



Public\Private Partnerships: Demystifying the Process

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By Donald Pierce, Goodmans LLP

INTRODUCTION

The use of public-private partnerships (known as P3s) is now well established in Canada at the federal level and in several provinces, notably Ontario, British Columbia, New Brunswick, and Nova Scotia. Currently, P3s are playing a bigger role in building and capital projects across all areas of government, including power generation, energy delivery, water and wastewater facilities, waste disposal, transportation, communications, education and health facilities, and public service buildings. Recently, its popularity has led to P3s being used more frequently in smaller-scale developments across Canada, such as schools, courthouses, and hospitals. China is moving to adopt the public-private partnership models used in Canada and other western countries.

The experience of Canadian participants in public-private partnerships can be useful in China for the structuring, construction, financing and operation of infrastructure projects. In this article, the author discusses process issues.

A. Process Issues

A great deal of thought and planning must go into developing the process that will govern the public-private partnership project. First of all, it is crucial to recognize that there are two distinct worlds that must be addressed when dealing with projects such as these: the business world and the political world.

Creation of a Government Team

The first step and probably the most important is for the government to create a team of experts to run the government side of the project (the “Government Team”). The Government Team’s task is to set up, monitor, and implement the various steps of the process throughout the entire project. The Government Team’s job is to create a process that once established, facilitates the development of a **fair business deal** while at the same time is, and appears to be, beyond reproach to public scrutiny. It is essential that not only must the business deal be fair, it must appear fair to the skeptical public. Fairness and the appearance of fairness are crucial for the ultimate long-term success of the project, and can only be achieved by the establishment of a fair process.

Who are the players on the Government Team? The team of experts will likely consist of four main groups of consultants: (1) process consultants; (2) legal consultants; (3) technical consultants; and (4) financial consultants.

1. Process Consultants

This role is generally filled by a large accounting/consulting firm whose job is to co-ordinate and steer the Government Team so that all the issues are addressed in a comprehensive and efficient manner. The process consultants are essentially the quarterbacks of the process. They assist in setting the rules, the evaluation criteria, the review process, and the selection process.

2. Legal Consultants

The lawyers on the team are responsible for providing legal advice both on the business transaction and on the process. As such, the lawyers must be experienced in all aspects of the business deal, fully understand the process, and ensure that the process can withstand the most intense public scrutiny. In developing a full understanding of the process, it is then the lawyers’ job to communicate this process to ensure that all members fully understand the potential pitfalls of certain actions. The lawyers want to be constantly anticipating future events and

constantly encouraging the other members to do so as well. Importantly, the lawyers must also endeavour to draft the documents in an even-handed manner to ensure lender participation, and an easy, quick closing.

3. Technical Consultants

The technical consultants are generally comprised of engineers or other technically trained people whose job it is to review the technical proposals and technical issues that arise in the planning stages, and throughout the process.

4. Financial Consultants

The financial consultants' specific job is to determine the real costs of the various project proposals, breaking them down into net present values, so that proper analyses can take place.

These four team members must start working together immediately and each member must fully understand the whole process. One of the most consistent themes across projects is that the better the consultants work as a team from the outset and throughout the project, the greater the chance that the project will operate smoothly.

A Well-Defined Process Framework

A properly prepared **Process Framework** is key to ensuring that all the players proceed with the same view to a defined result. The process framework is the internal government document that defines the procurement and evaluation process for a particular project. It provides detailed evaluation methodologies and criteria, as well as the forms to be used by evaluation teams in the conduct of their evaluations. It incorporates the RFQ (if any), the RFP, and the project agreement(s) by reference. It is designed to document to unsuccessful prospective proponents and third parties that the process followed was fair and rationally related to its objectives.

It is important to understand that the framework developed from the outset can either serve to guide the project to fruition with minimal conflict, or through lack of forward thinking and communication, bog down the process at every turn.

Development and Application of Evaluation Methodology and Criteria

The development and application of evaluation methodologies and criteria help to ensure that the selection of the successful proponent is unbiased and rational. It is generally recommended that government develop detailed evaluation methodologies and criteria in parallel with the development of the Request for Qualifications (if any) and the Request for Proposals for the project.

1. The RFQ - The Request for Qualifications/Expression of Interest

An RFQ is used in a two-stage evaluation process to solicit statements of qualifications from prospective proponents in order to generate a short list of eligible proponents. Typical contents of an RFQ include:

- A detailed description of the opportunity, couched in commercial, rather than legalistic language, as the opportunity should be marketed to prospective proponents in order to generate greater interest and thereby enhance project value;
- A summary disclosure of information related to the opportunity, with references to sources of more detailed information not contained directly within the RFQ, to allow prospective proponents to decide whether the opportunity is suitable to pursue, and if so, with whom they should partner;
- The procurement schedule, including submission deadlines, especially with respect to the RFQ stage if not also with respect to the RFP stage; and
- Evaluation criteria and submission requirements in enough detail to provide prospective proponents a reasonable opportunity to prepare a formally and substantially viable and compliant statement of qualifications.

A purpose of RFQs in large projects is to control the number and quality of companies entitled to bid on the project. From the Government Team's perspective, they have to determine from the outset exactly what type of private companies they are looking for and, within that type, which ones might be most qualified for the particular jobs. From the private sector's point of view, the issue is: how does your company get on this qualifying list?

Generally, there are two dominant criteria that the government uses to determine who is qualified: (1) experience; and (2) financial capability and stability. There are also ancillary criteria that vary in weight depending on the type of project and the political/economic climate.

Experience: The government is looking to the private sector to provide a certain expertise in developing the project. They want to be assured that only highly qualified, highly experienced companies apply for the jobs. These types of projects are not a great opportunity for a local company with little experience to gain experience at the expense of the government. The government wants to be comfortable that the companies bidding are capable of doing the jobs correctly, and the best assurance is to require experience.

Financial Capability and Stability: The financial capability of the private corporations is also very significant due to the relatively large size of the proposed projects. Obviously, the government wants to retain companies whose balance sheets are proportionate to their responsibilities under the project, including the provision of performance bonds. Once again, this is not a place for start-up companies to hope to make their mark with a huge contract that is disproportionate to their past dealings. Thus, the government, in striving to minimize problems from the outset, wants assurance that all the potential bidders are experienced and have financial capability to carry out the job.

2. RFP – Request for Proposals

An RFP is used to solicit proposals from pre-qualified bidders in an RFQ process, or if there is no RFQ process, it will also include the requirement to provide a statement of qualifications. The RFP is the key document in the process, and outlines what the government wants the private sector to bid on. Typical contents of an RFP include:

- A detailed description of the opportunity, couched in commercial, rather than legalistic language, as the opportunity should still be marketed to proponents in order to generate greater interest and thereby enhance project value, and (for two-stage evaluations) in order to ensure continued interest among prospective proponents so that they do in fact proceed to become proponents;
- A summary disclosure of information related to the opportunity, with references to more detailed sources of information not contained directly within the RFP. The disclosure of information, both within and outside the RFP, is ordinarily more detailed than in an RFQ;
- The procurement schedule, including submission deadlines;
- Evaluation criteria and submission requirements in enough detail to provide proponents a reasonable opportunity to prepare a formally and substantively viable and compliant proposal; and
- Legal disclaimers with respect to the government's liability for any inaccuracies in information provided to proponents, with respect to government's right to amend the RFP and with respect to government's right to reject the proposal of any or all proponents.

There are numerous other considerations that factor into process decisions.

Risk Allocation

Risks are generally allocated (item by item) according to the specific circumstances of each project, taking into account the following important considerations:

- It should be allocated to the party best able to manage risk, either through insurance or self-insurance, or through financial or operational risk mitigation strategies;
- It should be clearly allocated prior to the submission of proposals, since vagueness will force proponents to build sizable contingencies into their bid amounts that would not otherwise be incorporated given clear allocation; and
- It should be drafted by a team with cross-functional representation. Members of the team should expressly take on the advocacy of the various project stakeholders – one government, another the private partner, and another the private partner's lenders (if applicable). Other stakeholders, such as affected local governments or affected labour groups, where of sufficient importance to the project, may also have an advocate, but even if not, should be taken into account.

Changes to Consortia Membership and to Contractors and Sub-contractors

Government might require restrictions to ensure that capability requirements are not by-passed through making changes to consortia membership after the capability of the original membership has been assessed to be satisfactory. For example, restrictions may be imposed on changes to individual people within project organizations holding certain key positions. This helps ensure that highly qualified personnel put forward initially in order to attract selection are not later substituted with less qualified personnel that the government would deem unsatisfactory.

Confidentiality of Information

Confidentiality of information in the procurement process deals with who is to keep what confidential from whom, and in what manner. While there are important reasons to maintain the confidentiality of certain information

related to public policy and the protection of proprietary information and intellectual property, these reasons must be counter-balanced against the reasons for disclosing material information related to the infrastructure being procured.

In order to keep information that it receives from proponents confidential from the public at large, the Government Team may find it necessary to destroy or return that information at the conclusion of the procurement process so that it cannot at some later date be required to be made available by the government.

Disclosure of Information

Disclosure of information related to the infrastructure being procured, prior to submission of statements of qualifications and proposals, has a bearing on fairness in the procurement process and on project value. However, it must be weighed against competing requirements for confidentiality:

- Fairness in the procurement process, both as between government and proponents, and as between proponents themselves, is served by timely disclosure of identical information to all proponents. By disclosing as much information material to the proposed project as possible, information asymmetries cannot be exploited either by government or by proponents who may have special access to information (perhaps through extensive experience in the region). Moreover, failure to disclose material information may open government to legal liability; and
- Project value can be enhanced by detailed disclosure of information, as such disclosure of the structure of the deal renders more definite the assignment of risk and responsibility between government and the private partner, and helps to better quantify the exposure and cost that the allocated risk and responsibility bring. Contingencies incorporated into bid amounts, due to unclear allocation of risk and responsibility and due to sub-optimal information for the quantification of exposure and cost, can be reduced through increased disclosure.

Integration of Legal Agreements into Procurement Process

Legal agreements are the documents which define the deal structure of the project. The manner in which the agreements are incorporated into the procurement process is a key element of procurement management. Five methods are available to integrate legal agreements into the process, listed in order of increasing negotiability of contract terms: (1) forms of agreement issued; (2) forms of agreement issued based on comments from proponents; (3) forms of agreement issued with invitation to comment; (4) forms of agreement issued as basis for negotiation; and (5) no agreements issued.

The two key objectives which can be influenced by the method by which the legal agreements are integrated into the process are value (in particular, the maximization of bid amounts), and fairness (in particular, the establishment of a level playing field across proponents). Value and fairness are achieved by issuing all relevant information to all prospective proponents (at the RFQ stage) and to all proponents (at the RFP stage) in a timely manner, and in a way that does not discriminate between proponents.

Another concern is timely closing. Timely closing is achieved by drafting the legal agreements for a project in an even-handed fashion that takes into account the interests of government, the private partner, and the private partner's lenders, and by attaching them to the RFP documentation so that bidders and their lenders know exactly what is expected of them.

Selection of proponents is usually the first step in what could potentially be a very difficult process. If the government first selects a winner in the process, and then attempts to negotiate the legal agreements, the government has lost its advantage and must work at negotiation in order to ensure that the winner agrees to comply with important legal conditions and requirements. At this point, all other bidders are long gone, and the process has surely been prolonged. The key to attaching all the documents at this early stage is that there is little room for future negotiation. The most that the government may choose to offer in terms of compromise is to put out a draft, invite comments from the proponents, reissue a revised draft incorporating such comments as the government decides in its discretion should form part of the document, and then reissue the document as amended. Once a proponent bids, it is bound to sign those amended forms of agreement.

Economic Benefits Requirements

Economic benefits requirements, motivated by an intention to promote economic development, are often sought to be, and often are, incorporated into the Request for Qualifications (if any) and Request for Proposals for a project. However, the efficacy of such requirements has been challenged to the point where it may be best for government to make its policy decisions in advance, based on its own analysis, rather than impose this requirement on the bidders.

Economic benefits requirements may include: local employment requirements and employee training requirements; local procurement requirements and supplier development requirements; local management requirements, such as the maintenance of local design and construction management offices and of local operations management offices; domestic ownership requirements; technology transfer requirements, in order to develop export capability; and requirements not directly related to the project, as for example, funding of capital or social projects not related to the subject of the project.

An important option, not to be discounted, is not to impose economic benefits requirements at all, either because the free market is taken to ensure socially optimal outcomes more effectively, or because economic benefits requirements tend not to succeed in securing economic benefits. Any benefits that had been sought to be secured through economic benefits requirements could then be secured, if optimal in context, through win-win arrangements with the successful proponent or other parties outside of the procurement process altogether, or through general programs applicable across the jurisdiction.