

## Contract formation

**The contractual framework of a PPP infrastructure project involves a web of inter-dependent contractual relationships, organized around one main agreement. The choice of this main agreement is made by the public authority according to the type of project envisaged. Then the next step in the implementation of the project is to select the private concessionaire, and negotiate and draft the concession agreement.**

### Choosing the appropriate contract

Private sector participation in infrastructure projects may be devised in a variety of different forms ranging from publicly owned and operated infrastructure to fully privatized projects. The appropriateness of a particular variant for a given type of infrastructure is a matter to be considered by the government in view of the national needs for infrastructure development and an assessment of the most efficient ways in which a particular type of infrastructure facility may be developed and operated. In a given sector more than one option may be used.

#### Public ownership and public operation

When public ownership and control is desired, direct private financing and infrastructure operation may be achieved by establishing a separate legal entity controlled by the government to own and operate the project. Such entity may be managed as a commercial enterprise and opening its capital to private investment may offer an opportunity for attracting private investment in infrastructure.

Private participation may also be achieved in such a case by the negotiation of “service contracts” whereby the public operator contracts out specific operation and maintenance (“O&M”) activities to the private sector. Alternatively the public authority may also entrust O&M activities to a private entity acting on behalf of the contracting authority, under a so called “management contract”, with a possibility to link the private operator remuneration to its performance.

#### Public ownership and private operation

Alternatively the whole operation of public infrastructure facilities may be transferred to private entities. One option is to give the private entity usually for a certain period, the right to use a given facility, with the obligation to supply the service and to collect the revenue generated by that activity. The facility may already be in existence or may have been built by the said private entity. In some countries this is referred to as public works concessions or public service concessions.

When the private entity is selected to operate a facility that has been built or financed by government, the private operator assumes the obligation to operate and maintain

the infrastructure and is granted the right to charge for the services it provides. In such cases the private operator pays to the contracting authority a portion of the revenue to amortize the construction cost. Such arrangements are referred in some legal systems as “lease” or “affermage”.

### Private ownership and operation

In this situation, the private entity not only operates the facility, but also owns the assets related to it. When the facility is operated pursuant to a governmental license, private ownership of physical assets (eg the network) is often separated from the license to provide the service to the public, in that the license can be withdrawn under certain circumstances. Thus ownership of the facility does not entail an indefinite right to provide the service.

One additional consideration for the choice of the most appropriate contract is the allocation of project risks between the contracting authority and the private entity. This is a crucial point as a wrong allocation could jeopardize the viability of the project.

First it is important to state that this issue is raised where it belongs, that is, in the contract negotiation. Indeed there are so many factors that the parties need to take into account in order to allocate risks effectively, that it would not be advisable to have in place statutory provisions that limit unnecessarily the negotiators’ ability to achieve a balanced allocation of project risks.

Practical guidance in this respect often refers to a few general principles. One such principle is that specific risks should normally be allocated to the party best able to assess, control and manage the risk, including its mitigation. However a large number of risks result from events outside the control of the parties or attributable to the acts of third parties and for those risks, other principles need to be considered.

For example, the allocation of commercial risks falls generally on the private sector entity rather than on the contracting authority. However for some capital intensive project with slow cost recovery potential, such as toll road projects, the private sector may be reluctant to carry them out without some form of risk-sharing with the contracting authority, for example through fixed revenue assurances or agreed capacity payments regardless of actual usage.

### Selecting the concessionaire

Having defined the role and task to be assumed by the private sector, and the type of contract that follows, the public authority must then select its partner to implement it. For a long-term relationship, it is as important for the public authority as it is for the private sector entity to find the right partner, and there are several ways to achieve this objective.

## Competitive bidding versus direct negotiations

The issues faced by the contracting authority at the time of selection of the concessionaire have been addressed in Module 4 -> Legislation -> Legislative Framework -> Public Procurement. Moreover, Module 5 -> Procurement presents the modalities of conducting the procurement process.

## The case for unsolicited proposals

Most experience shows that the most advantageous solution for the selection of a concessionaire results from a competitive tendering process.

However specific attention should be given to instances where public authorities are approached directly by private companies who submit proposals for the development of projects for which no selection procedures have been opened. These are called “unsolicited proposals” and may result from the identification of a need that had not been identified by the public authority, or may involve an innovative proposal and offer the potential for a technology transfer to the host country.

From a policy standpoint the contracting authority would have a legitimate interest in stimulating the submission of proposals incorporating the most advanced process, design methodologies or engineering concept, that would clearly enhance the project outputs (eg by reducing construction costs). Such interest might be achieved with a competitive process if the selection procedure could place the emphasis on the expected output of the project without being prescriptive about the manner in which that output is to be achieved; the bidders would then have sufficient flexibility to offer their own proprietary processes or methods.

However if the uniqueness of the proposal or its innovative aspect are such that it would not be possible to implement the project without using a process or a concept for which the proponent possesses exclusive rights, then this will eliminate the scope for a meaningful competition.

The procurement laws of most countries allow single source procurement in such a case, but they also recommend contracting authorities to follow certain procedures to ensure that they have obtained the most advantageous solution for meeting their needs. These procedures involve obtaining elements of comparison for the unsolicited proposal, and then invite other interested parties to submit alternative or comparable proposals, with care being taken not to disclose proprietary information of the initial proponent to potential competitors. Such invitation should be published, in ensuring again to maintain the confidentiality of proprietary information.

If no alternative proposal is received, the contracting authority should be authorized to engage in direct negotiations with the original proponent. If alternative proposals are submitted, the contracting authority should invite all the bidders to negotiations with a view to identifying the most advantageous proposal. In such a case there may be a full-fledged competitive selection procedure subject to any incentives that may be given to the author of the original proposal. The contracting authority should establish a record of the selection proceedings and publish a notice of the award of the project.

Refer to Module 5 -> Procurement -> Unsolicited Proposals for further description for methods and procedures for managing unsolicited bids.

More detailed practical guidance and useful references can be found in the



Unsolicited Infrastructure Proposals - How Some Countries Introduce Competition and Transparency.  
J. Hodges and G. Dellacha. PPIAF Working Paper N°1, 2007