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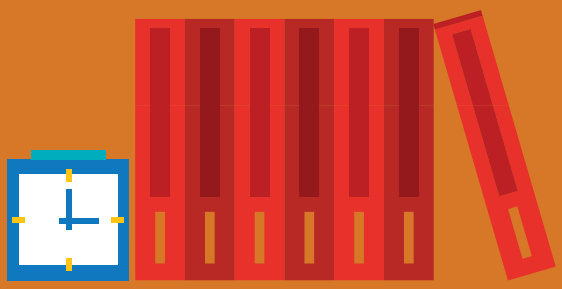

Chapter 5. Recommendations on PPP payment mechanisms

1. Payment mechanism principles

1.1 The following terms and abbreviations are used in the document:

PPP: Public-private partnership.

PPPA: A public-private partnership agreement.

Concession PPPs: PPPs in which the private partner operates the infrastructure, renders public services and charges the public a fee under permission issued by the grantor/concessionaire in accordance with the legislation of the CIS member state.

Non-concession PPPs: PPPs in which the private partner undertakes work in connection with an infrastructure, facility (including design and construction, renovation, expansion, maintenance or management, any contribution thereof) or services system (information or telecommunications, customer services) or undertakes full operation of, but does not charge any fees directly to the public, instead receiving payments from the contracting authority or other government agency.

Availability payments: Fixed periodic payments made by a public partner to a private partner under a PPPA during the term of use (operation) and/or maintenance of a PPP project by the private partner.

Private partner's fee: A fee payable to a public partner by a private partner under a PPPA during the term of use (operation) of a PPP project.

Public service: An activity arising from public interests, which is usually carried out by and/or on behalf of state government authorities and municipal authorities, and/or responsibility these authorities bear, as well as any service or activity in the regulated sphere of public services.

SGAs: The state government authorities and municipal authorities of CIS member countries.

1.2 A public-private partnership agreement (PPPA) may oblige the public partner to pay an availability payment to the private partner with due account of the private partner's right to receive revenues from the sale of goods and rendering of services (including public services) to the general public and other consumers. A PPPA may oblige the private partner to pay a fee to the public partner.

1.3 The payment mechanism lies at the core of the PPPA. This mechanism defines how the private party to the public-private partnership (PPP) is remunerated for what it does under the PPPA and how the public partner is remunerated for the use of rights or public assets by the private partner. The primary purpose of the payment mechanism is to remunerate the private partner sufficiently for it to agree to enter into the PPPA and provide the service. Moreover, under the PPPA, one of main ways to allocate risks between the public and private partners is through the payment mechanism. In addition to the cost of the services provided, the private partner's remuneration depends on the number of risks it takes. It is, therefore, important that the payment mechanism reflect both the level of public services required and the most cost-effective transfer of risk to the private partner. The payment mechanism should give the private partner an incentive to perform well and provide the public partner with remedies in the event that the private partner does not meet its obligations.

1.4 The objectives of the PPP payment mechanism are to:

- provide an incentive for the private partner to meet the availability and performance standards set out by the public partner
- provide an incentive for the private partner to rectify problems promptly when availability or performance fails to meet the agreed standards
- match payments to the outcomes and outputs that the public partner wishes to deliver
- provide an incentive for the private partner to innovate and secure efficiency gains and deliver best value for money throughout the project period
- make sure the public services provided remain affordable for the users and/or the public entity. If necessary, this could involve both lower user charges and a subsidy from the public partner.

1.5 The payment mechanism should reflect performance and create incentives for better performance by the private partner (by use of adjustments to payments and/or specific bonuses/penalties and/or clear exposure to market risk).

1.6 A useful way to approach the design of the payment mechanism is to start with a basic/ideal structure for the public partner or the users.

The public partner will want to pay the private partner, in arrears, a fixed price for (and only for) each unit of service that has been provided and has met the service quality requirements. This would comply with the key PPP principles that payments should be made only if the infrastructure and the public service are available, at the agreed standard of service, and that payments should not be based on the private partner's actual costs (a PPPA is not a "cost-plus"

agreement). This basic/ideal mechanism would give the private partner strong incentives to perform, but would require it to bear excessive risks. "Excessive" in this context could mean that the premium required by the private partner to bear the risks would not be worth the gain obtained from increased efficiencies. It could also mean that the private partner would be too likely to make excess profits or face large losses, which would threaten the viability of the PPP arrangement.

As far as users are concerned, the ideal structure would be any form of non-concession payment, where users do not have to pay for the services and the public partner remunerates all costs.

1.7 The detailed design of the payment mechanism can be derived by moving away from the basic/ideal mechanism and ensuring a balanced risk-reward scenario for the private partner. It is important to make sure that risks that are largely beyond the control of the private partner are not allocated to it.

1.8 Payment mechanisms should have, as far as possible, the following features:

- simplicity
- measurable project deliverables
- strong and appropriate incentives for the private partner to perform
- flexibility
- bankability (the ability of the private partner to finance the project given the risks allocated to it in the payment mechanism)
- affordability for the public partner
- accountability (the ability to resolve any disputes that may arise over the level of payments)

1.9 A variety of elements can be used in isolation or, as is more likely, in combination to provide payment mechanisms for a PPP infrastructure project. In general, payment mechanisms are likely to include one or more of the following basic elements:

- user charges – payments received by the private partner directly from private users of the infrastructure or public service (for example, road tolls)
- usage-based payments – payments from the public partner to the private partner that vary according to how much the infrastructure or public service is used
- availability-based payments – payments from the public partner to the private partner for making infrastructure or public services available for use at an acceptable standard
- performance-based payments – payments from the public partner to the private partner that vary according to the quality of the infrastructure or public service provided
- bonuses and penalties, or fines – deductions on payments to the private partner, or penalties or fines payable by the private partner, due if certain specified outputs or standards are not reached or, conversely, bonus payments due to the private party if specified outputs are reached

1.10 A PPP payment mechanism could include some or all of the above elements, which should be fully defined in the PPPA – including specifying the timing and mechanism for making the payments. The payment mechanism can take different forms, including user charges (such as direct tolls), payments from the public partner (including availability payment, shadow tolls, subsidies) or a combination of both. A minimum revenue guarantee may also be appropriate in some cases.

1.11 Tariffs can be controlled by establishing tariff formulae in the PPPA or by regulation, or a combination of the two. For example, a tariff formula may be set that establishes initial tariff levels and a formula by which the tariff can regularly and automatically adjust in line with inflation or foreign exchange rates. The PPPA may provide for regular tariff formula reviews, at which point other factors could be considered.

1.12 If the PPPA provides payments from the private partner in favour of the public partner, such payments should be based on the economics of the specific project, as determined ex ante by the financial model used in the feasibility study and appraisal of the project. This does not exclude adopting broad guidelines based on the economics of different sectors or subsectors. The rationale is that the economic benefit of a PPP is to be seen mainly in terms of benefits to society, rather than immediate revenue to the public partner. However, it should be noted that for the projects based on the right of use of public assets, the monetary revenue from the assets is important for the public partner. Therefore, a private partner in such projects is often required to pay the private partner's fee. This payment is needed to compensate the public partner for the use of publicly owned property by the private partner, to reimburse project development costs and/or management processes or to finance the PPP unit and other relevant authorities. This payment is inherent in concession PPPs and also called a concession fee. However, it should be noted that in some countries, a concession fee is prohibited in full concessions (to be distinguished from an affermage-type arrangement).

1.13 Payments paid by the private partner to the public partner shall usually be of three main types, where the values are determined based on the economics of each specific project and which can be used in combination:

- fixed periodic payment (for instance, monthly or annually)
- fixed payment per unit of goods or public services sold (for instance, based on throughput)
- revenue sharing or profit sharing (for instance, in PPP joint-venture companies).

1.14 Key considerations when defining public partner payments include the following:

- **Risk allocation implications of different public partner payment mechanisms** – for example, under a usage-based mechanism, demand risk is either borne by the private partner or shared, whereas an availability payment mechanism creates an alternative reward mechanism not related to the level of demand. Providing an upfront capital subsidy means the private partner bears less risk than if the same subsidy were provided on an availability basis over the PPPA's lifetime.
- **Linkage to clear output specifications and performance standards** – linking payments to well-specified performance requirements is key to achieving risk allocation in practice.
- **Indexation of payment formulae** – as for tariff specification, payments may be fully or partially indexed to certain risk factors, so the public partner bears or shares the risk.

1.15 PPPAs that involve private-sector finance give the public sector an opportunity to translate the large up-front capital expenditures associated with traditional projects into a flow of recurring service payments.

1.16 For projects involving the provision of new infrastructure, the unitary payment does not usually start until the operational period begins – that is, once the required public services are being provided to an acceptable standard. This increases the risk transferred to the private sector and provides a significant incentive for the private partner to complete construction as early as possible.

1.17 However, if a project involves the continued provision of an existing public service (for example, the upgrading of a major road), some payments may be made to the private partner during the construction period to reflect the continued availability of the existing public service.

1.18 Concessions may be financially free standing, but where public subvention is required, it can be used to cover some construction or operating costs. This reflects the fact that under concessions, the private partner recovers its costs either through direct charges on private users of the asset (such as road tolls) or through a mixture of user charging and public subventions.

1.19 Design, build, operate and finance contracts offer considerable scope for using the payment mechanism to transfer risk to the private sector. For example, the payment mechanism transfers significant design and construction risk to the private side and provides major incentives for the faster implementation of infrastructure projects. Payments depend on the performance of construction and operation.

1.20 When designing the payment mechanism, the public partner and its advisers should pay attention to features that could give the private partner inappropriate incentives or are complicated or ambiguous (as these may later give rise to disputes). The payment mechanisms of comparable projects/sectors (where available) may be a useful benchmark.

1.21 The public partner's advisers should use a model to test alternative payment mechanisms. A scenario analysis should be run to calibrate the parameters of the payment mechanism to ensure that it performs satisfactorily under a set of likely performance scenarios. Although poor performance should have a material impact on the equity return of the private partner, it would be counterproductive if it were to easily jeopardise debt service payments (as this could result in the bankruptcy of the private partner or make the PPPA difficult to finance).

1.22 Under a PPPA, the public partner is interested in the delivery of the public service rather than the construction of the asset. Therefore, when developing the basic structure of a payment mechanism, the following principles should be addressed:

- The public services to be delivered should be measurable, in terms of both quantity and quality. The public services to be delivered should be defined in the output specification.
- Payments should not start until the full public service is available to the required standard. An exception to this is when the project includes the continuation of an existing public service (for example, the upgrading of a road that is to remain open during the period of the works).
- The payment mechanism should be based on measures such as usage, availability and

performance, and not on the inputs needed to deliver the public service.

• Usage payments should be related to measures that can be forecast, such as traffic volumes along a road or flow volumes through a water treatment works.

• Availability payments should be based on objective measures, such as number of road-lane kilometres available or future traffic analysis reports.

• Performance payments should be based on the achievement of standards that are practical to measure over the entire contract period. It is important to think through carefully any practical difficulties in monitoring, measuring and auditing the basis for performance payments.

• The payment mechanism should make deductions for unsatisfactory performance.

• Private partners should be capable of managing the risks that are being transferred.

• The payment mechanism should be bankable insofar as private-sector bidders and their financiers must be able to model their probable revenue and expenditure streams with reasonable certainty, and the public partner should be able to model and cap its own costs.

• The payment mechanism must be simple to understand and any change from existing systems that are well understood and accepted by the private partners should, as far as possible, be evolutionary.

2. List of typical adjustments to be made to payments

2.1 Further adjustments to the basic/ideal mechanism should be considered:

• The payments to the private partner usually need to be "indexed" to compensate for cost increases due to inflation (the indexation should be based on an agreed set of published indicators).

• Cost items that are beyond the private partner's control can be handled on a "pass-through" basis (that is, the public partner reimburses the costs actually incurred by the private partner). Where this technique is contemplated, the public partner should ensure that the cost items subject to pass-through are limited and defined in detail. It is also possible to pass on only the price part while leaving the input quantity risk with the private partner (for example, in dealing with electricity to be used by the private partner in some PPPs). This could be done where the price is set administratively, but the quantity used depends on the private partner's efficiency.

• The deductions applied to the service fee for poor performance should be linked to the degree of deficiency in the quality of the public service. The public service quality measurement must be verifiable and objective. Generally, the amounts deducted should be consistent with the losses that the public partner or users would incur because of the public service shortfall.

• Demand risk is often considered to be at least partially beyond the control of the private partner. Various mechanisms are available to shift some or all of the demand risk away from the private partner. For example, the service fee/user charge can be increased gradually as demand falls. In addition, a minimum payment guarantee – where the private partner is paid a certain amount even if demand falls below an agreed minimum – can be implemented.

2.2 Under both public partner- and user-pays PPPs, bonuses and penalties can be tied to specific outcomes. Under public partner-pays PPPAs, bonuses and penalties are typically adjustments to regular payments. State government authorities (SGAs) may also provide bonuses or charge penalties under user-pays contracts.

2.3 When a PPP is paid by charging users, the approach to tariff setting and adjustment becomes an important risk allocation mechanism. In some PPPs, the private partner may be free to set tariffs and the tariff structure. However, in many cases, user-pays PPPs are in sectors with monopoly characteristics and relevant SGAs (along with service standards) typically regulate tariffs to protect users. The key question for risk allocation is how tariffs will be allowed to change – for example, with changes in inflation or other economic variables, or with changes (including foreign-exchange fluctuations) in different types of cost, and who can trigger a tariff revision.

2.4 A termination payment is the amount payable by the public partner or the private partner if an event or series of events provided for in the PPPA results in the termination of the PPPA. Termination may take place during the pre-construction, construction, post-construction or operating period of a PPP project. Events that may lead to termination include, but are not limited, to the following:

• public partner's default

• voluntary termination

• special events

• private partner's default

• force majeure.

2.5 When considering compensation provisions for the public partner's default or voluntary termination, the public partner is encouraged to take into account the basic principles listed below:

- **Assessing unjust enrichment** – The public partner should check the applicability of any unjust enrichment principle in its jurisdiction and assess how it may be interpreted when defining compensation provisions.

- **Principle of compensation** – The private partner must be compensated in the event of voluntary or public partner default termination to promote fairness and avoid any unjust enrichment of the public partner. The "no better and no worse" principle should ultimately drive the level of compensation payable to the private partner (the private partner should be put in a position that is neither better nor worse than if the contract had not been terminated).

- **Meeting stakeholders' needs** – The private partner's costs subject to compensation must be carefully considered. Lenders, third-party contractors and equity investors may need to be compensated for actual or opportunity costs as a result of early termination.

- **Simplicity** – Simple and objective calculation methods will provide greater certainty for private-sector stakeholders (and, therefore, a better outcome) and will minimise the risk of disputes.

- **Dealing with cash balances** – At the point of termination, the private partner will often have cash standing in a series of bank accounts (such as current account, debt service reserve account or maintenance reserve account). The public partner should consider how to treat these cash balances for the purposes of determining the compensation amount due (for example, netting of monies in the debt service reserve account against the compensation owed to lenders).

2.6 If the public partner defaults on the PPPA, leading to its termination, it will be obliged to make a payment to the private partner. A fair agreement should ensure the private partner does not lose out if the public partner chooses to default. Termination payments in this case are typically set to the value of debt plus some measure of equity, and may also include all or part of lost future profits (if any). A payment from the public partner may be required even if it is the private partner that is in default, although the former's actual losses (if any) attributable to the default would normally be deductible. The main reason is that senior lenders will want substantial repayment of their loans in any event. Thus the public partner that will own the facility and use it after the termination of the PPPA should pay something, roughly commensurate with the benefits that accrue to it as a result of an early termination (less appropriate penalties resulting from the default), to prevent "unjust enrichment", even if the private partner was at fault.

2.7 The way of calculating early termination payments (for different types of termination, including termination that is the public partner's fault, the private partner's fault or due to special or force majeure events) should be set out clearly and in detail in the PPPA and/or the "direct agreement" with senior lenders. This will help avoid unnecessary disputes.

2.8 If the private partner defaults, lenders are typically given step-in rights so they can remedy problems due to an underperforming contractor – termination only occurs if this is ineffective or if lenders choose not to do so.

2.9 Termination payments are typically defined to ensure that holders of equity bear the burden of default. Lenders may also be exposed to some possible loss – to strengthen their incentives to rectify problems – although this can affect bankability. Options of termination payment in case of the private partner's default include:

- full value or a specified proportion of outstanding debt

- depreciated book value of assets

- net present value of future cash flows (subtracting costs of rectification)

- proceeds of re-tendering the PPP on the open market – thereby also overcoming the possible difficulty of finding budget space for termination payment obligations that are realised unexpectedly.

2.10 The PPPA should clearly set out the grounds on which the public partner can invoke termination for fault of the private partner. This entails defining the specific events or breaches (for example, actions or omissions of the private partner) that may lead to termination. Where the PPPA relies on an itemised default list, that list usually consists of, but is not limited to, the following events:

- insolvency/bankruptcy of the private partner

- continued failure of the private partner to reach certain construction milestones or complete the project

- substantial failure of the private partner to deliver the public services according to the agreed specifications

- penalty points (awarded for intermittent failures to deliver public services) that exceed specified thresholds

• change of ownership of the private partner without the consent of the public partner

• failure to insure the PPP project assets/business as required.

2.11 When addressing compensation provisions for private partner default, the public partner is advised to take into account the following points:

• **Principle of compensation** – Compensating the private partner following termination for its default is required to avoid any unjust public partner enrichment and attract lenders to PPP projects. However, excessively generous compensation will raise value-for-money concerns and introduce some moral hazard (that is, the private partner and its lenders may not be sufficiently incentivised to perform). Choosing between the approaches requires a proper analysis of the pros and cons of each, taking into account the relevant market/jurisdictional circumstances.

• **Simplicity** – Simple and objective calculation methods will provide greater certainty for the private-sector stakeholders (and, therefore, a better outcome) and minimise the risk of disputes.

• **Lender preference** – Lenders are likely to be the main stakeholders involved in discussions about compensation upon termination for private partner default. They will tend to look for the highest possible recovery rate for their loan and the simplest/most objective solution possible. As a result, debt-driven approaches are likely to be more satisfactory to them.

2.12 Sometimes PPP or public procurement laws allow the public partner to terminate for reasons of public interest. Typically, termination payment should be treated the same way as public party default, otherwise, it creates perverse incentives to voluntarily terminate rather than default (or vice versa).

3. List of key performance indicators used in a sample non-concession availability payment agreement

3.1 The amount of non-concession payment (for example, availability payments) depends on the availability of the infrastructure facility to its users, so is closely related to how well the private partner has performed its obligations under the PPPA. Determination of relevant performance standards can be part of a contractually identified performance management system. Such standards are based on key performance indicators (KPIs), defined as more specific milestones in or components of performance measures that indicate progress towards the eventual achievement of the desired performance measures. The adoption of KPIs can ensure continued high-quality performance from the private partner, especially during the operation and maintenance phases of the PPPA.

3.2 Without an effective performance management system – one that contains KPI-related performance standards that reflect public partner, regional and larger societal goals, as well as project-related goals – the risk is that the private partners will have insufficient incentives to achieve optimal performance. The potential disadvantages associated with availability payments can only be overcome with a fully integrated public partner performance management system.

3.3 The following KPIs should be used for PPP projects based on non-concession models with availability (or other) payment mechanisms:

• safety of the public service delivery

• speed of the private partner's feedback on users' claims about quality of the public services

• taking note of users' observations and receptions and measures taken to meet users' suggestions

• overall rate of public service delivery.

3.4 The following KPIs are recommended for the healthcare sector:

• waiting time for patients

• frequency of medical mistakes

• maintaining the confidentiality and privacy of patients

• security and safety of patients

• satisfaction of patients in terms of the quality of the public service delivery

• number of patients who did not undergo a medical examination.

3.5 Several KPI levels should be used in addition to the minimum. The private partner can be paid additional bonuses and incentives upon satisfying these performance levels. This measure aims to encourage private partners to improve the quality of public services provided. Minimum quantitative thresholds (including in percentage terms) and several threshold levels can be set for the KPIs listed in 3.3 and 3.4 above.

4. Adjustments for risk-retained events

4.1 When a compensation event occurs, the private partner has the right to claim compensation to offset the loss it has suffered or will suffer, or part of the loss suffered in shared risk events. The loss may include forgone revenues (for example, revenue lost due to a delay in construction, where the delay is the result of a risk covered by the PPPA as a compensation event).

4.2 The PPPA should set out the process of claiming, determining and implementing the compensation, including the potential means to grant the compensation or liquidated damages for various situations (delays, consumption, maintenance default with a number of different penalties). The approach used to calculate compensation and restore the balance should be described in the PPPA.

4.3 Once the loss is determined (or estimated in events that affect future cash flows), the public partner will have to compensate the private partner. As a common rule, a direct payment will compensate for events that affect capital expenditure, and events that affect future revenues or costs will be compensated by supplementary payments or by agreeing to a change (increase) in the public service price or in the tariff (in user-pays contracts).

4.4 Another adjustment are force majeure provisions that deal with circumstances beyond the control of the parties to the PPPA and make it impossible for the affected party to fulfil its contractual obligations. These provisions aim to provide relief to the affected party. In a PPP, the occurrence of a force majeure event will raise two important issues: the extent to which the private partner is compensated during such events and whether the PPPA should be terminated if a force majeure event persists for a significant period.

4.5 In case of termination due to a force majeure event, the public partner shall pay either the depreciated book value of the assets or the value of the assets appraised in their damaged condition at the time of termination. The costs of restoring the assets to their condition before the occurrence of the force majeure event may be shared with the private partner in the case of natural force majeure.

4.6 When addressing force majeure provisions, the public partner is encouraged to take into account the following points:

• **Reducing uncertainties** – Investors and lenders will be concerned about the extent of coverage they obtain from force majeure provisions. They will seek protection for all unforeseeable events that are beyond the private partner's control. They will prefer defining/spelling out force majeure events (for example, itemised list) and including catch-all provisions.

• **Reviewing the legal framework** – The public partner should verify the extent to which the applicable legal framework (for example, the relevant PPP laws) caters to force majeure and assess whether the provisions are sufficiently clear and workable.

• **Force majeure relief and mitigation** – Force majeure relief should only be granted to the private partner if the relevant event makes it impossible to comply with all or a material part of the contractual obligations. The private partner should be responsible for mitigating the effect of the force majeure event wherever possible.

• **Payments during force majeure events** – Because of a force majeure event (and while it lasts), the private partner may not receive revenues, yet still incur fixed costs (for example, debt service) that may affect its financial standing. The public partner should assess the extent to which it is prepared to pay compensation to the private partner to prevent a default under its project or financing agreements for a certain period of time.

• **Insurance** – The relationship between force majeure relief and insurance coverage should be considered with care.

• **Prolonged force majeure** – The PPPA should provide for termination rights following a lasting force majeure. Both parties should be given the opportunity to terminate the PPPA after a certain period if it is unlikely that the project circumstances will return to normal.

4.7 When addressing issues related to compensation for force majeure termination, the public partner is encouraged to consider the following points:

• **Lenders' expectations** – Lenders will usually not agree to be exposed to financial losses because of a force majeure termination. As a result, the public partner should ensure that compensation provisions

cover at least all sums owed to the lenders (such as debt outstanding and hedging breakage costs).

• **Balancing interests** – It is widely recognised that the private partner should not receive equivalent compensation in force majeure termination compared with public partner default termination. A full payout to the private partner could represent poor value for money for the public partner. However, penalising the private partner unduly for events that are beyond its control would be equally untenable.

5. Periodic review and resetting of certain values

5.1 Any PPP requires a clear set of rules to index payments to capture the natural movement of inflation in terms of cost and the price of public services. Provided it is clear how indexation to the consumer price index (or a similar benchmark of price) provides value for money, the question is to what extent the payments should be linked to inflation to avoid overprotection of the inflation risk.

5.2 In the context of user-pays projects (for example, a toll road, a rail project including service operations or a water PPP including water supply to the public), revenue risk includes the risk of user charges not being at the anticipated level each year. This may cause lower- or higher-than-expected income.

5.3 When assessing risk, it should be noted that price volatility affects volume risk, so lower tariff levels will not necessarily result in lower revenues, or vice versa. The tariff or price of the user charge in user-pays projects may be unilaterally fixed by the relevant SGAs or set by the private partner, usually under certain caps and predetermined rules for indexation.

5.4 Inflation, when considering costs as well as revenues, is a two-sided risk: higher inflation affecting costs will result in lower operational margins. Inflation risk refers to the risk of inflation eroding the value of payments received by the private partner. If the payments do not capture inflation, the real value of revenues will be greatly eroded when inflation is higher than anticipated. This may be exacerbated by cost inflation, resulting in a lower operating margin. Inflation risk should be a shared risk, with the SGA protecting the private partner by indexing (to some extent) the payments.

5.5 When the project is user-pays, the risk of inflation may be transferred to the user (considering affordability issues and willingness to pay) as long as the private partner is able to revise the toll (or tariff). When inflation moves above the limits set out in the contract for indexation of the tariff levels, either party can bear the risk, depending on the specifics of the project and the agreement of the parties.

5.6 The principle is that, regardless of the actual tariff settled on each year for the user payment, the private partner receives the same amount per user. This is done through a settlement mechanism, whereby the public partner pays the difference between the actual revenue and the deemed revenue (calculated by applying the shadow tariff). Conversely, it can receive a payment from the private partner when the actual tariff exceeds the baseline tariff curve. This mechanism works well in projects where demand is highly or totally captive, especially when fare levels are subsidised or clearly below the maximising revenue level (for example, for public transport or water supply).

5.7 When the private partner can set the tariff, even if it is capped (for example, usually in road projects and always in rail projects), the certainty of the tariff level is high and the private party should bear the risk of different tariff levels affecting the revenue as projected. The fundamental point in these cases is to make clear in the PPPA the methodology used to raise or review the tariff during the course of the agreement, which refers to indexation issues.