Public-Private Partnerships: The Issues, Prospects and Challenges

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Introduction

Ideas efficacious at some times and in some human surroundings are not so at other times and elsewhere

- *William James*
The Varieties of Religious Experience[1]

So it has been in the provision of infrastructure and the emergence of public-private partnership (PPP). A PPP refers to a contractual agreement formed between a government organ (Ministry, Department or Agency - MDAs) and a private sector entity that allows for greater private sector participation in the delivery of public infrastructure projects. The financing of a PPP project must be 'engineered' to take account of the risks involved, sources of finance, accounting and tax regulations. In this regard project financing techniques are employed and a mixture of instruments and methods are available, including asset-based financing, leasing, hire purchase and the use of a special purpose vehicle (SPV) non-recourse financing vehicles. In other words, is it going to be an off-balance sheet transaction or some with limited recourse to the balance sheet.

If an SPV is formed, the secondary issue is whether the public sector should have equity interest in the entity. Having equity interest in the entity has its own problems and therefore, care should be taken in structuring a transaction and the allocation of risks between the public and private partners. If an SPV is not formed a joint venture company may be incorporated.

As a concept, PPP has assumed many meanings and models. In its strict construction, it may mean that there is really no partnership with the MDAs except that at the end of the project circle, it reverts to the MDAs or that the contribution of the MDA is the provision of the land for the facility or the facility itself. However, in its broader sense, it means a real partnership between the public and private sectors. In either case, the key principles in a PPP are value for money (VfM), public interest, transparency, risk allocation, output requirements, and competition. It is noteworthy that the Federal Executive Council approved the National Policy on PPP in April 2009.

Hitherto, the provision of infrastructure was seen as the exclusive preserve of the public sector chiefly because of the cost implications and the fact that the public sector was best able to provide them as they were seen as public goods. However, with the dwindling resources of the public sector and the fact that the private sector has the capacity to assume most if not all of the risks, there has been a paradigm shift.

The provision of infrastructure in developing countries presents a significant obstacle to meeting populations' needs, to developing enterprises and to achieving the goals of the Millennium Declaration. In some countries like Nigeria, some infrastructure like the railways face the double challenge of growing demand and aging physical assets – a challenge that has become an obstacle to sustained growth.

In this article, we shall examine the nature of a PPP and assess the issues, prospects and challenges. We will also examine the lessons to be learnt from other jurisdictions.

<u>The nature of Partnership</u>

Today, we are witnessing a world-wide revolution in the provision of infrastructure. This is essentially because of the paradigm shift. Infrastructure services are critical inputs in the provisions of goods and services and significantly affect the productivity, cost and competitiveness of the economy. Policy decisions regarding their provision and sector development have ramifications throughout the economy[2]. Indeed the boundaries between the public and private sectors are the most important political issues of our time. There is hardly a discussion today on the provision of infrastructure without reference to PPP. It seems, therefore, that PPP is the panacea for all public sector procurements. It is safe to assert that the primary responsibility to provide infrastructure rests on the public sector and that more than 70% of the responsibility still rests on the public sector. Consequently, the public entities must continue to make budgetary allocation for the provision of infrastructure.

The nature of the partnership is also determined by the type of infrastructure – hard economic infrastructure (roads, motorways, bridges, ports, railways, airport, power, telecommunications) or social economic infrastructure (export assistance, technology transfer and vocation training). It can also be hard social infrastructure (hospitals, schools, water supply, housing, sewerage, prisons) or soft social infrastructure (social security, community services and environmental agencies).[3] Another classification is between 'green field' (new infrastructure) and 'brown field' (existing infrastructure). Whereas economic infrastructure generally provide intermediate services to business and industry, the social infrastructure provide basic services to households. Sometimes the categories overlap. For example, some forms of social infrastructure such as those that enhance the skills, health, productivity and morale of the work force may have a bearing on the productivity of industries.

The basic elements or mechanisms of a PPP are as follows:

- The public sector defines the services it requires over a long term period (typically 15-30 years) by reference to an output specific and closely specified performance criteria, without being too prescriptive about the means of delivery;

- No payments are made until the asset is delivered and working, and subsequently payments are subject to reduction if service performance standards are not met;

- Design risk, in terms of the decision on the type of assets needed to deliver the services to the required standard, is left to the private sector entity and the assets are effectively managed and operated by the private sector;

- The public sector provides no funding during the construction phase, and the risk of cost overruns, delays, etc rests with the private sector unless the public sector takes equity in the SPV;

- The public sector has to devolve control to the private sector over the assets and resources needed to deliver the service to such an extent that the private sector bears the risks and receives the rewards of effective ownership[4]; and

- At the end of the concession period, the facility reverts to the public entity if there is no extension.[5]

Based on this mechanics, PPPs can take many different forms, the most usual being a Build, Operate, Transfer (BOT), Build, Operate, Own (BOO), Design, Build, Operate (DBO) arrangements, joint ventures (JV), leasing, contracting out or management contracts, service contracts, concession and various forms of public-private cooperation[6]. These examples constitute some of the more common types of partnership. In addition, in terms of the 'alphabet soup' of acronyms, there are also BLT (Build, Lease, Transfer), BLTM (Build, Lease, Transfer, Maintain), BOOR (Build, Own, Operate, Remove), LROT (Lease, Renovate, Operate, Transfer), DCMF (Design, Construct, Manage, Finance) and DBFOM (Design, Build, Finance, Operate, Manage)[7]. Each type differs in terms of government participation levels, risk allocations, investment responsibilities, operational requirements and incentives for operators.

Many of these new ideals are promising and valuable, but their novelty should not be overstated and their limits should be recognized. Today's changes are dismantling past structures, but they are also reviving earlier methods of financing and organizing infrastructure delivery. The expectations is that lessons have been learned and mistakes will be avoided. However careful the design and implementation, no perfect solutions exist for all times and places[8]. Those adopting PPP should, therefore, focus on the general issues in PPP, their prospects and provide institutional framework for addressing the challenges.

General Issues in PPP

In a PPP transaction, a number of issues generally arise. For example to what extent will there be 'bundling'[9], has a business case[10] been made, does the project pass the value for money and public interest tests and so on[11]. Indeed the Infrastructure Concession Regulatory Commission (ICRC) established under the provisions of the Infrastructure Concession Regulatory Commission Act (ICRCA) of 2005 has published a PPP Project Lifecycle in which the preparation of an Outline Business Case and Final Business Case are key elements.

However, in this article, we will examine the issue of legal and regulatory framework, engagement of Transaction Advisers, financing and value for money and public interest tests. Before the passage into law of the ICRCA in November 2005, various legal instruments regulated various sectors.[12] In all these legal instruments, there was no reference to concession or PPP. It was only in the Electric Power Sector Reform Act of 2005 that the National Council on Privatization (NCP) created under the provisions of the Public Enterprises (Privatization and Commercialization) Act of 2004 was empowered to determine the appropriate means of privatizing the successor companies to the Power Holding Company of Nigeria PLC[13]. The mode includes outright sale or concession.

The major boost to PPP in Nigeria is the ICRCA. Section 1 of the ICRCA provides that as from 10 November, 2005 any Federal Government Ministry, Agency, Corporation or body involved in the financing, construction, operation or maintenance of infrastructure, by whatever name called, may enter into a contract with or grant concession to any duly pre-qualified project proponent in the private sector for financing, construction, operation or maintenance of any infrastructure that is financially viable or any development facility of the Federal Government in accordance with the provisions of the Act. In other words, any Ministry, Department or Agency (MDA) involved in financing, constructing and operating any infrastructure can enter into a PPP. Although the word 'regulatory' is used in the name of the Commission, it is indeed not a regulator properly so called. This becomes clear when the functions of the ICRC are critically examined.

In terms of regulation of the key sectors of the economy, the NCP has sponsored bills aimed at providing the regulatory framework for PPP to flourish in a Nigeria.[14] Thus while the ICRCA has provided the legal framework for MDAs to enter into PPPs, until these bills are passed into law, Nigeria may not have the proper regulatory framework for the various sectors. The ICRC has through the National Policy on PPP tried to fill the lacuna in this respect but the fact remains that the ICRC is not a regulator properly so-called.

In most jurisdictions, there are no specific laws strictly on PPPs.[15] In Australia, Canada, England and Wales, Germany and Ireland, there are no specific laws on PPPs.

However extensive use is made of policies, guidelines and general law of contract and procurement rules. Similarly, the Organisation for Economic Cooperation and Development (OECD) Council has adopted a Recommendation entitled OECD Principles for Private Sector Participation in Infrastructure.[16] The Principles are intended to serve as a first step in the public authorities' consideration of private sector participation, offering a coherent catalogue of policy directions for these authorities to assess as part of their development strategies in the light of their national circumstances and needs.[17] Other instruments include the European Bank for Reconstruction and Development (EBRD) Legal Transition Programme which focuses on a particular category of PPP – concession type and build-operate-transfer (BOT)/design-build-finance (DBFO) type arrangements[18]. The EBRD undertook an assessment of concession laws (the 2005 Assessment) in the EBRD's countries of operations.[19] The thrust of the assessment is that any reform aiming to enhance PPP opportunities should start with a well-contemplated policy. This will then be complemented by further legal and institutional efforts to allow PPPs to work effectively[20]. Unfortunately in Nigeria, the ICRCA was passed before the formulation of the National Policy on PPPs.[21] The National Policy has listed the Public Enterprises (Private and Commercialization) Act of 2004, the ICRCA 2005, The Fiscal Responsibility Act 2007, the Public Procurement Act 2007 and other relevant laws as providing the legal framework for PPPs in Nigeria. However, even if there may be no specific laws on PPP, the level of political championing is fundamental. In Europe, the majority of the countries analysed have governments with a positive attitude towards PPPs even where there is no legal framework or a central unit on PPPs.[22]

Another issue that is worth consideration is the engagement of Transaction Advisers. PPP is novel in this part of the globe and still evolving. The MDAs are generally used to conventional procurement. Conventional procurement is further enlarged by the provisions of the Public Procurement Act of 2007 and the Fiscal Responsibility Act of 2007. It is advisable, therefore, to engage Transaction Advisers to assist the MDAs in the preparation of the transaction documents (Outline Business Case, Information Memorandum, Request for Proposal, Final Business Case, negotiation of the various contracts and instruments for monitoring the construction and operation phase). The tools used for conventional procurement are usually inappropriate for PPP transactions.

Hitherto financing a PPP transaction was a major issue. This is now compounded by the global financial crisis. However, issues to be considered are whether financing should be through equity capital, commercial loans, 'subordinated' debt sometimes called 'mezzanine capital', loans from institutional investors, capital market funding, financing by Islamic financial institutions, financing by international financial institutions, support by export credit and investment promotion agencies or a combination of funds from the public and private sources.[23] Generally it is usually the issue of what proportion should be debt and equity and whether the public authorities should take equity. A secondary issue is whether the public authorities should provide some form of guarantee or subsidy. Any borrowing, increase in government expenditure and guarantees must comply with the provisions of the Fiscal Responsibility Act[24] otherwise there are criminal sanctions.

Value for money simply means the optimum combination of whole-of-life cycle costs, risks, completion time and quality in order to meet public requirements. On the other hand, 'whole-of-life cycle' means costs associated with the repair and maintenance of a facility for the term of a facility's economic life. It is generally agreed that the public authorities can borrow at lower rates of interest than the private sector participants. Consequently it is wondered whether a PPP project provides any value for money. A contrary argument is that the management/financial skills of the private sector outweighs whatever advantage that the public authorities will have over the private sector in terms of rates of interest.

Be this at it may, for a PPP project to be viable, it must pass the value for money test and that of public interest. It is in the interest of the public that a PPP transaction must be completed on schedule and with quality delivery undertaken by the private entity.[25]

PPPs must comply with the procurement laws.[26] The Bureau of Public Procurement established under the provisions of the Public Procurement Act has through the Office of the Secretary to the Government of the Federation published guidelines on thresholds.[27] It is imperative for all MDAs to ensure that the thresholds are observed and that transactions are not broken up such that the Ministerial Tenders Board can approve without recourse to the Bureau of Public Procurement.

The drafting of project agreements[28] is usually a major issue in a PPP transaction. It is usually a requirement of a PPP transaction that drafts of project agreements prepared by the project proponent (concessionaire) should be submitted to the public authority for comments and observations. Such comments/observations do not relieve or absolve in any manner whatsoever the concessionaire of its obligations, duties and liabilities under the concession agreement nor make the public authority liable to the concessionaire in any manner whatsoever. Similarly the final copies of the project agreements are usually schedules to the Concession Agreement. The importance of vetting such agreements cannot be over-emphasised. This is because it is first and foremost a partnership and more fundamentally in case of default of the concessionaire, the public authority inherits the liabilities including payment of termination fees[29] and debts outstanding. It is imperative, therefore, for the public authority to vet all the project agreements critically especially the Financial Agreement to determine the terms of the contract and ensure that the financial close is properly defined and a date set for its achievement.[30] Every PPP transaction must provide for financial close. Indeed the achievement of a financial close is usually a condition precedent[31].

It is also necessary that the public authorities are involved in the selection of the construction contractor by providing in the concession agreement the qualifications, experience and selection procedure for such appointments. There should be provisions also for grounds for removal/replacement and the procedure.

A number of failed PPP transactions in the infrastructure sectors attest to the difficult challenges facing policy makers. Infrastructure investment involves contracts more complex and protracted than conventional procurements. For instance the provisions of 'step in' clauses either by the lenders or the public authority is a major feature. This is a realization of the fact that there is a high possibility of default by the private sector participant and, therefore, enough provisions should be made to ensure continuity of the project.

PPP Prospects

PPPs are used around the world to build new and upgrade existing public facilities/infrastructure such as schools, hospitals, roads, power plants, waste and water treatment plants and prisons, among other things. Compared with traditional procurement models, the private sector assumes a greater role in the planning, financing, design, construction, operation and maintenance of public facilities. In this regard, risks are allocated between the MDA and the private sector.

It must be stressed that the history of private sector participation in the provision of infrastructure has been chequered. The Greek historian and philosopher Strabo (63 BC – AD 21) writing in *Geographia* at the time of Caesar Augustus records there being tolls on the Little Saint Bernard's Pass. In the Middle Ages, tolls were used to support the cost of bridge construction, and as early as 1286 London Bridge had tolls. Turnpikes were roads partly or wholly paid for by fees collected from travelers at tollgates. Turnpikes have been described by Adam Smith as 'the precursors of the modern build, operate and transfer systems'. The mails and the clergy were exempt as were the construction workers for turnpike maintenance and improvement. It was not until after the War of Revolution that turnpikes were introduced in the United States – the first to be constructed and operated by a private corporation was the Philadelphia-Lancaster Turnpike, chartered in Pennsylvania in 1792 and completed two years later.[32] As in Britain, not everyone paid the tolls. The Massachusetts legislation exempted people going to church, those on military duty and those doing business within the tollgated town. France's long involvement with water concessions can be dated back to 1782 when the Perrirer brothers were granted the first water supply concession to provide a water distribution system to parts of Paris and another was that of the Suez Canal.[33]

Thus countries like the United States of America, Great Britain and France have had various relationships between varieties of ownership and financing for different kinds of infrastructure, demand for public goods and sources of market discipline. Provision of roads and streets in the United Sates has been characterized by great diversity and much change over time in both financing and ownership arrangements. So also is the provision of sewerage systems and waste water treatment, urban mass transportation, water works, electric utilities, and telephones.[34] Essentially the private sector has paid a major role in the provisions of infrastructure in the US. In contrast , Great Britain and France have exhibited a mixture of public and private ownership and provision of these infrastructures. For example state ownership dominated the provisions of telephone services in France, Germany, Switzerland and other European countries as decisions on development as well as ownership of these system have been shaped by consideration of national unity and military need. In the case of water and electricity provision in Britain, the presence of governments in their provision was prominent although views on these are changing with the involvement of the private sector. Thus the provision of pubic utilities like electricity was nationalized in 1947 in the UK until the privatization programmes of the 1980s. In France, franchising and contracting arrangements in the provision of infrastructure while government retained ownership was a major characteristics.

The fact that the United States operates federalism while the Great Britain and France operates unitary system of government played a major role in the ownership and financing of the provision of infrastructure. Decision-making concerning infrastructure development, public goods demanded, and the roles played by private firms have been shaped by the values of politically important actors and the works of governmental, political and legal institutions especially in the disparity and diversity in the various modes of ownership and financing.

Over the years, the United States have adopted PPP arrangements in transport, technology, water, prisons, health, welfare (food stamps benefits) and urban regeneration.[35] In Europe it has been used for Government buildings, airports, defence, housing, health and hospitals, information technology, ports, prisons, rail, roads, schools and universities, sports and leisure and water and waste water.[36] Thus the PPP landscape across Europe is evolving rapidly.

In the Supplementary Note to the National Policy Statement on PPP (Roles and Responsibilities for PPP in the Federal Government of Nigeria) which is part of the National Policy on PPP, the prospects are in the following areas:[37]

- Power generation plants and/or transmission
- Roads and bridges
- Water supply, treatment and distribution systems,
- Ports
- Airports
- Railways
- Inland container depots and logistics hubs
- Gas storage depots and distribution pipelines
- Solid waste management
- Educational facilities
- Urban transport system
- Housing
- Healthcare facilities

This is very ambitious indeed given that with the global recession and the crisis in the banking sector in Nigeria, financing of transactions will be daunting.

Challenges

Most literature on PPP are from developed economies. More fundamentally, the developing economies that suffered from colonialisation embarked on massive nationalization of industries on the attainment of independence. Thus the private sector had no managerial and financial role to play in these economies other than contracting with the public authorities. In a country like Nigeria, the indigenous programme of the 70s[38] has also not helped matters. With the 'commanding height theory' governments got involved in the provision of public utilities. The arguments were plausible then but are indefensible now in the face of technological advances and the privatization programmes.

The first challenge towards the institutionalization of PPP is the availability of people with the requisite technical capacity, ability and the political will to champion reform of the sectors and confining governments to policy formulation while regulators are established. In this regard, the engagement of Transaction Advisers is imperative. However, most government functionaries, after attending one or two courses on PPP see themselves as 'superstars' and therefore can structure a PPP transaction. Such courses are very important. However, a PPP transaction is very complex requiring expertise in law, economics, engineering, finance, management and so on. A PPP transaction involves two main participants, namely the public entity and the private entity. Each is necessarily a principal that must be capable of structuring, negotiating and contracting on its own behalf. It must have competent personnel to do this. The 'partnership' is a real relationship unlike the conventional procurement where for instance Dumez Nigeria Ltd, Julius Berger PLC or Setraco Nigeria Ltd has been engaged consistently by the Federal Ministry of Works year after year for a period of 30 years for the construction of roads. A PPP is much more enduring, relational and continuous because it is a partnership. This is underpinned in the framework contract (the Concession Agreement) which sets out the rules of the game. As a partnership each of the participants must bring something of value to the relationship.

PPPs seek to draw on the best available skills, knowledge and resources whether they are in the public or the private sector and deliver value for money in the provision of public infrastructure services. For this to happen, each partner must transfer resources, (money, property, authority, reputation) to the arrangement. More fundamentally, risks[39] and responsibilities are shared between the two main parties. In addition to the two main parties in the partnership, there are the project agreements. How are all these agreements to be structured to ensure value for money and harmony amongst them?

One instrument used for a PPP transaction is the incorporation of a Special Purpose Vehicle (SPV). There is a lot of misconception on the adoption of this approach. Many uninformed public commentators have always argued that a company not in existence at the time the publication of the expression of interest was made cannot be allowed to bid let alone being a winner. They perceive some fraud in this regard. Indeed one of the problems that the Bureau of Public Enterprises (BPE) established under the provisions of the Public Enterprises (Privatization and Commercialization) Act 2004 has had to contend with at the National Assembly, the Economic and Financial Crimes Commission and the other government functionaries is the use of an SPV.

When a transaction like a PPP is advertised, a fairly standard approach is for the sponsors of a project to establish an SPV in which the sponsors are principal shareholders. Each sponsor holds a sufficiently small share of the equity in the joint venture so that for legal and accounting purposes, it cannot be construed as a subsidiary[40] of any of the sponsors. Generally the bank, contractor, and operator may take a share in the SPV. Thus an SPV is simply a separate legal entity generally a company established to undertake the activity defined in a contract between the SPV and its client. Through the SPV the sponsors contract with the public entity and the principal sub-contractors. SPVs are used in PPPs for the following reasons:[41]

- ✓ to allow lending to the project to be non-recourse to the sponsors by virtue of the limited liability nature of the SPV;
- ✓ to enable the assets and liabilities of the project not to appear on the sponsors' balance sheets, by virtue of no sponsor having more than 50 per cent of the shares in the SPV and the application of normal consolidation principles when preparing the group accounts; and
- ✓ for the benefit of the project lenders, to help to insulate the project from a potential bankruptcy of any of the sponsors[42]

The sponsors and other equity holders in the SPV are responsible for meeting their contractual obligations which include:

- producing and delivering the defined services to the required standard;
- designing and building or upgrading the infrastructure asset;
- raising funds for the capital needs of the project;
- focusing on government's objectives, while responding in cooperation with the public entity to variations in the project environment;
- returning the assets in the specified condition at the end of the contract.

What we generally found in Nigeria is single entities without the requisite expertise in PPP transactions bidding for PPP projects as though they are conventional procurement. Where SPVs have been used, it is usually hurriedly put together that there is no internal cohesion. One way of ensuring an internal cohesion is to enter into a Shareholders Agreement[43] side by side with the documents of incorporation so that the roles of the various parties are clearly articulated. Such roles are not provided for either in the Memorandum of Association or Articles of Association of a company. The ability of sponsors to enter into an effective SPV is a major challenge to PPPs in Nigeria. More daunting is the possibility of the SPV to meet their contractual obligations.

When the reform bills sponsored by the NCP/BPE with the cooperation of the sector Ministries (or the reform bills sponsored by the sector Ministries) are passed into law, the issue of a regulation looms large. In Nigeria today, the Central Bank of Nigeria is a regulator, the National Insurance Commission is a regulator, the Securities and Exchange Commission is a Regulator and the Nigerian Communications Commission is a regulator. However, the kind of regulation to be carried out by the Nigerian Electricity Regulation Commission established under the Electric Power Sector Reform Act 2005 is profound. It has aptly been stated that around the world, governments perform three main functions: they tax, they spend, and they regulate. And of these three functions, regulation is the least understood.[44] Nigeria falls in this category.

One way of appreciating what regulation is all about is to highlight the attributes of an independent regulator or the benchmark used in evaluating regulators. The regulator must be organizationally separate from existing Ministry or Departments (**organizational independence**), earmarked, secure and adequate source of funding (**financial independence**) and autonomy over internal administration and protection from dismissal without due cause (**management independence**).[45] The other attributes include

- **Accountability –** regulators need to be held accountable for their action by providing for appeal rights in their enabling laws, ethical and procedural obligations and substantive reporting and audit obligations
- **Transparency –** the entire regulatory process must be fair and impartial and open to extensive and meaningful opportunity for public participation
- **Predictability –** the regulatory system should provide reasonable, although not absolute, certainty as to the principles and rules that will be followed within the overall regulatory framework
- **Clarity of Roles –** roles of the regulator as well as other sector agencies should clearly be defined so as to avoid duplication of functions, mixed signals to stakeholders and policy confusion
- **Completeness and Clarity of rules –** through laws and agency rules, the regulatory system should provide all stakeholders with clear and complete timely advance notice of the principles, guidelines, expectations, and consequences of behaviour
- **Proportionality –** regulatory intervention in the sector should be proportionate to the challenges the regulators are addressing
- **Requisite powers –** regulators must possess the powers to perform their functions. These include the powers to set tariffs, establish, modify, and monitor market and service quality rules
- **Integrity –** there must be strict rules governing the behavior of decision makers as to preclude improprieties or any conduct appearing to be improper. For instance prohibition against bribes and gratuities of any kind, prohibition of all forms of conflicts of interest and reasonable disclosure of financial interests.[46]

In view of what is happening in the telecommunications sector, no Minister will be willing to ensure that the existing regulators or those to be created under the reform bills will possess these attributes. However, in the absence of these benchmark for evaluating regulators, reform of the economy belongs to the distant future in Nigeria. It is a major challenge. Similarly what is happening in the power sector where functionaries were removed without regard to the provisions of the Electric Power Sector Reform Act 2005 is a cause for concern. Certainly the signals to the investing public especially foreign investors are that Nigeria is not ready for reform. Government's role should be confined to policy formulation if we must embrace reforms.

There are various risks in a PPP transaction. How are they to be allocated and managed? Simply put 'risk' is the unpredictable variation in outcome. It includes the possibility of unexpectedly good, as well as unexpectedly bad outcomes. The risk of a project is the unpredictable variation in the total value of the project, taking account not only of the value of the project company (may be an SPV) but also of the value accruing to customers, the government and other stakeholders.[47] In project finance, 'risk' frequently refers to the ways in which actual results may be worse than planned. However it can also be used in the sense of variance or volatility around a statistically expected outcome. Particular risks can be defined. For example 'demand risk' is the unpredictable variation in value arising from unpredictable value in demand. 'construction-cost risk' is the unpredictable variation in value arising from unpredictable variation in construction costs. The critical issue is how risk should be allocated. The conventional answer is that each risk should be allocated to the party best able to manage it. More fundamentally each risk should be allocated, along with the rights to make related decisions, so as to maximize total project value, taking account of each party's ability to

a) influence the corresponding risk factor;
b) influence the sensitivity of total project value to the corresponding risk factor – for example, by anticipating or responding to the risk factor; and
c) absorb the risk.[48]

Generally it is when the first two principles are ineffective that the last is applied. However applying the principle of risk allocation to a particular government's decision to bear a particular risk in a particular project can be very difficult indeed – this is the challenge. Paradoxically trying to give definitive general advice on whether governments should bear particular risks is futile. However governments should bear project-specific risks that they control and influence such as risks related to prices and quality standards that they set with appropriate incentives and sanctions. Governments should not bear exchange-rate and other economy-wide risks though governments can influence them but economy-wide policies should not be made to suit the interests of particular projects.

The World Bank has done extensive work in risk management and provision of various instruments.[49] Government should bear political and regulatory risks but should be reluctant to bear exchange and interest rate risks though Governments can, through macroeconomic policies influence them. While the importance of the infrastructure sectors in achieving economic growth and poverty reduction is well established, raising debt and equity capital for infrastructure development and service provision has been a challenge for developing countries. Risk mitigation instruments facilitate the mobilization of commercial debt and equity capital by transferring risks that private financiers would not be able or willing to take to those third-party official and private institutions that are capable of taking such risks. The literature on this is legion. However, due to the complex and diverse nature of risk mitigation instruments, what these instruments can and cannot offer and how these instruments can best be used for infrastructure financing are not well understood[50]. The types of risk mitigation instruments normally adopted by the World Bank is the credit guarantees[51], export credit guarantees or insurance[52] and political risk guarantees or insurance[53]. The providers of these instruments include Multilateral Agencies[54], Bilateral Agencies[55], private financial entities and complementary arrangements. Guarantees typically refer to financial guarantees of debt that cover the timely payment of debt service. Procedures to call on these guarantees in the event of a debt service default are usually relatively straightforward. On the other hand, insurance typically requires a specified period during which claims filed by the insured are to be evaluated, before payment by the insurer.

Risk mitigation instruments are financial instruments that transfer certain defined risks from project financiers (lenders and equity investors) to creditworthy third parties (guarantors and insurers) that have a better capacity to accept such risks. These instruments are especially useful for developing economies and local infrastructure entities that are not sufficiently creditworthy or do not have a proven track record in the eyes of private financiers to be able to borrow debt or attract private investments without support. Sources of financing include international bank market, commercial banks or bond market. The advantages of these instruments include mobilizing domestic and international private capital thus supplementing limited public resources, private sector lenders and investors will finance commercially viable projects when risk mitigation instruments cover those risks that they perceive as excessive or beyond their control and are not willing to accept, governments can share the risk of infrastructure development using limited fiscal resources more efficiently by attracting private investors rather than having to financé the projects themselves assuming all the risks, multilateral and bilateral institutions are able to leverage their financial resources through the use of risk mitigation instruments as opposed to lending or granting funds, thus expanding the impact of their support[56].

In all cases, the structure of a PPP transaction should also determine the risks assumed by government and the rights to make related decisions. The more rights are devolved to the private entity, the more risk it can reasonably transfer. Conversely the rights a government should retain depend on the risks it chooses to bear. Sometimes governments devolve rights to private entities and at the same time try to interfere in the making of the related decisions. It is all a balancing act. Maintaining the balance is the challenge faced by governments.

In a PPP transaction, monitoring, compliance and enforcement is a major challenge. Do the MDAs have the capacity to carry out these functions to ensure that milestones are met and services produced at the required standard? Every MDA involved in PPP should have a fully fledged PPP Unit and where there is dearth of expertise in these areas, this should be contracted out.

<u>Lessons from Other Jurisdictions</u>

In terms of legislation, policies and general laws, Nigeria is on the right track. For instance, whatever lacuna may have existed in the ICRCA is cured by the National Policy on PPP. We have also the Public Procurement Act and the Fiscal Responsibility Act. Since the National Policy on PPP was approved by the Federal Executive Council in April 2009 and an Inter-Ministerial Steering Committee on PPP has been set up by the Federal Government of Nigeria, it is premature to assess the PPP legal landscape in Nigeria. However, the serious area of concern is the regulatory environment. The experience so far from the telecommunications and power sectors are discouraging to any investor.

A regulator can be sector-specific or multi-sectoral. The draft reform bills sponsored by the NCP/BPE have proposed a National Transport Commission that will be a multi-sector regulator for the transport sector with sub-sectoral regulators for the ports, rail, roads and inland waterways. No matter the budgetary provisions for this sector, no meaningful reform will be realized if these bills are not passed into law. It does not matter whether they are sponsored by the NCP/BPE or the sector Ministers. What is important is that Nigeria needs them. It is also shameful that since the Federal Competition and Consumer Protection Council Bill was drafted since 2003 by the NCP/BPE, it is yet to be passed into law. Again there are various versions of such bill in the National Assembly. This applies to the draft Petroleum Industry Reform Bill originally sponsored by the NCP/BPE, finalized in 2005 and has now been mutilated by various interest groups. We need unity of purpose to advance the course of reform in Nigeria.

In accordance with international best practice[57], the National Policy on PPP has carefully articulated the PPP Process[58]. To what extent is this process being followed by MDAs? It is also expected that the Bureau of Public Procurement will publish guidelines on procurement under PPP. Nigeria is never short of policy instruments but we also fail to learn from other jurisdiction from where these instruments were adopted. For instance in developing the National Policy on PPP wide consultations were made and references made to standard documents already generated by the World Bank, the United Nations Commission on International Trade Law (UNCITRAL), the European Union, among others. We have the Partnership UK and various policies in Australia like the Partnerships Victoria Policy that have developed policies and procurement framework for PPPs in these jurisdictions.

One major lesson that Nigeria must now learn is how to develop communication strategies to articulate the availability of these instruments in Nigeria. This is so because technically sound PPP programmes can fail without a full understanding of the socio-political dynamics and the value of communication in their design implementation. We must deliberately incorporate communication analysis and stakeholder engagement at the policy and programme formulation stage. A strategic communication programme serves two broad purposes: first it helps to avert failure by identifying current and potential sources of both support and opposition and secondly it helps to achieve a well-tailored PPP programme serving as a two-way check and feedback mechanism at every stage, from planning through execution[59]. In this regard, the government must deliberately engage political parties, managers of publicly owned enterprises, unions, workers, civil servants, business leaders, potential investors, national and international civil society organizations and consumers about the programme's operations and benefits. General consensus may not be possible but information flow and awareness among all stakeholders are often prerequisites for success in the range of PPP initiatives. Stakeholder analysis provides a clear understanding of the nature, attitudes, value and interests of stakeholders. This provides a feedback mechanism.

Examples abound where privatization and public-private partnerships programmes have failed due to lack of communication[60]. Conversely there are well documented instances of reform successes due to inclusion of strategic communication[61]. In this connection building trust and ensuring transparency in the process are key elements. Gaining public trust in the institutions undertaking the project and in the persons who champion and implement these programmes is a key priority. Perceptions of corruption and absence of due process, even if unfounded, are enough to detail infrastructure reforms. Communication can pave the path for two-way dialogue on contentious issues, so people's concerns and misconceptions are addressed promptly before public confidence and trust are eroded. Often, reforms are viewed from the standpoint of the implementing agencies and not from the point of view of the people whose lives are directly affected by the reform. Strategic communication techniques can inform and encourage policy makers to base their decisions on a clear understanding of beneficiaries' perspectives from the beginning of a development initiative.

Managing the politics of reform is what we should learn from other jurisdictions. The road towards reform and PPP is a long and arduous one[62]. In the area of governance and anti-corruption (where lies the interface between politics and the economy), it is particularly challenging. Thus it should come as no surprise that pushing reforms requires considerable patience and a carefully thought-out strategy for managing the politics of the process. Various versions of the reform bills are in the National Assembly and none has reached an advanced stage of passage into law. Meanwhile those in the executive are pushing through their PPP programmes without the regulatory framework. We must learn to manage the politics of reform and ensure the passage of the reform bills.

The main driver behind the adoption of PPPs in Europe is the concept of value for money. The lesson that we must learn therefore is that before PPP is adopted, the project must pass the value for money and public interest tests. Legally, the ICRCA also provides that the project must be financially viability.[63] The consequence of this is that if a project is not financially viable and PPP is adopted, Government must be ready to subsidize or provide guarantees in form of, for example in the case of roads, average daily traffic or payment of shadow tolls.

In Europe, the PPP markets are still in their infancy with more than 50 per cent of the national PPP markets within Europe still at an early stage of development. The most developed market remains the UK, but a number of continental European markets – Spain, Italy, Ireland, France, Greece, Germany and Belgium – are developing rapidly. The UK is currently the clear leader in terms of deal flow: at the end of 2007, the cumulative value of signed deals in the previous seven years was 42.2 billion Euros, compared with a cumulative total for the whole of the rest of Europe of 31.6 billion Euros for the same period.[64]

Conclusion

The PPP market in Nigeria is large and evolving. The legal environment has been created but the regulatory environment has not been created. The global financial crisis and the dwindling revenue available to government, makes PPP a viable option but are all the projects listed as candidates viable? This is where caution is necessary in ensuring that the PPP process as encapsulated in the National Policy on PPP is followed sequentially before contracts are signed.

There is a high level of misconception of what PPP can and cannot be used for. The fact that it is not conventional procurement must be appreciated and a relationship lasting 20-30 years must be carefully thought out. The risk of failure and default is high. Thus governments must provide for contingent liabilities. The Inter-Ministerial Steering Committee set up by Government must be actively involved while the Bureau of Public Procurement must ensure that due process is followed before a ‘Certificate of No Objection’ is issued. In carrying out its mandate under the provisions of the ICRCA, the ICRC must ensure that monitoring and compliance with the terms of the contract are strictly observed. In the same vein, the Fiscal Responsibility Commission must be alive to its responsibilities under the provisions of the Fiscal Responsibility Act.

The prospects of using PPP to fill the infrastructure gap in Nigeria are high but PPP is no panacea for all infrastructure provision. Governments must still budget for the provision of infrastructure as PPP can only fill the gap up to about 30%. Before embarking on PPP projects, therefore, proper feasibility/viability studies must be undertaken.

The challenges are enormous but surmountable if the PPP process in the National Policy on PPP is followed. Examples abound where multilateral, bilateral and export credit agencies have either guaranteed or insured loans and credits obtained for the purpose of the provision of infrastructure. Governments and investors should approach these agencies for assistance.

End Notes

[1] Cited in Mody A (ed) *Infrastructure Delivery: Private Initiative and the Public Good*, Economic Development Institute Studies of The World Bank (The World Bank, Washington, D.C.), 1996 p xiii
[2] Guash J L *Granting and Renegotiating Infrastructure Concessions: Doing it Right* (The World Bank, Washington DC, 2004) ix. See also Kessides, I N R*eforming Infrastructure: Privatization, Regulation, Competition* (The World Bank, Washington DC, 2004) xi
[3] Grimsey D and Lewis, M K *Public Private Partnerships (*Cheltenham, UK: Edward Edgar, 2007) page 21
[4] Grimsey and Lewis Op Cit at 6
[5] Guash, Op cit at 27
[6] Guash, Op Cit at 24. See also Guislain P *The Privatization Challenge: A Strategic, Legal, and Institutional Analysis of International Experience* (The World Bank, Washington DC, 1997) 243
[7] Grimsey and Lewis, Op Cit at 12
[8] Mody Ashoka (ed) op cit at xiv
[9] This refers to the integration in a PPP of functions such as design, construction, financing, operations and maintenance of the facility and transferring same to the private sector participant.
[10] The business case provides an overview of a partnership approach, a preliminary view on how the project will be delivered, an analysis of the various impacts of the project, and an indication of the likely level of market interest, before significant resources are spent on its development.
[11] Grimsey & Lewis, Op cit at 127
[12] The Federal Highways Act, Cap F13, LFN 2004 regulated the roads sub-sector, the Nigerian Railways Corporation Act, Cap N129, LFN 2004 regulated the railways, the Civil Aviation Authority Act, Cap C13LFN, 2004 regulated civil aviation until the Civil Aviation Act of 2006, the Nigerian Ports Authority Act, Cap N126, LFN 2004 regulated the ports and harbours, etc
[13] See section 24 of the Electric Power Sector Reform Act 2005
[14] These bills include the Federal Competition and Consumer Protection Commission Bill, the National Transport Commission Bill, the Ports and Harbours Authority Bill, the Road Sector Reform Bill, the Postal Sector Reform Bill, the Nigerian Railway Corporation Bill and the Inland Waterways Bill.
[15] See generally *The International Comparative Legal Guide to PFI/PPP Projects 2007* published by the Global Legal Group and Button M (ed) *A Practical Guide to PPP in Europe*, 2nd Edn, (City and Financial Publishing 2008)
[16] An OECD Recommendation is a legal instrument which, while non-binding, all the Organisation's member countries are required to associate themselves with. The full text of the Principles can be found at http://www.oecd.org/dataoecd/41/33/38309896.pdf
[17] Schwartz G et al (eds) *Public Investment and Public-Private Partnerships: Addressing Infrastructure Challenges and Managing Fiscal Risk*s, (Palgrave Macmillan, New York, 2008) p 144
[18] Schwartz, et al op cit at 162
[19] For information on the assessment, see http://www.ebrd.com/country/sector/law/index.htm
[20] Schwartz, et al op cit at 171
[21] Other international instruments providing legal and regulatory framework for PPPs include the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects, 2003; Commission Interpretative Communication on Concession under Community Law, 2000; United Nations Industrial Development Organisation (UNIDO) Balance of Trade (BOT) Guidelines, 1996; European Commission Guidelines for Successful Public-Private Partnerships, 2003, and OECD Basic Elements of a Law on Concession Agreements, 1999-2000.
[22] Button (ed) Op cit at 6-7, *Reforming Public Institutions and Strengthening Governance: A World Strategy*, November 2000, (The World Bank, Washington, D.C. 2000) and Michel Kerf & Warrick Smith *Privatizing Africa's Infrastructure: Promise and Challenge*, (The World Bank, Washington, D.C. 1996)
[23] See *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*, Official Records of the General Assembly, Fifty-eight Session, Supplement No. 17 (A/58/17), para 171, 2003 pp 15-18
[24] See sections 36-47 of the Fiscal Responsibility Act.
[25] See Grimsey & Lewis, op cit at 145
[26] See the Public Procurement Act 2007

[27] The latest being that of 11 March, 2009 published by the Office of the Secretary to the Government of the Federation.

[28] Project Agreements include the Concession Agreement, Financial Agreements (agreement entered into between the Concessionaire and any domestic or international lender or consortium of lenders or any equity investor evidencing the grant and/or disbursement of credit facility to the concessionaire or otherwise evidencing equity participation for the implementation of the PPP transaction), the Construction Agreement, the Operation and Management Agreement, Technical Services Agreement, Security Agreement and other contracts entered into in connection with the PPP transaction

[29] Termination fees are usually payable in the event of default of either the concessionaire or the public authority especially where the concessionaire has commenced the construction and some milestones achieved and also where the facility (like a road) has no alternative use.

[30] Financial Close means the execution and delivery of such Financial Agreements to evidence the consummation of all transactions necessary for the concessionaire to have immediate access to such funding under the Financial Agreements for the construction work and commissioning of the PPP transaction together with the receipt of such equity commitments and contributions as may be required. The Concession Agreement should provide a date on which the financial close shall be achieved otherwise it is an event of default.

[31] Agreements may be entered into on the basis that certain events must take place before the contract will come into effect. In this regard, a distinction is usually drawn between the date of execution of the agreement and the effective date. The effective date is the date that all conditions precedent are fulfilled.

[32] Grimsey and Lewis, Op cit at 42-52

[33] Grimsey and Lewis, Loc Cit

[34] Jacobson C D and Tarr J A 'No Single Path: Ownership and Financing of Infrastructure in the 19th and 20 Centuries' in Mody (ed) op cit at 1 - 35

[35] Grimsey and Lewis , Op cit at 10

[36] Button (ed) op cit at 10. See generally Avery N (ed) *Public-Private Partnerships: A Practical Analysis*, (Globe Business Publishing Ltd, 2006)and Andres L A et al T*he Impact of Private Sector Participation in Infrastructure: Lights, Shadows, and the Road Ahead,* (The World Bank, Washington, D.C., 2008)

[37] See page 8 of the National Policy on Public Private Partnerships (Supplementary Notes): Roles and Responsibilities, 2009

[38] See the Nigerian Enterprises Promotion Act of 1972 and the subsequent amendments

[39] The risks include that of design, construction, financial, operation, management, environmental, social, revenue, force majeure, regulatory/political, project default

[40] Section 338 of the Companies & Allied Matters Act (CAMA) 2004 provides that a company shall be deemed a subsidiary of another if the company is a member of it and controls the composition of the its board of directors or holds more than half in nominee value of its equity share capital or the first company is subsidiary of any company which is that other's subsidiary

[41] Grimsey & Lewis, op cit 109

[42] See generally Finnerty J D *Project Financing: Asset-Based Financial Engineering,* John Wiley & Sons, Inc, New York, 1996 and Hoffman S L T*he Law and Business of International Project Finance*, 3rd Edn Cambridge University Press, 2008

[43] See Baylis D *The Law and Practice of Shareholders' Agreements*, 2nd Edn (LexisNexis Butterworks: 2007)

[44] Brown A C et al Handbook for Evaluating Infrastructure Regulatory Systems, The World Bank, Washington, D.C. 2006, p xi.

[45] Brown et at, op cit at 50

[46] Brown et al, op cit at 59-63. See generally Estache A and Rus Gines de (eds) *Privatization and Regulation of Transport Infrastructure: Guidelines for Policymakers and Regulators*, WBI Development Studies, (The World Bank, Washington, D.C. 2000), Kessides, Op cit at 79 and Klein M U and Bita Hadjimichael *The Private Sector in Development: Entrepreneurship, Regulation and Competitive Disciplines*, (The World Bank, Washington, D.C., 2003)

[47] Irwin T C G*overnment Guarantees: Allocating and Valuing Risk in Privately Financed Infrastructure Projects*, (The World Bank, Washington, D.C., 2007)at 5. See also Irwin T et al *Dealing with Public Risk in Private Infrastructure*, (The World Bank, Washington, D.C.) pp 4 and 8

[48] Irwin Loc cit
[49] See generally Irwin T et al and *Private Participation in Infrastructure Trends in Developing Countries in 1990-2001* published by the Public-Private Infrastructure Advisory Facility (PPIAF) prepared by a Team led by Ada Karina Izaguirre ;and Tomoko Matsukawa & Odo Habeck *Review of Risk Mitigation Instruments for Infrastructure Financing and Recent Trends and Developments*, The World Bank, Washington, D.C. 2007
[50] See Tomoko Matsukawa & Odo Habeck, Op cit at ix.
[51] They cover losses in the event of a debt service default regardless of the cause of default (that is, both political and commercial risks are covered with no differentiation of the source of risks that caused the default). Examples are the Partial Credit Guarantees (PCGs) which cover part of the debt service of a debt instrument regardless of the cause of default while the Full Credit Guarantees or Wrap Guarantees cover the entire amount of the debt service in the event of default.
[52] Export Credit Guarantees or Insurance cover losses for exporters or lenders financing projects tied to the export of goods and services – cover both political and commercial risks
[53] Political Risk Guarantees (PRG) or Insurance cover losses caused by specified political risk events, eg expropriation, war and disturbances
[54] These include The World Bank Group: IBRD, IFC and MIGA, African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, European Investment Bank
[55] These include Export Development Canada, Italian Export Credit Agency, Japan Bank for International Cooperation, Export Credits Guarantee Department (UK) and United Sates Agency for International Development
[56] See the Tomoko Matsukawa & Odo Habeck, Op cit at xi
[57] See Grimsey & Lewis, op cit at 82
[58] See National Policy on PPP (2009) p 14
[59] See Dabueke Calabrese *Strategic Communication for Privatization, Public-Private Partnerships and Private Participation in Infrastructure Projects* (The World Bank, Washington, D.C. 2008)
[60] See the dockside waterhouse privatization in Bangladesh in late 1990s, privatization programme in Turkey in the 1990s, reform programmes in Ukraine in the 1990s, privatization programme in Senegal in 1994 and privatization programme in Kenya in 1995.
[61] See the Reform in Guatemala in 1999, sector reform in Zambia in 1996, and electricity utility reform in South Africa in 1998
[62] See generally J Edgardo Campos & Jose Luis Syquia *Managing the Politics of Reform: Overhauling the Legal Infrastructure of Public Procurement in the Philippines* (The World Bank, Washington, D.C. 2006)
[63] See section 1 of the ICRCA 2005
[64] See Buton (ed), op cit at 3-5