SADC BANKING ASSOCIATION
Transforming banking in Southern Africa

IP3
Institute for Public-Private Partnerships

PPP Skills and Competency Development

ONLINE TRAINING PROGRAMME

Module I: PPP Concept, Rationale and Contract Structuring Options

Module Overview and Learning Objectives

This first module will provide participants with an introduction to the fundamental concept of Public-Private Partnerships (PPPs), the different rationales for their use, and the various forms of PPP contract structures. The purpose of the module is to provide programme participants with a common foundation upon which to build their technical knowledge relating to more specialized PPP techniques, to be covered in future modules.

By the end of this Content Article, participants should be able to:

- Define what a PPP and understand the basic concept of what a PPP is;
- Explain why PPPs are becoming increasingly popular within the SADC region and among similar developing economies;
- Be able to understand the principles that distinguish PPPs from traditional public sector procurement methods;
- Understand the different options for structuring PPP contracts;
- Understand PPPs are extensively employed globally and that PPPs cover a wide range of sectors;
- Understand the contractual and legal obligations relative to the various forms of PPPs;
- Have insight into the rationale for selecting a particular PPP based upon the contractual obligations; and
- Be able to understand the principles that distinguish the different forms of PPPs from a contractual and institutional perspective.

Introduction

Throughout Sub-Saharan Africa, Governments – including the public sector at national, provincial, and local levels – have often been legally or even constitutionally mandated to provide public services. In all of these cases, government pays for the entire infrastructure, from taxpayer or donor funding, and all operations and maintenance is likewise paid from public funds. Increasingly, governments in the SADC, elsewhere in Sub-Saharan Africa, and indeed throughout the world are turning to public-private partnerships (PPPs) as a means for accessing private sector financing and expertise that government does not currently posses, and therefore provide needed and enhanced services to end users that otherwise might not be available.

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What are Public Private Partnerships (PPPs)?

Despite the strong and increasing level of global interest in PPPs, especially during the past two decades, there is no single universally accepted definition of a Public-Private Partnership. This poses a significant challenge to any country striving to either complete a PPP pilot project transaction, or trying to set up a new PPP policy, legal, and institutional framework. The danger is that different stakeholder groups will come up with their own definition of what a PPP is, and experience has shown that in practice these definitions of a PPP may have little in common and prove irreconcilable. Governments may define any relationship with the private sector as a PPP, or they may use a more restrictive definition that entails the use of specific contractual models or financing mechanisms.

Within the SADC region, official definitions of PPP share the same fundamental concept, but show still show some variations:

- **South African** law defines a PPP as a contract between a public sector institution/municipality and a private party, in which the private party assumes substantial financial, technical and operational risk in the design, financing, building and operation of a project. Two types of PPPs are specifically defined:
    - where the private party performs an institutional/municipal function
    - where the private party acquires the use of state/municipal property for its own commercial purposes. A PPP may also be a hybrid of these types.

  The way a PPP is defined by South Africa's regulations makes it clear that:
    - A PPP is not a simple outsourcing of functions where substantial financial, technical and operational risk is retained by the (public) institution
    - A PPP is not a donation by a private party for a public good
    - A PPP is not the 'commercialisation' of a public function by the creation of a state-owned enterprise
    - A PPP does not constitute borrowing by the state.[1]

- In **Botswana**, PPP is defined as a contractual relationship between a public institution and a private entity where the private party performs a function (normally infrastructure provision) or uses Government property, in accordance with agreed output specifications for a significant period of time in return for a benefit.[2]

- The Government of **Mauritius** defines PPPs as an agreement between government and a private party in which the private party undertakes to perform a contracting authority's function for a specified period; the private party receives a benefit for performing the function by way of (i) compensation from a revenue fund, (ii) charges or fees collected by the private party from users or customers, or (iii) a combination of compensation and charges or fees; the private party is liable for the risks arising from the performance of its function; and state facilities, equipment or other state resources may be transferred or made available to the private party.[3]

For the purposes of this online program, the definition of a PPP should include at least the following key elements:

- ✓ A legally enforceable contract between a government or public sector entity and a private sector firm;
- ✓ Transfers some meaningful risks onto the private partner, such as for financing, designing, constructing, operating, maintaining a project to deliver services;
- ✓ The private partner receives its payments in accordance with its actual performance

[1] See webpage for South Africa National Treasury's PPP Unit at www.ppp.gov.za
[2] From Yeoman Ward International in association with Chibanda, Makgalemele, Ngcongco and Company, "Institutional and Legal Review," page 7.
[3] Government of Mauritius, "Public-Private Partnership Act 2004, (Amended 2008)" Clause 2.

- ✓ For the provision of some service that has traditionally been provided by the public sector.

This first required characteristic of a PPP, that it be a legally enforceable contract between the public and private sectors, distinguishes it from other important non-PPP activities, such as private corporate social responsibility. Large private firms or non-profit charitable organizations have often donated to important development projects that may provide water, health care, and education to low income groups and regions. However, such efforts are usually not PPPs because they are not explicit contracts that bind both parties to meet specific performance measures over an extended period of time. Such projects often announce admirable goals for improving social services and reducing poverty, but it very rare that they are included in binding contracts with clear penalties for lower than expected performance. Some PPP specialists have proposed that many public charity activities would be much more successful and sustainable if they were structured more like PPPs, with clear binding contracts and specific, measurable required performance standards.

The Jordan Education Initiative (JEI): Is it a "PPP" or Not?

One rare exception to definition of a PPP is the Jordan Education Initiative (JEI). In 2003 a team of leading international ICT corporations including Microsoft, Intel, Cisco Systems, and others *donated* $25 million to a project in Jordan install high-speed internet access and ongoing support services in the form of online teacher training and new electronically-based curricula to a selected group of 100 public schools in Jordan. As a donation, this consortium of private donors expected no revenues or financial returns from the project. In exchange, the Government of Jordan bound itself to providing specific support and contributions to the project. This was possible largely due to the active support and involvement of the King and Queen of Jordan. The private firms were willing to make this donation and ongoing support services primarily because they had an enforceable agreement with the Government of Jordan, they could count on it to perform its specific roles in making the project work, and the project had clear, measurable outputs.

This case example raises the possibility that more such private donations to economic and social development initiatives might be possible if they could be structured around clearer and more enforceable agreements – especially one with clear outcome targets and commitments for specific public sector contributions. For more info on this case, see: http://www.jei.org.jo/ . A summary analysis of the JEI by McKinsey & Company can be found at: http://pdfcast.org/pdf/building-effective-public-private-partnerships-lessons-learnt-from-the-jordan-education-initiative-a

Based on the definition of PPP provided above, one can see that PPPs can cover many different sectors and also include many different levels of risk-transfer or risk-sharing between the public and private sectors. This flexibility on the issue of "what is considered as PPP"can allow for numerous innovations and variations in structuring projects, as long as they further the overall goal of PPPs: to provide more available and higher quality public services that are affordable, and which provide better value for money to both government and end-users.

During the past 5-10 years, many Governments, including within the SADC region, have launched new PPP legal frameworks to clarify and streamline the process of implementing PPPs. Several of these have drafted and passed new laws that re-define "PPP"more narrowly to mean only those projects that require the private partner to *finance* a new long-term infrastructure facility in order to deliver the required public services. According to these new, more narrow legal definitions of PPP, a contract that requires a private party to manage and operate an existing town water system, but that does not require it to make new long-term investments in the water system, would not be considered a PPP, as defined by the new PPP Law. However, a contract requiring the private partner to raise new long-term finance (by investing its own equity and/or borrowing long-term loans from commercial lenders), and to design, build, and operate an expanded water infrastructure system or a new water treatment plant, *would* fall under this legal definition, and therefore have to comply with all of the conditions of the PPP Law and its implementing regulations and procedures.

While these kinds of "Private Finance PPPs" are more of a priority to developing country Governments facing chronic shortages of infrastructure assets, they are also much more risky for private firms to undertake, when compared to contracts that only require the operation of infrastructure assets that already exist. These Private Finance PPPs require much more analysis, preparation, and risk-sharing by Governments, which is why a growing number of countries are legally re-defining PPPs in hopes of streamlining the process and achieving more deal closures.

Internationally, this trend has been led by the United Kingdom, which set the precedent of creating the "Private Finance Initiative" (PFI) framework in 1992, including a detailed regulations, guidelines, regular audits and performance evaluations for privately financed, built, and operated schools, hospitals, roads, prisons, accommodation facilities, and other infrastructure assets.[4] Since then, many countries, including both industrialized and developing economies have re-defined PPPs through new PPP Policies and PPP Laws. For example, the **Government of Kenya's PPP Policy Statement of 2009** defines PPP as:

> A contractual arrangement between a public body and private party in which the private party and Government enter into a long term agreement, up to 30 years, to build a new infrastructure facility or to rehabilitate an existing one for the purpose of undertaking a public service on behalf of Government… The private party is required under the terms of the project agreement to take responsibility to mobilize finance – equity as well as debt – in order to complete the facility according to agreed specifications and schedule.[5]

It is important for PPP managers and analysts to understand that the definition of PPP can vary from country to country, and these definitions will likely continue to be refined for the foreseeable future. While the definition provided within a PPP Law (such as for private finance PPPs) should be well-understood by any practitioner, this does not mean that contracts that do not require new capital investments by a private partner should simply be ignored. Instead, both large Private Finance-type PPPs as well as smaller or operating-type contracts share many of the same goals, such improving services and providing better value for money, and they should both be managed to ensure competition, transparency, and fairness. The differences between these forms of PPP contracts as well as the different reasons for pursuing PPPs is discussed in more detail the following sections below.

Given the above, what makes a PPP different than any other form of cooperation between Governments and private firms? In the SADC region, governments face a daunting challenge. There is a massive need to expand infrastructure networks throughout the region, to extend vital public services to groups who are currently not receiving them, and to improve the efficiency, reliability, and quality of public services throughout the economy.

[4] For more information on the UK's framework for its Private Finance Initiative (PFI), see: http://www.hm-treasury.gov.uk/ppp_index.htm

[5] Government of Kenya, "Policy Statement on Public-Private Partnerships," 2009, pg. 7.

For More Information

The following websites provide useful information about PPP:

- South Africa's National Treasury PPP Unit: www.ppp.gov.za
- Republic of Mauritius PPP Unit: http://ncb.intnet.mu/ppp/
- The Irish Government PPP Unit: www.ppp.gov.ie
- The Canadian Council for PPPs: www.pppcouncil.ca

What are the Different Reasons & Goals of PPPs?

There are several different reasons for implementing PPPs. Perhaps the most important is that while the public sector is accountable for ensuring that public services get delivered, it is not, in many cases, the best *service provider* in terms of cost, quality, and ability to manage commercial risks. This limited ability of the public sector to manage commercial performance well is aggravated by the accelerating demand for infrastructure in developing economies.

The key underlying rationale for a PPP is that it offers better value for the public's money throughout the entire life of the project. This fundamental benefit can be realised through:

- Allocation of each of the project's numerous different risks to the party that that can manage each risk the best

- Harnessing of private sector's incentives for better innovation, and commercial management expertise by involving the private sector more directly in the provision of public services.

- More efficient project delivery based on performance-based management principles.

- Often transferring of financing responsibility to the private sector, thus freeing up limited public sector capital budgets to address other pressing social and developmental priorities.

The past three decades have witnessed a global transformation in the role of the public sector from that of being the direct provider of the public services, to that of overseeing and regulating the provision of such services, which are often delivered by private and non-governmental providers. The analogy often used to describe this is that government's role is changing from that of "rowing" the boat that is the country's economic infrastructure to instead that of "steering" (or regulating) the boat, by overseeing the private and public corporations that are now doing the rowing.[6]

PPP Principles

The most effective and sustainable PPPs are those that adhere to certain core principles. These principles are described in more detail in the sections that follow.

[6] Although this metaphor for the changing role of Governments may seem simplistic, many elected officials and policy-makers have found it an effective tool for communicating the new roles and National Visions for Governments. More information on this see, "Banishing Bureaucracy: The Five Pillars of Reinventing Govenments" by David Osbourne & Peter Plastrik, 1998.

Government purchases *services* not just assets

The concept of purchasing "services" and not assets is sometimes difficult to understand, especially when the provision of the services requires that some new physical infrastructure be financed, designed, constructed and operated. It is important for Governments, as the clients of a PPP agreement, understand that what is more than simply having a new power plant built is to receive the service of a reliable supply of generated electricity over the entire life of the project. Under traditional public management often new assets like power plants are built, but they are often over-budget, late in completion, not adequately-maintained, and therefore unable to provide the electricity services originally planned for. By contrast, a PPP should define the level of service the private partner must deliver. The private sector service provider would only be paid upon satisfactory provision of the services, in accordance with the key performance indicators in the contract.

PPP Principles

- Public Sector purchases services not just assets
- Public Sector specifies service outputs required
- Private Sector commonly selects the inputs it will provide: Design, Build, Operation and possibly Finance
- Risks are comprehensively identified and placed with party best able to manage
- Private Sector is paid according to performance actually delivered
- Objective is to achieve beter "Value For the Public's Money" (VfM).

Government specifies the service *outputs* required

One of the main differences between a traditional procurement and a PPP is that the requirements to be met by the private sector service provider are stipulated as *output* specifications – i.e., "a potable water treatment facility capable of providing 30,000 kilolitres of potable water per day, meeting World Health Organisation quality standards." This output-based approach is fundamentally different from traditional approaches to infrastructure, where the public sector is accountable for providing the inputs for the construction of the water treatment plant, including all of the equipment and machinery installed in it. The actual performance delivered by these public projects may or may not be measured and monitored, and it often varies greatly, usually deteriorating over time. These important PPP service outputs standards are developed during the feasibility study, which will be discussed in greater detail later.

The private sector selects and provides the *inputs* that it will provide: the design, construction, technology, management, etc.

The other side of this "government specifies the service outputs required" coin is that government leaves it up to the private sector to decide which inputs to provide (the design, technology, construction, maintenance & operation – and, if desired, the financing) in order to meet the specified outputs. It should be noted, however, that during the bid evaluation phase, the Government can review these proposed inputs and the "technical approach" of each bidder to assess if it seems capable of meeting the PPP contract's performance requirements. The Government should be able to reject PPP bids whose technical approaches look too risky, or "too good to be true."

Risks are comprehensively identified and placed with the party best able to manage

This is another cardinal differentiation between a traditional procurement and a PPP. Because the specifics of the design, construction, operation, etc., of the facilities by which the services are to be provided are left to the private sector, the private sector therefore assumes the risk that the infrastructure so designed, constructed and operated will, indeed, be capable of effecting the required outputs. The same applies to the non-infrastructure components of the PPP – the service components. If a PPP is for the supply and distribution of pharmaceuticals to certain hospitals, clinics and health care facilities, the private sector assumes all risks attendant to the distribution, and will only be paid if the materials are, in fact delivered. The identification and allocation of these and other relevant risks occurs during the feasibility study, and they must be specified quite clearly in all of the PPP procurement documents, so that the private sector can price those risks into its bid.

The private sector is paid according to the actual performance it delivers

As previously noted, the private sector service provider should be paid only when it achieves the service levels specified in the PPP contract. In practice, most PPP contracts have detailed payment formulas for how much payments will be deducted for specific reductions in services delivered. This should provide a strong incentive for the private sector to manage all of its risks well, or else end up receiving lower payments. Thus, the primary risk left with government is that it must have the funds available during the entire term of the PPP contract (such as 20-30 years in some cases) to pay for the services anticipated in the contract. It has been the worldwide experience in PPPs that so requiring is a significant incentive to the private sector service provider to be as efficient as possible in achieving the specified service levels.

The objective is to achieve better value for public's money (VfM)

Better value for the public's money (VfM) is the most important, fundamental, and long-term goal for any Government to enter into PPP. As will be explained in more detail during the upcoming discussion of the PPP feasibility study (in Module II), the concept of value for money in a PPP context is unique. Simply stated, "value for money" means that, over the *whole-life* (up to 20-30 years) of the PPP project, government's total expenditures (ie its payments to the private sector), adjusted for the risks that have been transferred to the private sector, will be less, on a Net Present Value (NPV) basis, than if the government had performed the services itself. VfM analysis will be explained and illustrated more later in this course.

Benefits of PPPs

The potential benefits of PPPs are many. They include:

- Acceleration of infrastructure provision through mobilisation of private sector capital: More public services can be provided when using PPPs than without using PPPs;
- Faster implementation, because government doesn't have to wait until later when it could finance and implement the given project;
- Reduced whole-life costs, because of private sector efficiencies and innovation. (Note that to determine this you must estimate the costs of construction, operation & maintenance, and periodic renewals & replacements over the entire 20+ year life of the project).
- Better allocation of risk, because the private sector has experience and incentives in handling commercial risks well, while government typically does not;
- Better incentives to perform, because a failure to perform means that payment is not issued;
- Improved quality of service, again because quality of service is a measurable key performance indicator (KPI) upon which payments are based;
- Generation of additional revenues as the result of the technical expertise and commercial incentives possessed by the private sector and the efficiencies that result;

- Strengthened accountability, due to explicit, written contractual provisions that link the private operator's remuneration with performance; and

- Enhanced public management, because government now has the time to plan sector development and reach development goals, rather than be distracted by daily emergencies and operational and service provision requirements.

Global PPP Experiences

There has been impressive growth in global PPP experience since 1990. A database that tracks PPP transactions in developing economies worldwide, the Private Provision of Infrastructure (PPI) Database of the World Bank, calculates that this market has grown from $12.8 billion in 1990 to over $155 billion in 2008.

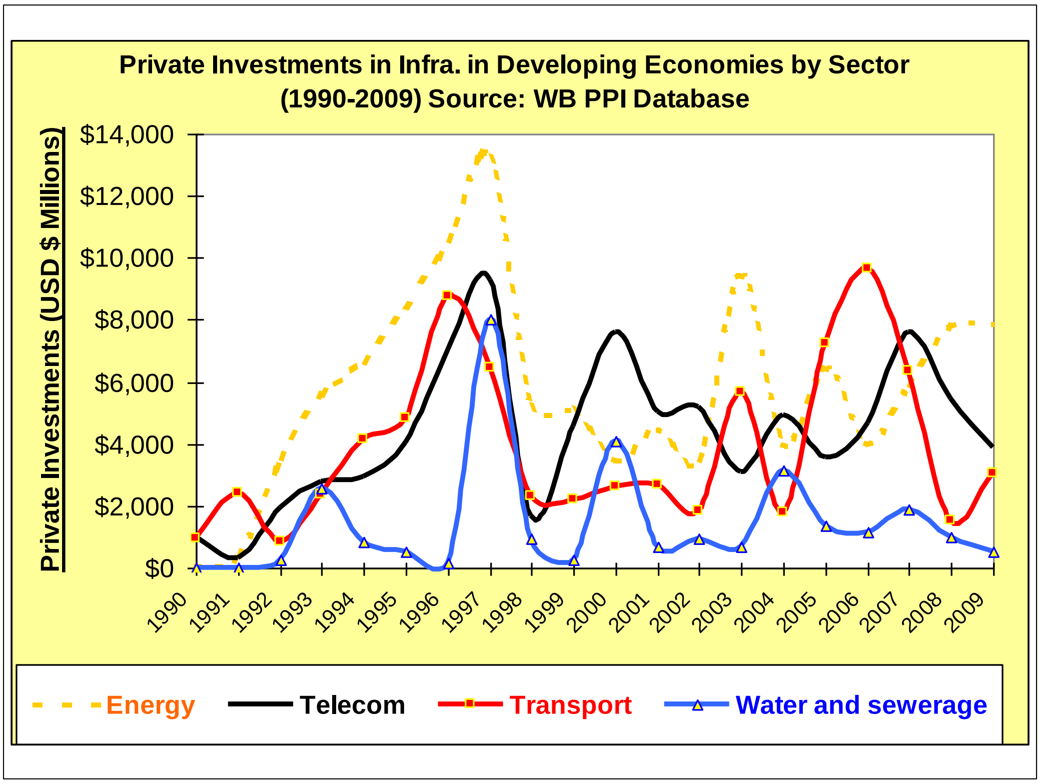


Figure 1 - Source: World Bank PPI Database

Data is also available on how much private investment SADC countries have been able to attract into their infrastructure sectors from 1990 – 2009.

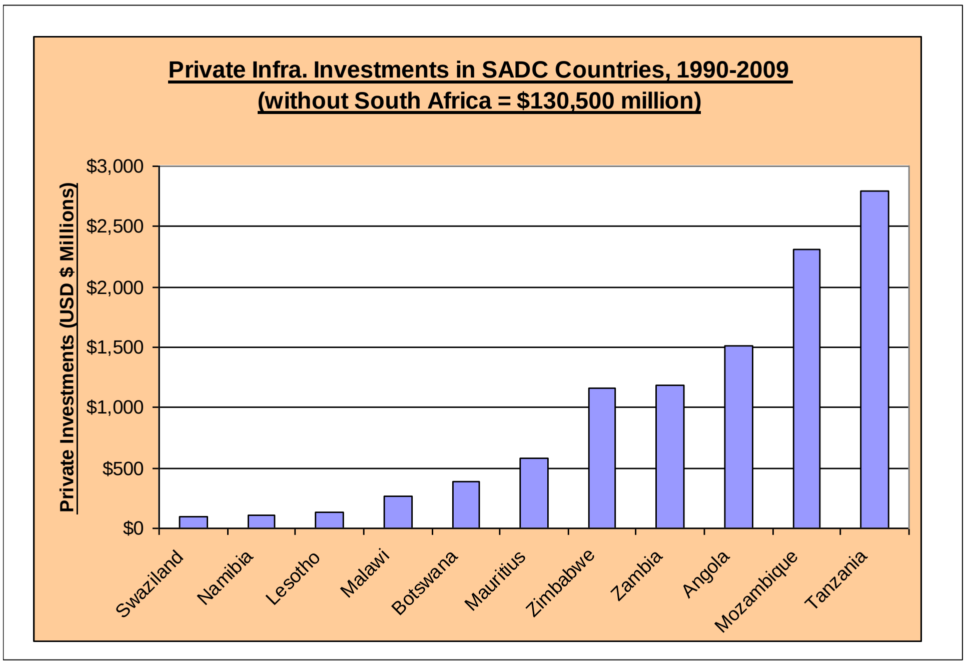


Figure 2 - Source: World Bank PPI Database

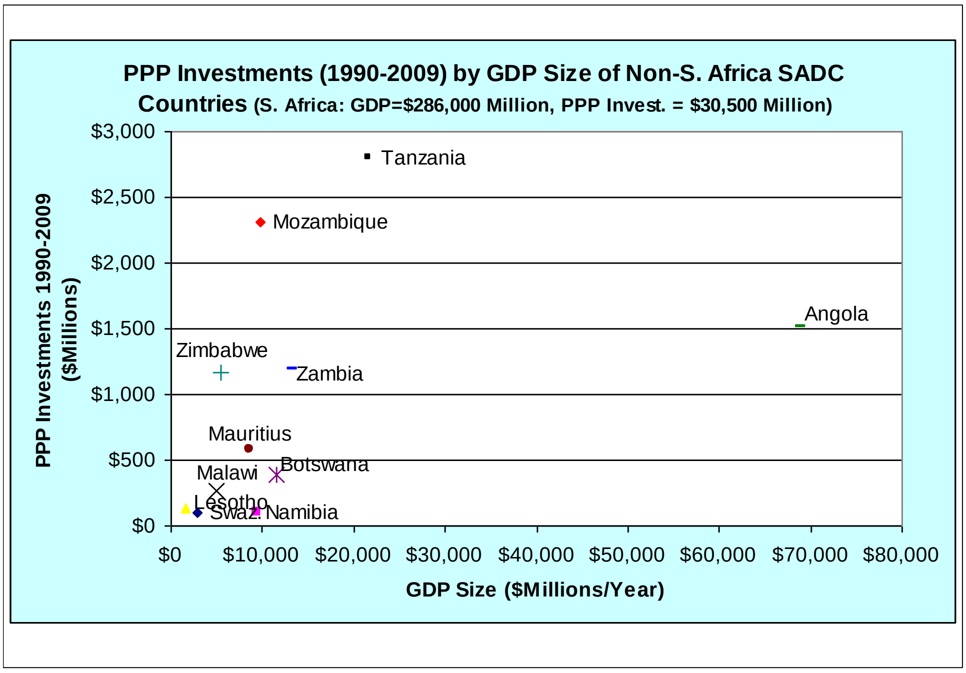


Figure 3 - Source: World Bank PPI Database

The sectors in which PPPs have been completed world-wide include:

- Power generation and distribution;
- Telecommunications & ICT services;

- Water and sanitation;
- Refuse disposal;
- Prisons;
- Pipelines;
- Hospitals;
- Stadiums;
- Olympic villages;
- Desalination of sea water;
- Air traffic control;
- Toll Roads;
- Billing systems; and
- Housing.

From the foregoing, it is evident that the possibilities for involving the private sector, through combinations of private sector financing and expertise are almost endless. If fact, PPPs could conceivably be applied to the delivery of almost any area of government activity.

PPP in South Africa

In South Africa, PPPs have been completed in the following sectors:

- Fleet management;
- Hospital machinery and equipment;
- Eco-tourism;
- Hospital co-location;
- Information systems;
- Toll roads;
- District hospitals;
- Water services;
- Electricity generation;
- Water and sanitation;
- Refuse disposal;
- Prisons;
- Head office accommodation; and
- World Heritage Site accommodation and operation.

In addition, there are a variety of PPP projects currently in the planning stages in South Africa. These are in such sectors as government office accommodation; naval dockyards; hospitals; Department of State accommodation; payment systems; road traffic offences systems; vehicle fleet maintenance; water conservation activities; pharmaceutical supply and distribution; IT systems; schools; grants payment systems; rapid rail systems; game reserves; trade ports; facility management; depots; emergency vehicle management services; bus company restructuring; black rhino conservation; rental housing; container inspection services; and eco-tourism.

Furthermore, and perhaps most heartening, there seems to be a large, and growing, desire from the private sector to participate in a growing range of different sectors. It is, therefore, an important consideration for all African governments to examine the potential of unlocking private sector financial liquidity that may reside within their countries, to accelerate the provision of fundamental government services. Within countries like Uganda, Mozambique, Ghana and others, there has been an increase in the number of PPPs in sectors like small town water systems and mini-hydroelectic plants using local investors and operators, and avoiding the complexities and controversies of foreign investors and operators.

Factors Affecting Desirability of PPP

- Nature of Project
- Risks inherent in the Project
- Status of the Project
- Speed of implementation
- Availability of revenues / application of User Charges
- Affordability

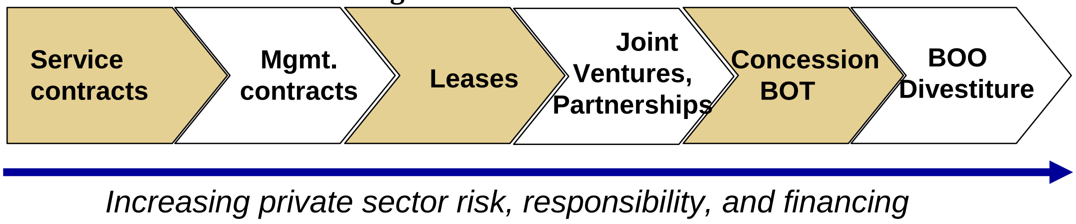
Comparing & Contrasting Different Forms of Public Private Partnerships

There are several general forms and major categories of PPP structures, and increasingly, permutations and combinations of them. The most commonly described PPP forms include:

- Service contract;
- Management contract;

- Leasing;
- Joint ventures and partnerships;
- BOT, concessions; and
- BOO, divestiture

Figure 1.1 – Forms of PPP



These forms of PPP can be understood as points along a broad continuum (see Figure 1.1, above), beginning with service contracts, and moving to management contracts, leases, joint ventures and partnerships, and finally to concessions, BOTs, BOOs, and divestiture. As one moves along the continuum, the forms of PPP entail an increasing amount of risk transfer to the private sector, as well as more responsibility and financial obligations.

The sections that follow contain more detailed descriptions of each of these forms of PPP.

Service contract

In a Service Contract, the public entity pays a fee to a private sector service provider to provide specific operational services. Service contracting is commonly referred to as "contracting out" and has been increasingly used by public and private sector organisations as a means of reducing operating costs as well as accessing new technologies it could not provide on its own. Such cost reductions are realized through competitive tendering, which awards the contract to the bidder offering to provide the service for the least cost.

It is important that prior to tendering for a service contract, the public organization must determine how much it currently costs (but direct and indirect/overhead costs) to provide the given service itself. This benchmark must be used to compare against outside private bids. If this is not done, it is impossible to tell if a private service contractor is providing any savings to the public organization.[7]

Outsourcing:
The Case of Chile

The water utility in Santiago de Chile was one of the first public utilities in the developing world to undertake a comprehensive strategy of competitive outsourcing, contracting out services equivalent to 30% of its operating budget. The utility designed its outsourcing program with competition in mind. Not only are service contracts competitively tendered, but there are two contracts awarded for each outsourced service. In this manner, service contractors are subject to *comparative competition*, which enabled the utility to continue to compare the performance of multiple contractors providing similar services.

Contracts have been awarded in such areas as computer services, engineering consulting, and network repair, maintenance, and rehabilitation. Each contract is two to three years in duration, after which it is subject to re-bidding. This approach has helped the utility to transform itself: substantially reducing its cost of services while improving its quality of services, while remaining a publicly owned corporation.

[7] As a general rule, Governments should never assume that the private sector is more cost-effective or efficient than the public sector. Private service providers can easily be more expensive and provide lower quality of services. Some would claim their profit motivation gives them a greater incentive to do just this when they are not facing competition. Therefore, rigorous PPP feasibility analysis should measure and compare public and private sector costs and only recommend proceeding with PPPs that can offer better

Typically, service contracting has been used to reduce the cost of *non-core* functions of the organisation, enabling it to focus more on its core competencies. Common examples of functions that might be contracted out include:

- Meter reading;
- Bill collection;
- Leak repair, pot-hole repair, etc;
- IT support services;
- Security; and
- Janitorial services.

Because the primary benefits of service contracting – the cost reductions – come through more efficient operations, rather than through any new investments in long-term capital assets, these contracts are typically short in duration, commonly lasting between one and two years. Therefore every two years the competitive bidding process helps keep the costs of service low.

Under a service contract, the private partner provides a service to the public enterprise, but provides no financing for capital investment. The contractual obligations of government usually entail, amongst others:

- Providing the private sector service provider such information in its possession as will allow the service provider to discharge its responsibilities;
- Providing access to all required public assets and facilities as will allow the private sector service provider to perform the required tasks;
- Requiring proof of the performance of the services procured in a form that is mutually agreeable; and
- Payment to the service provider, upon receipt of such proof, usually on a per-unit basis.

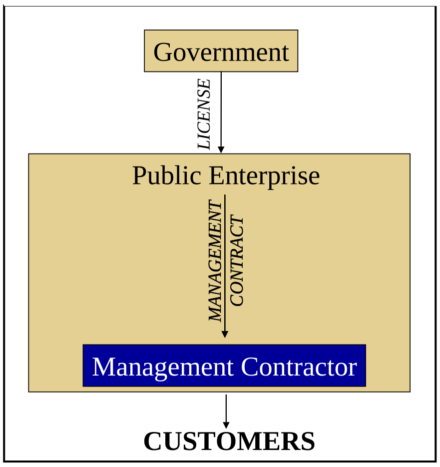
Although service contracting is a fairly common and relatively straightforward form of PPP, it does require careful monitoring and supervision.

Management contract

Under a management contract, the private sector assumes responsibility for providing the top level management team for an existing governmental service delivery system, with the freedom to make day-to-day management decisions. Often this requires providing the top 3-4 management positions.

Management contracts do not require significant institutional change to implement. Rather, the existing public enterprise generally remains in place, with the management contractor's personnel assuming line management responsibilities (see Figures 1.2 and 1.3, below).

Figure 1.2 – Management Contracts Institutional Structure



Whereas the goal of service contracts is to reduce the operating costs of one specific service, the goal of management contracts is typically to improve the overall performance of the organisation. Because such change requires some time to implement and take effect, the typical duration of a management contract is two to five years.

The obligations of government in a management contract may involve:

- Determining, with the private sector service provider, the mechanisms for handling employee performance matters, including discipline and terminations;

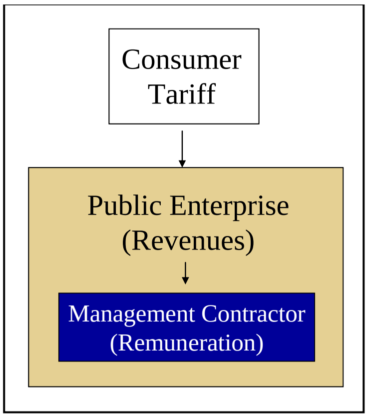
- Obtaining the input from the private sector service provider on the operational and maintenance financing needs of the service delivery system, and providing sufficient funding for the operations to be maintained at the agreed upon level;

- If the private sector service provider is required to advance any capital expenditure, agreeing on the timing and amount of such expenditure, in a manner that will permit government to (a) agree on the necessity for such expenditure and (b) provide adequate time for government to budget for such expenditure so that it may reimburse the private sector service provider in a timely manner;

- Agreeing with the private sector service provider on the key performance indicators (KPIs) for the operations and management of the service delivery system in order to receive remuneration; and

- Compensating the private sector service provider in a timely fashion upon receipt of reports indicating that the service delivery system has been managed in accordance with the contract, including the payment of any incentives for performance above the KPIs, and for deducting any penalties for performance below them.

Figure 1.3 – Management Contractor's Remuneration



Under a management contract, the private operator's remuneration is typically some combination of a fixed fee as well as performance-related pay (called "incentive compensation"). By linking a portion of the operator's pay with its performance, Government can ensure that the management contractor's priorities are in line with the overall organisational objectives. The overall amount of remuneration is generally determined through the competitive tendering process, with the management contract awarded to that bidder offering to provide the services for the lowest price. This form of payment does not explicitly link the management contractor's remuneration with the level of the average tariff. Rather, the management contractor's payment becomes a line item in the organisation's budget. As such, management contracts can be useful instruments where tariffs or user fees are not set at a level that allows for full cost recovery (see Figure 1.2, above).

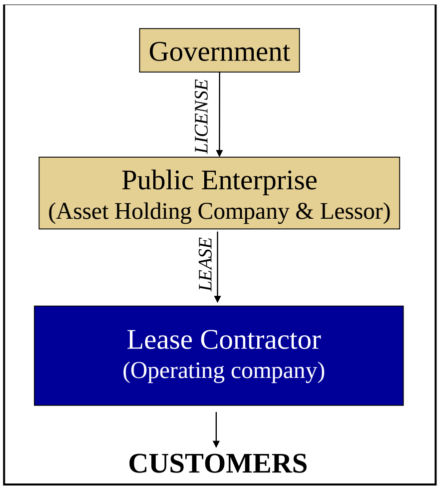
Management Contracting:
Kenya Power & Lighting Company's Management Contract 2006 - 2008

As part of Kenya's Electricity Sector Restructuring Project, sponsored by the World Bank, Kenya's public electricity transmission & distribution company (Kenya Power & Lighting Company, KPLC) signed a two-year management contract with Manitoba Hydro International in July 2006. The signing of the management contract was a condition for the disbursement of $153 million of long-term sector financing by the World Bank's Energy Sector Recovery Project. The management contract featured specific performance targets, including: completing 400,000 new connections over 2 years (from a previous rate of 70,000 per year), reducing system losses to 14.5%, reducing monthly outages from 11,000 to 3,000; reducing the average collection period from 90 to 60 days; and improving customer service. MHI provided 3 expatriate staff to manage the project. While the contractor met or exceeded its performance targets, a disagreement developed between KPLC's Board and MHI over a bonus payment for exceeding the minimum number of new connections achieved. The contract ended in 2008 and was not renewed. However, in 2009 KPLC and MHI signed a Memorandum of Understanding (MoU) to jointly pursue business together providing electricity utility management services in Africa as PPP service contractor. In 2010 the KPLC and MHI joint venture was awarded a 5-year management contract for the Liberia Electricity Company (LEC) sponsored by the IFC.

Leases

The goal of a lease is typically to improve the overall commercial performance and quality of service of an existing public enterprise Under a lease, the private sector service provider assumes responsibility for funding the regular operations and maintenance of the leased facilities (these facilities could be an entire enterprise such as a water distribution utility, or a portion of an enterprise such as a container terminal that is part of a larger port). In addition to operating and maintaining the facilities, the private operator is also responsible for providing working capital and funding the replacement of short-term assets and of spare parts, etc. The duration of a lease is generally between five and ten years, depending upon the payback period for the private operator.

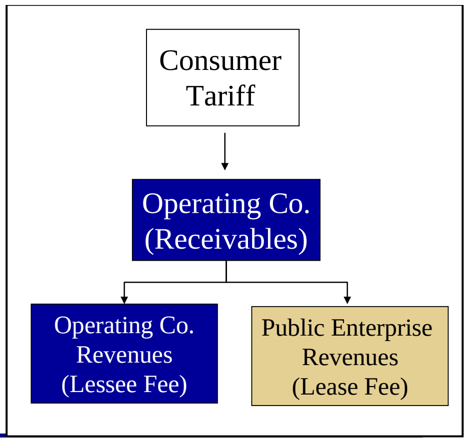
Figure 1.4 – Lease Institutional Structure



In most cases, the private operator that is awarded the lease will form a special purpose company ("SPC") that is created specifically to carry out the services under the lease (see Figure 1.4 at right). The private operator is almost always staffed with employees that were formerly associated with the public enterprise. The resulting smaller public enterprise thus takes on the role of an "asset holding company" ("AHC") and focuses on the government's obligations under the lease agreement, namely:

- Establishment of a lease period that is sufficient to allow the amortisation of any expenditure for new assets by the private sector;
- Determining an annual lease amount to be paid by the private sector that reflects a market value, as determined by reference to similar undertakings;
- Determining the KPIs for the activities to be performed upon the leased premises by the private sector, including maintenance and throughput requirements;
- Assessing the regulatory mechanisms by which the private sector imposes fees on third parties that are the customers or beneficiaries of the activities carried on in the leased premises;
- Providing for the taking over of any government employees previously involved in performing services on the leased premises, including any residual responsibilities on government in that regard upon the termination of the lease;
- Providing for the extension of the lease agreement within a certain period of the date when the lease would otherwise terminate; and
- Providing for the refurbishment/refreshment of the premises that must be undertaken by the private sector prior to the termination of the lease; and

Figure 1.5 – Lessee's Remuneration



Like a management contract, leases do not explicitly link the private operator's remuneration with the level of the tariff or user fee. Instead, the lessee is paid a "lessee fee" (also known as the "operator's tariff") that is commonly linked with its performance under the contract. In addition, the private operator (lessee) pays a lease fee to government, which uses these revenues to finance capital investments (see Figure 1.5, at right).

An example of leasing in Southern Africa is the Container Terminal lease in Tanzania. Other examples in South Africa include the leasing of hospitals and health maintenance facilities.

Leases:
The Case of Senegal's Water Sector

Leases can be one of the most challenging of the different PPP options to structure and implement. This is especially due to the difficulty of separating the ownership of infrastructure assets from the operation of those assets, and establishing distinct Asset Holding Companies and Operating Companies. Several leases have either been cancelled (Dar es Salaam's water lease contract in 2006) or had only limited success (Guinea's water lease from 1990-2000).

One notable exception has been Senegal Water Lease for urban water systems. Signed in 1996, this contract was extended by mutual agreement in 2006. Key performance indicators such levels of Unaccounted for Water (UFW) as well as collection rates clearly improved, while water tariffs for consumers were reduced. Key to the success of this case was the Government's commitment to establish a strong, capable, well-resourced, and properly-paid public Asset Holding Company (SONES). This AHC was able to diligently monitor and the large international private water company (SAUR) selected as the private operator.

For more information, see "Lessons from the Guinea Water Lease," at
http://siteresources.worldbank.org/EXTNTFPSI/Resources/SenegalWater.pdf

Joint Ventures and Partnerships

A joint venture or a partnership PPP involves the common sharing of risks, responsibilities and rewards of providing a public service by a private sector entity and government. This entails a sharing of expenditures as well, on a pro-rata basis as specified in either the joint venture or partnership agreement.

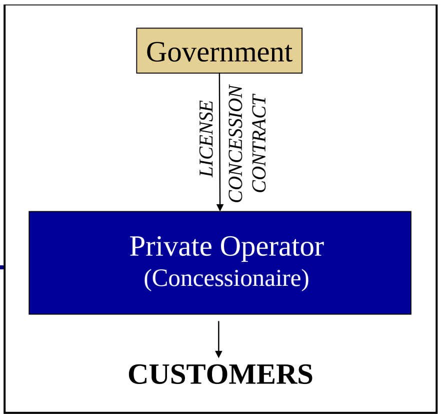
There is no "typical duration" for such a PPP, as it would depend upon the objective of the joint venture or partnership.

These types of PPPs are not common, and in South Africa, there is only one – a joint venture between a private sector entity and Johannesburg City Power (see www.citypower.co.za), a public corporation, for the refurbishment, maintenance and operation of two electricity-generating plants in the city. Because the endeavour generates revenues through the sale of electricity to residents of the city, the "profit" from such sale becomes the source of revenue to reimburse both parties, in accordance with the joint venture agreement.

BOTs and Concessions

BOT (Build, Operate, Transfer) arrangements and concessions are variations on a theme. In both cases, the private sector entity finances, designs, build, operate and maintain facilities for the public sector. The key difference is that BOTs typically are stand-alone facilities, such as water treatment facilities and electricity generating facilities, which entail Greenfield construction, whereas concessions generally transfer the responsibility for existing facilities to the private operator. Despite these differences, the two contracting forms are similar in that the revenues generated from the facilities

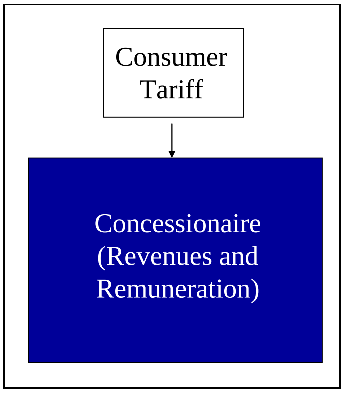
Figure 1.6 – Concession and BOT Institutional Structure



provide the funding by which the private sector service provider is compensated.

In a Concession, in addition to financing, designing, etc., the facilities by which the services are rendered, the private sector is further required to perform a range of services that support the realisation of the revenues that are the source of compensation by also undertaking the billing, collection and customer relations management activities that are normally undertaken by government. For example, in a water services concession, the private sector service provider becomes the Water Department, with all of the responsibilities that entails, including taking over the government employees that previously worked for government. As such, concessions entail a more complex process of institutional change than the forms of PPP described above. As with a lease, under a concession the private operator typically establishes a special purpose company that becomes the concession holder and operates the service (see Figure 1.6 above). This company is usually staffed in large part with employees that were previously part of the public enterprise. However, whereas the government under a lease retains significant responsibilities for capital investment, under a concession, the government's key role is as the regulator of the service. As such, it is common under concessions for the public enterprise to be dissolved (as opposed to being transformed to an asset holding company).

Figure 1.7 – Concessions and BOTs: Operator's Remuneration



Because the private operator under a BOT and concession is remunerated entirely through the collection of tariffs or user fees (see Figure 1.7, at right), these forms of PPP transfer a substantial amount of risk from government to the private operator. Here, the level of the operator's remuneration is explicitly linked with the level of the average tariff, and thus concessions and BOTs commonly require that the tariff be set at a level that allows the recovery of the full cost of operations, maintenance and depreciation.

The length of these types of PPPs depends upon the amount of financing that the private sector is required to contribute to the project. In order for the outputs of the facilities (in terms of the tariffs to be charged for, i.e., the treatment of water or the generation of electricity) to be affordable, the term of the PPP is usually the length of the financing required; hence they are anywhere from twenty to thirty years in length.

Among the obligations of government in this form of PPP, not previously mentioned, are the following:

- Commenting upon the design of the facility to be constructed in a manner that will ensure the desired output, but without taking back any construction risk;

- Ensuring that a suitable quality control programme is in place during construction;

- Accepting the construction of new facilities upon the receipt of a certification of completion by an independent expert, retained for such purpose;

- Approving the initiation of the service delivery portion of the PPP upon the receipt of a service delivery programme in compliance with the output specifications of the contract;

- Monitoring and regulating the delivery of the services in a systematic and regular manner, to ensure that the service delivery meets the output specifications;

- Implementing such procedures as are reflected in the PPP contract when the standard of service delivery falls below the specifications in the contract;

- Ensuring all reports, audits and information submittals are filed in a timely fashion, and taking such action as the PPP contract permits when this does not occur;
- Making such payments as are required by the PPP contract, where the required invoice and reports are filed in a timely fashion; and
- Receiving such fees and penalties required to be paid by the private sector service provider by the PPP contract.

Concessions:
Nigeria's Lekki Toll Road

Outside of South Africa, one of the first concessions in the toll motorway sector has been the Lekki toll road in Lagos, Nigeria. The 30-year concession contract, signed in 2006, requires the private concessionaire, Lekki Concession Company, to upgrade, expand and maintain 50km of the existing Lekki-Epe Expressway (Phase I), and construct 20km of the Coastal Road (Phase II) on the congested Lekki Peninsula of Lagos. An estimated 85,000 vehicles travel on the existing expressway daily. The financing for the project was not raised until 2008, in the face of the challenges of the global financial crisis affecting international commercial and investment banks. The project has attracted an estimated $382 million of new private investment, with up to $85 million being provided by the African Development Banks' Private Sector Operations (PSO), which provides equity and debt to private sector investment projects (like PPPs) that have economic development impact. After several attempts to challenge the collection of toll by a private concessionaire, the toll road opened in January, 2011.

For more information about this project, see http://allafrica.com/stories/200806200902.html

BOOs and Divestiture

In many ways, Build Own Operate (BOO) and divestiture arrangements are similar to concessions and BOTs. All of these forms of PPP transfer responsibility for operations, maintenance and capital investment to the private sector, and all link the operator's remuneration with the tariff or user fee. The key difference, however, is that BOOs and divestiture do not have any limits on their duration, whereas concessions and BOTs generally last between twenty to thirty years. In this sense, both BOOs and divestiture are what would classically be termed "privatisation."

There is a distinct difference between a PPP and privatisation. In a PPP, ownership of the responsibility for service provision always remains with government. Hence the analogy of "steering" versus "rowing." Privatisation entails the disposal of the services infrastructure to the private sector, and with it, the responsibility for service provision. An example is the sale of a national airline. After the airline is "privatised", the ownership and the responsibility for providing airline services always resides with the private sector. In the case of a BOO, the second "O" stands for "own". What this means is that the private sector service provider "owns" the facility, which means that it pays property taxes and levies, another source of revenue to government. It is important to resist the temptation to equate PPPs with privatisation.[8]

Output-Based Aid and PPP

Traditionally, many of the above forms of PPP were seen to be feasible only where tariffs or user fees could be set at a level that would allow full recovery of the cost of service (including the cost of operations, maintenance and depreciation). In many cases within Southern Africa, particularly in the infrastructure sectors, such cost recovery is not immediately possible due to the level or extent of

[8] While the definition used for PPP in this course draws a distinction between PPP and privatisation, many governments around the world have their own definitions for PPP, some of which *include* privatisation or divestiture (ie the permanent sale of shares in or the assets of infrastructure companies). This is the case in Botswana, where privatisation is considered to be a form of PPP.

poverty amongst potential end users or customers. To address such challenges, governments are increasingly experimenting with forms of PPP that bring in private investment but also allow services to be subsidized. Such strategies, called "Output-Based Aid" (OBA), use explicit and performance-based subsidies to deliver basic services where policy concerns would justify public funding to compliment or replace user fees.

Output-based aid arrangements have been employed in a variety of sectors, from hospitals and pay phones, to water and energy. Their key distinguishing features are that they structure subsidies in a manner that is both *explicit* and *performance-based*. In this manner, they are effective tools for ensuring that scarce public funds are targeted towards the needs of the poor, and that some of the risks for service provision are transferred to the private operator.

For More Information

For more information on output-based aid, visit the Global Partnership for Output-Based Aid (GPOBA) at www.gpoba.org. GPOBA is a multi-donor trust fund that aims to fund, design, demonstrate, and document OBA approaches to support the sustainable delivery of basic services to those who can least afford them and those currently without access. GPOBA funds OBA activities throughout the world, including the SADC region, and in all the infrastructure sectors.

More information on output-based aid is also available in the required reading materials for this Module.

General contractual provisions appearing in all PPP contracts

PPP projects tend to be quite large investments (in fact the larger the project, the greater the *potential* benefits of implementing the project through a PPP, instead of as a publicly financed and managed project), they tend to be technically and legally complex. Therefore, PPP contracts are often long and detailed. To address this many Governments are developing either model PPP contracts or "Standardised PPP Contract Provisions" to shorten the process of drafting and negotiating such detailed contracts. While each PPP contract still needs to be customized, having either a standard outline or standardised contract provisions makes it much easier for officials in line ministries, finance ministries, PPP Units, transaction advisors, as well as private bidders and lenders to quickly understand the key elements of any new candidate PPP contract. The following are some of the more common contractual obligations or "Contract Sections" within PPP agreements:

- **Interpretation:** Setting forth the definitions of important terms and providing guidance on the interpretation of the contract's provisions;
- **Description of the term of the project:** Defining the length of the contract and whether and by how much it may be extended by mutual;
- **The objective of the contract:** Describes the intent of the undertaking;
- **The requirement for construction and operating bonds:** Provides security for government if the construction and/or the service delivery falls below standards;
- **Insurance requirements:** Provides security for the insurable matters within the ambit of the project;

- **Delay provisions:** Describes what is and is not an excuse for a delay in construction or operations, and describes the remedies and penalties for such delay;
- **Force Majeure:** Describes what constitutes a force majeure event and what the consequences are of its occurrence;
- **Governmental action:** Describes what actions by government that affect the contract may give rise to a change in the terms and conditions of the contract, and how these are effected;
- **Government warranties:** Describes what warranties government is making in terms of the project;
- **Private sector warranties:** Describes the warranties that the private sector is making in terms of the project;
- **Change in the law:** Similar to Governmental action – describes what the consequences are if the law is changed;
- **Variations:** Sets forth the procedures to be followed when either party to the PPP contract wishes to change any material portion of the contract;
- **Termination:** Describes the conditions under which either party may terminate the contract, the processes to be undertaken in that regard, and the consequences to each party of a termination;
- **Indemnification:** Describes how and under which circumstances either party may be called upon to indemnify the other because of a given circumstance;
- **Intellectual property:** Describes the rights of each party to any intellectual property brought to the project or created during the project, including the steps to be taken to protect the intellectual property of third parties, such as IT software manufacturers;
- **Claims:** Sets forth the procedures to be followed when either party has a claim against the other;
- **Financial security:** Defines the actions that either party that may give rise to a breach of any financing agreement by which project financing was obtained, and the remedies for such breach;
- **Dispute resolution:** Describes the steps to be taken by either party to resolve any dispute that may arise as to the interpretation of the PPP contract;
- **Step-in rights:** Sets forth the circumstances that may permit the private developer's lenders may "step in" to replace a failing private operator in order to protect the lenders' unique rights under the PPP contract;
- **Changes in the composition of the private sector service provider:** Describes the consequences, especially where the private sector service provider is a Special Purpose Vehicle (SPV), of a change in the ownership or key personnel thereof;
- **Partnership management:** Sets forth the mechanisms whereby the parties to the PPP contract will interact with each other going forward;
- **Compliance with all laws:** Requires each party to comply with all laws pertaining to the project, including obtaining environmental, zoning, planning and other permits;

- **Personnel:** If the PPP contract involves taking over government employees, describes the manner in which those employees are employed by the private sector service provider, including any restrictions on terminations or redundancies for operational reasons; and

- **Conditions precedent:** Describes any conditions precedent to be fulfilled by either party before the contract takes effect.

The foregoing list is not exhaustive. The number and subject matter of such provisions varies from project to project, and is informed by the Host Government line ministry's PPP transaction advisors, local custom and practice and legislative requirements. It is, however, illustrative of the wide range of matters that government must be aware of when embarking upon any PPP.

The following table illustrates the progression of risks typically transferred from government to the private sector in the main types of PPPs referred to above:

Table 1.2 – PPP and Risk

Option	Service Contract	Management Contract	Lease Contract	Concession
Ownership	Public Sector	Public Sector	Public Sector	Could be either
Financing of Investment	Public Sector	Public Sector	Both	Private Sector
Financing of Operations & Maintenance	Public Sector	Public Sector	Private Sector	Private Sector
Private Sector risk profile	Low	Low	Medium	High
Financial & commercial risk	Low	Low	Medium	High
Duration (years)	1-2	3-5	5-10	20-30
Responsibility for setting tariffs	Public Sector/ Regulator	Public Sector/ Regulator	Private sector/ Regulator	Private Sector/ Regulator
Method of payment	Unit price	Cost + bonus	Portion of tariff	Tariff
Objective of private sector participation	Operating efficiency for one specific service	Operating efficiency for the entire public enterprise	Improved Commercial Operation of an existing public corporation or asset	Long-term investment in improvement of an infrastructure network through new private capital

In summary, the foregoing provides a framework by which government officials may assess the various forms of PPPs, and the concomitant obligations that may arise based upon the selection a particular PPP, in order to assist in the initial decision to assess the feasibility thereof to a particular service delivery need government has.

Conclusions

PPPs can be a valuable tool for introducing private sector management techniques, expertise, investment and/or efficiency into a public enterprise. To achieve these objectives, however, it is important to select a form of PPP that best matches the public sector's objectives for the partnership, and that is realistic given the challenges and constraints facing the enterprise specifically or the sector as a whole. The best PPPs are those that transfer a degree of risk from the public to the private sector, however in structuring risk sharing arrangements, careful attention must be given to ensuring that each party is allocated those risks that it is best able to manage.

This module is designed to provide a foundation of knowledge about PPPs. Subsequent modules will go into further detail on the principles of risk sharing, as well as options for procuring PPPs, regulating them, and involving stakeholders in contract design and implementation.

Module 1: Content Assignments

In order to successfully complete your work on the Content component of this Module, you must complete the following:

- Read this Module I Content piece

- Read the required background reading materials:

  Public-Private Partnership Handbook, Asian Development Bank, 2008.
  http://www.adb.org/Documents/Handbooks/Public-Private-Partnership/Public-Private-Partnership.pdf

  Attracting Investors to African Public-Private Partnerships: A Project Preparation Guide, by World Bank & Infrastructure Consortium for Africa (ICA) & Public-Private Infrastructure Advisory Facility (PPIAF), 2009.
  http://www.ppiaf.org/ppiaf/sites/ppiaf.org/files/publication/Attracting_Investors_to_African_PPP.pdf

- Answer the following question (with the answer posted to the Discussion Board under Module I of the coursesite) relating to the Content piece:

  1. Describe a PPP that is currently in progress in your country (any sector), including the general form of the PPP (ie, service contract, management contract, lease, BOT, etc.), the responsibilities of the parties, and the key risks.

  2. Do you consider this a successful or unsuccessful PPP? Explain your answer.

  3. Based on the PPP experience in your country to date, and your understanding of PPPs from this Module I content article. What do you believe are the 3 most important “lessons learned” to ensure that PPPs in your country are successful.

- Read other participants’ postings to the Discussion Board and provide substantive comments (in the Discussion Board) on at least two other participants’ answers to the Content question.

In addition, participants may elect to read the following *optional* background reading materials for this module:

> Africa’s Infrastructure: A Time for Transformation, by World Bank, Edited by Vivien Foster and Cecilia Briceno-Garmendia, 2010.
> http://www.ppiaf.org/ppiaf/sites/ppiaf.org/files/publication/WB%20-%20Africa%20Infrastructure%20Time%20Transformation%202010%20AICD%20report.pdf
>
> Emerging Market Investors and Operators: A New Breed of Infrastructure Investors, Working Paper No. 7, PPIAF, by Stephan von Klaudy, Arpuva Sanghi, & Georgina Dellacha, 2008.
> http://www.ppiaf.org/ppiaf/sites/ppiaf.org/files/publication/WP7-Emerging%20Market%20Investors%20-%20SvKlaudy%20ASanghi%20GDellacha.pdf
>
> Private Provision of Infrastructure (PPI) Data Update No. 48: Private Activity in Infrastructure in Sub-Saharan African Declined in 2009 (2010).

http://ppi.worldbank.org/features/December2010/2009-Sub-Saharan-Africa-PPI-infrastructure-Note-12-13-2010.pdf

Public-Private Partnerships: Harnessing the Private Sector's Unique Ability to Enhance Social Impact, by McKinsey & Company (Social Sector Office), 2009.
http://www.mckinsey.com/clientservice/Social_Sector/Knowledge/~/media/Images/Page_Images/Offices/SocialSector/PDF/Public%20Private%20Partnerships%20%20%20%20Enhancing%20Social%20Impact.ashx

National Public-Private Partnership Policy Framework, Infrastructure Australia, Australian Government, 2008.
http://www.infrastructureaustralia.gov.au/files/National_PPP_Policy_Framework_Dec_08.pdf