

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



**Le Conseil Canadien des
Sociétés Publiques-Privées**

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FOR PUBLIC-PRIVATE PARTNERSHIPS**

TO

THE COMMITTEE ON PUBLIC FINANCE

REGARDING

**BILL 61: AN ACT RESPECTING THE AGENCE DES
PARTENARIATS PUBLIC-PRIVÉ DU QUÉBEC**

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Executive Summary

Governments around the world have recognized the value of using public-private partnerships (PPPs) to deliver services, develop infrastructure and finance projects. The most successful programs have utilized the expertise of a dedicated PPP unit that is mandated to review programs, identify candidates and/or provide support to government ministries and agencies.

The Canadian Council for Public-Private Partnerships (CCPPP) has been Canada's national voice on PPP since 1993, providing research, hosting events and offering support to public and private sector organizations interested in using the PPP approach. CCCPPP has conducted extensive research on what makes PPPs most successful in delivering public services and infrastructure at better value for money to the taxpayer. Countries like the United Kingdom and Australia are considered PPP leaders, but Canada is developing its own record of PPP expertise at all levels of government. This submission represents a compendium of best practices used to deliver PPPs as well as recommendations on what attributes a dedicated PPP agency would need to deliver a successful PPP program at the provincial and municipal level.

When a government decides to pursue a PPP agenda, it is by no means considered "business as usual". PPPs traditionally experience opposition both within government, by those who oppose a dramatic change in delivery model, and from interest groups that wish to preserve public sector jobs or protect traditional public services. But this opposition can be countered with three compelling realities:

- 1) A proven track record of PPP success at home and abroad under a wide variety of government systems and economic conditions.
- 2) A strong appetite among Canada's investment community for PPPs with a solid business case.
- 3) A commitment by senior Québec officials to deliver better government services and revitalize Québec's public infrastructure effectively and at less cost to the public.

While cost savings are most often cited as the reason for entering into a PPP, there are many other positive characteristics: the transfer of cost overruns and delay risks from government to the private sector; the ability to cost and maintain an asset over the long term; the improvement in services and efficiency; the separation of the regulator from the operator; and the significant job creation potential resulting from private capital investment in the public sector. These results have been experienced in a variety of sectors in Canada and other countries, including hospitals, highways & bridges, water & wastewater treatment and schools & universities.

CCPPP has identified several factors that make a dedicated PPP agency effective. Although we conclude that the most successful PPP agency model reflects the

unique political, social and economic characteristics of its own jurisdiction, we note that PPP units in other countries have demonstrated several common characteristics:

- 1) Political Support – a strong commitment from political and government officials that PPPs are an important part of the overall government’s strategy to delivery better value for money to taxpayers.
- 2) Authority to Conduct Activity – while the proposed Agency’s legislation outlines broad powers, those powers may be restricted by legislation governing other public bodies that need to be revised or streamlined.
- 3) Size of the Organization and Scope of Activity – a small specialized team of PPP experts focussed on particular projects will be much more effective than a large agency with many competing priorities.
- 4) Clearly Articulated Role & Responsibilities – while the Agency may be taking responsibility for PPP projects, this will surely impact the respective Ministries. Reporting requirements and decision-making authority will need to be coordinated.
- 5) Timely and Accepted Approval Process – a documented approval process will ensure that PPPs meet the necessary legislative requirements without taking too long to come to fruition.
- 6) Communications – the inevitable opposition and multi-stakeholder nature inherent in PPPs requires a concerted communications plan and dedicated resources.

The Agency will also require several operational attributes so that the PPPs strike a balance between accountability, efficiency and cost-effectiveness:

- 1) Comprehensive Guidance and Preparation – thorough documentation made available to any applicable government bodies will ensure that mistakes are minimized and due diligence is conducted up-front.
- 2) Procurement – an open competitive process for the selection of a private partner and prudence when dealing with unsolicited proposals.
- 3) Fairness, Transparency and Efficiency – the use of publicly available documents, a market grade proposal and a timely and non-prescriptive proposal process.
- 4) An Accurate Public Sector Comparator – an independently developed benchmark with which to compare private sector delivery using common accounting methods and factoring in the probability of cost overruns and time delays.
- 5) Standardization – common procurement and contract documents help minimize a protracted proposal process and the “reinvention of the wheel”

for each project. They are especially useful for smaller projects that need to keep consultant costs down.

- 6) Clear & Effective Contract Provisions – a non-prescriptive contract focuses on the measurable outcomes rather than detailed input specifications. Allowing for private sector innovation to determine how requirements are met keeps the PPP as efficient as possible.
- 7) Mechanisms to Incentivize Good Performance and Discourage Underperformance – both penalizing for underperformance and rewarding for exemplary service strikes a necessary balance between accountability and continuous improvement.
- 8) A Reasonably Established Security of Partners – a bond or other formal security that correlates with the size and risk of the project.
- 9) Anticipate Changes – contracts need to anticipate changes in government, legislation, economic conditions and revenue streams in order to remain effective over the long term.
- 10) Significant Project Size & Revenue Stream – focussing on projects with a minimum revenue stream and project size ensure that economies of scale are achieved.
- 11) Appropriate Measurement and Allocation of Risk – the PPP needs to allocate risk to the party best able to deal with it. Commonly, commercial risks (construction, financing, deadlines) are assigned to the private party and regulatory risks are given to the public party.

These recommendations will help ensure that the proposed Agency becomes an integral part of the Government of Québec's agenda for service and infrastructure improvement.

Introduction

The Canadian Council for Public-Private Partnerships (CCPPP) welcomes the opportunity to make a submission to the hearings being conducted by The Committee on Public Finance regarding *Bill 61: An Act Respecting the Agence des partenariats public-privé du Québec*.

The Canadian Council for Public- Private Partnerships is a non-profit and non-partisan organization made up of public and private sector organizations that promotes greater use of private sector capital and expertise in conventional public sector activities where it can be proven to offer value to the public. Many of the individuals involved in CCPPP have worked in the public sector and all came to the conclusion that by relying on public sources of investment only to finance infrastructure, we will severely curtail the extent to which we can address the backlog of infrastructure projects in this country and in this case, in the Province of Québec.

Outsiders to Canada are impressed by the availability of private capital in this country, especially to those managed by pension funds, and yet question why the public sector has been reluctant to leverage this capital in projects that would benefit the Canadian public. The Province of Québec has taken a significant step forward in accepting public-private partnerships (PPPs) as a reasonable approach to be tested and in the introduction of *Bill 61* to establish the Agence des partenariats public-privé du Québec (herein referred to as “Agency”) to conduct the activities that are required. This is a necessary first step in the process and one that is supported wholly by CCPPP.

Given that CCPPP monitors public-private partnership activity around the world and has had the benefit of exposure to other models being used to deliver PPP programs, it is our observation that there is no single model that is universally accepted. The structure and organization of the unit charged with delivering a PPP approach within the government must fit the unique needs of the particular government it is required to serve. Our submission, therefore, is intended to give support to the Government of Québec’s direction and to share some observations about conditions that enable PPP units (similar to the proposed Agency) to function effectively and to meet the expectations of the government host.

Acknowledging the PPP Model as a Legitimate Approach

Governments are large organizations that can find change difficult to absorb. Whether it is reconsidering the level of services that is being provided or a fundamental change in how the government conducts its business, change can cause uncertainty for the government organization and for its electorate.

Shifts in public policy should never be undertaken lightly and it is advisable for governments not to be pressured to move quickly in a new public policy direction without ensuring that the public and the public service are keeping pace. That can mean considerable work in explaining the motivating factors that are driving a

change in the way of doing things and also ensuring that the public is on side with the objectives that are being set and the method that will be used to achieve those objectives.

As we move further into a PPP environment in Canada, we are encouraged by the successes of other countries and increasingly with Canadian PPP experiences that are gaining momentum. We can look to the results of real projects and services and get a sense of what the full benefits can be of a well-run PPP program. This paper provides an overview of the public benefits gained through public-private partnerships and best practices that have helped PPPs maximize their value. The most successful PPPs have managed to demonstrate tangible improvements in the lives of taxpayers as well as new business opportunities for domestic companies.

Why Do Governments Consider the Use of Public-Private Partnerships?

It is the responsibility of governments to provide services to the public and to offset the expense of providing them through taxes, user fees, transfer payments and other typical sources of funding. The challenge for governments across the country is matching the funds raised with the ever-expanding list of services required. Typically, while the demand for increasing services grows, the appetite for increased taxation does not.

Responsible governments, when faced with this situation, will look beyond the conventional approaches they have used to determine if there is another way to meet public needs without compromising quality or sacrificing good public policy objectives. Over the past decade in Canada, public-private partnerships have been on the list of innovative approaches to be considered.

PPPs are simply projects that engage one or more private sector partners and a public sector sponsor in the development and delivery of services and infrastructure. They can range from very simple arrangements, such as contracting out a particular government service, to more detailed arrangements where the private sector partner might also finance the undertaking, design and build the facility and possibly operate it for a specified period of time. Public-private partnerships are not a panacea. They require a very thorough analysis of the projects to be undertaken and they must be structured in a way that the private sector can realize a return on the investment it makes. But for those governments that have invested the time and expertise to develop good public-private partnership approaches, there have been tremendous achievements.

The United Kingdom has the largest PPP program in the world – the Private Finance Initiative (PFI). Although the central government invests only 15% of its total annual public spending on PFI projects, it is clear that those projects are making a very significant contribution to the modernization of the UK's public infrastructure.

What Are The Benefits of Public-Private Partnerships?

The following seven characteristics are most often cited as the benefits of the public-private partnership approach.

Value for Money

In the context of PPPs, value for money equates to better services at a lower cost for the taxpayers' dollar. This is the most common reason governments enter into partnerships with the private sector. Value for money is achieved through lower costs, greater efficiencies and higher productivity.

Appropriate Risk Transfer

All capital projects carry risk to the party undertaking them. PPP shifts the burden of increased project costs from the government (and consequently the taxpayer) to the private company and ultimately, their financing partners. When government carries out a capital program, they are normally responsible for cost overruns and delays, while the contractor has the potential to benefit. In a PPP, the contractor is responsible for cost and time overruns and the government benefits. While the degree of risk can be a challenge both to assess and allocate appropriately, it is an important and often overlooked benefit to PPPs. In a typical PPP, 15-30% of the project value is private sector equity. Any cost overruns that reach that level effectively negate the ability of the private sector to recoup its investment. The UK National Audit Office conducted a survey of PFI projects in 2003 and found 76% of them were delivered on time or earlier than expected (versus 30% of public projects previously surveyed). Moreover, 78% of projects reported no price increase after contract award (versus 27% of public projects). Being able to transfer reasonable risk to the private sector, which under a PPP structure is obligated to control the risk, is a smart thing for governments to do. Note: a more detailed description of risk transfer can be found on page 16.

Life Cycle Costing

Most PPP contracts contain requirements that the private partner must maintain the asset in a minimum state of repair for the life of the agreement. Although the length of the agreements can vary depending on the size and type of project, typically they run between ten and thirty years. It is the private partner's responsibility to allocate sufficient resources throughout the contract period to maintain the infrastructure. Traditionally, operating budgets for infrastructure are often cut back when the government faces fiscal constraints. As a result, the asset begins to deteriorate faster and repair costs rise dramatically. This would not be the case under a long-term PPP contract. Many in government would see this as a highly desirable objective and something very unique in public projects, which are usually subject to yearly variances in funding availability.

Service Improvements & Efficiency

Service improvements are most notable in cases where the private sector has specific operational expertise. For example, in the case of a water treatment plant, the private operator can draw on the resources and staff expertise available to it from a number of different projects nationally and even internationally. On the other hand, a government agency has competing resources for a wide variety of service areas and can often only draw on the expertise available internally.

While operational efficiency is often equated with profits (which are not viewed favourably in the context of government services), the avoidance of loss provides a powerful incentive for the private partner to maximize efficiency, whether it is related to technology, human resources or processes. This is especially important in the front end of capital projects when huge outlays are required to construct projects. Avoiding losses by carefully controlling expenditures is a hallmark of PPP projects. PPPs consistently demonstrate greater worker productivity and operational efficiency as compared to traditional government operations.

Separation of Regulator and Provider

Having the operator of a service or asset also act as its regulator may result in a conflict of interest. The decision to *set and enforce* standards should not be conflicted by the obligation to fund service or equipment upgrades to *achieve* the standards. In a PPP, the government remains responsible for regulation and the private sector assumes operational responsibility. The contract serves as a comprehensive checklist of what must be performed at what price. There is no room for error and the private partner must adhere to rigorous performance specifications or risk losses. This “carrot and stick” approach is a compelling model and has proven to be effective in maintaining minimum standards of operation and environmental compliance in many PPPs. Ontario’s gas industry provides an excellent model of efficiency and objectivity, where prices are relatively stable, regulations are effective and operations are efficient.

Enhanced Accountability

While PPP opponents contend that the farther away the service or asset resides from the government, the weaker the accountability, quite the opposite is true. A solid contract defines performance standards that had not often even been considered when the government built or operated an asset or service. Detailed contracts are required to ensure that all eventualities are documented and considered. Under-performance provisions and incentive mechanisms combined with the threat of contract termination keep the private partner on target, and are much more stringent than most internal accountability mechanisms in government.

Job Creation

When government funding for infrastructure and capital-intensive services is scarce, PPPs can be a powerful generator of economic activity and jobs. They bring in new sources of private finance and an infusion of capital into the system. Lew Adams, former General Secretary of the UK train drivers' union (ASLEF), was a staunch opponent to the PPP concept when it was first introduced in 1995. Upon further analysis, however, he concluded that job creation and capital investment was stagnating under traditional government operation and private sector involvement would bring benefits to his 17,000 union members and the public at large. Since the private sector took over operation, 4,500 more train vehicles worth \$9.8 billion have been added to the service providing hundreds of new jobs.

Evidence of PPP Success

The following is a synopsis of experience from various sectors where PPPs have shown their value as a proven alternative to traditional government infrastructure development and service delivery. Other examples can be found in CCPPP's detailed case studies and project inventories.

Hospitals

Over the past seven years, the United Kingdom's National Health Service (NHS) has experienced the biggest new hospital building program in its history under PFI. In England alone, 64 major capital schemes worth over £11 billion have been given the go-ahead, 21 are already completed and operational, and a further seven have signed contracts and are under construction. All the completed hospitals have opened on or ahead of time, which never happened under traditional public sector infrastructure development.

Canada also has some noteworthy examples of hospital development using non-traditional financing, construction and operation. The East Coast Forensic Hospital in Nova Scotia is financed under a 25-year lease/sublease. It was able to stay on budget and experiences annual cost savings in the order of \$250,000 due to operational efficiencies and shared services. The University Health Network's bond offering allowed the hospital redevelopment to be approved sooner (three months in total) and construction to be completed faster than through traditional grants-based funding. The Royal Ottawa Health Care Group's operating contract resulted in total savings of over \$6 million in the first five years and the project's tripartite agreement between the hospital, private partner and union is a model of effective employee transition.

Highways & Bridges

Three examples of PPP road projects in Canada demonstrate the important role that tolls (user or shadow) play in the development of new highway infrastructure.

Highway 104 (Cobequid Pass) in Nova Scotia was the first to include non-recourse financing and achieved an important risk balance between the government, the design-builder/operator and the lenders. Cost savings are estimated at \$10 million (8%) on the capital cost of the project. The Fredericton-Moncton Highway was built under a 50-year design-build-finance-operate (DBFO) concession agreement. Initial capital cost savings were estimated at \$170 million and operating savings are \$13.7 million over 20 years. The road was built 10 to 15 years earlier than through traditional procurement. The Confederation Bridge's 35-year DBFO contract includes a \$41.9 million (1992 dollars) fixed annual payment to the private partner, which represents estimated annual cost savings of \$9.2 million. The design, construction, financing, revenue, operation and maintenance risk are all borne by the operating company, representing a significant value to the Government of Canada. Cost overruns for the project were estimated to be \$240 million, which were all borne by the private sector. Contrast that with the cost overruns on the Laval subway project in Montréal, where a similar cost overrun fell to taxpayers to cover.

Water & Wastewater Treatment

Three Canadian water/wastewater projects deserve mention as successful PPP initiatives. The City of Moncton entered into a 20-year licensing agreement with USF Canada in 1998 under a two-part DBFO contract. The \$85 million contract is expected to save the municipality \$23 million versus a traditional design-build approach. Water quality must meet or exceed Canadian Drinking Water Guidelines, the rate is fixed for 20 years and the company must adhere to a detailed repair and replacement schedule. In December 2000, USF Canada began an operations and maintenance contract for the Town of Goderich's water supply and distribution as well as wastewater collection and treatment. Cost savings of 8% have been achieved based on the \$1.4 million annual payment from the Town. The Regional Municipality of Haldimand-Norfolk (now Counties of Haldimand and Norfolk) entered a five-year operations, maintenance and management contract with US Filter in 1998 (renewed in 2003) for their wastewater treatment facilities. The 34% (\$1 million per year) cost savings have been reinvested in water and wastewater infrastructure and performance has exceeded requirements. Existing staff was offered equivalent wages and benefits when transferred from the municipality.

Schools & Universities

Just as in the healthcare sector, the United Kingdom has invested billions in its public schools under PFI. As of June 2003, there were 50 signed projects representing a capital value of £1.3 billion and covering nearly 600 schools. Twenty-three of those projects are operational and the government has allocated £1.6 billion for FY 2002/03 and 2003/04. They typically bundle the schools, representing a capital investment of between £50 million and £100 million supplied by the private sector, in return for a guaranteed payment over the length of the contract.

Canada has two major PPP initiatives of note in the school sector – one previous and one still in development. Although the Nova Scotia schools program has been

one of the most hotly debated PPP initiatives in Canada, it succeeded in: delivering 39 schools in record time, introducing a new way of designing and planning school infrastructure, and providing outsourced maintenance services at greater value. The Calgary Board of Education is in the midst of a tender process for the design, construction and possible financing of 29 new schools and refurbishment of existing capital. The total project is estimated to be in the range of \$255 to \$300 million, and may prove to be a valuable model for school projects in Québec.

Organizing Government to Deliver a PPP Program

Governments that have demonstrated success in delivering PPP programs typically have developed a centre of expertise to do so. Sometimes these are established within the government organization itself and others act at arms-length to government. There is no single organizational structure for a PPP unit that will fit all governments. Clearly, each government has unique characteristics and each jurisdiction has its own unique requirements that must be reflected in the PPP unit's mandate and operation.

The establishment of the Agence des partenariats public-privé du Québec would fulfil the function of providing specialized expertise and focus to a PPP initiative.

The Government of Québec may want to consider some of the characteristics that CCPPP has observed in high functioning PPP units:

Political Support

Without qualification, the Agency must have the strong and unflinching political support of the government. When opposition occurs, this reinforcement must extend beyond the individual Minister to which it reports. Ideally, the Agency can look to the most senior cabinet ministers to support its position as well as the function that it is performing on behalf of the government. Without firm political support, the ability of the Agency to conduct its activities becomes markedly compromised or diminished.

Much of the success of the PFI program in the United Kingdom can be attributed to the government and public's fundamental belief in the value of delivering infrastructure through the private sector. As evidenced by the start of PFI under the Conservative government and the expansion of PFI under the Labour Government, the program has clearly transcended political doctrine. It is no longer viewed as an ideology, but rather as a prudent business practice to get infrastructure developed better, faster and cheaper.

There must also be an understanding within the Ministries that there is support for the activities of the Agency and that there is a political desire to test the value of a PPP approach to infrastructure projects against conventional delivery. Should this remain unclear, there may be some resistance to invest the time and energy in exploring alternatives to the traditional approaches with which they are comfortable.

The policy directive to pursue a PPP framework for public infrastructure is a policy of the government. The role of defending the policy is that of the political representatives of the government, not the Agency. The role of the Agency is to defend the work that it does in fulfilling the policy of the government. That is, the Agency must accept the responsibility to provide support for its research, analysis and recommendations. As an agent of the government, it is also its role to provide objective and defensible information to assist the respective Ministries as they take their projects through the various stages.

Authority to Conduct Activity

Bill 61 establishes the legal authority of the Agency to carry out the activities assigned to it by the government. As projects are identified for review, a full legal audit should be conducted to ensure that the authority exists to undertake the specific project and that the structure of the arrangement is permitted.

Size of the PPP Organization and the Scope of Activity

Without qualification, public-private partnerships are not merely “business as usual”. They require a shift in public thinking, acceptance of a new philosophy, and the development of new skills. Now matter how professional and qualified individuals are in their jobs, there will be a steep learning curve when working on PPP projects. If they have joined the organization from elsewhere within the public sector, they will need to learn the business side of the project, gaining a strong sensitivity to the needs of the investment community and what makes projects “investment worthy”. If they are from the private sector, they will need to gain an appreciation of the considerable level of scrutiny when working in the public sphere and to the rigours of the approval process.

There must also be an appreciation that all the skills required to bring a PPP project to fruition may not necessarily have to be on staff. Contracting out specialized work may be more efficient and cost effective in the long run.

It is advisable to start out with a core group of people who build expertise as they work their way through the early projects. Over time, the organization may need to grow to keep up with the demands placed on the office, but growth should be approached with caution. Large organizations build their own inefficiencies and it is not at all a desirable characteristic for a PPP unit.

It is advisable for a government to move into a PPP environment building on its accomplishments. In the successful UK experience, a number of projects were undertaken as pathfinder projects. These were projects selected from different sectors that gave the PPP unit (i.e. UK Treasury Taskforce) time to develop its expertise on smaller projects and then build upon that foundation of expertise, move into a larger number of projects and meet higher degrees of complexity. It is recommended that the Government of Québec consider this as a reasonable approach and in addition to being selective about the number of projects, also

consider project types for which Canadian experience already exists so that a ready pool of talent can be called upon if required. Much of the skills development in one sector can be transferred to another. Starting on projects that have a high degree of success with existing expertise will allow Agency staff to hone their skills before moving into more difficult projects. The idea of selecting a small number of “pathfinders” seems to be a reasonable and widely-accepted first step.

Clearly Articulated Role and Responsibilities

Bill 61 spells out the roles and responsibilities of the Agency in a generic sense. As the Agency engages in specific projects with other public bodies, it will be necessary to clearly define these responsibilities further among the participating parties. While it may seem like an obvious course of action, leaving this as a vague understanding can cause difficulties, especially when projects are under inevitable pressures.

In addition, the public bodies and the Agency may have different reporting requirements and those should be thought out well ahead of time to ensure that materials and information are assembled in a manner that meets the needs of the respective organizations.

Timely and Accepted Approval Processes

Public-private partnerships often require detailed documentation to ensure that agreements between the parties (the private consortia and the public sector party or parties) are thorough and capture every eventuality. As such, parties to the agreements are often put under considerable pressure to approve documents. All parties should document the approval process that is necessary within their organizations so there is no uncertainty when the time comes about to whom documents must go for sign-off.

Communications

It has been said of public-private partnerships that they are 80% communications and 20% project. Simply put, there cannot be enough emphasis put on a well thought-out communications strategy for each and every stage of the process. By their nature, PPPs have multiple partners. While there will be some level of responsibility for each of the participants in the communications strategy, one party needs to take the lead and be given the authority by the other parties to coordinate the communications activity. That activity will be directed to the public, to the media, to the Ministries or public body (ies) involved and to other parties or interest groups. All projects should have someone assigned to fulfil this role and it should be anticipated that on major projects this might, in fact, be a full-time undertaking.

Operational Matters Related to the Agency

Comprehensive Guidance & Preparation

In jurisdictions where the use of public-private partnerships was relatively scarce (e.g. UK, Australia), the government agency developed comprehensive guidance materials applicable to specific sectors and types of transactions. It takes time for intellectual knowledge and expertise to spread throughout a government, and guidance materials provide the first step in disseminating best practices. Partnerships UK and Partnerships Victoria (Australia) have both published a wide variety of guidance materials that are worthy of study and emulation. In terms of preparation, success by other PPP agencies worldwide has shown that getting the organizational capacity in place and conducting a thorough review of candidates before issuing the first request for proposals (RFP) proves to be more effective. There is often an urgency to achieve deal flow at the expense of due diligence.

Procurement

It is advisable that private partners' selection be done through an open competitive process. Only through a well run and sound competition can the government be assured that it has engaged all qualified and interested parties and secured the most competitive proposal. Unsolicited proposals are difficult for governments to deal with and should be considered only in exceptional, defensible circumstances. There are practices in use that allow unsolicited proposals received by the government to be put out to the market in a limited competition. These models of procurement are worth investigating and would be considered more reasonable approaches compared to entertaining individual proposals in isolation.

Fairness, Transparency & Efficiency

The Abbotsford Hospital PPP in British Columbia provides an excellent example of transparency when it comes to the business case and RFP process. The project website contains almost every document associated with the project, from the business case developed in 2000/2001, to the entire RFP document released in 2003/2004, to updates on each project milestone. This openness, combined with a sound communications plan, keep the bidding process open to the public and helps ensure stakeholder support for the project. Best practices from the UK have shown that such measures are critical during all stages of the PPP process. They are also beneficial to the bidding community as everyone has full access to the same information.

The second element of note related to fairness and transparency is the delicate balance of the public's need for freedom of information and the private partner's need to protect proprietary know-how. One way to alleviate the private sector's reluctance to propose proprietary innovations is to reward it in the RFP process (e.g. assign it a separate value) and to provide incentives during the agreement phase (e.g.

provide a greater proportion of the revenues if standards are exceeded or assets are delivered early).

In terms of efficiency, CCPPP recommends the following:

- 1) Establish a market grade proposal, through market analysis and a widespread Request for Expressions of Interest (RFEI) process, before developing the RFP.
- 2) Recognize that a protracted and prescriptive RFP process will add undue burden to the proponents, and result in a more expensive solution. If due diligence is spent in drafting an effective RFP document up front, less time will be spent in the proposal stage and the government is more likely to get an appropriate market response.

An Accurate Public Sector Comparator

Without a comprehensive and accurate benchmark with which to compare alternative delivery models, the government and the private sector will be hard pressed to prove that a PPP could deliver value for money. CCPPP recommends the following criteria when it comes to developing a Public Sector Comparator (PSC):

- 1) Responsibility for drafting the PSC should lie with a completely independent body (either inside or outside government) that has no vested interest in the outcome of the process.
- 2) Accurate comparisons among government departments can be difficult enough, let alone against a private sector solution. Consistent accounting principles and similar treatment of capital expenditures and debt will ensure that an “apples to apples” comparison is achieved.
- 3) The probability of cost overruns and time delays must also be factored into any comparison, which is typically not considered in traditional public infrastructure development and service delivery. This is referred to as a risk-adjusted comparison. As mentioned, the UK National Audit Office found PPPs were delivered sooner and at lower cost compared to traditional government projects (see page 6).

Standardization

Standardization means that individual government entities do not have to “reinvent the wheel” when it comes to effective procurement and contract language. The challenge with standardized procurement is to retain a degree of flexibility that allows the government to reflect local market conditions. Well thought out templates will achieve this goal over time.

The United Kingdom is considered one of the best countries in the world for standardized RFP processes, but it must be emphasized that the most useful

documents were the ones developed from a solid base of experience. Although the UK's centralized government system lends itself to more universal procurement practices throughout the country, the local authorities have benefited greatly by the adoption of standardized contracts and comprehensive guidance materials for hospitals, schools and water/wastewater treatment plants. CCPPP has also published several guidance documents as well as case studies that detail successful procurement practices at the provincial and municipal level.

Clear and Effective Contract Provisions

The final contract negotiated between the government and the public partner becomes the linchpin for how the asset will be built and operated as well as what happens if the private partner does not meet its obligations. While PPP contracts necessitate much more detailed performance specifications, they do not have to be overly prescriptive. The protection of the public interest can be maintained much easier if the contract clearly specifies outcomes, rather than details input specifications. In the case of operations like water treatment plants, the government agent can use water quality standards as easily quantifiable outcomes, but does not need to dictate how these standards are achieved.

Mechanisms to Incentivize Good Performance and Discourage Underperformance

Contracts that contain clear incentives for exemplary performance and provisions of consequences for under-performance (i.e. liquidated damages) can provide additional value for money assurances. While governments often concentrate on punitive measures for poor performance and contract breaches, there is significant benefit to rewarding outstanding service or improved efficiencies. Combined with the profit motive of the private sector, these provisions will help leverage additional value in the construction and operation of Québec's infrastructure.

A Reasonably Established Security

A reasonably established security, such as a bond or other formal security, will ensure a financial cushion should a contract default arise. Given the financial obligation on the part of the private partner with such requirements, it also ensures that only financially stable companies become preferred proponents. These should be established at reasonable limits.

Anticipate Changes

Contract language should anticipate changes in government, legislation, economic conditions and revenue streams. Such provisions protect both partners and ensure that future actions beyond the control of the parties involved are dealt with judiciously.

Significant Project Size & Revenue Stream

Partnerships UK and Partnerships Victoria have both recognized the value in pursuing PPPs that provide a minimum revenue stream and project size. In Victoria, for example, few projects under A\$100 million are considered eligible for PPP. Given the costs on the government side to develop RFP documents, pay advisors, auditors and legal counsel and on the private side to respond to complex RFPs, it makes sense to pursue projects of a certain size. Partnerships BC may give some direction in the future on undertaking projects of lesser value.

The PPPs with the strongest business case will also have a significant revenue stream, typically involving some form of usage payment. The adoption of user fees in conjunction with private finance can be a controversial course of action. What they do achieve, however, is a revenue stream that is essential to attracting private capital and a way to ensure that those who benefit most from the service pay for it. Aside from the critical importance of political support in imposing user fees, they are most appropriate when:

- There is a clearly defined user
- There is a demonstrable value applied to the user
- Fees can be linked directly to costs
- The fee is set at a cost recovery rate equal to the users' perception of the value added

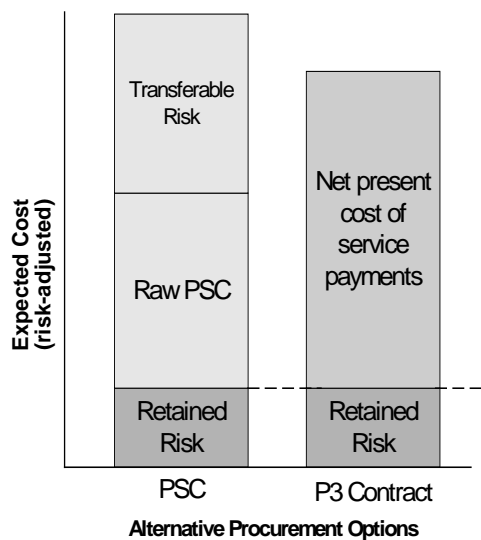
Shadow tolls or fees paid by the government based on usage may be an appropriate strategy to transfer usage risk and mitigate the public's resistance to user fees. This model has been used for several road projects in the UK as well as the Fredericton-Moncton Highway.

Appropriate Measurement and Allocation of Risk

While government borrowing rates are often cited as the most compelling reason to use public financing, a thorough analysis of risk reveals that there is more to value for money than simply interest rates. The valuation of risk transfer is a difficult exercise; yet allocating a financial value to risk transfer is an important way to objectively measure value for money against a public sector comparator.

Proper risk analysis recognizes that conventional capital procurement exposes the government to a number of risks, including design and construction, operation, legislation, regulation, available volume, technology, residual value, finance and employment risks. The risk of construction cost overruns remains one of the most significant risks to be allocated and valued. The total risk-adjusted value for money assessment of the Public Sector Comparator (PSC) and a rival PPP bid should consider not only the raw private construction costs but also the value of risk that

may be assumed by the private sector partner rather than by the government agent (see Figure below).



The best approach to PPP risk sharing is to allocate each risk to the party best able to deal with it. Optimum risk allocation generally begins with allocating most commercial risks to the private party, most regulatory risks to the public party, and the sharing of additional risks. The early PFI projects in the U.K. attempted to excessively transfer risk to private partners in a way which was either not acceptable to the private partner, or for which the risk premium demanded by the private partner was high, leading to an inefficient project model. More recently, the National Audit Office has provided significant guidance on the appropriate allocation and pricing of project risk. In Australia, Partnerships Victoria has released a guide that contains a comprehensive matrix for risk allocation and valuation, which is integral to the value-for-money criteria to be tested under the program. CCPPP has also written several publications and made presentations that discuss risk allocation in various sectors.

Conclusion

Bill 61, an Act respecting the Agence des partenariats public-privé du Québec, establishes a strong model to deliver a PPP program within Québec. In addition to a sound structure, there are operational protocols that have been included in the CCPPP submission that will assist the Agency in achieving success.

As the Government of Québec creates its own path when it comes to public-private partnerships, it can be assured of an established record from other jurisdictions. While PPPs take time and dedication to develop, they have proven their worth as a sound alternative to traditional infrastructure and service delivery. CCPPP is confident that they can provide the same benefits to Québeckers. We offer our support and resources to the Government and the Agency as you further develop your PPP program.