?**
- **What impact does the quality of external professional advice play in securing VFM in contract renegotiation?**

PPP contract re-negotiation – Main causes

- Procurement errors by the awarding authority
- Demand forecast errors by economic operator
- General economic shocks/*Force majeure* events
- Mismanagement/under-resourcing by economic operator
- Project-specific changes in economic circumstances (e.g. need for more/less service, service obsolescence, technological/best practice process change, insured risks becoming uninsurable etc.)
- Legislative change (controllable/non-controllable)
- Public acceptance change
- Attempted budgetary manipulation by the awarding authority
- Change of political control/orientation
- Collusion

PPP contract re-negotiation – Options for the awarding authority

- **Change contract in favour of private partner (e.g. contract length, contract scope, performance targets, input requirements such as maintenance schedules, implementation of penalty régime, payment amounts, payment flow, shift to partial or full availability basis, tariff changes i.e. increases or delayed future reductions, changes to future tariff-setting process, future revenue or refinancing guarantees, partial debt re-financing by public sector, hand-back terms, lower DSCRs subject to lender approval, enhanced tax relief, other risk re-acceptance such as re-assumption of change of law risk, redefinition of *force majeure* and relief events, change of hand-back arrangements etc.)**
- **Don't change/leave private partner responsible for recovery**
- **Rebalance contract on the “something for something” principle**
- **Considering buying out the PPP contract**
- **Terminate the contract**

PPP contract re-negotiation – Evaluating options in case of requests by the economic operator

Determine approach on case by case basis based on:

- **Responsibility for specific contract issues arising**
- **Responsibility in original contract for risk materialising**
- **Partnering behaviour of private partner**
- **Scale of recovery needed**
- **Scope for change (affordable?, foreseen in contract review clauses? legally permissible?)**
- **Consequences of failure for public sector**
- **“Balance of power” between the parties (linked to attractiveness of alternatives)**

PPP contract re-negotiation – Options for rebalancing the contract

- **Activate guarantee options (if relevant)**
- **Portfolio/territorial re-negotiation**
- **Compensating adjustments by SPV (e.g. more sponsor equity, new equity investor, acceptance of public sector equity/board representative in SPV, future public sector gain sharing in upside traffic, refinancing with gain sharing, future enhanced monitoring/certification/audit, future requirement for performance bond/sponsor parent company guarantees, earlier recovery of asset, lower user tariff, pass through of energy/insurance/sub-letting shared savings, requiring personnel change, requiring sub-contractor change etc.)**

European PPP Forum

WEB SITE

<http://www.eipa.eu> then search for PPP

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