

# Beyond the New Public Procurement Directive – the Future for Public Private Partnerships (PPP)



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Public Private Partnerships (PPP) matter as a way of delivering public services, because there are so many pressures driving public authorities to use them across different sectors and Member States. They are often complex transactions, leading to long, high-value contracts, in high-profile sectors, so the opportunities and risks are correspondingly greater than in other public procurements. And, because they are relatively new, there is a need to ensure that the way they are carried out and their impact over time on public service delivery are watched very closely. It is also important to make sure that they are not adversely affected in future by legal uncertainty, even though this has not been a major barrier so far. After analysing the risks and challenges, this article goes on to propose how PPP can be used more effectively and how the potential legal uncertainty can be reduced, thus helping to ensure that PPP remains a viable option for public service delivery in the EU, Accession States and Candidate Countries.

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## *Why do PPP matter?*

In November 2005 the European Commission published a Communication on the future treatment of Public Private Partnerships (PPP) and concessions in EU law.<sup>1</sup> But PPP should in any event already be on the agenda of policy makers and those responsible for public service delivery in the EU.

PPP are complex transactions. They are often high-value contracts for public services and necessitate a lengthy selection process. So the opportunities and risks for public entities are correspondingly greater in PPP than they are for other public contracts. It is important to know when they are the right solution, to make the right operational and commercial decisions when implementing them and to have the legal certainty necessary to attract competition for the role of private partner. PPP are becoming more widely used but few PPP have gone the full course of their life in the sense that they have completed all of their design, construction and operational phases. So, in a wider context there is a need now to try to understand the medium and long term political and economic effects of PPP as a means of public service delivery.

This article aims to explain what PPP are, why it is now important to understand when and how to use them, and some of the issues affecting how they can be used more effectively.

## *What are PPP?*

PPP has become a widely-used term to describe different types of contractual arrangements. It is a term characterised by a lot of acronyms and titles.<sup>2</sup> But, as the International Monetary Fund has recognised,<sup>3</sup> there is no clear agreement on what constitutes a PPP.

PPP are thus best described by the typical features of a such a transaction. These can be summarised as follows:

- the creation and/or re-development of an asset by a private sector supplier. This can, for example, be a road, a bridge, a school or a hospital, normally using land and/or buildings which were publicly owned before the PPP;
- the use by the same private sector supplier of the asset created or re-developed to provide a new or existing service to the public over a defined period of time. This period is often longer (up to 30 years or more) than is customary in other public contracts;
- the payment of a periodic charge by the public entity to the supplier for the provision of the service using the asset. The periodic charge may vary according to the volume of service supplied;
- the absence of a commitment by the public entity to pay the periodic charge until and unless the asset is used in the provision of the service;

- the sharing of the risks and rewards of the outcome of the project by both partners.

This list of features captures the essence of PPP, namely that they are about partnership between the public and private sectors to deliver a public service, which is how PPP have been characterised by the European Commission.<sup>4</sup>

But even this description of the features does not cover all the different options. There are several different models of financing and asset ownership. Concessions are also characterised by the European Commission<sup>5</sup> as a form of PPP, so that the term can also be used to describe the exploitation by a private sector supplier of a right to provide a service where payments are made directly by the public as customer, payments which may or may not be partly subsidised by the public entity.

### *Why is it important to understand PPP now?*

Transactions which might now be called PPP existed before the term came into common use in the 1990s. But there are three main reasons why, more than ever, it is now important that policy makers and those responsible for public service delivery understand PPP.

Firstly, PPP is a dynamic field of activity. The high level of PPP activity across Europe shows no sign of slowing down. The UK, Ireland, Italy, France, Spain and Portugal already have high levels of activity in different sectors and other Member States are following.

There are strong pressures both in old and new EU Member States driving public authorities to use PPP as a means of delivering public services. These include budgetary pressures (in or out of the Euro zone) leading to the need for cost reduction, the pursuit of better revenue collection and limitations on resources available for public financing of infrastructure investment, as well as pressures from citizens as consumers with ever higher service expectations. In some cases public entities seek also to use PPP as a way of introducing private sector management skills for different methods of service delivery and to use public assets more effectively. As a result, PPP is being used for an ever wider range of public services.

Secondly, because PPP is a dynamic field of activity, there is also a need now to try to understand medium- and long-term political and economic effects as a means of public service delivery, i.e. the implications for public service delivery of the wider use of the private sector as a service deliverer. In most sectors and Member States, most public services are still delivered directly by the public sector, so any conclusions must by definition be provisional. But two developments can be observed where there has already been significant use of the private sector for service delivery.

- Where the public sector has withdrawn completely as a service provider there can be difficulties for public entities to regulate the sector effectively. This has been observed in the provision of long-term residential and nursing care for the elderly, chronically ill and physically disabled in the UK, where municipalities are now heavily dependent on the private sector for the provision of this care.<sup>6</sup>
- Market liberalisation has led to consolidation amongst potential private sector providers, for example within the EU in the water, energy and solid waste management sectors. This could make it difficult for public entities to

ensure continuing effective competition for individual contracts, especially when a high level of activity allows the private sector to select which opportunities it responds to.

It is too soon to say whether or not there ought generally to be concerns about the value for money of PPP in the long term. This has been demonstrated by the uncertainty of the UK National Audit Office in some high profile cases such as the London Underground PPP.<sup>7</sup> Very few PPP have gone the full course of their life. But those who claim that PPP have already delivered value for money savings are by definition basing their claims on savings foreseen in PPP transactions negotiated and/or savings claimed to have been achieved during the project construction phase.<sup>8</sup> A more useful assessment of value for money for a public entity can in reality only be made over the whole life of the transaction.

Thirdly, there is a risk that insufficient legal certainty may impact in future on PPP transactions, This is particularly important to the supplier market in the type of long-term high-value contracts which PPP often involves.

It is possible to identify two main sources for this potential risk.

- PPP are a form of public procurement. So the new Public Procurement Directive,<sup>9</sup> due to be transposed into national law in EU Member States by 31 January 2006, generally applies to PPP. But the complexity of an increasing number of PPP mean that they do not fit very comfortably with the different definitions and different treatments in the new Directive on public contracts, works concessions and service concessions. The Commission has highlighted the fact that in some transactions it has not been easy at the start of an award process to be sure whether they are a public contract or a concession, and that the initial definition might change as a result of negotiations.<sup>10</sup> In the new Directive works concessions are less regulated than public works contracts, while service concessions remain entirely outside the scope of the Directive and are governed only by the need to apply EU Treaty principles.
- The new Directive introduced measures designed to make the use of PPP easier ie a new contract award procedure known as Competitive Dialogue.<sup>11</sup> It is meant to allow a public entity which knows what outcome it wants to achieve but not how best to achieve it to discuss, in confidence, possible solutions in the dialogue phase of the tender process with short-listed bidders before calling for final bids.

Competitive Dialogue is intended to be used more frequently and be easier to justify than the negotiated procedure in the existing Directive. It will be able to be used for "particularly complex contracts" where a *Contracting Authority considers*<sup>12</sup> that use of the open or restricted procedures (requiring pre-determined specifications) will not allow the award of the contract. Unlike the negotiated procedure (the award procedure generally used now in such situations), it is not necessarily to be used only exceptionally. The Directive envisages that the Competitive Dialogue procedure could, for example, be used to award contracts for integrated transport infrastructure projects or large IT projects or with complex financial and legal structures which cannot be determined in advance of the tender process.

The European Commission believes<sup>13</sup> that the Competitive Dialogue procedure, clearly giving public bodies

the freedom to negotiate the technical, legal and financial aspects of public contracts, is particularly well adapted to PPP and will provide the necessary legal certainty so important to confidence in long-term PPP-type contracts. This contrasts with the narrower view taken by the Commission about the permissible uses of the negotiated procedure, namely that it applies principally to technical aspects of the contract and not, strictly, to legal and financial aspects.<sup>14</sup>

But suppliers have some concerns<sup>15</sup> about how the procedure will work in practice:

- whether in reality the confidentiality of bids enshrined in the new Directive will actually be protected in the dialogue phase of the process;
- whether the dialogue phase of the process will be conducted in a manner consistent with the principles of equal treatment, non-discrimination and transparency, especially if there is more than one stage to the dialogue;
- how lenders, whose needs often lead to significant changes to projects at a late stage, will regard this process, in which negotiations are not permitted after the selection of the most economically advantageous tender. This could lead in practice to public entities seeking to stretch the limit of the meaning of clarification of tenders or confirmation of commitments included in the tender, both of which the new Directive does permit.

### **What needs to be done to make the use of PPP more effective?**

The above analysis highlights the significant operational and legal challenges facing public entities seeking to use PPP as a means of public service delivery, and the possible responses fall naturally into the same categories.

There are a number of *operational strategies* which can be deployed to make the use of PPP more effective.

Firstly, because of the high level of activity, Member States need a mechanism to allow themselves to step back from individual projects and look at the medium and long term effect of PPP on public service delivery. Since there are relatively few examples so far of PPP schemes which have completed all of their design, construction and operational phases, continuing interim assessment is needed. Are there, for example, any services in which PPP is working notably better or worse than elsewhere? Is risk transfer truly effective in all services? Are PPP consistently delivering better performance in all services? Is there a difference between the value for money at the design and construction phase and in the operational phase? As PPP markets mature, do suppliers and public entities expect profit margins be higher or lower in future? Will PPP be used for more services, less services or different services in future? Is there a level of private sector provision beyond which public entities lose control of the means to effectively regulate service provision? Will there be more competition

or less competition for individual contracts in future?

The answers, and the means used to reach them, will almost certainly be different in different Member States. But it is hard to argue that such a review process should not be undertaken by some entity in each Member State.

Secondly, at the level of the individual public entity, there needs to be a mechanism for confirming that PPP is the most appropriate solution in each particular project. PPP is not – or should not be seen as – the default option. To regard it as such can lead to the risk of weakening the bargaining position of public entities with suppliers, possible over-dependence of a public entity on the private sector for service delivery and/or stretching the capacity of the market to supply public sector needs.

Thirdly, there needs to be a mechanism to ensure that the lessons of PPP award processes and delivery are being learned to improve future PPP. For example, PPP models are continuing to evolve; using standard contract docu-

mentation as a baseline for customisation is one important way to learn lessons from experience and avoid reinventing the wheel. In the UK, contract clauses on benefit sharing for the public sector, where there is debt refinancing by the provider, is one area where this has helped.

Further, there are a range of difficult issues emerging in the award process and

implementation of PPP which need to be dealt with effectively. There is, for example, a continuing need to ensure:

- that encirclement of public entities by suppliers (relationship-building by suppliers before major award processes which influence the outcome of the procurement) is effectively controlled;
- that there is true risk transfer from public entities to suppliers in return for profits and no unplanned transfer back of risk;
- that public entities allocate appropriate resources for contract management and market regulation;
- that contract variations and break points in long term contracts are dealt with in a way which avoids unduly increasing the profitability of a PPP above what was envisaged at the time of contract award, except where this is justified by a change in risks accepted by the supplier;
- that public sector service “corporate memory” is maintained so that contracts can be terminated if supplier performance is unsatisfactory. This is crucial to avoiding contract lock-in and allowing public entities to take back a service in-house or to switch suppliers;
- that the basis for calculation of payments to and from the supplier on premature contract termination in different situations is clearly stated and does not form a barrier to contract termination by a public entity where this is necessary;
- that a change of supplier ownership, especially through secondary markets in PPP consortium stakes, is not harmful to service delivery.

## Member States need to step back from individual PPP projects and make sure that they look at the overall effect of PPP on public service delivery in the medium term.

In relation to the specific issues arising from the Competitive Dialogue procedures, public entities seeking to attract competitive bids for a PPP need to be aware of the level of care needed to manage the process. They will have to address supplier concerns seriously to show that they are competent and reliable and genuinely seeking to treat all bidders equally. There will now need to be a clear three-stage structure for the award of complex contracts, which has not always been the case in the past:

- a short-listing phase, in which suitable tenderers are selected who meet the minimum eligibility standards for financial, economic and technical criteria;
- a dialogue phase with tenderers where alternative solutions are discussed;
- a final tender phase during which fine tuning, further specification and clarification are permitted provided that they do not change the basic features of the tenders or the contract's key terms. Further clarification of the winning tender and/or confirmation of commitments in it can then be sought if required.

In the existing negotiated procedure there is no obligation after short-listing for the process to follow any particular structure for the negotiations. Though many public entities have in practice set out a clear structure and timetable in advance and fixed the key elements of the specification and contract conditions in a competitive environment, the need is now clearer because of the restrictions on negotiations after the final tender is submitted. The use of the Competitive Dialogue procedure could thus have the effect of underpinning existing good practice in PPP – that selection of the preferred bidder should not happen until all substantial terms and conditions affecting the price and delivery of the scheme are settled while there is still competition.

In addition there will also be a need, specifically, for:

- a commitment within the public entity, early in the dialogue phase, to invest time and resources in understanding the potential solutions likely to be proposed by the bidders (strengths and weaknesses, outcomes and performance standards for those solutions, potential deal breakers etc.);
- a clear and transparent timetable and structure for information flows between bidders and the public entity and assessment of solutions in the dialogue phase;
- a clear code of practice for conduct of the dialogue phase, for example, clearly identifying what is confidential and non-confidential data, setting out how confidentiality of data will be preserved (transmission, storage, access etc.) and how equality of treatment for each bidder in the dialogue will be achieved (frequency, scope, conduct, recording of meetings etc.);
- internal guidance notes within the public entity (prepared before the final tenders are submitted) about how the

evaluation criteria will be applied to different solutions at final tender stage.

As regards *legal issues*, the key question centres around whether or not different treatments for PPP which are public contracts and those which are classified in the Directive as concessions can continue to be justified. There is a clear risk that diversity of practice and lack of co-ordination of national legislation in the award of PPP in EU Member States could act as a barrier to competition, to the ability of public authorities to procure infrastructure development as quickly as they want to, and to the development of the public procurement component of the EU Internal Market. This is significant, given that the Commission has already highlighted public procurement as an area lagging behind in implementation of the Internal Market.<sup>16</sup> In addition, challenge on the grounds of using the wrong award procedure (and thus the uncertainty of legal outcome) is a greater risk given the increasing number of cases dealt with in the field of public procurement by the European Court of Justice.<sup>17</sup>

But, having developed the analysis, the Commission concluded in the Communication<sup>18</sup> that there was “significant stakeholder opposition to a regulatory regime covering all contractual PPPs” (public contracts and concessions) and therefore “the Commission does not envisage making them subject to identical award arrangements”.

Elsewhere in the Communication<sup>19</sup> there is a recognition of the need for a stable, consistent legal environment for the award of concessions, particularly to enhance competition, that general

EU Treaty principles do not provide enough legal certainty in the award of concessions and that it is “difficult to understand why service concessions which are often used for complex and high value projects are entirely excluded from EU secondary legislation”.

The author's view is that the most straightforward way of bringing about legal certainty in this field is the solution which the Commission appears to have ruled out, namely making public contracts and all concessions subject to identical award arrangements. Nevertheless, if a new legislative initiative includes, as the Commission suggests in the Communication that it might,<sup>20</sup> both works and services concessions this would at least reduce the scope for avoidance of the aim of the initiative, to promote competition.

Two key conclusions can be drawn as regards the legal issues relevant to PPP. Firstly, while there is no concrete evidence so far that legal uncertainty is having a significant impact on the pace of growth of PPP, the nature of the issues highlighted above means that it has the potential to do so in the future.

Secondly, Competitive Dialogue has the potential to enable public entities to enhance their procurement procedures, combining the disciplines it requires with existing best practice in the negotiated procedure. This

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should be helpful for complex PPP. But if it is not applied with great care there is potential scope for legal challenges. Hence the urgency for technical guidance on the application of the Competitive Dialogue procedure, called for by a substantial number of stakeholders<sup>21</sup> in response to the Commission's consultation, and promised by the Commission in the Communication.<sup>22</sup> ::

## NOTES

- <sup>1</sup> Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions on Public-Private Partnerships and Community Law on Public Procurement and Concessions, COM (2005) 569, European Commission, November 2005.
- <sup>2</sup> For example, the UK Private Finance Initiative (PFI) is a form of PPP, as is the Betreibermodell in Germany.
- <sup>3</sup> "Public-Private Partnerships", IMF Fiscal Affairs Department, March 2004, p. 6.
- <sup>4</sup> For example in "Guidelines for successful Public-Private Partnerships", European Commission, Directorate-General for Regional Policy, March 2003, p. 16.
- <sup>5</sup> See "Green Paper on public-private partnerships and Community law on public contracts and concessions" COM(2004) 327, European Commission, April 2004, p. 9.
- <sup>6</sup> See "NHS plc – The privatisation of our health care", Allyson Pollock, Verso, 2004, p. 157 et seq.
- <sup>7</sup> "The London Underground PPP: Were they good deals?" Report by the Comptroller and Auditor-General, HC 645 Session 2003-2004, June 2004, p2, pp. 25-26.
- <sup>8</sup> The willingness to claim that PPP deliver value for money based on comparisons between bid values negotiated and the claimed cost of public sector provision is well established. See, for example, the report commissioned by the Treasury PFI Task Force from Arthur Andersen and Enterprise LSE "Value for Money drivers in the Private Finance Initiative, January 2000, and quoted in "Public Private Partnerships – The Government's Approach", Her Majesty's Stationery Office, 2000, p. 17.
- <sup>9</sup> Directive 2004/18/EC on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts. Author's note: this article does not deal with issues arising specifically in the Utilities sector which are within the scope of Directive 2004/17/EC on the co-ordination of the procurement procedures of entities operating in the water, energy, transport and postal services sector.
- <sup>10</sup> "Green Paper on public-private partnerships and Community law on public contracts and concessions" COM(2004) 327, European Commission, April 2004, p. 12.
- <sup>11</sup> See Directive 2004/18/EC, Article 29.
- <sup>12</sup> Author's emphasis, taken from the Directive. Public entities are referred to in the Directive as "contracting authorities".
- <sup>13</sup> "Green Paper on public-private partnerships and Community law on public contracts and concessions" COM(2004) 327, European Commission, April 2004, p. 10.
- <sup>14</sup> "Green Paper on public-private partnerships and Community law on public contracts and concessions" COM(2004) 327, European Commission, April 2004, p. 9.
- <sup>15</sup> As, for example, expressed in various responses to the Commission's consultation on the Green Paper.
- <sup>16</sup> See, for example, "Internal Market Strategy – Priorities 2003-2006", European Commission, May 2003, pp. 17-19.
- <sup>17</sup> 95 public procurement cases decided by the European Court of Justice between 1995 and 2004 as compared to 31 between 1985 and 1994.
- <sup>18</sup> Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions on Public-Private Partnerships and Community Law on Public Procurement and Concessions, COM (2005) 569, European Commission, November 2005, p. 5.
- <sup>19</sup> COM (2005) 569, pp. 7-8.
- <sup>20</sup> COM (2005) 569, p. 8.
- <sup>21</sup> See "Report on the public consultation on the public-private partnerships and Community law on public contracts and concessions" SEC (2005) 629, European Commission, May 2005, p. 10.
- <sup>22</sup> COM (2005) 569, p. 5.

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