



**Award Procedures for Public-Private Partnerships (PPPs) for project  
delivery**

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## Table of contents

1.	Introduction .....	4
1.1.	Definitions.....	4
1.2.	Essential characteristics of PPP projects .....	4
1.3.	Contractual and institutional PPPs.....	6
1.4.	Major drivers for the PPP approach.....	7
1.5.	Applicable law .....	8
1.5.1.	Principal applicable legislation .....	8
1.5.2.	Provisions for award of contractual PPPs.....	8
1.5.3.	Provisions for award of institutional PPPs.....	11
1.5.4.	In-house services .....	14
1.6.	The need for an educated contracting authority .....	14
2.	Identification of projects for PPP .....	15
2.1.	Introduction .....	15
2.2.	Identification process.....	15
2.3.	Suitability assessment.....	16
2.4.	Private initiatives .....	16
3.	The preparation of projects for PPP .....	18
3.1.1.	Definition of performance requirements.....	18
3.1.2.	Degree of project preparation .....	20
3.1.3.	Investigation of alternative solutions .....	21
3.2.	The preparation of legal & financial aspects .....	25
4.	The award of a PPP project .....	29
4.1.	The award procedure.....	29
4.2.	Invitation to tender.....	31
4.3.	Selection of suitable candidates.....	31
4.4.	Discussion of legal & financial issues.....	33
4.5.	Preparation of technical and financial proposals.....	34
4.6.	Project award.....	35
5.	Setting up the IPPP .....	37
5.1.	Signing the contract for contractual PPPs.....	37
5.2.	Establishment of institutional PPPs.....	37
6.	Contracts awarded by concessionaires .....	39

- 7. Role of the engineering consultant ..... 41
  - 7.1.1. Scope of the engineering consultant..... 41
  - 7.1.2. Significance of design in PPPs ..... 42
- 8. References..... 43

# 1. Introduction

## 1.1. Definitions.

The term *Public-Private Partnerships* (PPPs) is used in the Green Paper as a generic term indicating forms of cooperation between public authorities and the private sector for construction, operation and/or maintenance of a project or the provision of a service [CEC, 2004].

This document concerns PPP's involving construction of projects. The terms *PPP*, as well as *concessionaire* and *concession period* are used as generic terms.

## 1.2. Essential characteristics of PPP projects

The main distinctive feature of works concessions is their right to exploit a project in return for its construction [CEC,2000]. Thus, the essential characteristics of a PPP project are [CEC, 2004; B. Meganck, 2004; CEC, 2000]:

- the significant contribution to the project funding from the private sector, and
- the responsibility of the concessionaire for the construction and operation of the facility during the concession period.

The financing, construction and operation may be undertaken by one or separate joint ventures, herein referred to as concessionaires.

In PPP projects, the remuneration of the concessionaire will be achieved during the operation of the project; this remuneration may stem from its users and/or the government itself; the mix will depend on the nature of the project, e.g. for a transportation project users may contribute significantly, while for a school project the government will undertake to pay the instalments. The contributions from the government may be associated with the (degree of) availability of the project for operation or, alternatively, with the demand for the project, as well as with the quality of the delivered operation.

In the above context, the concessionaires assume the risk associated with the construction costs<sup>1</sup> (commonly referred to as *construction risk*) and the risks associated with the operation of the project, i.e.:

- the risk associated with part or whole of the project not being available at any given time<sup>2</sup>, e.g. due to delays in the project construction, commonly referred to as *availability risk*, or
- the risk that the demand for the project will be less than envisioned in the project setup, commonly referred to as *demand risk*.

In addition to the above, the valuation of the project on the basis of its true economic value at the end of the concession period is considered significant from an accounting point of view<sup>3</sup>.

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<sup>1</sup> Some exceptions may be necessary in particular cases, e.g. it may be inappropriate for contractors to undertake the geological part of the construction risk for the Lyon-Turin alpine base tunnel.

<sup>2</sup> If the penalties for unavailability do not affect the instalments for construction then the project is not regarded as a PPP according to Eurostat.

<sup>3</sup> If, at the end of the concession period, the project is transferred back to the public sector at a value that is (significantly) above its true economic value, the project could be considered as supported by a loan.

### **1.3. Contractual and institutional PPPs.**

The concessionaire may comprise wholly of private enterprises, in which case the partnership between the public and private sector is solely based on contracts – which are referred to as a contractual PPP - or, alternatively, of a company jointly owned by the public and private sector for management or construction and/or operation of a particular project – referred to as an institutional PPP or IPPP [CEC, 2004]. The public partner may choose the latter form of cooperation for the purpose of:

- retaining a relatively high degree of control over the project, and
- enhancing his experience through the cooperation with the private partner(s).

In the case of IPPPs, the partnership between the public and private sector is more pronounced; thus:

- the public partner will have a stronger say in the operation of the jointly-held company as compared to a contractual PPP, and
- the private partner(s), in addition to undertaking certain obligations, will have increased rights as shareholder of the legal entity carrying out the project.

Moreover, the private partner will contribute to the capital of the legal entity carrying out the PPP, i.e. will contribute to its financing, the major difference from contractual PPPs being the timing of the financial contribution.

IPPPs can be set-up by entities of the public sector for the provision of works, supplies and/or services by:

- setting up a new entity in joint venture with a private partner, or
- transferring shares (or ownership rights) of public companies to the private sector.

The Member States are responsible for defining the conditions and making the decisions on which form to adopt in each case

The scope of the IPPP may be:

- the construction and/or operation of a project, or
- the management of the construction and/or operation of a project.

In the latter case, the construction and/or operation of the project may be delivered by conventional design and build, DBO or another PPP.

### **1.1. Major drivers for the PPP approach**

The major driver for the PPP approach to project delivery is the infusion of expertise, innovation, drive and efficiency of the private sector for project delivery and operation, which may result in:

- the improved quality of construction, provided service and maintenance of the project, and
- savings in the construction and/or operation of the project.

An additional incentive for some countries is the contribution of the private sector to project financing, which reduces their burden on national debt<sup>4</sup>.

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<sup>4</sup> According to EUROSTAT [Meganck B., 2004] PPP projects with the essential characteristics mentioned in section 1.2 are considered as off the government's balance sheet – and thus do not burden government debt.

The above should however be weighed against:

- the substantial investment required from both the public and private sector for their preparation and award of PPP projects, and
- the increase in project cost due to the increased cost of financing for the private sector on the one hand, and the allowance for profit of the private sector on the other.

## **1.2. Applicable law**

### 1.2.1. Principal applicable legislation

The applicable law for award of PPP projects in the EU includes:

- the principles of non-discrimination, equality of treatment, transparency, mutual recognition and proportionality of the E.U. Treaty
- for projects considered as public works contracts, the detailed provisions of Directive 2004/18 (Title II), and
- for public works concessions, the provisions of the Directive (Title III).

It should be noted that the award of public works concessions by entities operating in the water, energy, transport and postal services sectors are specifically excluded from the provisions of Directive 2004/17.

### 1.2.2. Provisions for award of contractual PPPs

The detailed provisions of the Directive for public works adequately define the award process. However, the provisions of Directive 2004/18 for public works concessions are restricted to the publication of notices advertising such projects and awarding of additional works to the concessionaire; issues such as:

- methods of project award (such as open or restricted)
- the assessment of candidates in two stages, selection and award
- the obligation for minimum numbers of selected candidates (mainly for the restricted and competitive dialogue procedures)
- the criteria for the assessment of the personal situation of the candidates
- the selection criteria (and the obligation to clearly define them in the invitation)
- the award criteria (and the obligation to clearly define them in the invitation)
- the allowance for adequate time for preparation of tenders

are not defined for concession contracts. Thus, with the existing legal framework any award process can be used for concession contracts by the awarding authorities after publication according to the provisions of the Directive.

Moreover, the criteria by virtue of which the projects are considered as public works or, alternatively, public works concessions, have not been adequately defined<sup>5</sup>.

Thus the consistency of the award process of public works concessions with the principles of the E.U. Treaty cannot be ensured. Because of this shortcoming, the Commission launched a

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<sup>5</sup> According to the Interpretative Communication [CEC, 2000] public works projects are those for which (i) the construction cost is essentially borne by the contracting authority and (ii) the contractor does not receive remuneration from fees paid directly by the users.

debate through the Green Paper [CEC, 2004] on whether additional legislation should be foreseen for concession contracts.

*In view of the above, EFCA has the opinion that, in order to ensure consistency with the principles of the E.U. Treaty, the provisions of Directives 2004/18 and 2004/17 for the award of public works contracts should be adhered to for the award of all contractual PPPs – independently of whether they are considered as public works or concessions.*

*Moreover, EFCA proposes that National guidelines should be drawn up regarding:*

- *project identification, ref. section 2 below*
- *project preparation, ref. section 3 below*
- *the contract conditions, ref. section **Error! Reference source not found.** below*

*In view of the limited experience to date with PPP projects in most countries, such guidelines should afford contracting authorities the freedom of deviation.*

The extension of Directives 2004/17 and 2004/18 for the award of PPP projects would also:

- render continuity between the provisions for award of conventional public works projects and PPP projects<sup>6</sup> - which is reasonable in view of the fact that PPP projects are, after all, forms of public project delivery, and
- ensure that, even if in the course of discussions of legal & financial conditions of a PPP project it were redefined as a conventional public works project, the procedure applied for the selection of the private partner would stand.

### 1.2.3. Provisions for award of institutional PPPs

The Commission has provided the following guidance concerning the set-up of IPPPs in the Green Paper on Public-Private Partnerships [CEC, 2004]:

#### (a) For the case of IPPPs set-up as new entities in joint venture with a private partner

When the set-up of an IPPP is accompanied by the award of tasks that can be designated as a public contract, or even a concession, there should be compliance with the rules and principles arising from public procurement law (the general principles of the Treaty or, in certain cases, the provisions of the Directives), i.e. competition between candidates.

Moreover, the selection of a private partner called on to undertake such tasks while functioning as part of a mixed entity can therefore not be based exclusively on the quality of its capital contribution (i.e. investment) or its experience, but should also take account of the characteristics of its offer – the most economically advantageous – in terms of the specific works to be provided. The conditions governing the creation of the entity must be clearly laid down when issuing the call for competition.

#### (b) For the case of IPPPs set-up through the transfer of ownership rights of the public entity

Regarding the transfer of ownership rights where they have the effect of entrusting to the private partner tasks falling within the scope of the law on public contracts which had been previously exercised, directly or indirectly, by the public authorities, the provisions on

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<sup>6</sup> Thus a project with very little project financing by the private sector and a small concession period should will be governed by the same legal framework as a full-fledged PPP project on the one hand or a conventional public works project on the other.

freedom of establishment require compliance with the principles of transparency and equality of treatment, in order to ensure that every potential operator has equal access to performing those activities which had hitherto been reserved. In addition, good practice recommends ensuring that such a capital transaction does not in reality conceal the award to a private partner of contracts that might be termed public contracts, even concessions<sup>7</sup>.

In the above the Commission identifies that if the private partner will undertake the provision of works, supplies or services through the IPPP, the principles of public procurement should be complied with and, to some (undefined) extent, the relevant legislation, i.e. Directives 2004/18 and 2004/17.

From the above it is apparent that the Commission has provided some guidance to date on the legal background for the set-up of IPPPs involving the provision of works, supplies and/or services; however, limited guidance has been provided by the Commission to date on how legislation, which has been developed for the award of public works, supplies and services, can be used to select a private partner in an IPPP involving the provision of works or services.

EFCA is concerned that the lack of clarity on the legal background for the set-up of IPPPs and especially on the application of existing legislation for the selection of the private partner may result in widely differing procedures within the E.U. and questionable adherence of such procedures to the principles of the E.U. Treaty, with a negative impact on consulting engineers taking part in these procedures

*EFCA proposes that the Commission provides detailed guidance in the set-up of IPPPs and that such guidance includes that if the IPPP will undertake the provision of works, supplies or services, public procurement should in every case take place for the selection of the private partner(s), according to the provisions of Title II of Directive 2004/18 and Directive 2004/17. This will guarantee transparency and equality of treatment with other forms of public procurement.*

*EFCA considers that the abovementioned provisions for the award of public procurement contracts are applicable for the selection of the private partner(s) for IPPPs, the primary objective of the tender being the provision of the required services, supplies and/or works; in this case, the participation in the IPPP is the secondary objective, since it reflects the means by which the primary objective will be met.*

*In addition, EFCA recommends that:*

- *provisions be made in national legislation for the award of IPPP contracts, and*
- *guidelines be drawn up for project identification, project preparation and contract conditions*

*ref. the recommendations in section 1.2.2.*

#### 1.2.4. In-house services

According to recent jurisprudence [Teckal], the award of works, supplies and/or services cannot be made to an IPPP without a public procurement procedure unless the said IPPP is considered as in-house, i.e.:

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<sup>7</sup> This is the case in particular when, before the capital transaction, the entity in question is awarded, directly and without competition, specific tasks, with a view to making the capital transaction attractive

- the control that the awarding public authority exercises over it is similar to that which it exercises over its own departments, and
- it carries out the essential part of its activities (e.g. 85%) with the awarding public authority.

It may thus be concluded that, since an IPPP is not normally under the full control of the public authority, the award of any works, supplies and/or services to it should involve a public procurement procedure.

*EFCA considers that the award of additional works to established IPPPs eliminates competition and constitutes preferential treatment of the private partner in this IPPP and proposes that, in accordance with current jurisprudence<sup>8</sup>, institutional PPPs should have the sole objective of providing the specific project(s) defined at the outset.*

### **1.3. The need for an educated contracting authority**

The preparation, award and management of public works through PPP require considerable expertise by the contracting authorities involved, i.e. an 'educated' contracting authority.

*In view of the above, EFCA recommends that contracting authorities rationally assess their capabilities prior to the launching of a PPP contract and duly procure adequate legal, financial and technical expertise to successfully support them in the project preparation, award and management.*

## **2. Identification of projects for PPP**

### **2.1. Introduction**

The identification of projects is generally made by the public sector. In cases where the identification of projects requires a systematic assessment of alternative project arrangements, the responsible authority may engage engineering consultants for technical assistance.

Alternatively, projects may be identified by the private sector and proposed to the respective authorities; engineering consultants may have a significant contribution in this respect.

### **2.2. Identification process**

For the PPP approach to be feasible for a project, the return on its investment from operation should be financially attractive. To this end, the awarding authority should at first undertake or procure a feasibility study of the project, in order to:

- define the project objectives
- take into account the alternative forms of the project<sup>9</sup>
- estimate the expected level of usage of the project, and
- estimate the associated investment & operational costs and revenues.

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<sup>8</sup> ref. the Teckal case [ECJ, 1999]

<sup>9</sup> e.g. alternative methods for crossing a strait: by tunnel in the seabed, tunnel on the seabottom, floating system, bridge – and suitable types thereof.

### 2.3. Suitability assessment

Subsequently, the economic viability of the project delivery through PPP or IPPP should be assessed through a comparative study for materialisation of the project with conventional means and PPP in terms of cost and time for delivery; such an assessment would mainly concern the potential interest from the private sector but also the requisite financial participation of the public sector in the project in the context of available public finances; some countries have prepared “Comparators”, i.e. procedures for the assessment of the added value of PPP projects. For the assessment of the economic viability of the project delivery through PPP or IPPP, the contracting authority may engage appropriately qualified consulting firms.

In view of the relatively large time frame and investment that is necessary for the setting up of each PPP, it appears that only large projects may be suitable for such a delivery method – at least until the process for awarding PPP projects is streamlined, including the determination of the legal and financial setup of the project at the outset by the contracting authority, ref. section 3.2.

### 2.4. Private initiatives

The private sector may have innovative ideas and contribute positively to the identification of projects for delivery with PPP.

For the materialisation of private initiative PPPs, first-movers (i.e. natural or legal persons proposing an innovative idea for a PPP project) should be offered adequate incentives for the identification and assessment of suitability of projects. However, providing for advantages to first-movers in the award process (including the right of first refusal) breaches the equality of treatment of candidates. Thus, public procurement of such projects will be necessary:

- in order to comply with the principles of the E.U. Treaty and
- ensure that the technical, legal and financial terms of the contract are in the public interest.

*EFCA considers that private initiatives could infuse innovation in project development or operation through PPPs and recommends that, for first-movers to have a strong incentive for the identification of projects, national legislation should stipulate a commensurate reimbursement for such first-movers<sup>10</sup>, provided that:*

- *an official decision is made to proceed with the project within a certain period from the submission of their proposal, and*
- *it retains the basic characteristics of the proposed one<sup>11</sup>.*

*In this context, EFCA is looking into the applicability of legislation on intellectual property rights (IPR) to this matter.*

The proposal of the private entity should be documented, including the elements of the previous paragraphs and its proposal for reimbursement from the project revenue. Subsequently and in order to ensure that the project is in the public interest, the responsible authority should assess the requisite financial participation of the public sector in the project and determine whether the project should be procured as a contractual or institutional PPP.

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<sup>10</sup> e.g. from the project revenues

<sup>11</sup> The reimbursement should stand even if the first-mover participates in the PPP consortium that undertakes the project, since the extent of this participation and the returns to the first-mover cannot be defined.

### 3. The preparation of projects for PPP

#### 3.1.1. Definition of performance requirements

The first step for the preparation of a project is the clear definition of its performance or functional requirements. In order to maximise the benefit of innovation from the PPP process, performance or functional requirements should not unduly restrict the allowable options.

The definition of the performance or functional requirements of the project is made by the contracting authority, which may be assisted in this task by appropriately qualified consultants through technical assistance contracts awarded by conventional procedures or, in certain cases, negotiated procedures with prior publication [Art. 30, par. 1 (c) of the Directive].

For particularly complex projects or projects involving new technologies (e.g. the maglev train systems), where the contracting authority is not objectively able to define their performance requirements, it may according to Directive 2004/18 [Art. 1, par. 11.c] use the competitive dialogue procedure, whereby the contracting authorities consult selected candidates to one of whom the project will be awarded. This option may also be exercised for the refinement of the scope of complex projects e.g. the creation of facilities for the Olympic games.

It should be borne in mind, however, that a dialogue for the definition of performance requirements will have a very high cost to the private sector due to the necessary involvement of high-level staff for the preparation and their participation in discussions with the contracting authority.

*EFCA has the opinion that:*

- *the use of competitive dialogue for the definition of performance requirements is inefficient, since significant resources both in the private and public sectors are mobilised, and*
- *the contracting authorities can effectively define the project performance requirements, with the assistance of appropriately qualified consultants or experts.*

Moreover, for appropriate candidates to be selected for the competitive dialogue, their technical and/or professional ability should be evaluated.

*EFCA believes that the evaluation of candidates for a project with undefined performance requirements will involve considerable uncertainty; subsequently, it will not be possible for the contracting authority to select the most qualified candidates for the project as defined through the competitive dialogue process.*

*In view of the above, EFCA recommends that contracting authorities refrain from using competitive dialogue for the definition of the performance requirements; if however such a procedure is used for the definition of performance requirements, EFCA recommends that:*

- *the number of candidates selected is reasonably limited e.g. to 3-5, and*
- *the candidates are remunerated for their participation in the process*

*Competitive dialogue may, however, be used for the refinement of the project scope, if its principal objective(s) have been adequately defined prior to its procurement.*

### 3.1.2. Degree of project preparation

The degree of preparation of technical aspects, especially for a works project, is a matter of economic significance. In general, the higher the degree of project preparation, the higher the degree of project definition and the lower the degree of freedom that can be extended to the candidates in technical matters.

Higher degrees of project preparation are more efficient in terms of the design process, since the respective work is undertaken by one party (the contracting authority itself and/or consultants to it); thus the costs of site investigation & design preparation are lower. Moreover, higher degrees of preparation may reduce construction risks (e.g. by means of adequate geotechnical investigations) if the project location is known and/or result in increased permitting coverage of the project (e.g. environmental permitting).

Thus, although PPP has been historically perceived as an extension of the design-build project delivery method, the design of the project by the concessionaire is by no means necessary in all cases, since PPP can be restricted to the financing, construction and operation of a project.

*In view of the above, EFCA considers that the required project preparation by the awarding authority should depend on the degree of required technical innovation sought in the project. If technical innovation is of high significance for a project, then the extent of design prior to procurement of the of the PPP project should be limited. For other projects, contracting authorities should consider preparing the design (and advancing the permitting) to an advanced stage prior to the procurement of the project.*

*In view of the above, EFCA recommends that, where the contracting authority intends to prepare some level of design prior to the procurement of a PPP project, it be awarded to an appropriately qualified consultant.*

Design contracts could be procured according to the provisions of Directive 2004/18 as conventional public service contracts or design contests; if a preliminary design of the project is only deemed necessary for the PPP, the negotiated procedure with prior publication can be considered – provided that it can be justified that contract specifications cannot be established with sufficient precision for award of the project with the open or restricted procedure [Art. 30, par. 1.c of the Directive].

### 3.1.3. Investigation of alternative solutions

In the above context, the contracting authority will need to assess the extent of investigation of alternative technical solutions prior to the launching of a PPP project; the more extensive this investigation, the more focused will be the invitation to tender<sup>12</sup>. This may be achieved by means of a more focused definition of the project and/or by refinement of the performance or functional specifications. In any case, each candidate for a PPP project will include his proposed technical solution in his bid, ref. section 4.1.

Directive 2004/18 [Art. 29] allows considerable freedom to contracting authorities for concession contracts; moreover, the Explanatory Note on competitive dialogue [CEC, 2005]

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<sup>12</sup> For the example of the crossing of a river, if the contracting authorities investigate the cost-effectiveness of the tunnel and bridge prior to launching a PPP project, the said project may be launched only for one of the two means of crossing the river.

specifically foresees the competitive dialogue as a tool for discussion of alternative solutions. The discussion of alternative solutions with the candidates, although requiring minimal project preparation on behalf of the contracting authority, has the following drawbacks:

1. The discussion of alternative solutions with the contracting authority has a high cost to the private sector due to the time necessary for preparation of the alternatives and participation in discussions with the contracting authority by high-level staff; this cost will be additional to the cost of preparing the final technical solutions for the bid for the PPP project and the cost of discussions on legal & financial issues (ref. sections 4.4 and 4.5 below), which experience to date shows are already too high.

It should be noted that, since the cost of discussion of alternative solutions prior is normally borne by all candidates and only one of them will be awarded the project, the budget of each successful candidate will eventually have to include the costs of the competitive dialogue process in all the unsuccessful projects - which will disproportionately increase the cost of PPP projects<sup>13</sup>.

2. In addition, in the discussion with the candidates of alternative technical solutions, the contracting authority may adopt the best ideas from each one and transfer them to the rest in order to achieve the best final result (commonly referred to as "cherry-picking"). This process is characterised by reduced transparency and offers no guarantee for equal treatment of the candidates.

It is understood that the Directive stipulates in Art. 29 par. 3 for competitive dialogue that "Contracting authorities may not reveal to other participants solutions proposed or other confidential information communicated by a candidate participating in the dialogue without his/her agreement". However:

- candidates who have invested time and effort in their participation in the competitive dialogue process may be pressured to cooperate with the contracting authority and agree to the use of their ideas
  - even if such permission is not granted by the candidate(s), it should be expected that some contracting authorities will have a strong incentive to disseminate successful ideas in order to improve the tenders that will be submitted; indeed, it could be argued that the discussion of alternatives by the contracting authority with the candidates has little meaning unless such ideas are exchanged.
3. Moreover, the dissemination of successful ideas among candidates in the context of discussions of alternative technical solutions for PPP projects (in the context of competitive dialogue processes or not) will discourage participants to invest in the preparation of

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<sup>13</sup> In this respect, Directive 2004/18 foresees the possibility in Art. 29, par. 8 for reimbursement of the participants of competitive dialogue. However, is deemed unlikely by the consulting sector that contracting authorities will be in a position to appropriately reimburse the candidates participating in discussions of alternative solutions. In fact some contracting authorities may be tempted for a "free ride" i.e. use the competitive dialogue procedure in order obtain alternative solutions at a minimal cost. In any event, the consulting sector expects that a large share of these costs will ultimately be borne by the candidates.

comprehensive concept designs; thus, this procedure will in effect stifle innovation instead of enhancing it<sup>14</sup>.

*In view of the above EFCA strongly recommends that the investigation of alternative solutions by means of discussions with the candidates during the award process should be avoided because:*

- *it will have an unsustainably high cost to candidates due the substantial input that is required from high-level staff of for the preparation and discussions with the contracting authority, and*
- *may result in the transfer of the best ideas from some candidates to others (commonly referred to as "cherry-picking"), which acts as a counter-incentive for meaningful contribution to the process and could result in unequal treatment of the candidates.*

*In this respect, EFCA suggests that, where the contracting authority intends to investigate alternative solutions prior to the procurement of a PPP project, it be awarded to an appropriately qualified consultant.*

### **3.2. The preparation of legal & financial aspects**

The legal & financial aspects of PPP contracts normally include:

(a) Clauses regarding the contract award stage such as:

1. The scope, location and characteristics of the project.

*EFCA considers that the definition of the scope, location and characteristics of the specific project are of paramount importance, in order to ensure equality of treatment of the candidates.*

2. The performance or functional requirements of the project, unless they will be determined by competitive dialogue, ref. section 3.1.1.
3. The selection and award criteria of the project
4. The amount stipulated for remuneration of the candidates for the preparation of their proposals, especially for situations where competitive dialogue is foreseen

(b) Clauses regarding the contract execution stage such as:

1. The distribution of investment between the private and public sector
2. The types of revenue of the concessionaire during operation of the project, i.e. user fees and/or fixed or demand-driven payments by the public partner, e.g. "virtual tolls" or availability fee
3. The concession period and provisions for the PPP dissolution at its end; the concession period is fixed in general - but may conceivably be tied to predefined economic indices for the return on capital.

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<sup>14</sup> An extreme case of the above is the merging by the contracting authority of the solutions submitted by candidates into one solution with elements from all - for which they subsequently request financial proposals from all candidates.

4. The performance-related provisions of the project, by virtue of which the concessionaire will be assessed during the concession period
5. The valuation of the project at the end of the concession period and its fate, i.e. whether it will be transferred to the public sector or not
6. The provisions for adjustments to contract conditions; due to the particularly long duration of PPP contracts, the stipulation of the conditions under which adjustments will be permissible and which adjustments will be allowable can be particularly difficult.

*In this respect, EFCA recommends that only conditions that could not have reasonably been foreseen and which the concessionaire cannot reasonably alleviate should warrant adjustments, which should be commensurate to the gravity of the conditions; any other adjustments may have discriminatory results against bidders that reasonably foresaw the ensuing conditions.*

7. The provisions for additional works

*EFCA strongly recommends that the concessionaire should not undertake any works not directly related to its scope, since this would amount to the direct award of further contracts that normally should have been tendered.*

For additional works directly related to the scope of the project, provisions could be made for unforeseen circumstances where such works are necessary or inseparable from the project as awarded, the value of which should collectively not exceed a certain limited percentage (e.g. 15%) of the PPP contract; in all other cases additional works related to the project should be openly procured by the contracting authority.

8. The possible correction measures available to the contracting authority or financial institutions in case of under-performance in the execution of the project, e.g. "step-in" clauses. Such clauses reduce the risk from to the contracting authority or the financial institutions from under-performance and may be justified instead of other more expensive forms of guarantee; since they constitute heavy-handed interventions in the PPP contract though, they should be drafted and deployed with the utmost attention.

*In view of the above, EFCA considers that step-in clauses are necessary in cases of clear under-performance in the execution of the project.*

9. The distribution of risks between the contracting authority and the concessionaire; although it is generally acknowledged that each item of risk should be allocated to the parties which are most efficient in assuming that risk, there is to date no clear consensus regarding the exact distribution of risk in the E.U.
10. The provisions for transfer of shares of the concessionaire; although the shareholders of the concessionaire have the right to transfer their shares, such a transfer may have a significant impact on the composition of concessionaire and eventually on the construction or operation of the works. In the case of IPPPs, the mixed capital entity itself may enter the stock market or other organised markets.
11. The liability of the private partner towards the contracting authority, including that of the consulting engineers.

In this context it is noted that the liability of consulting engineers towards the concessionaires and/or contracting authorities in the context of PPPs may be significant – and in fact disproportionate with their size and financial strength.

*EFCA considers that the contractual liability of consulting engineers should be limited to the value of reasonable professional indemnity insurance coverage.*

The above aspects are not covered by European law, save for the principles of the E.U. Treaty. Moreover, the definition of such provisions requires considerable expertise, the state-of-knowledge of which is evolving at present.

The definition of the contract conditions is commonly the subject of extensive negotiations between the contracting authority and the selected candidates or the preferred bidder. This process results in significant delays and a very high cost to the private sector due to the time necessary for preparation and participation in discussions by high-level staff. Moreover, in cases where such discussions are held solely with the preferred bidder, the equality of treatment of candidates is not ensured.

Under the present circumstances, the use of competitive dialogue with all the selected candidates will normally be necessary for the definition of legal & financial aspects in the context of PPP projects.

*EFCA considers that, on the basis of the outcome of the above discussions, the contracting authority should ultimately decide on a uniform and comprehensive set of legal and financial conditions that will be common to all candidates and will be included in the contract with the successful bidder.*

*In view of the above significant effort required for the discussions of the legal & financial conditions, EFCA recommends that the member states and contracting authorities give due consideration to defining the applicable legal & financial conditions in the invitation<sup>15</sup>, if adequate experience is or can become available to the contracting authority and several suitable candidates can be expected to express interest, i.e. such unilateral definition of contract conditions will not unduly restrict competition. Such a procedure will result in appreciable savings of cost & time for the project set up.*

## **4. The award of a PPP project**

### **4.1. The award procedure**

There are no guidelines for award of PPP projects in Directive 2004/18; the conventional processes, especially the restricted procedure, as well as the process of competitive dialogue may be used if so deemed appropriate.

For most cases where situations where the legal & financial aspects of the contract will need to be discussed between the contracting authorities and the candidates, the competitive dialogue award procedure will be necessary.

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<sup>15</sup> save for one or more specific economic parameters that will be the subject of the financial proposal, e.g. the amount of their investment or the proposed duration of the concession period.

*Where the legal & financial aspects of the contract will need to be discussed between the contracting authorities and the candidates, EFCA recommends that:*

- *the award process be structured, with clear objectives at every stage, and*
- *competitive dialogue be used only for the discussion on the legal & financial aspects.*

*Specifically, EFCA recommends the following award process for those cases:*

1. *Invitation to tender by the contracting authority, in the framework of competitive dialogue*
2. *Selection of the suitable candidates for participation in the competitive dialogue*
3. *Discussion of the legal & financial issues and solutions by the contracting authority with the candidates and definition of the legal & financial aspects that will be applicable to the contract.*
4. *Submission by the selected candidates of the technical & financial proposals in accordance with the performance requirements and the defined legal & financial aspects of the contract*
5. *Award of the contract to the most economically advantageous tender.*

The preparation of technical proposals may be carried out in parallel with the discussion of legal & financial issues (if applicable). During this process:

- questions may be raised by the participating candidates regarding the performance or functional requirements, and/or
- some legal or financial issues may have implications on the performance or functional requirements

In these cases the contracting authority may deem it necessary to refine the performance or functional requirements – on the conditions that (i) such refinements are issued well before the deadline for submission of the technical & financial proposals in order not to avoid unduly restricting competition and (ii) they do not alter the characteristics of the project tendered.

*The above process should be applicable both to contractual and institutional PPPs. As a rule of thumb, the order of magnitude of the cost of the tendering procedure to the private sector should be 1% of the contract value.*

*If the technical, legal and financial conditions that will be applicable to the contract have been defined at the outset by the contracting authority, ref. section 3.2, EFCA recommends that the project should be procured with the restricted procedure.*

#### **4.2. Invitation to tender**

The invitation to tender should at least include:

- the scope, location and characteristics of the project
- the performance or functional requirements of the project
- the selection criteria for the project
- the legal & financial conditions of the contract - if the contracting authority has defined them in advance, and
- the award criteria for the project.

#### **4.3. Selection of suitable candidates**

The selection process includes the assessment of:

- the personal situation of the candidates, ref. Directive 2004/18
- their financial standing, and

- their technical/professional standing.

For the restricted procedure, the most suitable candidates should be selected on the merits of their qualifications.

*In view of the significant costs of the award process both to the candidates and to the contracting authorities, EFCA recommends that a limited number of candidates be selected, i.e. between 3 and 5.*

*In view of the particular significance of design as a source of innovation for the project outcome, EFCA recommends that the selection criteria for the candidates for PPP projects explicitly include the technical and/or professional ability of the consulting firms that will undertake the design of the project.*

*For candidates to substantiate such expertise, they will rely on appropriately qualified engineering consultants either as partners or as named third parties by way of Article 48, par. 3 of the Directive. In this respect, EFCA recommends that, as for contractors and financial institutions, the consultants proposed or engaged by the concessionaires for design of the works are appropriately qualified according to their national legislation.*

*For the case of IPPPs in particular, EFCA recommends that the qualifications of the candidates, i.e. personal situation, economic & financial standing and technical and professional ability, are assessed in depth, in view of the significance of the selection for partners to the public sector. The personal situation and the economic & financial standing will be of particular significance in view of the capital investment to be made into the public sector and the long duration of the public-private relationship; the technical and professional ability will be of particular significance in view of the works, supplies and/or services to be entrusted to the private partner.*

#### **4.4. Discussion of legal & financial issues**

The discussions have the objective of defining the legal & financial conditions that will be applicable to the contract. The discussions require significant input from experienced lawyers and high-level staff from financial institutions.

*In view of the above significant effort required for the discussions of the legal & financial conditions, EFCA recommends that the candidates selected for participation in the competitive dialogue are reasonably reimbursed for their participation, in order to externalise the associated costs; such reimbursement should be commensurate with the project scope, size and complexity.*

*In any event, EFCA recommends that for significant projects the contracting authorities undertake risk evaluation for the definition of the underlying risks and the appropriate distribution thereof.*

In the discussions, some aspects are common to all candidates, e.g. the distribution of risk between the public and private sector, while others will affect or be affected by the financing solutions for the project that each candidate has in mind. In this respect the Directive stipulates in Art. 29 par. 3 "Contracting authorities may not reveal to other participants solutions proposed or other confidential information communicated by a candidate participating in the dialogue without his/her agreement".

*In view of the above EFCA recommends that, for the increase in efficiency of the procedure while ensuring the equal treatment of all candidates, the dialogue should be structured so that:*

- *the legal and financial issues that are not affected by financing solutions are first discussed in an open & transparent dialogue i.e. with the participation of all candidates*
- *subsequently, the remaining issues should be addressed in dialogue with each candidate separately; the dialogue should be documented and copied to all other candidates - exclusive of issues deemed by the candidate as confidential.*

#### **4.5. Preparation of technical and financial proposals**

The selected candidates are invited to submit technical and financial solutions for the design of the project, taking account of:

- the performance or functional requirements of the project
- the project design, to the degree it has been advanced by the contracting authority
- the results of the geotechnical & other investigations undertaken in the project preparation stage
- the environmental conditions, to the extent defined at the project preparation stage, and
- the legal and financial conditions set forth in the notice or established through the competitive dialogue process.

For the case of IPPPs in particular, the technical and financial proposals concern both the participation of the candidate in the IPPP and the provision of the works.

EFCA would like to emphasize the importance of the quality of the tender design for the success of PPP projects, on the basis of which candidates are bound for issues relating to both the construction and operation of the project.

*In order to ensure the quality, reliability and success of the design in the PPP proposals, EFCA considers that consulting engineers should be afforded adequate time and financial resources for the preparation of the project design in the tender stage. Thus, due consideration should be given to the remuneration of candidates (as is the case for design contests).*

If competitive dialogue is used, Directive 2004/18 stipulates [Art. 29, par. 6] that the final tenders may be clarified, specified and fine-tuned at the request of the contracting authority, provided that no changes to basic features of the tender are involved.

*EFCA recommends that, in the interest of equal treatment of candidates, the technical & financial proposals of the candidates, which will have to be consistent with the functional or performance requirements and the legal & financial conditions of the contract as defined by the contracting authority, are considered final and not amended in any way.*

#### **4.6. Project award**

*For contractual PPPs, the award procedure results in the selection of the concessionaire. For IPPPs, the assessment of the technical and financial proposals by the contracting authority will lead to the selection of the partner with whom the IPPP will be established or to whom the transfer of ownership rights will take place.*

The award criteria are not defined in Directive 2004/18. For the restricted procedure of award, the most economically advantageous tender or the tender with the lowest price may be

selected. Where competitive dialogue is used however, Directive 2004/18 stipulates that the contract should necessarily be awarded to the most economically advantageous tender.

*In view of the above and since quality is significant in PPP projects in order to achieve the best possible value for public investment, EFCA recommends that in all cases the award of the contract is made to the most economically advantageous tender, i.e. include the assessment of quality in addition to cost for PPP projects.*

*The award criteria should be more functional-oriented in PPP projects than in conventional public works projects. EFCA strongly recommends that, in the context of an amendment to Directive 2004/18 for the extension of its provisions to PPP contracts, the Commission also engages in an in-depth dialogue for the improvement of the award criteria<sup>16</sup>.*

Such criteria could include:

- quality of proposed works, based on the assessment of proposed materials, construction specifications and drawings
- the aesthetic value of the proposed solution
- degree of functionality, which can be based on key performance indicators of the proposed solution, and could include additional uses (mainly for buildings)
- perceived environmental impacts of the proposed solution during construction and operation
- the proposed measures for reduction of energy consumption (mainly for buildings)
- the total life cycle cost to the public sector; this should include the financial proposal for construction and operation of the project, e.g. the required contribution of the public sector, as well as the expected cost of operation by the public sector after the concession, as well as the cost of decommissioning (if applicable).

In order to award the PPP project to the economically most advantageous offer, the assessment of project proposals by the contracting authority should be detailed, impartial and objective.

*In cases where the assessment of technical proposals requires additional resources or in-depth expertise, contracting authorities may engage independent engineering consultants for technical assistance.*

## **5. Setting up the IPPP**

### **5.1. Signing the contract for contractual PPPs**

For the delivery of the project after the selection of the private partner, the contract is drawn up between the contracting authority and the concessionaire in accordance with the contract conditions stipulated in the tender stage.

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<sup>16</sup> An improvement of the award criteria is also necessary for conventional public works projects, where the present provisions are practically inadequate.

## 5.2. Establishment of institutional PPPs

For the delivery of the project through the IPPP after the selection of the private partner, the requisite new mixed-capital entity will be set up or part of the shares of an existing public entity will be transferred to the successful candidate.

*In this respect, EFCA recommends that:*

- 1. If the IPPP will undertake the provision of works, supplies of services, it should be established as an entity governed by public law<sup>17</sup>, in order to retain its public character; thus the public sector should retain a reasonable control over the IPPP in terms of shares and management.*
- 2. The scope, location and characteristics of the project should be included in the Articles of Association of the mixed-capital entity for delivery of the IPPP; this is necessary in order to ensure that the scope of the mixed-capital entity is limited to the scope tendered, ref. section 3.2 (b) 7.*

Subsequently, the contract is drawn up between the contracting authority and the mixed-capital entity for the procured works, in accordance with the contract conditions stipulated in the tender stage.

*EFCA considers that, since the private partner for the provision of the works was selected through a public procurement process, no further tendering will be necessary for the award of the procured contract(s) from the public authority to the IPPP.*

*However, EFCA considers that the mixed-capital entities established for IPPPs should not award any works to their private partners that have not been included in the original notice; any additional work should be the subject of a public tender according to the Directives. This applies directly to mixed-capital entities established for the purpose of managing projects, where the required services, supplies or works should clearly be publicly tendered. In order to ensure that distortion of competition is avoided, the candidates for such additional works, supplies or services should be independent from the private partner of the IPPP<sup>18</sup>.*

## 6. Contracts awarded by concessionaires

Contracts awarded by concessionaires include:

- sub-contracts by concessionaires of PPPs and IPPPs, and
- contracts by mixed-capital entities established for the management of projects to third parties, e.g. for construction.

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<sup>17</sup> i.e. as a contracting authority according to the definitions of Directive 2004/18

<sup>18</sup> Two firms are deemed as dependent if the one exercises a dominant influence over the other or if a third legal entity exercises a dominant influence over both of them. Dominant influence shall be presumed between two legal entities, without prejudice to proof of the contrary, when one of them [Directive 94/45 and 2004/18, art. 63]:

- holds a majority of the other's subscribed capital, or
- controls a majority of the votes attached to the other's issued share capital, or
- can appoint more than half the members of the other's administrative, management or supervisory body.

Contracting authorities may either require the concessionaire to indicate the percentage to be subcontracted or to subcontract a minimum of 30% of the total value of the work to third parties [Directive 2004/18, Art. 60].

For the award of works to third parties, concessionaires which are deemed to be contracting authorities are obliged to follow all provisions of the Directive [Art. 62]; concessionaires which should be deemed to be contracting authorities are the mixed-capital entities established for undertaking the project in institutional PPPs, in which either the shares of the public sector are more than 50% or the management of which is controlled by the public sector [Art. 1.9]. Thus, if the concessionaire is essentially government-controlled, the provisions of the Directive should apply for the award of public works to third parties.

However, concessionaires which are not deemed to be contracting authorities are obliged only to publish an invitation for the award of works contracts valued above the threshold of Directive 2004/18 to third parties [Art. 63]; such concessionaires are thus given considerable freedom in the award of works contracts. Moreover, for such concessionaires, third parties are not deemed to include related companies [Art. 62, par. 2]<sup>19</sup>.

There has been some discussion in the Green Paper regarding the possible extension of tendering rules for subcontracting to concessionaires that are not deemed to be contracting authorities.

*EFCA considers that the efficiency of concessionaires may be reduced if provisions for specific percentages of work to be contracted out are made in the contract. Thus, EFCA expresses its strong preference for simply requiring the concessionaire to indicate the percentage to be subcontracted.*

*Moreover, in the interest of flexibility, EFCA considers that no further tendering requirements should be imposed on the concessionaires for the award of contracts within their scope of work.*

## **7. Role of the engineering consultant**

### **7.1.1. Scope of the engineering consultant**

The role of the engineering consultant is significant in PPP projects. On the basis of the above presentation, consulting engineers can be involved in the following activities:

- a) Identification of projects and preparation of associated proposals as first-movers
- b) Services to the contracting authorities:
  - technical assistance for project identification
  - feasibility studies of identified projects
  - design of the project to the extent deemed necessary
  - technical assistance for the definition of performance or functional requirements of the project

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<sup>19</sup> Related companies are companies over which the concessionaire exerts a dominant influence, whether directly or indirectly, or any company which exerts a dominant influence on the concessionaire or which, together with the concessionaire, is subject to the dominant influence of a third entity; dominant influence is defined in footnote 18.

- technical assistance evaluation of the proposals submitted
- technical assistance the assessment of the conformity of the construction with the proposal and the terms of the contract during construction and/or
- technical assistance for the assessment of the compliance of the project with the performance or functional requirements during operation, incl. the compilation of key performance indicators, evaluation of claims etc.

The latter are often undertaken by consulting firms as Independent Engineers; in those cases, the consulting firms are engaged by the contracting authorities with the objective of an independent management input in the project.

c) Services to the concessionaire:

- design of the project,
- provision of project management services
- provision of technical advisor services, and
- provision of quality control services of the project

*The role of the consulting engineer is particularly significant for IPPPs established for the management of the construction and/or operation of a project (as for the IPPP for the construction of schools in Belgium, the scope of which is financing, designing, constructing and maintaining a selected list of schools) - whereby the construction and/or operation of the project are subsequently tendered by the mixed-capital entity and may be delivered by conventional design and build, DBO or another PPP.*

d) Advice to the investors/banks during the proposal and operation phase.

#### 7.1.2. Significance of design in PPPs

Engineering consultants providing design or quality control services to the concessionaire may do so as subcontractors or partners. The design in particular is a primary source of innovation in PPPs since it determines:

- the layout, shape, dimensions, materials and constructibility of the project, which affect the aesthetic impact of the project and the project construction cost
- the operational characteristics of the project, which affect the utility to users and the operational cost, and
- the safety of the project.

Thus, although the fees of engineering consultants generally amount to a small percentage of the project cost, the value of the engineering services is a much larger percentage of the project value.

*EFCA is strongly interested in the acknowledgement from all partners of the PPP of:*

- *the value of consulting engineering input and innovation to PPP projects, which is not reflected in the associated fees – especially so for the project design*
- *the relatively large proportion of work that consulting engineers undertake for candidates during the pre-award phase, where their remuneration is marginal.*

*In view of the above, EFCA recommends that the financial participation of the engineering consultancy firms in PPPs, especially those engaged for design of the project, should be a multiple of their fees, in order to accurately reflect the significance of their input in the project*

*and the fact that a large proportion of their work is undertaken with marginal remuneration in the pre-award phase.*

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