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Volume II

EBRD PPP
Regulatory guidelines collection

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Foreword

This publication consists of three volumes, issued electronically with a limited number of hard copies. The collection is a culmination of over five years of hard work by a dedicated group of experts, most of whom took an active part, either on a pro bono basis or with a symbolic honorarium, in leading efforts for at least one of the chapters.

This publication was led by Chief Editor Alexei Zverev, Senior Counsel at the EBRD, with support and contributions from Reviewing Co-editors Christopher Clement-Davies, independent lawyer and consultant, and Chris Shugart, independent consultant. Additionally, this collection has benefited from a series of substantial commentaries and edits by a wide circle of stakeholders and contributors. The EBRD extends its thanks to all those who contributed to the publication, with special mention to Dražen Crčić and Sapun Ltd, the collections publishing agents, for their wonderful cooperation and dedication in bringing this publication to fruition.

The publication was created in response to feedback from governments and authorities in EBRD economies regarding the need for internationally accepted standards and best practices for the public-private partnership regulatory and institutional frameworks.

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Chapter 1.
Guide to preparing a PPP policy statement

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Definitions

Contracting authority	The public-sector (government-related) entity that enters into a public-private partnership agreement with a private partner
Country X	The fictitious country that is supposed to have prepared the policy statement of which the executive summary is given in Part C
EES	The executive summary example given in Part C
Guide	The present document in its entirety
PPP	Public-private partnership
Private partner	The entity that enters into a PPP agreement on the private-sector side

N.B. The country's policy statement should include a list of acronyms and definitions. These are not provided in the Guide. They will depend to some extent on the choices the country makes about its PPP policy.

Part A. Introduction for the user

General

Countries – or subnational administrative units (provinces or states) – that are contemplating launching a coherent, systematic programme of public-private partnerships (PPPs) may find it helpful to begin by formulating and formally approving a policy on PPPs. This can be useful as PPPs are complex and touch on many different aspects of public policy which evoke many different points of view – and misunderstandings and misconceptions – about PPPs.

A PPP policy can serve several purposes. It can:

- give an overall, coherent policy framework for PPPs in the country
- constitute a first step in drafting (or amending) a PPP law and in drafting implementing regulations
- educate stakeholders about PPPs
- facilitate and help structure debate about PPPs, with a view to obtaining consensus on main issues
- send a message about the government's intentions to operators, lenders, equity investors and donors.

Process

The process of working on a PPP policy is useful to bring out misconceptions and inconsistencies. Working through these issues first at policy level will make for stronger legal and institutional frameworks. The process should ensure that all major stakeholders – including the private sector and potential financiers – provide input. The process can help achieve consensus within government and among major stakeholders on at least the main points.

The policy preparation process might include steps such as:

- constituting a policy team
- reviewing existing policies, practices and perceived problems
- discussing and agreeing on key issues and questions
- instructing researchers to summarise international practice and opinions concerning key issues and questions
- consulting with a wider group of stakeholders
- undertaking study trips to other countries
- preparing and discussing drafts.

Terminology

It will be helpful to clarify terminology. Different terms can be used: "policy", "policy document" and "policy statement" are common and usually mean about the same thing. The present document will often use the term "policy statement".

In some countries (notably, Commonwealth countries, but also those in the European Union), the term "white paper" is often used to mean an official paper describing the government's policy on a particular topic. White papers may be presented for debate in parliament.

The term "policy paper" is more often used to mean a research piece focusing on a policy issue and providing clear recommendations intended for policymakers. It could be written by a government department or by external authors or a think tank. The term "policy paper" is generally not used for the final official statement of policy issued by the government.

A "policy brief" or "policy memo" (or "decision memo" or "option memo") is likely to be a shorter document giving policy arguments relating to a narrower issue that needs to be decided. It may, for example, be submitted by staff to a government minister.

In Commonwealth countries and in the European Commission, the term "green paper" is often used for a more provisional document, intended to initiate or stimulate debate. The term "consultation document" is similar. A country may wish to begin the process of preparing a PPP policy by issuing a consultation document. The contents would be similar to those given in Part B, but more options for each policy choice might be presented and a list of questions would normally be included as a way to stimulate comments by readers.

A related term is "drafting instructions", which is used in some countries for a document written by the staff of policymakers that describes, in non-legal language, the intended substance of a new or amended law. The purpose is to inform the legislative drafter about the objectives, the actors and their responsibilities, and so on. It is like a policy statement in some ways, but it is more tightly drafted and more focused on what the legislative drafter needs to know. It could be in the form of an outline of main substantive points ("heads of terms").

No standard model

There is no "one size fits all" model for a PPP policy statement. Different countries have different administrative traditions and different needs and constraints. The length of the document normally ranges from 10 to 50 pages. Longer documents are well served by including a short executive summary. Another possibility would be to issue a shorter policy statement accompanied by a longer working document.

Style

A policy statement should be drafted in a style that differs from that of a law or regulations. It can include statements about the government's findings, conclusions, expectations and intentions – aspects that would not normally be treated in laws or regulations (except in a distinct first part – a preamble or "recitals"). Matters of fact and opinion can be mixed in with normative statements – again, unlike legislative style.

The style of writing in a policy statement depends very much on administrative convention in the country. Some countries prefer a formal "administrative report" style. Others favour a more informal document – for instance, using the word "we" in place of "government" and using colloquial expressions. This can also depend on the subject matter; a policy document that is expected to be read only by specialists in the field is likely to be written in a drier and more bureaucratic style.

Two slightly different styles for a policy statement (white paper) are illustrated in Box 1 and Box 2.

Box 1.

Example tending towards a more formal, administrative style

Statements taken from the European Commission's White Paper on Sport (July 2007).

- "Sport is a growing social and economic phenomenon which makes an important contribution to the European Union's strategic objectives of solidarity and prosperity."
- "This initiative marks the first time that the Commission is addressing sport-related issues in a comprehensive manner."
- "In preparing this White Paper, the Commission has held numerous consultations with sport stakeholders on issues of common interest as well as an online consultation."
- "The Commission will facilitate the exchange of information and good practice, in particular in relation to young people, with a focus on the grassroots level."
- "The Commission believes that better use can be made of the potential of sport as an instrument for social inclusion in the policies, actions and programmes of the European Union and of Member States."
- "When addressing sport in its development policies, the EU will make its best effort to create synergies with existing programmes of the United Nations, Member States, local authorities and private bodies."
- "The White Paper contains a number of actions to be implemented or supported by the Commission. Together, these actions form the 'Pierre de Coubertin' Action Plan which will guide the Commission in its sport-related activities during the coming years."

Box 2.

Example tending towards a more informal, colloquial style

Statements taken from the United Kingdom's Open Public Services White Paper (July 2011).

- "We believe that a new approach to delivering public services is urgently needed." "We can do better – these outcomes are neither socially just nor economically efficient."
- "Too many of our public services are still run according to the maxim 'the man in Whitehall really does know best'." [Whitehall is the road on which many government offices are located and so refers in general to the British civil service.]
- "Gone is the assumption that a small collection of politicians and bureaucrats have a monopoly on knowledge – and with it the idea that the state alone is equipped to run public services."
- "We will consult on how this can best be achieved in each of the individual services."
- "The Government would welcome views on the following: [...]"
- "To improve the commissioning of public services, it is important to get the balance right between specifying outcomes and enabling innovative approaches to service delivery."
- "This White Paper commits the Government to a programme of modernising public services based on the key principles of increasing choice, decentralising services, opening services to a range of providers, ensuring fair access and accountability to users and taxpayers."
- "In preparing this White Paper, the Government has undertaken consultation with voluntary, community, social enterprise and private organisations, as well as the public. We received over 400 responses to our Modernising Commissioning Green Paper in December last year, and over 50 responses to our public service reform consultation in January this year."

Underlying economics in the policy framework for PPPs

The Guide is based on certain assumptions about the underlying economic principles for a PPP policy. This reflects a strong, although perhaps not universal, tendency in international thinking about PPPs. PPP policy statements do not usually explicitly articulate the assumptions; instead, they remain in the background. It is more appropriate to state them here in Part A rather than in Parts B or C. They are as follows:

- PPP policy is strongly influenced by economic policy relating to public investments and other public expenditures and to the economic regulation of private-sector business activity.
- PPP policy focuses on getting the most economic/social net benefit from PPP projects, and the greatest value for money (see below for how the term "value for money" is used in the Guide.) This is strongly related to welfare economics and more specifically to cost-benefit analysis.
- Policy for PPPs typically focuses on setting conditions for the entry of firms into the market (competition for the market) for certain services serving a public purpose. This includes setting out how these firms will be permitted to price their products and, in transferring risk to the private party, there is an appropriate balance between granting incentives to increase efficiency without imposing costs on firms that lower the overall net benefit of PPPs. These topics are very much the subject matter of classic economic regulation (principal-agent theory, mechanism design and so on.). The difference is that a regime of contracts regulate PPPs. As such, a major aim of PPP regulation is not how to regulate PPPs directly (as in typical utility regulation), but how best to design long-term contracts that will serve various regulatory functions.
- Just as under best-practice policy for the economic regulation of firms, PPP policy must include as an underlying principle that a reasonably efficient and well-performing private partner in a PPP agreement will be able to recover its investments and earn a fair return on them. Otherwise, private partners will not participate.

How to use the Guide

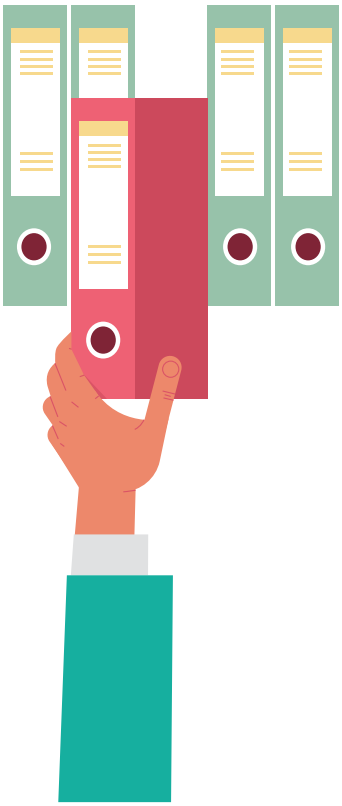
This document is not a full guide to drafting a PPP policy. A large textbook or compendium of papers would be needed to achieve that aim. The purpose of the Guide is much more limited. It consists of two sections after Part A:

- **Part B. Headings and guidance.** This section gives an example of typical headings (first and second level) for a PPP policy statement. They should not be copied unthinkingly by the user, but should be adapted to the country's needs. They are meant to be indicative only, based loosely on PPP policy statements that other countries have adopted.

A list of questions and comments are given under each heading to provoke thought and help the user in formulating government policy for that section.

- **Part C. Executive summary example with annotations.** This section presents an example of what the executive summary of a PPP policy statement would look like – or possibly a very short full policy statement. It is not meant to be a model to be copied in its entirety. Every country has different conditions, concerns and preferences.

Annotations are given on each page in the form of extensive footnotes, often to indicate some of the other positions (or variants of positions) that a country might wish to take on certain issues.



Part B. Headings and guidance

• The guidance points given under each of the headings below are a non-exhaustive selection of questions and issues that might be examined in writing the relevant section. They are not meant to be a point-by-point outline of the text of that section. The organisation of ideas as expressed in the sections of the policy statement may differ from the order below.

• To minimise repetition, examples of elements to include in the policy statement that are found in Part C are sometimes not included in Part B – and vice versa. For this reason, Part B should be read together with Part C.

[Foreword]

In some countries, the policy statement will include a short foreword under the name of a high-level government official – for example, the head of the ministry that has primary responsibility for preparing the policy statement. The foreword (if there is one) will usually send a strong message of government endorsement of the country's PPP programme and of commitment to create conditions attractive to private investment through PPPs.

Executive summary

An executive summary is always useful and recommended. An example of such an executive summary (but longer than an actual one should be) is given in Part C of the Guide. As noted in Part A, some countries may prefer to issue a short policy statement (like Part C), accompanied by a longer "working paper", or similar.

1. Introduction

1.1 Background

(a) How do PPPs fit within a broader range of activities involving cooperation between the public and private sectors?

(i) Some countries refer to the entire range of cooperation between the public sector and the private sector as PSP (private-sector participation).

(b) Should there be different and distinct legal regimes for different kinds of PPP (in the broad sense of the term) such as concessions and non-concession PPPs? Why or why not?

(c) Should there be a bias in favour of implementing PPPs over public-sector investment projects, or the other way around (all else being equal)? Or no bias whatsoever?

(i) The modern tendency is to have no bias in favour of or against PPPs in deciding how to implement an investment project. Each project should be assessed in a neutral, unbiased way.

(d) What consultations have been carried out during the work to prepare this policy statement? Was a green paper or consultation document circulated? What kind of comments were received?

1.2 Improving public infrastructure

(a) The policy statement might include a short section on the state of public infrastructure, the needs for improving it and how PPPs can help. The contents would depend greatly on the particular circumstances of the country.

(b) Giving a few key facts and figures might enrich this section.

1.3 Links with other government policies and programmes

(a) The policy statement might include a section indicating how PPP policy fits with related policies and programmes. For example, depending on the country, linkages and interrelations could be highlighted between PPP policy and the government's policies on the following:

(i) public investment management

(ii) public procurement

(iii) infrastructure improvement

(iv) public service provision

(v) decentralisation of functions to local governments

(vi) foreign investment promotion

1.4 Purpose of the policy statement

(a) What are the main purposes to be served by the policy statement?

(b) One purpose is often to constitute a first step in the process leading to the passage of a new (or amended) PPP law.

(c) Another purpose can be to prepare the way to launch carefully shepherded best-practice pilot projects.

2. Objectives of the PPP programme

2.1 Primary objectives

(a) What are the main public-policy objectives to be furthered by the use of PPPs, as opposed to traditional public-sector investments and service projects?

(b) These should be objectives for the PPP programme of the government in general. These are not meant to be a checklist for assessing each specific PPP. Some worthwhile projects may not help promote any of the primary objectives, but they may be valuable for other reasons.

(c) Be careful not to include means to an end in the section on objectives. For example, "allocating each risk to the party best able to manage it" is not an objective in itself; it is rather a means to obtain greater value from the PPP.

2.2 Secondary objectives

(a) Some countries may wish to list objectives that take second rank to the primary objectives. For example, strengthening local small and medium-sized enterprises may be one of the objectives of the PPP programme, but it is not likely to be a primary objective.

2.3 Dispelling myths and misconceptions

(a) This is not a common section in countries' PPP policy statements, but it is being included here because it might be useful.

(b) Examples:

(i) One example is the idea that financing by the private sector relieves fiscal pressures on the government. It may relieve fiscal pressure in the short term, but not necessarily in the long term. Ultimately, long-term fiscal benefits through PPPs arise only through reduced costs or increased cash receipts from customers (usually linked to improving the quality of services).

(ii) Another example is the idea that the cost of debt in PPP projects is higher than the cost of government debt. If the implicit cost of bailing out government-financed projects is taken into account, much of the difference disappears.

(iii) A final example is the belief in some countries that there is (or should be) a PPP whenever the government subsidises private-sector business activities. This is not correct under most PPP frameworks.

(c) Different misconceptions (if any) arise in different countries. So if a section like this is used, the contents should be carefully tailored to the specific country.

3. Definition and characteristics of PPPs

3.1 Essential attributes

(a) What are the essential attributes of (key criteria for) a PPP – that is, those that must be present for the arrangement to qualify as a PPP under law?

(i) If the government has a PPP policy and there will be a PPP law, there needs to be a definition of PPP that makes it reasonably clear whether a described project is or is not a PPP. The definition should therefore reflect a well-thought-through decision about what kind of projects need to be treated in this special way. The boundaries of any definition like this will be somewhat arbitrary, of course.

(b) Recognise the difference between saying (i) an arrangement is not to be considered as a PPP unless it meets certain conditions and (ii) an arrangement may be a PPP, but not a PPP worthy of being pursued (not a "good" PPP) unless it meets certain conditions. There could be two sets of conditions: one to determine if the arrangement is (minimally) a PPP and the other (appraisal criteria) to determine if the PPP is worth carrying out.

(c) Necessary elements of a PPP in common usage internationally include items such as the following (where all must be present for the arrangement to be a PPP):

(i) Based on a long-term contract between a public-sector contracting authority and a private partner (a private-sector, majority-owned company).

(ii) Involves the provision of infrastructure or services, in either case serving a public purpose, and involves provision of services of some kind (at least maintenance) until the end of the contract.

(iii) Required performance specified mainly in terms of outputs, not inputs.

(iv) Includes significant/substantial risk transfer to the private partner and incentives given to the private partner for efficient performance and adequate service quality.

(d) One important distinction for countries in, or associated with (or inspired by the law of) the European Union (EU), will be the distinction between concessions and non-concession PPPs. Some countries may view this as the distinction between user-pay and government-pay PPPs. While this is

generally correct under EU law, there are also some more complex criteria focusing more on risk allocation.

(e) Should there be a minimum term (duration) of the contract for there to be a PPP?

(f) Should there be a minimum value? If so, should the policy give a rough indication of how the value of a PPP will be calculated, or should this be left to later regulations?

(i) Given that transaction costs have a fixed component, it will not make sense to carry out very small projects as PPPs (the transaction costs will likely outweigh any net benefit). But if the documentation for a type of PPP project has become more standardised, the transaction costs might fall.

(g) Should private-sector financing be an essential attribute of a PPP, in which case certain arrangements such as DBOs (design-build-operate, with public-sector funding of capital costs) would be excluded from being PPPs? Some countries list private-partner financing as an essential element of a PPP.

(h) Will a government entity be permitted to be a passive, minority shareholder in the private partner (the PPP company)? Some countries permit this.

(i) A government entity can also be a controlling shareholder. This option will not be considered in the Guide because it creates an arrangement very different from a classic PPP and so deserves more extensive and separate treatment.

(ii) The European Union uses a special term – institutional PPP – for mixed-ownership PPP companies (applicable where the government entity has a minority or majority share in the private partner). There would not seem to be any particular advantage in using this term if the only type being considered in the PPP context is one in which the government entity has a minority share and is a passive investor.

3.2 Permitted activities of the private partner

(a) Given that PPPs may be a new concept for the country, it may be useful in the policy statement to list some of the activities for which the private partner can be made responsible. These could include some or all of the following: design and engineering; financing; construction, renovation, rehabilitation, expansion; installation of equipment; operation; maintaining works and equipment (routine and periodic maintenance, preventive and corrective maintenance, and including periodic asset replacements); charging prices to customers (determined by the terms of the PPP agreement); and directly billing and receiving revenue from them.

3.3 Illustrative types of PPP

(a) There are many activities that could be included in a PPP and many ways that a PPP could be structured. Some countries find it useful to list example types of PPPs in their policy statements. This concretises the basic definition, helps explain the concepts and gives assurances that the listed types are indeed permitted (safe harbour).

(b) Common PPP arrangements include: operation and maintenance contracts; operating PPP (sometimes called operating concession); operate-maintain-manage (OMM); design-build-finance-operate (DBFO); build-own-operate-and-transfer (BOOT); rehabilitate-operate-transfer (ROT); and design-build-finance-maintain (DBFM). These types do not have consistent precise definitions in international practice. They are often meant to be merely suggestive.

3.4 Excluded arrangements

(a) Should a natural-resource concession (such as mining) be considered a PPP? Many national policies would exclude this arrangement because it operates under very different principles.

(b) Should an arrangement in which a national utility regulator periodically sets or adjusts user tariffs be considered a PPP, or would it be considered a regulated utility?

(c) Are there other types of arrangement involving private-sector participation that should not be considered to be PPPs (for purposes of policy and law)? Examples might include:

(i) a privatised company that now operates in the free market

(ii) a government-owned hotel under a management contract

4. PPP sectors

4.1 Priority sectors for PPPs

(a) What are the priority sectors for PPPs?

(b) Generally, the list given will be a non-exhaustive list of permitted sectors where the most attention will be given.

(c) It might be helpful in the policy statement to summarise the known PPP opportunities in the various priority sectors.

4.2 Excluded sectors and activities

(a) The government may wish to exclude PPPs from certain sectors or activities.

(b) As this is policy and not law, the government may wish to state that little attention will be given to promoting PPPs in certain sectors or certain activities, even though there will not be an exclusion.

5. Key PPP principles

(a) The headings that follow are one possibility. Governments may wish to formulate a somewhat different list.

5.2 Introduction

(a) What are the key public policy principles that should govern PPPs? These would be overarching principles that should be considered when preparing and procuring PPPs.

(b) The subsections below give some possibilities for key principles. These are not the only possibilities; they are merely illustrative.

(c) The allocation of principles, attributes and criteria to the different categories – (i) aspects of basic definition of a PPP, (ii) key principles and (iii) appraisal criteria – is somewhat arbitrary. Or at least there can be an overlap.

5.3 PPP suitability factors

(a) Some projects are more suitable when carried out as public-sector investment projects and some are more suitable implemented as PPPs. It is useful when initially screening projects to have a set of factors that helps decide what model to use to implement the project.

(b) The list below is of typical PPP suitability factors. Many are based on a key characteristic of a PPP – namely, that it should be based on a "tight" long-term contract. It is not being suggested that the user should necessarily include all of these factors in the policy statement.

(c) None of these factors is decisive taken alone and quantitative scores are not recommended, although that is one possibility. In any event, the rationale for undertaking a PPP, as opposed to a public-sector investment project, becomes weaker as more of the factors below receive a negative assessment and as that assessment becomes more strongly negative.

(d) The criteria below should not be used just to screen projects, but also to gain a better understanding of the project and the areas in which the project can be strengthened if implemented as a PPP.

(e) Example list of PPP suitability factors (it is not being suggested that the policy statement should necessarily include all of these):

(i) The outputs to be delivered can be specified objectively and precisely and measured and monitored well.

(ii) The service needs are not expected to change in unpredictable ways in the short or medium term.

(iii) The technology and other relevant aspects of the sector are expected to be fairly stable.

(iv) The risks affecting the project are well understood and the contract can include adequate mechanisms to address the consequences of these risks materialising.

(v) The arrangement is not highly complex from a contractual point of view.

(vi) There are strong opportunities for economies of scale by bundling together design and construction, and operation and maintenance (or some of these).

(vii) The private sector is expected to have greater capacities and skills than the public sector to implement the project and deliver the required services.

(viii) The project is large enough in relation to expected transaction costs to make it worthwhile to pursue as a PPP.

(ix) There is strong expressed interest from operators, investors and lenders.

(x) It is expected that there will be strong competition in bidding for the PPP project.

5.4 Value for money

(a) It is generally accepted that PPPs should be selected and designed to enhance value for money in some sense.

(b) "Value for money" is defined in different ways in PPP policy statements and laws. It is important to be clear about the definition used. (Unfortunately, some PPP policy statements and even laws use the term, but do not define it.) One distinction found in different definitions is between the financial perspective of the government department and the economic perspective of society as a whole.

(c) The definition used in the Guide (simply as an illustration to provoke debate and not necessarily to be copied verbatim by users) is given below.

5.5 Affordability

(a) There are two different ways the term "affordability" is used in this context.

(i) First, the prices charged to users must be affordable.

(ii) Second, any payments to be made from the government budget in the future must be "affordable" in the sense that they can be paid from the budget without jeopardising other planned expenditures.

5.6 Stakeholder consultation

(a) Efforts need to be made to hear the views of major stakeholders of all types. Good communication helps enable buy-in by these stakeholders and prevent political and social objections later.

5.7 Transparency

(a) Transparency of process, documentation and results is important to reduce the risk of corruption and enhance public confidence.

5.8 Competition

(a) Strong competition is often considered an important element to achieve high value for money.

(b) Should there be a preference for selecting private partners by full competitive bidding, with any abbreviated procedures (including single-source procurement) being the exceptions? Views on this differ.

6. PPP design

(a) Countries may wish to describe briefly the main issues related to the design of the PPP arrangement. Alternatively, it may be sufficient in the policy statement simply to list these items.

(b) The four subheadings below cover the most important aspects of the basic design of the arrangement. Of course, many other details are involved in designing a PPP.

6.2 Allocating responsibilities

(a) It is important to begin thinking early about which responsibilities will be given to the private partner and which will be retained by the contracting authority. This is a core consideration.

6.3 Specifying required performance

(a) What key performance indicators (KPIs) and corresponding values must the private partner achieve to comply with the PPP agreement? These should be carefully selected.

(b) There should be some type of sanction for deficiencies in performance. The required KPIs must have "teeth" of some kind.

6.4 Payment mechanism

(a) What principles should govern the remuneration that the private partner receives?

(b) A well-specified payment mechanism is crucial to a PPP. Several purposes must be served: to ensure that a reasonably efficient provider can recover its costs and make a fair return on its investments, to allocate certain risks and to provide appropriate incentives for efficiency and good quality of assets and services.

6.5 Allocating risks

(a) What principles should govern how risks are to be allocated between the parties?

(b) Note that a large part of the risk allocation will flow naturally from decisions made about the allocation of responsibilities, required KPIs and the payment mechanism. But there are residual risks that will need to be allocated.

7. Institutional framework

7.1 Public contracting authority and project preparation team

(a) The government entity that is the public-sector contracting authority almost always takes primary responsibility for preparing, procuring and overseeing the project. "Single-point responsibility" is an important principle on both sides of the deal.

(b) Some countries require that the contracting authority explicitly designate which team in the authority will be responsible for preparing the PPP project.

7.2 PPP unit

(a) Should there be a central PPP unit (or similar) of some kind? (Remaining questions in this section apply only if the answer to this question is "yes".)

(b) What are the main functions of such a PPP unit?

(c) What possible functions needed for a sound PPP programme should not be performed by the PPP unit (at least not in the short and medium terms)? Who should perform these instead?

(d) Where should the PPP unit be located administratively, and how should it be organised?

(e) How should the PPP unit be funded?

(f) Should other entities be set up to deal specifically with PPPs, such as a PPP steering committee or a PPP commission? What roles will they have?

7.3 PPP units in other departments

(a) Should there be other PPP units (or nodes) in certain line ministries – those with a potentially large PPP deal flow? If so, when should these be set up?

7.4 Other institutional responsibilities

(a) Some countries may wish to list other ministries and departments that make decisions that affect PPPs and describe their main responsibilities in this regard.

7.5 Municipal level

(a) What should the institutional set-up be for municipal-level PPPs (if there will be one)?

(b) What roles should the central PPP unit have and what roles should be retained at the municipal level?

7.6 Approvals

(a) At what stages of project preparation must a specified entity (other than the contracting authority) approve the project to proceed to the next stage, if such approvals are required?

(b) Who will be the deciding body ("gatekeeper"), if there will be one, at each approval point?

(c) Should there be a fast-track procedure for PPPs of lower value or lesser importance?

7.7 Capacity strengthening

(a) What activities will the government undertake to strengthen the capacity of staff in the PPP unit (if there is one) and in relevant ministries to prepare projects and exercise effective oversight of PPPs?

(b) Have any international or bilateral donors been contacted about providing funds for this purpose?

8. Project preparation for PPPs

8.1 Process overview

(a) What stages must a PPP project go through during the preparation process (and afterwards)?

8.2 Identification, screening and project pipeline development

(a) What should be envisaged for these steps? How will the PPP unit (if there is one) help?

(b) Should there be a defined methodology (or at least a list of considerations) for the screening of pipeline projects?

8.3 PPP feasibility report

(a) In most countries, the major appraisal of the PPP takes place based on a comprehensive PPP feasibility report, which can go by different names depending on the country – for example, business case.

(b) What topics would normally be addressed in a PPP feasibility report? Who prepares it? Who reviews it? Is a "go/no go" decision made based on the appraisal of the feasibility report?

(c) Should a full feasibility report be prepared for every proposed PPP project?

(d) Should a pre-feasibility report or concept note be prepared for every proposed PPP project?

8.4 Appraisal of the PPP project – criteria for appraisal

(a) To what extent should the review and appraisal process followed for PPPs be the same as for public-sector projects?

(i) One possibility is to use the same review process until it is decided whether the project will be a public-sector investment or a PPP.

(b) Should there be a major appraisal step after a PPP feasibility report has been prepared and before detailed preparation of the draft contract and tender documents begins?

(c) What should be the methodologies, criteria and processes for the appraisal?

(d) Should an economic appraisal (looking at net benefits to economy and society) be carried out for every PPP? Should there be an abbreviated version for lower-value or simpler projects?

(e) Should the fiscal impacts of the PPP (that is, direct and contingent liabilities to the state or municipality) be estimated quantitatively in the feasibility report – and then reviewed and reported to the appropriate debt management department?

(i) How should the government account for the liabilities arising from PPPs?

(f) Should a quantitative "public sector comparator" exercise be carried out for every PPP project?

(g) If appraisal takes place at the municipal level for municipal PPPs, should the central PPP unit (if there is one) be involved in some way in reviewing the feasibility report or appraisal memorandum?

8.5 Funding of PPP project preparation

(a) Should a special facility be created to fund PPP project preparation activities? If so, what are the broad features of such a facility?

9. Selection of the private partner

9.1 General

(a) Should full competitive bidding be the preferred route?

9.2 Competitive bidding

(a) Should full competitive bidding be required for all PPPs?

(b) Under what conditions, if any, should single-source procurement of PPPs (direct negotiations) be permitted?

(c) Should PPPs use a different set of procurement rules, or should they follow the country's procurement rules for ordinary works, goods and services – with a few modifications that are specified in law?

(d) Should different procurement rules be used depending on the type of PPP (for example, concession versus non-concession PPP)? (Countries in or associated with the European Union are likely to do this.)

(e) Should there be a specific policy for how to proceed if there is only one responsive bidder in a PPP bidding procedure?

9.3 Unsolicited proposals

(a) What principles should govern the treatment of unsolicited proposals (privately initiated proposals) for PPPs?

(b) Should unsolicited proposals be considered only for potential PPP projects that are innovative and unusual in some way? Or for any PPPs that are not already in the official PPP pipeline?

(c) Should the proponent of an unsolicited proposal for a PPP be compensated for its reasonable preparation costs if it does not win during the subsequent competitive bidding procedure?

(d) Should other advantages or benefits be given to the proponent of an unsolicited PPP proposal?

10. Legal framework

(a) This section should ideally be written based on the results of a detailed legal review.

10.1 PPP law

(a) What are the main laws and amendments that will need to be passed to reflect and implement the policy statement? What are the main reasons for such laws and amendments?

(i) This is meant to include only the most obvious laws that the policy statement will affect. Legal specialists will develop the full list of consequential amendments, which would not usually be included in the policy statement, which is intended for a more general audience.

10.2 PPP agreement

(a) The PPP agreement sets out the core elements of the PPP – starting with the precise obligations and rights of each party.

(i) Notably, the private partner promises to provide certain services over the term of the PPP and to carry out the works and activities needed to provide these services. In exchange, the contracting authority promises to pay the private partner for the services or to allow the private partner to charge end-users directly.

(b) Should the PPP law (if there is one) include a list of the main topics that must be covered in the PPP agreement? Some countries find a mandatory list of key topics useful to ensure that the agreement does not contain gaps. Other countries may include a non-mandatory list that is illustrative only.

(c) What are the public policy issues involved concerning the payments to be made by the parties in the event of early termination? This is an important issue for private partners and their lenders. Each PPP agreement will need to set out the circumstances justifying early termination with clarity and precision.

(d) Senior lenders will insist that all of the outstanding debt (or in any case, most of it) will need to be paid back upon any early termination. Given that potential lenders (especially international financial institutions) will look carefully at the policy statement, it may be useful to discuss this issue briefly in the policy statement.

11. Financing of PPPs

11.1 General

(a) As the private partner generally provides or organises the financing for the PPP, there is no need to spend many pages on this. However, certain issues are worth highlighting in the policy statement.

(b) In certain countries, it might be useful to carry out a financial market review as a prelude to writing the policy for this section. The purpose of this review would be to assess the country's financial suitability for financing PPP projects. The availability of financing will depend crucially on the country's perceived level of risk, among other factors.

11.2 Rights of lenders

(a) What rights should senior lenders be given in connection with their financing of a PPP?

(i) In a PPP financed by project finance, senior lenders will generally insist on having a so-called direct agreement with the public authority. The main feature of the direct agreement is to allow the senior lender to step in and replace the private partner if the private partner defaults or is about to default on the PPP contract or loan.

(ii) Lenders rarely (in fact, almost never) exercise their step-in rights. As with other seemingly draconian provisions in project-finance agreements, the main purpose is to make sure that lenders have a seat at the negotiating table if things start to go wrong and to give them sufficient bargaining power to force the private partner to take the remedial action needed.

(b) What kinds of security interests should senior lenders be able to obtain? The treatment of this issue in the policy statement, if discussed at all, would not be detailed and legally technical; it would merely sketch out a broad direction to follow.

11.3 Government financial support

(a) Should the government be permitted to partly finance or guarantee the financing of a PPP? Under what conditions?

(i) A common kind of government financial support in certain user-pay PPPs consists of a minimum-revenue guarantee, or similar.

(b) What types of credit enhancement from the government should be allowed, and under what conditions?

(c) Will the government consider giving certain kinds of financial support? For example, there may be a need for "viability gap funding" to make an economically sound project financially feasible for the private partner. Should there be a policy about viability gap funding?

(d) Another question related to government support is whether the central government will give guarantees for the PPP payment obligations of specific state-owned enterprises or for municipalities. This question arises frequently.

12. Contract monitoring, oversight reporting and evaluation

12.1 Principles relating to transparency, disclosure and communications

(a) What should the policy be in these areas?

(b) The modern trend is to make the process transparent and to permit most project-related documentation to be disclosed to the public, with suitable safeguards for legitimate commercially sensitive information.

12.2 Monitoring and oversight

(a) What should the requirements be for PPP contract monitoring and oversight?

(b) Who should be responsible for carrying this out?

12.3 PPP data analysis and reporting

(a) What should the responsibilities be with respect to compiling, analysing and reporting (to government and to the public) information based on all PPPs in the country?

12.4 Ex post evaluation

(a) Who should carry out ex post evaluations at the end of the life of every PPP, and possibly at periodic intervals before that?

(b) What should these ex post evaluations consist of?

Part C. Example executive summary with annotations

This example executive summary (EES) is not intended to be a model document or to illustrate international best practice. Although the broad lines attempt to reflect generally accepted views, it is merely an example of a possible executive summary of a PPP policy statement that might be prepared by a hypothetical country. Countries' views differ on many aspects covered in the EES.

- For simplicity, the organisation of the EES follows the first-level headings given in Part B.
- The EES is probably too long for an actual executive summary. The length serves a useful purpose here, however, as the main text of the policy statement is not provided.
- The comments given as footnotes are not intended to be part of the EES or policy statement. They are annotations for use by the preparer of the policy statement.
- "Main text" here means the main body of the policy statement, which would follow the executive summary.

1. Introduction

Over the past decade, [Country X] has made great strides to improve the investment climate for both foreign and local private-sector companies.[1] As part of a continuing effort, the government intends to create a solid foundation for public-private partnerships (PPPs), which allow the private sector to become involved in the economy, expand public infrastructure and improve public services, in alignment with [Country X's] development objectives.

PPPs or similar arrangements already exist in [Country X], but a systematic framework has not existed until now.[2]

By harnessing the financing, know-how and management capabilities of the private sector through long-term contracts that transfer certain risks to the private sector and encourage better asset utilisation and whole-of-life costing, PPPs can deliver improved services more efficiently.[3]

[1] It may be useful to begin the policy document by showing how PPPs fit into the government's broader efforts to build infrastructure and promote private-sector investments. The EES refers to the latter, but not to the government's efforts in the area of public infrastructure – a topic that could be added.

[2] Countries adopting a new PPP framework often find that various arrangements already exist that are, or are similar to, PPPs. One purpose of a policy statement, in that case, may be to clarify how new PPPs are similar and how they are different from the most common existing PPP-like arrangements.

[3] Some countries may wish to place this in the context of international PPP practice as it has developed over the past few decades.

PPPs are not intended to replace traditional public-sector investment projects.[4] The aim instead is to use each method in a strategic way that results in greater value for money.

The government is committed to developing a coherent and systematic approach to PPPs, aligned with best international best practice. The process will start with this PPP policy statement.

Preparation of the policy statement began with a consultation document that was posted on the Ministry of Finance website.[5] Comments were received from numerous departments and stakeholders and the general public. (These comments are available on the website.) In addition, several discussion meetings were held.

The policy statement will be followed by a PPP law and the creation of a PPP commission and PPP unit. Detailed regulations and guidance documents will also follow.[6]

A set of carefully selected and supervised pilot PPP projects will then be prepared and implemented. Establishing a good track record from the start will boost investor confidence in the process and give assurances of the government's commitment.

The purpose of the policy statement is to describe the overall policy of the government concerning PPPs. The PPP law will include some of the ideas in the policy statement. Some will be used later in implementing regulations and guidance documents.

The policy statement should prove useful to private operators, investors and lenders in understanding the government's vision for PPPs in [Country X].[7]

2. Objectives of the PPP programme

The primary objectives[8] of the PPP programme in [Country X] include the following:[9]

- Accelerate investment in new infrastructure and further the upgrading of existing infrastructure.
- Bring additional financing for investments in infrastructure.[10]
- Lower the cost and improve the quality of public infrastructure and services through better construction, operation and maintenance.
- Ensure optimal maintenance throughout the life of the assets.
- Benefit from the private sector's experience, technologies, efficiency and innovation.

3. Definition and characteristics of PPPs

Not all valuable arrangements involving participation of the private sector for a public purpose are PPPs.[11] The policy statement sets out a definition of PPP and gives its general characteristics. It is important to have a clear definition of a PPP to know when the policy and PPP law do or do not apply.

A PPP involves a legally binding long-term contract between a public-sector contracting authority and a private partner, for the provision of public infrastructure or services with a public purpose.[12] The services in question are of a kind that would traditionally be provided by government, not by

[4] In the past, some countries officially prioritised PPP projects: a traditional public-sector project would be considered only if a PPP was not feasible. It is now more common to put both on a level playing field and to assess which mode of implementation is likely to yield greater value for money.

[5] Some countries do not yet have the practice of posting consultation documents and soliciting opinions from people outside government before issuing policy statements or regulations. There can be great merit in doing this, if carefully managed.

[6] In the EES, "guidance document" refers to a non-binding document that explains in a more user-friendly way the laws and regulations and how to carry out all the steps needed to prepare, procure and manage the oversight of a PPP.

[7] Outsiders will pay careful attention to the policy statement and it may have a considerable influence on the degree to which they want to become involved (provided that the subsequent new legislation is also sound). An important purpose of the policy will be to convince the private sector and the financial community of the genuine commitment of the government to a sound PPP framework.

[8] As noted in Part B, a set of less important (secondary) objectives might also be noted in the main text.

[9] There is some overlap between this list and the list of appraisal criteria for PPP projects. This does not mean, however, that every PPP must do something to further all of these objectives. This point should be made clear in the main text.

[10] Although many countries use PPPs to overcome short-term budgetary constraints, this can be dangerous because the financing must be repaid, and this can constrict fiscal space in later periods. In the long run, PPPs create additional value by reducing costs and improving services (and hence augmenting revenue). As the topic often causes confusion, these issues might be discussed in the main text.

[11] The main text might describe other kinds of private-sector participation common in the country as a way to make the distinction with PPPs clearer.

[12] Countries use different terms for the public-sector party and private-sector party.

a private-sector operator. The duration of a PPP agreement will normally be from 5 to 30 years.[13]

Broadly speaking, the contracting authority for a PPP can be any government-related body that is normally responsible for the relevant infrastructure or services.[14]

Responsibilities given to the private partner can include: design and engineering; financing;[15] construction, renovation, rehabilitation or expansion of assets; installation of equipment; operation; maintenance of works and equipment, and related activities. The private partner must continue to be involved operationally in some way during the entire term of the PPP.[16]

The required performance of the private partner will be specified principally in terms of performance outputs (services to be delivered) rather than physical inputs (detailed description of capital works or equipment).[17] This allows the private partner sufficient freedom to innovate and achieve efficiencies.

The PPP arrangement must involve substantial risk transfer[18] to the private partner and sufficient incentives being given to it to induce efficient performance and adequate service quality.

The private partner may be remunerated by payments made by users of the service, payments from central or local government budgets, revenue from ancillary commercial activities or a combination of any of the above.[19]

The policy statement sets out examples of various types of PPP arrangements – among others – that will be permitted. They involve various combinations of responsibilities for design, construction, operation and maintenance, and various possibilities for ownership of assets.[20]

4. PPP sectors

It is expected that the PPP programme in [Country X] during the first years will place an emphasis on the following sectors and subsectors:[21]

- solid waste processing and disposal
- healthcare
- information and communication technology and related administrative services
- road and rail transport
- airports and seaports
- electricity generation.

PPPs in other sectors will also be permitted.[22]

[13] More should be said about this in the main text; it is a very important issue.
Some countries restrict PPPs to arrangements that are at least a specified minimum number of years – for example, 3, 4 or 5. There are several reasons for doing this. First, it may be felt that the added requirements and protections for PPPs are not needed for shorter-term (and hence generally lower-value) projects. Second, if there is a PPP unit, it may be felt that the unit should not be burdened with a large number of shorter-term contracts – including simple service contracts.
Some countries also set a maximum term for PPPs. The rationale is generally that the PPP mechanism should not be used to create unnecessarily long-term monopolies and that more frequent rebidding brings greater value for money. Other countries do not set any maximum term as a policy matter, leaving this to be decided for each specific PPP agreement.

[14] More specificity should be given in the main text. A question that frequently arises is whether state-owned (or municipally owned) enterprises can be PPP contracting authorities.

[15] Some countries require significant financing of investments by the private partner to be an essential element of a PPP. Other countries do not impose this requirement, permitting long-term management or leasing (affermage) contracts, and similar, to be PPPs.

[16] The idea here is that an arrangement would not be a PPP, for example, if it consists essentially of construction only, with deferred payment to be made by the contracting authority over a number of years.

[17] This is one of the classic distinctions between traditional public-sector projects and PPPs.

[18] Countries differ as to the degree of risk transfer that must take place for the arrangement to be a PPP. It is generally agreed that if the private partner bears no risks at all (essentially a cost-plus contract), then the arrangement should not be considered to be a PPP.

[19] Country X has decided to use "PPP" in an all-embracing way to include both user-pay arrangements and government-pay arrangements. Countries that wish to follow EU law, and some countries influenced by the French administrative law tradition, distinguish between user-pay arrangements and government-pay arrangements, calling the former "concessions". (With more complexity, they may define "concession" in relation to the kinds and degrees of risk transferred to the private partner.) This is a specialised topic that will not be addressed in any more detail in the Guide.
An example of an "ancillary commercial activity" would be the rental of space in a PPP parking garage by the private partner to shops, restaurants and so on (done in compliance with the PPP agreement).

[20] The main text might give as examples, and describe, some of the typical acronyms used in connection with PPPs: DBFO, ROT and so on.
Some countries restrict PPPs to a set of types defined in this way, perhaps with exceptions to be granted by a higher authority. Other countries permit many combinations of activities and ownership to be PPPs, as long as the arrangement includes the essential attributes.

[21] This list is specific to the fictitious Country X. Countries have different priorities.

[22] Some countries limit the eligible sectors to those explicitly indicated in the PPP law, with higher-level approval needed for PPPs in any other sectors.

5. Key PPP principles

Several overarching principles will be reflected in the way the PPP programme is carried out. They are summarised below.

PPP suitability factors. Some projects are better suited to being implemented as public-sector projects and some are better as PPPs. The factors that favour using PPPs – for instance, where PPPs are more likely to bring significant added value compared with traditional public-sector procurement – include the following:

- The outputs to be delivered can be specified objectively and precisely, and measured and monitored well.
- There are strong opportunities for economies to be realised by bundling together design and construction, and operation and maintenance (or some of these).
- The project is large enough in relation to expected transaction costs to make it worthwhile to pursue as a PPP.
- It is expected that there will be strong competition in bidding for the PPP project.

These factors (among others)[23] will play a role in the screening and appraisal of potential PPP projects.

Value for money.[24] An important consideration in selecting and designing PPPs is to enhance value for money, which is defined for the purpose of the policy statement as the overall value to consumers and the broader public sector, taking into account long-term quantity and quality of services and whole-life costs.

Affordability. PPPs will be pursued only if the prices paid by users are affordable and the payments made by central and local governments are affordable from the budgetary point of view.

Stakeholder consultation.[25] During the project preparation process, it is important for the contracting authority to consider the views of all significant stakeholders: potential operators, investors, lenders, customers and other groups in society that may be affected by the project.

Transparency. Transparency is a key principle of a good PPP process. Experience in other countries shows that if the process of selecting the private partner and the resulting terms of the deal are opaque, the public can become suspicious and there can be a strong reaction against doing PPPs. The government is committed to greater transparency in how PPPs are identified, how the private partner is selected and how the PPP agreement works.

In addition, all signed PPP contracts will be made available to the public, subject to reasonable safeguards to protect national security and legitimate concerns about commercial sensitivity.[26]

Competition. Except in special cases, the selection of private partners to implement PPPs will be subject to full competitive bidding. This is an important aspect of enhancing value for money.[27]

6. PPP design

Designing the PPP arrangement requires care and skill. Good design involves:

- clearly allocating responsibilities to the parties
- specifying the performance required of the private partner
- specifying the "payment mechanism" – the precise way the private partner will be remunerated
- allocating risks.

Particular attention during the design process will be given to the allocation of risks. As a general rule, each risk in a PPP should be allocated to the party best able to manage that risk. This helps maximise total project value.

Most risks related to construction, operation and maintenance are generally allocated to the private partner. A principal reason why PPPs are used is that the private sector can carry out these activities more efficiently and quickly than the public sector.

[23] The main text would probably discuss these factors and others in more detail.

[24] There are numerous definitions of value for money – many of them somewhat vague and suggestive. The definition given above is one possibility. If the policy statement specifically mentions value for money, a definition of some kind should be given to avoid confusion.

[25] The preparer may wish to summarise in the main text some of the methods that will be used for stakeholder consultations – for example, focus groups and opinion surveys.

[26] In some countries, freedom-of-information acts would impose similar disclosure requirements.

[27] In the main text, the preparer may wish to distinguish between total value to society (that is, including value to domestic shareholders) and value to the public sector (government, customers and so on). A PPP might bring high total value without competition. It is effective competition that can transfer excess value from private-sector shareholders to the public sector.

Demand risk[28] should generally be allocated to the private partner if it has significant control over the level of demand for the services. If not, allocating demand risk to the private partner could make the project more costly and reduce overall value.[29]

7. Institutional framework

The contracting authority is, loosely speaking, the owner of the PPP project. It remains ultimately accountable to government and to the public for the provision of the services and infrastructure provided under the PPP.

The centrepiece of the new institutional framework will be the establishment of a PPP unit located under the Ministry of Finance[30] and an inter-ministerial PPP commission.[31] The PPP unit will serve as the secretariat of the PPP commission.

The PPP unit will have a number of functions related to the preparation, approval and promotion of PPPs – notably:

- Develop regulations and non-mandatory guidance documents and assist contracting authorities in understanding and following the required methodologies and procedures.
- At various stages, review, appraise and give an opinion on specific PPP projects submitted to it by contracting authorities.[32] Coordinate the reviews by other departments and agencies.[33]
- Keep a registry of all PPP projects.
- Propose improvements to the PPP programme and system.

The PPP commission will formally approve PPP projects at various stages and approve methodologies, procedures and guidelines, in both instances based on the analyses and recommendations submitted to it by the PPP agency.[34]

8. Project preparation for PPPs

The policy statement sets out the different stages that will be followed in preparing a PPP project and taking it to market.

Led by the PPP unit, a major appraisal of each PPP project will take place based on a comprehensive PPP feasibility report, submitted by the contracting authority and usually prepared with support from consultants. This is a critical step before moving to the procurement stage (that is, selection of the private partner).[35]

[28] "Demand risk" refers to how cash flow changes in response to changes in the level of demand for the services. If the private partner has substantial fixed costs (fixed per period of time), then changes in revenue in response to changes in demand can have a large effect on the return it makes.

[29] In the early years of PPPs in some countries, it was thought that all or most demand risk should be transferred to the private partner in all PPPs. It is better understood now that if the private partner can do little to influence demand for the services, such a risk allocation is generally not optimal.

[30] Countries may wish to locate the PPP unit (if there is one) under another ministry. Alternatively, it could be a special, higher-level body directly under the prime minister or president.

[31] There are many different institutional frameworks for PPPs. This is just one of numerous possibilities. A rigorous institutional assessment should be carried out before deciding on the best institutional framework. It is strongly advised not to simply copy the set-up seen in another country. The best way to carry out such an assessment is to start by considering the functions that need to be performed to ensure a sound PPP system. Then look at the entities (existing or new) best suited to carry out these functions.
One thing missing from the EES is the designation of who will set the direction and vision for PPP policy and strategy in the future. This might be added to the commission's responsibilities (based on recommendations of the PPP unit).

[32] In some countries, the PPP unit (if there is one) will not be involved in the formal appraisal of the PPP project. This will remain an activity to be carried out by the contracting authority (ideally by a different team than the one that prepared the PPP feasibility report – to lessen the risk of bias).

[33] Some countries use the PPP unit to organise and coordinate the reviews by all relevant departments and agencies – each reviewing within its field of competence.

[34] The idea behind this hierarchy is that the commission would be set up at a high enough level so that its decisions would have legitimacy and be respected. If a country decides to place a PPP unit at a very high level (for example, directly under the prime minister), then having a PPP commission in addition would probably be superfluous. Institutional set-ups are very much country-specific.

[35] Although preparation procedures for PPPs differ depending on the country, it is very common to see the requirement of a comprehensive PPP feasibility report (or business case) prepared and appraised before moving to the procurement stage.

The main appraisal criteria for a PPP project include:[36]

- technical, commercial, financial, institutional feasibility
- economic soundness[37]
- value for money[38]
- affordability to users and to central and local government budgets
- acceptable environmental and social impact
- acceptable fiscal impact,[39] both short term and long term.

Financial feasibility must not be overlooked: the project must be sufficiently attractive to private-sector operators, investors and lenders. Otherwise, they will not participate and the PPP will not be able to be implemented.

The policy statement describes procedures and methods for earlier stages of project identification and screening.[40]

9. Selection of the private partner

The full benefit of PPPs to the public sector can only be achieved when PPPs are procured through well-structured and transparent bidding with strong competition. Competitive bidding enhances the value to be gained by the public sector from a PPP. Transparency strengthens the legitimacy of the government's procurement process.

The requirements of sound procurement of PPPs differ in certain ways from the requirements commonly applied to the public procurement of ordinary goods, works and services. For this reason, PPP legislation will specify a procurement regime for PPPs.[41] The public procurement law will not apply to the selection of the private partner in a PPP.

The main stages of the selection process for the private partner will be:

- setting up a tender commission by the contracting authority

publishing a procurement notice

- prequalification and shortlisting of potential bidders

requesting proposals[42]

- managing the process during the bidding period
- evaluating final proposals and selecting the preferred bidder
- final negotiations and signing of the PPP agreement.

Single-source procurement (direct negotiations with one company or consortium) to select the private partner, without the use of competitive tendering, will be permitted only in limited circumstances.[43]

[36] Only the principal criteria would be listed here. More might be indicated and discussed in the main text.

[37] This basically means positive net value to the economy and society – determined in line with the principles of cost-benefit analysis. It does not necessarily mean a full, quantitative cost-benefit analysis.
Ideally, this kind of analysis should be done based on the underlying project before a decision is taken whether to use the PPP mode or the public-sector-project mode – and then should be adjusted as necessary to deal with the peculiarities of the PPP mode (if that mode is chosen for implementation). In some countries, however, this will not have been done by the time the project is being considered for implementation as a PPP.

[38] Based on the definition of value for money given in the EES (see above), this analysis would be similar to the one immediately above ("economic soundness") except that in the case of value for money (as defined in the EES) the perspective is that of the public sector only. To be more specific: conventional cost-benefit analysis looks at costs and benefits to society as a whole, including domestic private-sector shareholders.

[39] Given the serious macroeconomic consequences that can arise when a country ignores the long-term fiscal impact of PPPs (including from contingent liabilities), this issue should be given appropriate attention in the main text. Countries that already have a high debt-to-GDP ratio may wish to say more about the issue and its importance, even in the executive summary.

[40] The early stages are very important. Countries can find themselves with a huge pipeline of possible PPP projects, but without the needed capacity to boil down the list to the most promising ones – ready for further study and preparation. Some countries have therefore adopted the practice of requiring a pre-feasibility report or initial concept note as a way to carry out a preliminary assessment of the project before it goes to the full feasibility report stage. These aspects would be described in the main text.

[41] This depends very much on the country. Procurement rules continue to evolve, and it may be that the ordinary public procurement rules in the country can be applied satisfactorily to PPPs, perhaps with just a few adjustments, which can be set out in its PPP law. (Note that EU countries are required to use the ordinary public procurement rules for non-concession PPPs.) In other countries, however, it may be considered the best solution to have a completely different procurement regime for PPPs.

[42] Some countries prefer the term "invitation to tender".

[43] These circumstances would be described in the main text. A common and straightforward example is where only one source is capable of providing the required service, such as when the provision of the service requires the use of intellectual property, trade secrets or other exclusive rights, and only the single source possesses them.

The preferred route to select a private partner is for the contracting authority (often supported by transaction advisers) to initiate preparation of a PPP project and develop the bidding documents and the draft PPP agreement. However, unsolicited proposals (that is, privately initiated PPP proposals) will also be permitted in certain circumstances.[44]

To be eligible for further consideration, an unsolicited proposal must be for a project that has not been registered with the PPP agency and that is not included in the contracting authority's pipeline of potential PPP projects. Moreover, the project must have innovative or unique features,[45] in the sense that it would not normally have been identified or adequately developed as a potential PPP project by the contracting authority on its own (including by consultants of the contracting authority).

An unsolicited proposal, if initially cleared, will go through a rigorous review process[46] and a procedure of full competitive bidding. The difference is that, if the promoter loses in the competition, it will be reimbursed the reasonable costs it incurred in making its initial proposal.[47]

10. Legal framework

The next step to be taken after the policy statement will be the preparation of a comprehensive PPP law,[48] to be followed by implementing regulations and guidance documents.[49]

The parties formalise a PPP by a long-term legally binding PPP agreement that explicitly sets out the important elements of the PPP and the practical and commercial relationship between the parties – including their rights and obligations – for the duration of the PPP.

The PPP law will include a section relating to the PPP agreement. Especially important will be to provide a list of critical topics that will need to be covered in any PPP agreement to ensure that it is comprehensive and does not leave any important gaps.[50]

11. Financing of PPPs

Lenders' rights. It is customary for senior lenders to enter into a "direct agreement" with the contracting authority to allow for step-in and related arrangements to ensure the continuity of the PPP.[51] Senior lenders in a PPP arrangement will often require secured interests over all the project assets to enable the lender to step in if the project is failing and temporarily to play the role of private partner and arrange for the appointment of a replacement private partner.

State financial support. One great advantage of a PPP is that the private partner is generally responsible for providing or mobilising the financing for needed capital expenditures. Nevertheless, state funding and support – grants or specific guarantees, for example – can be useful in certain circumstances. The government's policy permits this when it is beneficial, especially when projects are economically sound but

[44] Some countries may not wish to give preference to contracting authority-initiated PPPs, but to place both routes on an equal footing.

[45] The idea behind Country X's policy of requiring genuine innovative or unique features is to restrain contracting authorities from giving favoured companies an advantage for straightforward and obvious PPPs (for instance, a water treatment plant PPP) simply by refraining from initiating them to let the favoured company initiate them instead. A requirement like this in the context of unsolicited proposals is not found in all countries.

[46] Some countries require the contracting authority to prepare a full feasibility report even in the case of an unsolicited proposal (in which case, certain parts could be taken from or based largely on documentation submitted by the proponent).

[47] Other kinds of advantages can be given to the promoter of an unsolicited PPP proposal if the project results in a signed PPP agreement. Country X has chosen to include only this one – which is perhaps the most common and uncontroversial one.

[48] This assumes that the country does not already have a specific PPP law and wishes to enact one. It may instead be a question of amending an existing PPP law to improve it.

[49] The section in the main text on the legal framework might be relatively short or long, depending on the contentiousness and complexity of the legal issues and on whether lawyers have played a key role in preparing the policy statement. The composition of the intended audience of the policy statement should be borne in mind.

[50] Many countries include in their PPP law a mandatory list of the topics that must be addressed (one way or another) in any PPP agreement. Some countries allow complete freedom to the parties in this respect, and may give a list of topics only as non-binding examples.

[51] This may seem to be a technical issue not worth noting in the executive summary or even in the main text of the policy. The reason for highlighting it is that public authorities and governments are often surprised that they will need to enter into a direct agreement. So it is good to raise the issue at an early stage, as a way to educate stakeholders and preempt later objections.

not financially viable based on user charges alone, or when there are certain risks that the private sector is less capable of managing. State support, if used judiciously, can increase private-sector interest and confidence in a PPP.[52]

12. Contract monitoring, oversight, reporting and evaluation

Effective monitoring and oversight by the public partner is very important to the success of a PPP. Systematic monitoring systems will need to be set up to assess whether the private partner is performing in accordance with the requirements of the PPP agreement.

Monitoring and oversight of PPPs requires adequate capacity in the contracting authority. Sometimes, the contracting authority can carry out these activities using its existing departments and staff. But for large projects, it is often useful for the contracting authority to set up a dedicated oversight unit.

The PPP unit will establish and maintain a systematic and well-organised database of all PPP projects. A unified information portal will be developed with information about PPPs in the country for potential investors and the public.

A post evaluation of each PPP project, conducted after completion of the PPP (and sometimes more frequently), will be carried out by an independent team – independent also from the PPP unit because the PPP unit was involved in appraising the project and recommending approval. The main objective of the ex post evaluation will be to assess a project's successes and failures and to adjust policy, legislation and practice to help ensure better outcomes from future PPPs.

[52] An important issue in some countries is whether, and in what circumstances, the state will guarantee the payment obligations (under a PPP agreement) of a state enterprise. Some countries may wish to address this issue in their policy statement.

Chapter 2.
PPP institutional set-up recommendations

1. The typical functions and their delineation

1.1 The development of a public-private partnership (PPP) framework requires an adequate and appropriate institutional set-up. An effective PPP institutional set-up is essential for modernising infrastructure and enhancing the attractiveness of PPP arrangements. Well-designed frameworks will make it easier to initiate and implement different PPP projects. Developing a suitable PPP institutional framework in every Commonwealth of Independent States (CIS) member country is a long-term process and, in the years after the relevant legislation is adopted, this framework is likely to be complex and multifaceted. Effective governance of a PPP system by the government bodies and institutions involved is critical to the success of that system. It takes time and thought to define and develop all the relevant roles and relationships, and to carry out all the necessary capacity building.[1]

1.2 The best way to conduct an institutional analysis is first to determine the functions needed to develop and implement good PPPs. The next step is to look at which actors (organisational entities) in the CIS member country are best suited to playing which roles. In other words, the focus should first be on what needs to be done to enable the development and implementation of sound PPPs in a CIS member country, and then to allocate obligations between the state government authorities (SGAs) and municipal authorities of that country.[2]

1.3 The general principles for creating an institutional set-up in a CIS member country are as follows:

- The programme should be developed on the basis of existing institutional functions and processes.
- Account should be taken of the possible objectives of infrastructural development and infrastructure policies.
- The programme should be built in accordance with PPP policies and programmes.
- The responsibilities should be properly distributed among relevant SGAs.
- Overlaps, conflict of interests and excessive procedures should be avoided.

1.4 Typical functions are recommended to delegate to existing or new SGAs while developing a PPP framework in a CIS member country:

- developing PPP policy, coordinating and promoting PPP development
- enacting PPP legislation, regulations, guidelines and recommendations
- identification and procurement of PPP projects, including project screening, appraisal, structuring, conducting tender procedures and contract management
- approving PPP projects
- ensuring coordination between authorities and best-practice approaches
- public financial management, identifying sources and providing required financing.

1.5 As mentioned, there can be different bodies and institutions with functions in the sphere of PPPs. All SGAs participating in the preparation, approval, procurement, implementation and monitoring of PPP projects should be given clear mandates and sufficient resources to ensure the high-quality, efficient and successful development of PPPs.

1.6 The government should be the main policymaker in respect of PPPs and should develop PPP policy and coordinate and promote PPP development. Responsibilities such as the enactment of PPP legislation, regulations, guidelines and recommendations can be distributed among the law-making authority (PPP legislation), the government of a CIS member country (PPP regulations) and the PPP unit (non-mandatory regulation).

1.7 The government should be empowered to determine priority sectors for PPPs and stimulate private parties to participate in infrastructure projects. The government is advised to consider that the development of an effective PPP policy requires active consultations and engagement with all stakeholders and end-users. The government may create committees with representatives of different ministries, the private sector and the general public to ensure their views are taken into account. Another way to consider their opinion is by involving PPP development institutions as provided by the CIS Model PPP Law. These institutions may conduct surveys and studies and organise and moderate discussions and conferences.

[1] For an example of a CIS country's PPP institutional set-up, including PPP units, see Government of the Republic of Armenia (2022), Decision No.1118-N of 28 July 2022 on Approving the Procedure for Public Private Partnerships, Yerevan.

[2] For examples of best standards related to the institutional set-up of PPP units, see OECD (2010), Dedicated Public-Private Partnership Units: A Survey of Institutional and Governance Structures, Paris; EPEC (2014), Establishing and Reforming PPP Units – Analysis of EPEC Member PPP Units and Lessons Learnt, Luxembourg; EPEC (2012), United Kingdom – England PPP Units and Related Institutional Framework, Luxembourg.

1.8 An executive body responsible for implementing the government's PPP policy should be created. It may be an existing ministry or the government may establish a new body as a separate ministry or agency (or a department within an existing ministry). Another option is to delegate certain functions – such as identification and procurement of PPP projects, including project screening, appraisal, structuring, conducting tender procedures and contract management – to the PPP unit or to spread them among different authorities. Responsibilities for procurement and conducting tender procedures can be delegated to the procuring authority.

1.9 The power of project approval may be assigned to the line minister, the government or other SGAs (for example, depending on the project's value).

1.10 Governments are advised to clearly define the role of the PPP unit, the procuring and controlling authorities, and the line ministry in PPP projects in a transparent and consistent manner to avoid any conflicts of interest or unclear and/or overlapping responsibilities.

1.11 It is also recommended to create an oversight body. The government may establish a new body that will oversee the preparation and implementation of PPP projects, the compliance of tender procurement with the requirements of applicable legislation and the effective use of budgetary funds in PPP projects. However, if existing authorities are responsible for procurement and budget control, the government may delegate these tasks to them.

1.12 SGAs may have little experience in the PPP sphere, so a body to ensure best-practice approaches should be established. The responsibility of ensuring best-practice application can be allocated to a dedicated PPP unit or to PPP departments within line ministries. External consultants should be engaged, especially for complicated and high-value PPP projects.

1.13 To coordinate the PPP process, special committees for large PPP projects should be created with representatives from different SGAs to avoid bureaucratic and other delays. Alternatively, an SGA may establish a PPP department that deals with PPP projects, including contract management. Another way is to involve a planning ministry that performs coordination functions in infrastructure and economic policy.

1.14 It is recommended that the ministry of finance (or other SGA responsible for public finance) have functions in public fiscal management, identifying sources of funding (such as state programmes or budgets) and providing required financing for PPP projects. It should be involved in the project preparation process to ensure that the PPP project creates the best value for money and value for the people and that all fiscal risks are managed.

1.15 There has been a growing trend to have one unit in the country that deals with infrastructure investment, with just one office of that unit dealing with PPPs (and another office dealing with public investment projects, perhaps). There are numerous advantages to having an overarching entity with functions over all infrastructure investment in the country. For example, the kind of appraisal needed is similar for both private- and public-sector projects and, to the extent possible, this entity can ensure methodologies are the same – or at least consistent.

2. PPP unit

2.1 The existing institutional set-up in a country should be considered, as it plays a significant role in determining why a country would decide to establish a PPP unit. Although there are arguments against establishing units, such as the need for separate policy formulation and technical support during project implementation or to avoid conflicts of interest, many countries have created such units. The existence of a PPP unit often demonstrates the government's commitment to PPPs. It also demonstrates to potential private partners that the government has the requisite skills to manage PPPs. SGAs should be aware that once a higher public entity has made the initial decision to go down the PPP or public-investment route, one of the main objectives of establishing the PPP unit is to verify that the PPP is the best public procurement form for the project and that it creates the best value for money.

2.2 The typical functions of the PPP unit are:

PPP policy development: Develop and update PPP policy, prepare a long-term infrastructure plan, initiate or propose changes in primary legislation, and review and possibly update the PPP policy from time to time covering optimum ways of developing the country's plans for harnessing PPPs and attracting private-sector involvement.

- **Developing a list (pipeline) of PPP projects to be prepared:** Develop a pipeline of potential PPP projects by working with SGAs.

- **Legislation framework development:** Initiate the necessary changes in primary and secondary legislation in accordance with PPP policy and PPP/infrastructure programmes.

- **Mandatory regulations on procedures and methodologies:** Help the relevant SGA establish mandatory regulations on procedures and methodologies, including the preparation and updating of regulations, mandatory guidelines and methodologies – for example, relating to feasibility studies and appraisal processes, possibly preparing required model PPP agreement clauses or structures.

- **Appraisal or review of specific PPP projects:** Appraise the project, based on the feasibility report, and reach conclusions about the feasibility and soundness of the PPP project before it is approved – or review the appraisal made by another SGA.

- **Decision to proceed (or not to proceed) with specific projects:** A decision based on an appraisal carried out by the same or another body. This function involves approval (or rejection) at several different points in the project preparation process and helps avoid spending money to fully prepare a PPP project when an early assessment would have determined that the project is not appropriate and should not be pursued.

- **General advice about how to apply regulations and prepare PPP projects:** General guidance for SGAs and other stakeholders about how to apply the law and regulations and prepare PPP projects. This advice also explains the regulations to SGAs, broadly advising them in face-to-face meetings on how to prepare and structure specific projects and how to hire and manage transaction advisers and experts.

- **Collection, analysis and reporting of data about PPPs and results:** Analyse project reports and the PPP database, prioritise the project master plan and so on (the transparency and availability of data to both the public and private sectors will be vital), collect information about PPP projects in the CIS member country and their performance, especially by requiring copies of contractually required project reports to be sent to the PPP unit, maintain the project database, analyse and report findings.

- **Non-mandatory guidance on PPPs:** Prepare or disseminate non-mandatory guidance materials, best practice notes and so on, disseminate sample PPP agreement clauses.

- **Capacity building:** Organise training courses for SGAs.

- **PPP coordination and promotion:** Make introductory presentations about PPPs to SGAs, organisations and companies on the basic concepts and to promote the PPP model. Liaise with PPP units or staff in other SGAs, and discuss critical issues with other SGAs to try to find ways to overcome identified obstacles. Maintain contacts and coordinate with other players outside government that are working on PPPs to understand what they are doing, bring organisations together, share best practice, fill gaps and so on.

- **Work to improve the financing of PPPs:** Suggest financing and credit-enhancement methods for PPPs to international donors, as well as private-sector financing.

- **Intensive transaction advice and support for specific PPP projects:** Actively participate in preparing the PPP project; for example, take part in the tender committee and in negotiations.

- **Direct monitoring of results:** Proactively monitor each PPP project to ensure that the private partner is performing in compliance with the PPP agreement and applicable regulations. Potentially have the power to enforce compliance and impose deductions and penalties for poor performance.

2.3 The functions of the PPP unit depend greatly on the institutional set-up and the laws of the CIS member country. It is recommended that the government delegate powers to approve, conduct tendering procedures, and award and manage a PPP project to other competent bodies. This is to avoid possible conflicts of interest that could arise if the PPP unit were to give hands-on intensive transaction advice, then also appraise and green-light the project.

2.4 If the PPP unit was established as non-dedicated unit, it should initially focus on those functions that are most important, to ensure that substantially unsound PPP projects are not implemented. It should not attempt to fine-tune the projects; that should be left to the public partner. Other functions, while not to be ignored, can be given more emphasis later. The core functions in relation to this goal could be seen as the following:

• Mandatory and associated regulations: General advice about how to apply the regulations.

• Non-mandatory guidance about PPPs: Appraisal or review of specific PPP projects and, linked to that for state-level projects, approval power.

• Collection, analysis and reporting of information: These functions form a coherent whole and serve the main objective well.

Mandatory regulations set out the requirements for preparing and properly appraising PPP projects. These need to be supplemented by non-mandatory guidance to fill in the details for users. The main way the PPP unit can obtain feedback on how the regulations are being applied and any problems in their application is by reviewing some feasibility reports and appraisals of the PPP projects. Lastly, understanding how PPPs actually perform is key to knowing how to design and appraise them better in the first place.

2.5 Governments are advised to establish a system of interaction between the PPP unit and other SGAs. The PPP unit shall not deprive these SGAs of their authority, but work jointly with them. Investors, already accustomed to working with these entities, can continue to do so.

2.6 The PPP unit shall work closely with the relevant SGAs (and their PPP cells/departments), which will remain ultimately responsible for all PPP projects. As the "owners" and gatekeepers of PPP projects, the SGAs and public partners will take project-related decisions at all stages of the project.

2.7 Measures designed to improve the performance of existing PPP units in CIS member countries include the following:

• conducting training, seminars and other events to increase the level of competence of the staff of the PPP unit and other SGAs in the field of PPP

• analysing the PPP unit's activities to identify possible obstacles and granting additional powers or redistributing powers between SGAs to ensure the PPP unit's effective implementation of its functions

• surveying and researching the views of the staff of the PPP unit and other SGAs to identify the main difficulties they face in carrying out activities in the field of PPP and to search for possible measures to remove legal and other restrictions

• providing material, technical and financial support for the activities of the PPP unit in accordance with its functions and the scope of powers

• introducing a system of rewards and penalties for the PPP unit's staff to stimulate responsible and efficient work

• exchanging international experience with other PPP units in CIS member countries and building regular communication and cooperation to conduct joint research, analysis and activities in the field of PPP.

3. Recommendations on the form, size and role of the PPP unit

3.1 There are two main approaches to establishing a PPP unit: as an independent dedicated unit or keeping it as a department/commission in an SGA. A dedicated PPP unit is an organisation set up with the full or partial help of the government to ensure that the necessary capacity to create, support and evaluate multiple PPP agreements is available and clustered together within government. The PPP unit deals with multiple PPPs. This is an important distinction to differentiate a dedicated PPP unit for government from a dedicated PPP project unit that may be located in an SGA to support the management of an individual project. The functions, location and jurisdiction of dedicated PPP units shall conform to each CIS member country's needs and possibilities to create a high-quality PPP framework. PPP units may provide policy guidance, technical support, capacity building, promotion and/or direct funding for PPP projects. They can also be required to green-light a project before it can go forward. They may be located within an independent body or a centralised unit within the finance ministry, or devolved within dedicated units in one or more line ministries.

3.2 The decision to establish a dedicated PPP unit depends on a combination of factors, including the types of institution already in place, the sectoral composition of PPPs under consideration, the operation, construction and various stages of preparation, and the political commitment of the government. There is no clear evidence that a dedicated PPP unit is more advantageous for improving the deal flow or quality of the resulting PPP project than if ministries or the government independently implemented the project.

3.3 Where PPP units primarily screen PPPs, assess value for money and affordability to the government or disseminate good practices, they often take the form of a cell or group within an existing SGA. That SGA is often the finance ministry or treasury, reflecting concerns about a need to strengthen the understanding and monitoring of the fiscal costs of PPPs.

3.4 Where PPP units are to provide transactional support, their ability to buy in these skills from the private sector and provide the right incentives to staff to close deals requires close attention.

• One option is to establish a unit within a ministry and rely on long-term consultants/experts.

• Another option, creating greater independence from the government, is to set up the PPP unit as an autonomous entity, attached to but not fully part of the government bureaucracy.

• A third approach is a government-owned company. It is overseen by a public-private board and offers salaries outside the normal civil service ranges to attract people with key financial and transactional skills.

• A fourth way is to set up a joint-venture company owned in part by private shareholders. Such units often receive performance-based payments linked to deal closure.

3.5. There are numerous advantages to creating a dedicated PPP unit. PPP units can:

• operate independently from the government of the CIS member state and other SGAs in terms of PPP policy formulation and implementation

• carry out activities to develop the PPP market, aimed at improving the investment climate for the implementation of PPP projects

• act as a knowledge centre on PPP project preparation, negotiation and execution

• help regulate the creation of PPPs by SGAs to ensure that they fulfil all requirements in terms of affordability, value for money and risk transfer

• ensure that appropriate budgetary considerations are taken for PPP projects and that contingent budgetary liabilities are also evaluated

• exercise centralised control over the implementation of PPP projects; among other things, they can be used to manage risks in PPP projects and may also be entrusted with state supervision in the field of PPP

• give a boost to a country's PPP programme, soliciting projects, attracting potential partners/ investors, building trust and goodwill with private partners.

• centralise knowledge, generate cost savings for the government and improve SGA staff capacity to implement PPPs.

3.6 Disadvantages of a dedicated PPP unit include:

• They can make the PPP process more complicated and bureaucratic, adding preparation costs and creating delays.

• The same authority that develops policy for traditional procurement can also develop a PPP policy.

• A dedicated PPP unit may not separate policy formulation and implementation if it can directly fund PPP projects.

• There may be no need for a PPP unit if knowledge can be supplied by internal and external project advisers appointed directly by SGAs with specific expertise in the relevant sectoral area and/or project issues.

• SGAs and the finance/planning ministry have expertise in assessing costs and benefits of projects and prioritising projects politically.

• The closer a dedicated PPP unit is to the relevant political leadership, the more susceptible it is to political influence in deciding which PPP projects should be initiated.

• Establishing a dedicated unit may imply implicit approval of PPP as a policy tool and weaken the case for other viable procurement methods.

• A dedicated PPP unit reveals weaknesses early on, such as having a poorly prepared PPP programme, a low level of legislative initiatives and legal technique, and a lack of expertise and experience in preparing and implementing PPP projects.

3.7 Regardless of its form, the PPP unit should develop internal procedures, checklists, guides and so on for the staff's core activities. This would help make the activities more effective.

3.8 The PPP unit must be able to review at least a sample of the feasibility reports and the appraisals of PPP projects at the municipal level. If the PPP unit develops the mandatory regulations and the non-mandatory guidance material, but has no knowledge of how these are actually being applied at the municipal level, it will be operating blindly and the regulations will not benefit from the best feedback. One option to ensure that the PPP unit's advice and recommendations are accepted at the municipal level is to establish it as an independent unit from the central government body and an expert organisation. Another option is to create subdivisions of the PPP unit in different sub-sovereigns or to let sub-sovereigns establish their own PPP units.

3.9. It is difficult to estimate the number of staff needed to conduct PPP unit activities because this depends on the future deal flow of PPP projects, as well as how qualified/trained staff must be to efficiently carry out appraisals and reviews.

3.10 Where necessary, PPP units either need to have a budget for contracting out certain activities or to increase interaction with potential donors who can provide funds for that purpose. Some of the activities the PPP unit needs to carry out are highly specialised and occur only infrequently (for instance, writing certain guides). These are best contracted out, with close supervision by the unit.

3.11 Dedicated PPP units may be funded from the government budget, through user charges or a combination of both. Government budget financing refers to funds appropriated through the annual government budget. The precise details will vary depending on the budget's appropriation structures and rules. User charges are levied on a government organisation to capture the cost, in part or in full, of services provided to other government organisations in implementing their activities and delivering public services. Funding is influenced by the location of the dedicated PPP unit, as well as practices with regard to charging for services more generally within the government.

3.12 PPP units can be financed through project development facilities that are funded through government and donor funds. As a result, the proceeds of project development facilities are used to finance the project preparation and operation of the PPP unit. The project development facilities operate on a revolving basis and a winning bidder may reimburse the budget the unit has spent on a specific project.

3.13 The PPP unit could benefit from intensive training that involves independent consultants working with the unit as it appraises or reviews several real-life PPP proposals. The unit must put considerable effort into strengthening its skills in project appraisal techniques. Traditional training courses are useful, of course, but closely combining training with actual cases is especially important.

4. Improving the regulatory framework

4.1 Improving legislation often consists of simplifying it and focusing more on its users. Investors involved in PPP projects require a predictable and reliable regulatory framework, such as low quantity, simplicity and quality of norms.

In addition, the regulatory framework should take into account the interests of end-users and enable them to participate in legal procedures that protect their rights and guarantee them access to the decision-making process.

4.2 PPP development should be based on the following key principles and priorities:

- protection of investors' rights when disposing of their property and assets
- improving the quality of the regulatory framework by reducing the number of legal norms and improving and simplifying them
- a more attentive approach to the interests of business
- improving the efficiency of control over compliance with the requirements of agreements
- developing a system of rules and regulations for PPPs based on consultations on issues directly related to the launch of projects and their management, including concessions, taxes, competition, procurement and company regulation.

4.3 The PPP regulatory framework should not be constraining and should allow the parties to focus on the result by establishing sufficient opportunities for the preparation and implementation of projects. Excessively voluminous legislation slows the process of creating and managing PPP projects and inhibits the activity of potential investors. It is recommended to focus on the flexibility of the regulatory framework.

4.4 Laws should be understandable and reliable and allow investors to plan their decisions and set long-term goals when entering the market. This factor is significant for attracting high-quality investments in PPP projects. A predictable regulatory framework is especially important when implementing PPP programmes, as predictability allows for more accurate risk assessment.

4.5 PPP processes are often very complex. This leads to higher costs, as well as to the fact that only the largest companies remain among the candidates for contracts. In general, simplification of rules promotes competition, which in turn expands the range of applicants for a contract, which will allow government agencies to choose the best partners for them.

Addendum 1:

Typical functions of PPP units around the world

1. As follows from international practice, PPP units are asked to perform a range of functions. As governments turn to the private sector to provide services once delivered by the public sector, they must learn new skills. An increasingly common way of providing the capacity needed is to establish PPP units as dedicated bodies or as special departments/ agencies within an SGA, such as a finance or planning ministry.

2. One option is to locate the PPP unit as a subdivision in the department within the government body dealing with public investment management. Some countries, such as Canada (Québec) or France, have converted their PPP units into infrastructure units with PPP specialists in charge of a specific branch of the public investment organisation.

3. It is critical to the success of PPP units that their role, location and conflicts of interest management mechanisms are well chosen by the CIS member country.

4. Many PPP units provide advisory support and funding to contracting authorities and other SGAs developing PPPs. This usually involves PPP unit staff acting as resource people, but it can include additional funding to pay the costs of transaction advisers. In some cases, PPP units play a leading role in closing the transaction and receive compensation for deal closure.

5. A critical question here is what role PPP units should play in relation to contracting authorities. For departments with far fewer deals, building up PPP capacity may not be cost effective. For example, local authorities in the United Kingdom that implement school and hospital projects rely on support from central bodies.

6. Another essential matter is timing. A PPP unit can assist a contracting authority at the start of its programme, when the authority lacks experience. However, contracting authorities that helped to implement pilot PPPs may have more experience than a newly established PPP unit. In these cases, the PPP unit needs to take care not to slow the more experienced authorities, though it should ensure that they properly address critical issues (such as affordability and value for money).

7. PPP units often play a role in the approval of PPPs developed by contracting authorities. This usually involves providing input into decisions made by others rather than having direct clearance authority. The PPP unit may be involved at three points: after the feasibility study, before the bidding documents are issued and/ or before the PPP agreement is signed. In other cases, the link is less direct. In the Philippines, for example, the BOT Centre is just one member of an interagency committee that approves build-operate-transfer projects.

8. This oversight role is potentially the most important one for a PPP unit. In some countries, such as South Africa, the PPP unit's primary role and motivation is to scrutinise the quality, affordability and expected fiscal cost of proposed PPPs. In South Africa, the clear regulatory process for PPPs has helped the unit perform this role. Another way to make guidance binding is by requiring the use of model contracts developed by the PPP unit or to ensure heavy scrutiny by the unit if they are not used.

9. The existing institutional structure in a country usually plays a significant role in determining whether to establish a PPP unit. While the argument against the establishment of separate bodies is the need to separate policy development tasks from technical support during project implementation, some countries have created such bodies. Often, the presence of a PPP unit shows how strongly the government supports the idea of PPP. As stated, the establishment of a dedicated PPP unit serves as confirmation to potential private investors that the state has the necessary qualifications to manage PPP projects.

10. In terms of functions, most dedicated PPP units are involved in technical support and policy guidance. Indeed, these two aspects seem to be the defining characteristic of PPP units across countries. These two functions also follow closely from the rationale for the establishment of PPP units in several countries and can be explained by the rather technical nature of PPPs.

11. Capacity building and PPP promotion also feature in many countries. Capacity building features especially high in countries such as Australia, South Korea, South Africa and the United Kingdom. In the United Kingdom, the PPP Policy Team and Partnerships UK are responsible for technical support to government entities wishing to enter into PPP agreements, PPP promotion and capacity building. There are differences between PPP units when it comes to their relationship with public entities implementing public-private partnerships and the finance ministry. The units mostly act as consultants for contracting authorities, but may also have a mandatory review dimension.

12. PPP units can be involved in approving projects and fulfilling a gate-keeping role. However, the extent and nature of their involvement varies according to the needs and capacity of individual countries. In the United Kingdom, Australia and South Africa, PPP units fulfil such a gate-keeping role. In Germany and South Korea, the ministry of finance fulfils this role. The difference between these countries coincides with the location of the units; in the United Kingdom, Australia and South Africa, the PPP units reside within the ministry of finance, while in Germany and South Korea, they are independent agencies. Where units are PPPs themselves (and thus not strictly speaking public bodies), the question also exists as to whether they can be endowed with the necessary authority to green-light projects.

13. In CIS member countries, the PPP units often have advisory, expert and educational functions. For example, the PPP unit in Kazakhstan is established in the form of the PPP Development Centre and has the following functions:

- conducting studies and developing recommendations on PPP
- examining feasibility reports of state PPPs implemented through direct negotiations
- examining tender documentation of state PPPs
- monitoring and evaluating PPP project implementation
- educating specialists
- maintaining the register of PPPs to be implemented.

Other functions related to PPP projects are spread among different government bodies. Many powers are concentrated in the Central Authorised Body on Government Planning, which deals with all state PPPs. Others are distributed between the relevant authority on budget execution, the relevant authority on management of government property, local authorities and the relevant authorities in particular sectors that have powers to initiate and implement PPPs.

14. Another CIS member country that has developed a novel PPP framework is Uzbekistan, where the PPP unit is very important. The PPP Agency has been established under the Ministry of Finance and has broad powers, including:

- examining feasibility reports for PPP projects
- helping to prepare and implement PPPs
- approving or denying PPP project concepts worth less than US$ 10 million
- approving tender documentation
- engaging consultants for PPP project preparation
- monitoring PPP implementation.

Chapter 3.

Recommendations on the development of municipal PPP programmes

This guidance document may be used by central government staff to prepare rules and guidelines for local government, or even formal regulations, and by municipal officials to prepare their own plans.

1. General

1.1 A municipal/sub-sovereign public-private partnership (PPP) is simply a PPP where the government entity is a municipal/sub-sovereign body and where the public asset or service is a municipal/sub-sovereign asset or service. Therefore, it is recommended that the municipal/sub-sovereign PPP programme define municipal and sub-sovereign PPPs to separate them from large infrastructure projects and take into account their specific profile, described below.

1.2 PPP is only one of many tools available to municipalities/sub-sovereigns to meet their infrastructure needs and should be viewed as such. In considering whether and why to pursue a PPP, a municipality/sub-sovereign is encouraged to weigh the pros and cons of using a PPP rather than another option to deliver the same project. While creating the PPP programme, it is essential to consider specific features of municipal/sub-sovereign projects.

1.3 The PPP programme should focus on sectors where investments are needed. Municipal authorities should be oriented to implementing projects in such sectors and developing these sectors. Moreover, focusing on and highlighting specific sectors in the PPP programme will underscore local authorities' commitment to implementing projects in these areas and making available funding to launch such projects. This may also narrow down in a positive way the scope for unsolicited proposals.

1.4 Municipal authorities may draft the PPP programme. If state government authorities develop such programmes, they are encouraged to consider the points of view of municipalities and sub-sovereigns and to cooperate with them to address their needs and promote their agendas. That said, the PPP programme shall comply with the long-term national programme for the development of infrastructure.

1.5 The municipality/sub-sovereign should follow a few general principles. The project features and structure determine the extent of the private partner's participation in the project. In turn, the extent of the private partner's involvement in the project affects the amount of risk that may be transferred to the private partner. As the private partner's role expands, so too does the amount of risk it may be asked to bear. As the private partner assumes more risk, it will require more operational control over the project to manage those risks. The PPP programme should describe the possible extent of the private partner's involvement in the PPP projects (PPP project implementation schemes and ways to allocate risks between the parties).

1.6 The private sector can perform certain functions better than the public sector. This is particularly true in terms of innovation, service delivery, commercial orientation and operational efficiency. The PPP programme may outline when PPPs are strongly recommended, which objects may be transferred in PPPs and which may not, and in which sectors other types of cooperation could be efficient.

1.7 The PPP programme should identify possible ways to screen and prepare the project, offer recommendations and measures of state support for screening and appraising PPP projects, and identify the objectives of efficient service delivery, public investment management, fiscal risk management and capital planning – that is, whether the project represents value for money.

1.8 The structure of a PPP used for a specific project is flexible, with a wide variety of options that allocate different rights and responsibilities to the parties to the PPP. The appropriate project structure can only be determined with reference to the unique context of the municipality/sub-sovereign and a specific project. The PPP programme may list permitted arrangements for the municipal and sub-sovereign PPPs or exclude several arrangements.

2. Features of municipal/sub-sovereign PPP projects

Municipal/regional PPP projects differ with regard to a number of features that should be considered when preparing a municipal/regional PPP programme:

A. Some features are associated primarily with the smaller scale of projects:

2.1 Municipal/sub-sovereign PPP projects may be expensive to prepare because they require disproportionate levels of due diligence and specialist support for the contracting authority and for investors compared with larger projects. This is one reason the PPP programme may include some flexibility and make preparation of these projects easier and less complicated. This applies to unsolicited proposals and tender procedures. For example, it can be

recommended that only one-stage tenders for PPPs be used on the municipal level. However, such measures should not limit competition and must be transparent.

2.2 Municipal/sub-sovereign PPP projects are less attractive to experienced investors, Foreign investors, in particular, prefer larger projects to absorb risk and bid costs. The PPP programme may stipulate that requirements (especially in terms of experience) for the private partner be lower than for partners in large projects. National operators and investors are typically more interested in implementing PPPs at the local level.

2.3 Municipalities typically undertake few PPPs in any five-year period – some only one, for instance. As such, these smaller municipalities may not develop the same first-hand knowledge of PPPs. This is important to consider when thinking about procedures.

B. Some features relate specifically to the local nature of the projects:

2.4 Getting approval for municipal/sub-sovereign PPP projects may be more difficult because approval processes are designed for larger projects and approval power lies at levels of government that may not be familiar with or interested in municipal projects. A growing practice in municipal/sub-sovereign PPPs has led to the development of mechanisms to mitigate some of these challenges. These mechanisms may need to be implemented in the PPP programme.

2.5 Municipal/sub-sovereign PPP projects may merit a simplified approval process, sufficient to ensure quality and compliance, without the complexity and high-level participation of large-scale processes. Simplification may include fewer approvals and/or approvals at a more familiar (and more accessible) level of bureaucracy, less documentation (for example, less extensive studies, reports and consultations, or fewer of them) and fewer procedural steps (for example, no approval at pre-feasibility is required).

2.6 Municipal/sub-sovereign PPP projects may be subject to the control of central PPP institutions (PPP units, ministry of finance and so on) depending on decentralisation rules and policy applicable. In some countries, specific subnational PPP rules apply. Lenders and investors will check the consistency and legality of the subnational law. Even in the absence of a general requirement for central approval, such prior approval may also result from the necessary guarantee (or other kinds of financial support) to be provided by the state with respect to the proper fulfilment of its obligation by the subnational contracting entity.

2.7 Local bankers and financiers may not be familiar with PPPs and may need help to understand PPP projects, their dynamics, the opportunities they provide and how to address the challenges they raise. The municipal/sub-sovereign PPP programme should set out the ways the PPP unit (or other relevant authority), local authorities and other parties involved in the project can cooperate. The PPP programme may also include provisions on training for local authorities and other steps to help personnel to become qualified in PPP.

3. Recommendations for taking into account features of municipal/regional PPPs

Commonwealth of Independent States (CIS) member states are encouraged to consider the specifics of municipal/regional PPPs as follows:

3.1 A team of PPP specialists can be formed centrally, with a mandate to provide advice and support to small PPPs. This team may be part of the central PPP unit or be a separate unit. The municipal/sub-sovereign PPP programme should stipulate an institutional framework for PPPs at the municipal/sub-sovereign level and set out ways of cooperating among institutions on different levels.

3.2 Municipal/sub-sovereign PPP projects can be made simpler to implement and manage for contracting authorities and investors. This approach would mean that the PPP programme may contain standard processes and documents that can make it easier for investors and lenders to understand the project implementation scheme and, in the end, to fund. A procurement framework can use a single process for multiple projects.

3.3 A PPP may be small in value, but create substantial fiscal liabilities. A more comprehensive approval process should be used in such a case. All projects create some form of liability. Quantifying those liabilities (actual and contingent) in an objective manner is difficult. Another approach is to limit the types of government support that a municipal/sub-sovereign PPP might receive and still be considered “small”. For example, a small PPP may be one that does not receive:

- an indemnity or guarantee from the public sector for lost revenues, lost profit, loan repayment (other than as a basis for calculating termination compensation) or other indirect damages
- any grant, loan, investment or other direct financial support from the public sector (possibly above a specified cap).

3.4 Under a large PPP, a consortium of advisers provides transaction advice for a single project. The size and complexity of the project often require one consortium to ensure focus and sufficiency of staffing. The PPP programme may give the local authorities the right to bundle small PPP projects into a single project or portfolio of projects, making the investment larger and more attractive for engaging more significant and experienced investors and lenders. The cost of advisory services is reduced by combining multiple processes into one and using one set of advisers to develop feasibility studies and/or provide transaction advice for more than one project. The cost of funding for one large project should be lower than the cost of several smaller projects, including by making the process simpler and less burdensome for due diligence and documentation of the project. Economies of scale reduce total cost and may speed development, cross-fertilise lessons learned more effectively, ensure continuity of commercial terms and, therefore, make it easier and cheaper for bidders.

3.5 Small projects often do not need limited recourse financing. The PPP programme may allow investors to finance the project's balance sheet. It will simplify the procurement process and keep costs down because there is no need to incorporate a special project vehicle and raise project financing.

4. Key recommendations and principles

4.1 The following steps are recommended while selecting municipal/sub-sovereign PPP projects:

• **Select projects intentionally:** The municipality/sub-sovereign should understand the purpose and expectations of the project and then select the project accordingly. Every project has to pass all the required assessment procedures, such as cost-benefit and value-for-money analyses. Such assessments should be carried out without emphasising the benefits and/or downplaying the costs. The municipality/sub-sovereign is encouraged to consider that PPPs by their nature can be adapted to its needs. The municipality/sub-sovereign should choose the best approach to design a PPP project based on its interests and consider international best practice and standards.

• **Select the best projects:** The municipality/sub-sovereign should choose projects that are best suited for implementation through a PPP mechanism. It is strongly advised that the authorities block poor projects. The PPP programme should include recommendations on a proper selection process that will improve infrastructure development, allocate projects with the highest chance of successful implementation as a PPP and free up limited public resources for projects that need them.

• **Do not focus on new construction:** Reconstruction and modernisation of existing assets are often more efficient than new construction.

• **Bundle small projects:** As already noted, the procedures for large PPP projects will not be suitable for smaller PPP projects because of their high price and complexity. An effective approach is to bundle projects that can leverage economies of scale – including by enlarging the perimeter of the activity to several municipalities regrouped in a syndicate of municipalities for the purpose of the contemplated joint activity – to reduce the total cost and speed of development and to make investments larger and more attractive for private parties.

• **Verify that a project complies with its primary focus:** It is important to recall why a project was structured as a PPP. Implementation may be challenging and the municipality/sub-sovereign shall periodically confirm that the project still meets its objectives. The project shall bring advantages to the region/municipality and provide best services, value for money and economic growth.

4.2 While funding PPP projects, the following should be considered:

• PPPs always need a source of financing sufficient to cover costs and loans. An adequate and predictable payment mechanism is essential for a PPP project. The municipality/sub-sovereign should understand who will reimburse a private partner and how this will be done. The municipality/sub-sovereign shall always account for the fiscal risks arising from a PPP.

• The municipality/sub-sovereign is encouraged to find all possible revenue streams and focus on maximising revenues from beneficiaries.

4.3 While preparing PPP projects, the following are advised:

• Take into account that proper preparation of a PPP project requires time and money. Preparing properly will help ensure the project's success by lowering costs on both sides, mitigating risks and improving bankability. The municipality/sub-sovereign is encouraged to use sufficient personnel and resources to deliver a quality project;

• Ensure that the municipality/sub-sovereign has a sufficient budget to prepare the project well and avoid failure. The preparation of PPPs is expensive and requires qualified personnel.

• A municipality/sub-sovereign that has limited resources should coordinate with the PPP unit and other experienced authorities. The municipality/sub-sovereign may look to engage external specialists and experts.

• It is important to lay the groundwork and ensure that the project site and necessary rights are free of encumbrances, so that the project can earn a sufficient profit for the private partner and private parties are interested in it, and that the tender process will be competitive.

• The municipality/sub-sovereign should know the views of all stakeholders, because PPPs may raise political or ethical concerns, and new management techniques may impact employees, making them subject to discipline by the contractor. The municipality/sub-sovereign should understand such concerns and address/mitigate them. To this end, the municipality/sub-sovereign should engage and communicate with all stakeholders and consider that: (i) the PPP will provide more opportunities for employees and a performance-based employment regime should not violate labour rights and (ii) the project assets remain under public ownership.

• The municipality/sub-sovereign can mix public and private money to improve value for money. This reduces fiscal constraints and creates an incentive mechanism, as both parties have a financial stake, aligning public and private interests. The municipality/sub-sovereign is encouraged to be flexible when considering sources of financing, especially when private markets are weak.

• The municipality/sub-sovereign is advised to use public finances properly to improve PPP projects. The public side is a key partner in PPPs and its support is a key element in successful PPPs. Public support, incentives and stimulating measures are an effective way to achieve better value for money.

• PPP projects should be designed to mitigate possible challenges. As PPPs are long-term relationships, the relevant contractual arrangement should anticipate possible disputes, provide parties with ways to resolve conflicts and allocate risks in a reasonable manner.

4.4 While carrying out procurement procedures:

• The municipality/sub-sovereign should avoid entering into direct negotiations just because it is more expedient and costs less (at least in the short run). Maximising competition through good, transparent public procurement is one of the key benefits of PPPs. The municipality/sub-sovereign should be open to bidders and clearly indicate milestones, criteria and results to investors. The municipality/sub-sovereign should be open to discussions with bidders because they may have useful suggestions.

• When selecting the winning bid, the municipality/sub-sovereign should keep in mind that a poorly designed competitive process may result in an unrealistic bid and a project vulnerable to changing circumstances. The municipality/sub-sovereign is advised to evaluate bids properly and do its own analysis, replicating a reasonable bid to understand the kinds of bid it is likely to receive and to identify overly aggressive bids. The municipality/sub-sovereign should exclude overly optimistic bids, as assessed by clear, objective and indisputable criteria.

• Balance should be maintained between lenders' concerns and protecting the interests of the municipality/sub-sovereign. It is important to communicate with lenders and focus on their key needs and perceived risks.

4.5 While implementing PPPs, the following are recommended:

• Regulate and monitor the PPP: The municipality/sub-sovereign is advised to create a contract management team to manage project implementation with the necessary funding.

• The municipality/sub-sovereign should be ready for changes during the project. Adequate mechanisms must be in place to address problems related to changing circumstances and other challenges. The municipality/sub-sovereign is encouraged to ensure a practical fall-back position that protects consumers.

• Include provisions in PPP agreements to resolve challenges collectively with the private partner.

• Be flexible and ready to reconsider each aspect of the PPP to find the best solution in case of a dispute or material change of circumstances.

Chapter 4.
Recommendations for the development of legal terms and incentives to increase the attractiveness and transparency of unsolicited proposal mechanisms

1. General

1.1 This guidance document has been designed to offer recommendations to governments on how to develop formal regulations under the country's PPP act (or equivalent), in line with best practice.[1]

1.2 Unsolicited proposals provide several potential benefits to the state government authorities (SGAs) and municipal authorities of CIS member countries. They may:

- allow SGAs to better identify and prioritise projects in their pipeline of public-private partnership (PPP) projects
- generate innovative solutions to infrastructure challenges
- help overcome challenges related to early-stage project assessment.

1.3 However, they also introduce potential challenges. Unsolicited proposals often worsen a lack of technical capacity to evaluate, prepare, procure and implement PPPs. They might also create difficulties with fiscal planning if they were not part of normal infrastructure-budgeting processes.

1.4 SGAs shall consider the main principles of unsolicited proposals recognised by the Commonwealth of Independent States (CIS) Model PPP Law: availability of unsolicited proposals, the right of the private initiator to negotiate with the considered public partner, the obligation of the relevant authority to consider the unsolicited proposal, and the requirement of justified refusal in accordance with the law.

1.5 Other challenges relate to creating competitive conditions and aligning public and private interests. Lastly, the relevant SGA may need to overcome adverse perceptions associated with unsolicited proposals, including perceptions of corruption. SGAs shall avoid poor projects (for example, projects that are badly planned, provide unjust enrichment on the private partner's side, or represent poor value for money) and accept only well-planned and high-quality PPP initiatives, because only they can bring success. To overcome these challenges, there are key recommendations for SGAs that plan to develop and operationalise unsolicited proposals for infrastructure projects based on international best practice.

2. The main stages of implementing an unsolicited proposal

Unsolicited project proposals typically follow a five-stage cycle:

1) submission of the proposal by the private initiator

2) evaluation of the unsolicited proposal by the public partner

3) development of the studies for the unsolicited proposal project

4) procurement of the unsolicited proposal project

5) implementation of the project (the construction and operating phases).

3. Principles and recommendations for the development of legal conditions for the mechanism of unsolicited proposals

3.1 The following principles should be considered when developing an unsolicited proposal mechanism in CIS countries:

1) **Public interest:** Initiated projects must comply with national infrastructure priorities and meet a real social and economic need.

2) **Value for money:** SGAs should only structure privately initiated projects as PPPs if they are expected to generate greater value for money under PPP delivery than under conventional delivery or procurement.

3) **Affordability:** SGAs must understand the impact of an unsolicited proposal mechanism on public finances, including whether fiscal liabilities are acceptable and risks are sufficiently manageable.

4) **Fair market pricing:** SGAs should ensure that PPP agreements (PPPAs) resulting from unsolicited proposals reflect market prices, avoid excessive private returns and include a risk allocation appropriate for the SGAs.

5) **Transparency and accountability:** SGAs should disclose all relevant project information to allay stakeholder concerns regarding transparency and accountability.

6) **Alignment of PPP and unsolicited proposal mechanism procedures:** SGAs are advised to align PPP and unsolicited proposal mechanism policies

[1] For detailed examples of best practice, see World Bank (2018), Policy Guidelines for Managing Unsolicited Proposals in Infrastructure Projects, Volumes I- III, Washington, DC.

to increase stakeholder support, enhance market interest and ensure consistency in public decision-making.

7) **Public accountability:** SGAs and the government are accountable to the public for their activities in the areas of PPP, public infrastructure and public services.

8) **Necessity to reconcile interests:** Harmonisation of the interests of the SGAs and the private sector should be ensured when implementing projects through the mechanism of unsolicited proposals, including the clear establishment of the obligations of the parties on the basis of mutual responsibility, trust and respect.

3.2 A common set of recommendations can be presented to the SGAs to improve their PPP frameworks and capacity to manage unsolicited proposals:

• **Develop an unsolicited proposals policy framework** – policies for steps and timelines to manage the unsolicited proposal mechanism, covering minimum submission requirements, reimbursement and protection of intellectual property, procedures for introducing competition and reward systems (bonus system, direct compensation, automatic shortlisting and so on), and eligibility for and types of government support, if any.

• **Build institutional capacity** – build capacity and empower PPPs or similar units to manage unsolicited proposals, conduct feasibility studies independently or in-house, design and implement clear regulations for the assessment of fiscal risks and liabilities, incorporate blind reviews of unsolicited proposals, seek assistance from multilateral development banks and use transaction advisers for due diligence and the selection of proposals.

• **Follow competitive procurement processes and procedures** – establish communication with initial unsolicited proposal proponents and competitors, develop stakeholder coordination, ensure commitment for contract enforcement and follow typical PPP processes and procedures.

3.3 The CIS member country's government needs to consider the most important decisions to shape the unsolicited proposal mechanism:

• Government should determine the extent to which it will define the parameters of unsolicited proposals. The government may choose to encourage unsolicited proposal submissions that provide for particular types of PPPs and/or address specific infrastructure challenges, geographies, sectors or technologies. Defining parameters too narrowly, however, may limit the scope for innovation.

• Government should determine how to incorporate the unsolicited proposal regulation into the existing regulatory framework. The government may incorporate it into procurement laws for conventionally delivered projects, into PPP-specific laws, regulations or policies, or as a standalone act. In any case, the main principles of the unsolicited proposals framework shall be set out in the law.

• Government should determine the extent to which the project initiator may be involved in project development. Involving the project initiator in project development has major disadvantages for SGAs, including loss of control over project structuring, loss of negotiating power due to information asymmetries, and difficulties generating competition during a competitive tender. They have two options: project development by the SGA (with external advisers) or project development by the SGA and project initiators, whereby the SGA (and its external advisers) undertake specific public-interest studies, and the SGA and its advisers undertake a detailed review of any studies developed by the project initiator.

• Government should determine which procurement methods and incentives will be allowed. Governments are advised to tender unsolicited proposals competitively whenever possible. Some SGAs may opt to negotiate directly with the project initiator when market interest is limited to the project initiator, but the project is in the public interest. The legislation should clarify whether direct negotiation is acceptable and, if so, in what circumstances. In case of a competitive tender, the legislation should also specify whether the project initiator will be given any advantages over competing bidders. These recommendations strongly go against the right-to-match mechanism, given its potential to discourage competition compared with the bonus mechanism and automatic shortlisting.

4. Possibility of using unsolicited proposals

4.1 The mechanism of unsolicited proposals, if properly structured and fine-tuned, is an effective way of implementing PPP projects.

In the CIS member states, PPP projects implemented through the unsolicited proposal mechanism are, by and large, innovative and socially oriented, as they typically already have some legal framework for unsolicited proposals, aided in part by the 2017 Eurasian Economic Commission's PPP Guidelines. This mechanism also reduces the duration of procurement procedures and lets investors propose self-developed projects to public partners. Nevertheless, SGAs should realise that not all

privately initiated PPPs are really innovative, unique or contain new technologies. They must be aware that unsubstantiated claims of intellectual property or innovation by private initiators may lead to challenges in terms of transparency and competitive procurement.

At the same time, it is important to find a balance between the interests of all PPP parties and provide them with transparent procedures on unsolicited proposals that will not substitute competitive procedures for the selection of the private partner.

4.2 Unsolicited PPP proposals may be permitted as a way of accelerating PPP deal flow in accordance with the recommendations outlined in section 3. A person who qualifies as a private partner can submit an unsolicited PPP proposal. As there are risks for the public side, legislation shall establish other requirements for a private investor submitting an unsolicited proposal. These can include technical expertise and qualifications, level of investment and resources behind the proposal, non-liquidation, financial stability and, perhaps, funding confirmation requirements. The legislation should also establish the SGA for the receipt of unsolicited proposals and procedures and terms for its consideration, as well as regulate in detail the decision-making process involved. This ensures fair competition, as any other interested investors may apply to have the opportunity to bid for the project.

5. Submission and substantiation of unsolicited proposals

5.1 When the proposal is submitted, the SGA has to verify whether it meets all the requirements. These requirements must not be complicated or ambiguous; they must be clear and standardised. The SGA is advised to adopt an exhaustive list of reasons for denying a submission. Legislation should provide a dedicated timeframe for consideration of unsolicited proposal submissions to streamline their processing. It may be feasible to require the project initiator to pay a review fee to discourage private partners from submitting poor-quality, incomplete or opportunistic proposals. Another effective measure is to require criteria for assessing the project initiator – including integrity or due diligence criteria and requests for past qualifications. This information would help the relevant authority evaluate the reputation, experience and integrity of the project initiator. Moreover, specifying how the SGA addresses requests to protect proprietary or confidential information from the project initiator will minimise unnecessary safeguards that reduce transparency.

5.2 It is recommended that the unsolicited proposal undergo the applicable procedure for assessment of the PPP project. This should be initiated by the public partner according to the CIS member countries' approved methodology for evaluating the effectiveness of PPP projects, in line with Interparliamentary Assembly of Member Nations of the Commonwealth of Independent States (IPA CIS) Resolution No. 48-7 of 29 November 2018. Recommendations for evaluating proposals include:

- Introduce clear evaluation criteria and procedures to help the relevant authorities process unsolicited proposals efficiently and ensure that these proposals are aligned with public objectives.

- The evaluation criteria should cover public interest, project feasibility (including affordability considerations), PPP suitability for implementation of the project and the provision of related services.

- The use of benchmarking to evaluate the initiated project, so the relevant authority can compare its terms with those of similar projects. Benchmarking refers to identifying and qualitatively and/or quantitatively analysing projects in similar sectors and market settings. The comparison can focus on the type of solution being proposed, the cost components, the proposed timelines, the proposed risk allocation and the extent of market interest.

- Disclose parts of the submission and evaluation process to boost transparency and accountability.

Disclosure should cover material elements of the submission, the process and findings of the evaluation process, and a description of the proposed project development and procurement process.

• Seek approval from a decision-making authority before moving to the next stage.

5.3 If the proposal passes all stages successfully and the public partner considers it unique and innovative (the legislation may list other criteria), a PPPA may be entered into with the project initiator without tendering. Tendering procedures will be held if the project passes all the approvals but is not considered unique or innovative (or when the public partner believes it necessary to initiate a tendering process). In any case, an investor proposal to initiate the PPP project shall be published on the public partner's official website and/or the official website about the tendering procedure (if applicable) and/or in the official publication about tendering procedures (if any). If other parties are interested in implementing the project, the relevant authority shall conduct competitive procedures to select a private partner for the project.

5.4 To ensure balanced regulation in terms of unsolicited proposals, legislation should generally lean towards competitive tendering for unsolicited PPP proposals and provide the project initiator with certain bonuses or incentives in any tendering process (such as bonus bid points or a waiver of the requirement to submit bid security).

6. Incentives for developing unsolicited proposals

6.1 Incentives and bonuses may be offered to the project initiator during tendering procedures to find a balance between the interests of the parties, ensure competition and transparency, and increase the attractiveness of the unsolicited proposal mechanism. Incentives could include the following:

• The right to demand that the bidder that has entered into an agreement with the public partner (if this bidder is not the project initiator) reimburse the project initiator's costs for preparing the project in the amount established by the tender documentation. The SGA is to decide whether, upon entering into the PPPA, the winning bidder (if not the project initiator) remunerates the project initiator in full for its reasonable expenses in connection with (pre-tender) project preparation. Alternatively, the SGA itself may reimburse the project initiator.

• Exemption from the need to provide security to fulfil its obligations at the preliminary selection and/or competition stage (which means not requiring the project initiator to provide security during tendering), or exemption from performing other obligations at the preliminary selection and/or competition stage. This will reduce the expenses for the project initiator (which has already borne the costs of preparing the project and is not likely to walk away from its own proposal).

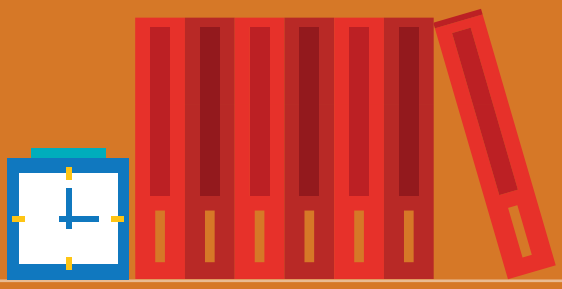
• Giving the project initiator a bid bonus – an additional percentage added to its evaluation score, though this can be difficult to apply and may distort the competitive process unhelpfully.

• Other benefits and incentives.

Lastly, the project initiator may be automatically invited to the final stage of the tendering procedures.

6.2 The public partner will choose which of the above support measures to use based on the methodology to be adopted by the relevant SGA. The amount of compensation shall not be excessive and shall not affect the competition between bidders. The SGA should adopt rules specifying the maximum level of compensation.

6.3 A project initiator should be able to contact the public partner before submitting an unsolicited proposal (and even before preparation begins) to discuss key aspects of the proposed project and determine whether it interests the public partner. The project initiator may also discuss its proposal with the SGA at any stage during its submission and/or review.



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.

Chapter 6.
PPP projects implementation guidelines

Introduction

These guidelines on the preparation and implementation of public-private partnership (PPP) projects have been developed for the officials and specialists of state government authorities (SGAs) and municipal authorities of Commonwealth of Independent States (CIS) member countries to specify the main objectives and activities to be performed by them at different stages of preparing and implementing PPP projects.

The guidelines contain recommendations for SGAs with respect to the following stages of implementing PPP projects:

(a) PPP project identification

(b) PPP project preparation

(c) PPP project viability/feasibility assessment, including the determination of PPP project price/quality ratio (PQR)

(d) selection of a private partner

(e) commercial close

(f) financial close

(g) monitoring of implementation of the PPP project

(h) further PPP project assessment.

1. PPP project identification

1.1 At this stage, the SGA shall form the initial concept of the project, determine the needs of the public and specify the project objectives.

1.2 One of the SGA's main objectives at the stage of PPP project identification shall be an assessment of the applicability of PPP mechanisms to the project and an assessment of the need to implement the project.

1.3 It is recommended that CIS member countries develop and approve the applicable methodologies for this stage based on the identification of those projects that may be effectively implemented as PPPs. This is required to avoid incurring unnecessary expenses using budgetary funds for projects that do not fall into this category.

1.4 The SGA shall select the most promising PPP projects in terms of their potential for attracting private investments and their need to develop the relevant industry or sector. Priority shall be given to projects that satisfy the needs of the public and public sector to the greatest extent and provide an optimum PQR.

1.5 Each PPP project shall comply with the strategic plans and objectives for infrastructure development of the relevant CIS member country, as well as with the plans and objectives for development of the relevant industry or sector in which the PPP project is being implemented.

1.6 At the stage of PPP project identification, the SGA shall prepare a preliminary technical feasibility study (TFS) confirming the viability of PPP as a basis for the relevant project, as well as the practicability of implementing the PPP project. The development of a preliminary TFS may be preceded by the development of the original concept for the project. This concept and the TFS shall be submitted to the authority responsible for preparing the PPP in the relevant industry or sector.

1.7 Preparing a preliminary TFS before preparing an extended final TFS can help from the outset to analyse any applicable "stop factors", determine what difficulties and problems the PPP project may face, and take them into account when preparing the final TFS.

1.8 When identifying the PPP project, if it is necessary to ensure the quality of project management, the SGA shall create an interdepartmental project group by engaging specialists from a selection of subordinate organisations, independent experts, design, engineering and other companies, interested and authorised state bodies, representatives of the

chamber of entrepreneurs, business entities and consultants. The interdepartmental project group shall study PPP proposals and initiatives, assess and determine the priority and method of implementation of the PPP project and tender structure, and study the results of relevant research and preliminary calculations.

2. PPP project preparation

2.1 The objective of preparing the PPP project shall include developing such terms and conditions that will attract private investors and provide the best PQR, including, but not limited to, the commercial, financial, technical and legal basis of its implementation.

2.2 CIS member countries shall determine the requirements for the professional qualifications of the officials of the SGA and other parties responsible for PPP project preparation. Significant experience within the SGA in PPP project implementation shall be one of the key factors behind the successful implementation of any PPP project.

2.3 At the stage of PPP project preparation, as a rule, the SGA's tasks shall include performing the following activities, some of which may in certain circumstances be delegated to the private partner, for example, in the course of implementing private initiative arrangements (an unsolicited proposal):

(a) economic, technical and legal studies for the PPP project
(b) preparing the TFS or business plan for the project
(c) preparing a financial model (should its preparation be the responsibility of the public party)
(d) analysis and assessment of PPP project risks
(e) PQR assessment
(f) preparing the PPP project implementation plan
(g) preparing project documentation
(h) preparing necessary changes in current legislation (if applicable)
(i) taking reasonable measures with respect to land plots (for example, formation of the land plots [including assignment and surveying thereof] and the registration of title to the land plots)
(j) obtaining necessary (preliminary) permits, consents and agreements from the state authorities
(k) legal structuring of the project
(l) holding public hearings
(m) holding meetings, conferences and negotiations with potential investors.

2.4. One of the main tasks of the SGA while setting up the PPP project shall be to prepare the TFS (or a business plan of the project). The public authority responsible for the PPP or the consultants they engage (legal, financial, technical) shall prepare the TFS. Once it has been prepared, the TFS shall be subject to approval by the relevant ministry or the public partner's other legally authorised authority.

2.5 Member countries should develop the methods of analysis and application of the criteria for the financial, social, economic and budgetary viability of PPP projects, as well as evaluation of their environmental and social impacts.

2.6 Among other requirements, stipulated by normative and regulatory acts of the relevant CIS member country, the TFS shall include:

(a) justification of the need for and feasibility of implementing the PPP project in terms of the public needs of the member country in the context of the relevant public infrastructure and/or public services

(b) legal analysis of the PPP project (for instance, the ability to implement the project in accordance with the current laws of the country, what kind of amendments to current legislation may be required to implement the project, if such amendments may be stipulated within a reasonable time)

(c) technical analysis of the PPP project (whether the project can be implemented with the use of technologies available without any material technical risks)

(d) assessment of the budgetary consequences of implementing the PPP project, including its tax consequences

(e) analysis of the investment potential of the PPP project and its compliance with the strategic development plans of the relevant industry or sector and the wider infrastructure development plans of the country

(f) assessment of the ecological consequences of implementing the PPP project and available steps to minimise any negative impact on the environment

(g) Justification of the efficacy of using PPP for the project, and the comparative advantage of doing so, compared with other options available to the public partner.

2.7 To take into account the interests of the public, consumers, users of the infrastructure objects and other stakeholders, the SGA shall conduct public hearings once the TFS of the PPP project has been prepared.

2.8 Where necessary, adopt any regulatory acts or amendments to ensure the legal viability of the PPP project. It is advisable to conduct an analysis of the regulatory impact of any such acts or amendments on the wider market and business conditions in the country.

2.9 Upon preparation of the PPP project, the SGA should assess the project's efficacy, based on the TFS and the relevant supporting documentation.

2.10 Banks and other financial institutions and organisations interested in financing a PPP project can participate in the development and discussion of the concept of the PPP project, its tender documentation and the draft PPP contract. This includes making proposals on the financing structure for the project, security for loans, payments in the event of early termination of the PPP agreement and other issues related to the financing of the project.

2.11 To attract potential private partners to discuss the proposed PPP, round tables, meetings, road shows (presentations), industry conferences, fora, exhibitions, investment marketing and other necessary events can be held (including with the participation of consultants).

3. PPP project efficacy assessment

3.1 The SGA shall provide assessments at key points during the lifecycle of a PPP project's implementation (selection, preparation, procurement, construction and operation), updating the results of earlier PPP project efficacy assessments to reflect new information.

3.2 The SGA shall also provide an independent verification (analysis) of the results of the assessment of the PPP project's efficacy (including the TFS) and the assumptions used in the assessment. Member countries shall specify the regulations and rules applicable to such assessments. A team of specialists not previously involved in preparing the project shall carry out the verification exercise. This is required because the team engaged in preparing the project cannot, in most cases, provide an independent and unbiased assessment.

3.3 The initial stage of assessing a PPP project shall include a strategic analysis that includes identifying the project, confirming compliance of the project objectives with the SGA strategy and long-term objectives and priorities of the state, preliminary determination of the project's forms of state support, identifying any stop factors and verifying the sufficiency of the information provided. (The components of the strategic analysis are provided in detail in the Chapter in this volume on the methodology for conducting a PPP project appraisal.) The strategic analysis may be conducted at the project identification or project preparation stages.

3.4. In addition to the strategic analysis, the assessment of a PPP project's efficacy shall include a complex analysis involving the criteria representing the financial, social, economic and budgetary impacts of the project. (The components of the complex analysis are provided in detail in the methodology for assessing PPP project efficacy.)

3.5 At each stage of the project's implementation, the assessment and its subsequent updates shall be based on the information contained within the PQR, as well as the risk analysis.

3.6 Should the project initiator have already prepared the project efficacy assessment subject to the strategic and complex analyses, as well as the PQR analysis and risk analysis, the SGA shall provide independent verification of the results, assumptions and appropriateness of the assessments.

3.7 In addition to the initial assessment of the PPP project, the SGA shall assess each material change to the PPP agreement, the scope of which shall depend upon the changes proposed. In the case of insignificant changes to the agreement, the assessment may be carried out in short form, involving fewer resources and within a shorter timescale.

3.8 The financial and economic analyses of the PPP project shall also be agreed with the financial authority of the relevant public legal entity (that is, the government agency or organisation with the legal authority to oversee the financial aspects of the PPP project), authorised to perform executive functions in the sphere of economic development of the relevant territory and/or with other bodies authorised by the laws of the relevant member country.

3.9 The PQR shall be one of the key assessment criteria of the PPP project for the SGA. The PQR shall indicate the optimum balance between the total expenses of the project and the quality of the services, to maximise the net value of the project via PPPs compared with other forms of state procurement. The SGA shall use qualitative and quantitative criteria for the PQR assessment.

3.10 It is recommended that member countries adopt a methodology for carrying out their PQR assessments, specifying the applicable criteria, procedures and terms, as well as their allocation of responsibilities for the assessment among the different SGAs and levels (federal, state or municipal), depending on the nature and characteristics of the PPP project. The PQR assessment methodology should comply with the methodology for evaluating the effectiveness of PPP projects and the PQR assessment matrix in CIS member countries.

3.11 If the PPP project complies with the requirements stipulated by the laws of the relevant member

country, as shown by the results of its preparation and assessment, the relevant authority shall decide on its implementation. The content requirements for such a decision shall be established by the laws of the relevant member country.

4. Selection of a private partner

Procedure for selecting a private partner for PPP projects

4.1 The state typically derives the greatest efficiency from PPPs by using a transparent competitive tendering process to select the private partner. Competitive procedures enable the most favourable PQR to be achieved, while the transparency of the process confirms the legitimacy of the state's decisions associated with the implementation of PPP projects.

4.2 The SGA shall implement the procedures for selecting the private partner in accordance with the laws of the relevant member country, including the principles stipulated in the normative and regulatory acts on PPP.

4.3 In some exceptional cases stipulated by applicable law, the SGA may conduct (direct) negotiations for concluding the PPP agreement with a potential private partner without any competitive procedures.

4.4 For the purposes of selecting private partners for PPP projects, the SGA shall establish a tendering commission, which, among other things, shall include specialists in the sphere of PPP project implementation. The laws of the relevant member country shall provide for the functions, powers and operational procedures of the tender commission.

Tender notices

4.5 Upon deciding to implement a PPP project, the SGA shall prepare and publish the relevant tender notice. The tender notice shall be published on the official website of the public partner, as well as on the official website of the tendering procedure (if applicable) stipulated by law and in any official publication (if any) for information about tendering procedures.

4.6 A tender notice shall specify the terms of the tendering procedure, its subject, participant qualification criteria, as well as other terms and conditions stipulated by the laws of the relevant member country. The SGA may amend a tender notice only subject to any necessary extension of the deadline stipulated for the preparation of bids or tender proposals for bidders/participants.

Pre-qualification

4.7 The SGA shall provide criteria for the pre-qualification stage of tender participants. Such criteria:

(a) shall not entail any (unfair) competition restrictions or unwarranted restriction on the participation of bidders

(b) shall refer to the professional and business qualifications and capabilities of the bidders and include other objective standards enabling the identification of their respective abilities to implement the relevant PPP project.

4.8 In the course of determining the criteria, the SGA shall be guided by the project specifics to select bidders that are best suited to implementing the relevant PPP project.

Invitation to tender

4.9 The tender documentation included in the invitation to tender (the tender documentation) shall contain all the information required by bidders to prepare their tender proposals. The SGA shall specify precise criteria to be used for the evaluation of the bidders, as well as the relative value and weighting of each criterion.

4.10 The tender documentation shall reflect the tendering procedure's compliance with all applicable requirements and the PPP principles stipulated by applicable law. It is also recommended to include in the tender documentation other data and information that may not be specifically required by applicable law but which may be important for participants in the course of drawing up their bids.

The tender documentation should contain the following information:

(a) contents of a bid, form, location, deadline and period of validity of submission
(b) form and conditions of bid security
(c) terms and methods for obtaining clarifications of the contents of the tender documentation
(d) compliance requirements for potential private partners/bidders
(e) a description of the criteria for determining the winning bid
(f) procedures, place, date and time for the opening of bid documents
(g) estimated types and amounts of state support, as well as sources of income generation for the PPP project

(h) main terms and conditions or a full draft of the PPP agreement (submitted as an annex to the tender documentation)

(i) language requirements

(j) an indication of the right of a bidder to change or withdraw its bid before the deadline for final submission.

4.11 The SGA shall be entitled to amend the tender documentation subject to publication of the relevant amendments and granting any necessary extension of the term for preparation and submission of tenders by bidders.

4.12 Interested bidders have the right to ask the organiser of the tender for clarification of any of its provisions. At the same time, a deadline shall be set for the submission of such requests (for example, no later than 30 calendar days before the deadline for submission of bids). The tender organiser shall send a response to any such request within a reasonable timeframe and, without specifying the source of the request, publish its response on the official website for posting information about the bidding process and/or inform all bidders to whom the tender documentation was provided (if it was provided to selected parties).

Tender stage

4.13 In the course of the tendering procedure, more active participation may be required from the SGA in addition to clarifying the provisions of the tender documentation to the tender participants, which is especially important in the course of implementing more complex and costly PPP projects.

4.14 Competitive dialogue can be organised to optimise decisions on the technical, financial, legal and other necessary parameters of the PPP project, as well as state support measures and the criteria for determining the winning bid.

4.15 The SGA may conduct meetings, consultations or conferences with any pre-qualified bidders (if applicable) for the purposes of negotiating and discussing the provisions of the tender documentation and possible adjustments thereto. The SGA shall refrain from making any unnecessary amendments to the tender documentation, as most significant parameters of the project should have been developed during its identification and preparation.

4.16 In the course of these meetings and conferences, the SGA shall comply to the fullest extent with the principles for selecting a private partner, and provide equal rights and access to the relevant information for all bidders. These meetings and conferences shall not cause undue delay to the selection process.

4.17 The SGA shall keep records of all communications with the bidders, along with clarifications and justifications for all decisions made by the SGA at this stage. The SGA shall respect the confidentiality of all commercially classified information received when communicating with bidders.

4.18 The SGA has the right to involve PPP consultants at the tender stage.

Assessment of bids and selection of the winner

4.19 It is recommended that CIS member countries develop a methodology for assessing bids that will be mandatory for tender commissions.

4.20 The list of criteria for determining the winning bid may include:

(a) [terms of] construction, reconstruction, modernisation and/or operation of the facility

(b) technical and economic aspects of the facility

(c) amount and terms of the public partner's payments to the PPP project

(d) amount of private partner funding (both debt and equity) to be invested in the PPP project

(e) proposed risk allocation

(f) marginal prices (tariffs) for work performed or services rendered, and any additional surcharges.

4.21 At the bid assessment stage, tender commissions shall keep a detailed record of all stages leading to each bid assessment. The record shall describe the decision-making methodology applied by the members of the commission, as well as the rationale for all its decisions.

4.22 The SGA shall notify bidders about any decisions made by the tender commission and shall publish them on the official website of the public partner and/or the official website for the tendering procedure (if any).

Final negotiation

4.23 Typically, any PPP project requires additional negotiation with the tender winner to decide on the final draft of the PPP agreement. In the course of negotiation with the tender winner, however, the SGA shall not amend those terms and conditions of the PPP agreement that were material to making the decision on participation in the tender (selection of the short-listed/winning bidders) and which formed part of the selection criteria. With respect to certain projects, the legislation of the relevant CIS member country may provide for certain restrictions or an absolute prohibition on further negotiation following determination of the tender winner.

4.24 If the estimated cost of the PPP project increases, including due to a change in legislation or a significant change in the exchange rate of the national currency, the project documentation may be adjusted and new tender documentation approved if such an increase does not entail a change in the project's technical features. In this case, a new competition is not required.

Publication of information about the results of the competition

4.25 Information on the results of the competition for the selection of a private partner, with the exception of information constituting state secrets or other secrets protected by law, shall be posted by the SGA on the official website for publishing information about tenders and/or in the official print media.

Private initiative

4.26 The laws of the relevant member country shall stipulate the rules and procedures for concluding a PPP agreement where private initiative arrangements are used (for example, private unsolicited proposals upon conclusion of the PPP agreement).

4.27 In the context of private initiative arrangements, one of the principle objectives of the SGA is to define the conditions for implementing and financing PPP projects by private initiative investors and to assure sufficient transparency in the selection methods used and the achievement of an optimum PQR.

4.28 In the course of implementing private initiative arrangements, the project proposal shall also undergo the relevant procedure for assessing PPP project efficacy applicable to PPP projects initiated by the public partner, in accordance with the CIS member country's chosen methodology for evaluating the effectiveness of PPP projects.

4.29 The proposal of the investor initiating the PPP project shall be published on the official website of the public partner and/or on the official website of the tendering procedure (if applicable) and/or in the official publication for information about tendering procedures (if any). If any other interested parties ready to implement the project are available, the SGA shall select the private partner on the basis of a competitive tender.

4.30 If a competitive tender is held, the relevant public body should ensure the protection of the rights and legitimate interests of the investor initiating the PPP project. The investor may be granted certain benefits and incentive measures in accordance with the laws of the CIS member country, in particular:

(a) exemption from the need to provide security for the fulfilment of its obligations at the stage of preliminary selection and/or competition or exemption from certain other obligations at that stage

(b) the right to change its proposal after the evaluation of the proposals of other bidders if one of the latter was recognised as the highest scoring;

(c) the right to receive from the bidder who has entered into an agreement with the public partner (if this is not the initiator of the project) reimbursement of the costs incurred by the project initiator in preparing the project in an amount specified in the tender documentation

(d) other benefits and incentive measures.

5. Commercial close

5.1 Upon determining the winner of the tender or concluding any negotiation specified in paragraph 4.24 above, or if no other interested parties are available in the context of the private initiative arrangement (paragraph 4.30), the public partner and the private partner shall conclude the PPP agreement.

5.2 The PPP agreement shall be concluded within the period established by the legislation of the CIS member country, the tender documentation or within the PPP agreement.

5.3 If it is necessary to conduct final negotiations at the stage of commercial close, the period for concluding a PPP agreement may be extended. In practice, the final negotiations may last for several weeks or even months. However, the SGA should seek to minimise the duration of such negotiations.

5.4 At the stage of commercial close, the draft PPP agreement can be changed only to the extent permitted by the legislation of the CIS member country.

6. Financial close

6.1 Commercial and financial close of a PPP project may take place at different periods of time because, after the commercial closing, the financing institutions may need time to analyse the provisions of the PPP agreement and other project agreements, and a private partner may need time to comply with all the preliminary terms and conditions required for the availability of financing.

6.2 In such a situation, there is a risk that the project will not be implemented due to a failure to achieve financial close, or that the relevant public authority will have to make changes to the PPP agreement, which are in some respects unfavourable for the public partner, to comply with the requirements of the financing institutions, as a new selection process for a private partner would require additional time and expense.

6.3 To minimise this risk, the relevant public authority may specify in the tender documentation the requirement that private partners fulfil their obligations as a prerequisite to financial closing. Other options to mitigate this risk may be mandatory confirmation of availability of the required financing or conclusion of preliminary financing agreements in the tender proposals of bidders. However, the SGA should note that including such provisions will complicate the process of preparing bids and may decrease the project's appeal to potential investors.

6.4 The SGA shall fulfil in a timely way the preliminary conditions of financial close related to the public partner and, upon compliance with all preliminary conditions, including receipt by the public partner of confirmation that the private partner has in place sufficient funding (debt and/or equity) for implementation of the PPP project, shall guarantee the signing and issuance of a report to confirm the parties' achievement of the financial close of the PPP agreement.

6.5 If debt financing is used for the project, a public partner, a private partner and a creditor/lenders can conclude a direct agreement at financial close. This agreement may include the following conditions:

(a) obligations of the private partner to inform the other parties about the occurrence of any material breach of obligations under the PPP agreement, the direct agreement and the financing agreements, including (in particular) those which may lead to the termination of these agreements

(b) a procedure for party interaction in case of a breach by the private partner of the terms of the financing agreements or PPP agreement, including for the purposes of preventing the project from being stopped

(c) an allowance and procedure for transferring the PPP agreement to a lender and/or a third party to replace the private partner in a project, in circumstances specified by the direct agreement, including the inability to implement the project using the existing private partner

(d) consent of the public partner to the creation of various types of security interest in favour of the lenders and to make payments under the PPP agreement to (an) account(s) specified by the lenders

(e) restrictions on making changes to (certain) provisions of the PPP agreement and other project agreements that may affect the rights of the lenders

(f) a clause prioritising the provisions of the direct agreement over the provisions of the PPP agreement and other project contracts

(g) other conditions included in the direct agreement to protect the interests of the lenders.

7. Supervision of performance under the PPP agreement

Control and supervision

7.1 The public partner shall continue to be responsible for the provision of the relevant public services following conclusion of the PPP agreement. After the commercial and financial close are achieved, the public partner shall ensure that performance under the PPP agreement is systematically monitored, both at the stage of creating/reconstructing the facility and at the stage of its operation/maintenance, and that the reporting documents submitted by the private partner are systematically reviewed.

7.2 The public partner shall appoint an authorised body responsible for monitoring and supervising the PPP agreement. The authorised body shall have sufficient experience in implementing PPP projects, knowledge of the relevant industry or sector, and sufficient resources to carry out these tasks.

7.3 Apart from monitoring the fulfilment of its obligations by the private partner, the authorised body shall also provide monitoring and supervision of fulfilment by the public partner of its own obligations. If any breach by the public partner of its obligations under the PPP agreement is detected, the SGA shall take appropriate measures to minimise the consequences and reduce the probability of it recurring.

7.4 For the purposes of monitoring and supervising performance under the PPP agreement, the public partner may engage independent experts and specialists in the relevant industry or sector and conduct a survey among the users of the services provided by the private partner to make possible a proper determination of the quality and availability of such services.

7.5 Applicable laws and the PPP agreement shall strictly regulate the rights and responsibilities of the public partner with regard to monitoring and supervision. In discharging them, the public partner shall not unreasonably interfere with the economic and business activities of the private partner or prevent the latter from fulfilling its obligations under the PPP agreement.

7.6 More detailed requirements for the monitoring and supervision of PPP projects shall be set out in the brief recommendations on monitoring the quality of services provided and the results of PPP projects in CIS member countries.

Transparency and information on PPPs

7.7 The SGA shall maintain a database of PPP agreements, subject to any legally recognised exceptions, including to protect national security and confidentiality. For these purposes, the database may include PPP agreements in redacted form or the main provisions thereof.

7.8 If the PPP agreement is changed, the SGA shall ensure that the relevant information is recorded in the database of PPP agreements.

7.9 The maintenance of such a database shall contribute to the transparency of the applicable tendering procedures and enable the public partner to track the performance of its own obligations.

8. Further PPP project assessments

8.1 The SGA shall procure a further assessment of each PPP project after its completion. A team of specialists independent of the public partner that took part in the preparation and implementation of the PPP project shall carry out such assessments.

8.2 The laws of the relevant CIS member country shall stipulate the criteria and methods for any further assessments of PPP projects, as well as the information required for their conduct. The SGA shall collect the relevant information for the post-project assessment when preparing and implementing the PPP project.

8.3 The SGA shall use the conclusions reached in these further assessments of PPP projects to identify the positive and negative aspects of such projects and to update and refine the processes involved in preparing and implementing them.

Chapter 7.
Risk allocation matrix

1. Risk matrix preparation methodology

1.1 Common definition of the risk matrix

The risk matrix is a table (systematic list) that classifies and distributes identified risks among the main project participants. For this purpose, risk can be understood as the probability of a harm occurring (for instance, less revenue being generated than expected) multiplied by the severity of that harm (the extent of its impact on the project). The risk matrix may also contain a description of risks, ways to minimise these risks and the ranking of risks according to the likelihood of occurrence and impact.

The risks related to the implementation of a public-private partnership (PPP) project must be taken into account during its preparation.

Risk management:

cmakes it possible to achieve the optimal "price-quality" ratio for the public partner during implementation of a PPP project (for example, the transfer of a number of risks to the private partner makes the project more attractive to the public partner)

• reduces the likelihood of occurrence and impact of negative risk events on the project during the implementation of the project (as risk accounting is a part of the risk management process).

The detailed composition and contents of the risk matrix may vary across different PPP practices. In these recommendations, the designations and descriptions of risk are represented in the risk register. Risk categorisation, allocation and management are recognised directly in the risk matrix. The risk ranking process (the relative significance of risks in comparison with each other) is not included in this document and is performed if the risks can be reliably measured. Broadly speaking, the preparation of the risk matrix and its role in the development of the PPP project will involve preparing both the register and the risk matrix.

This methodological approach to separation of the risk register and risk matrix is based on the following:

• The risk identification stage ends with the preparation of a particular report, the role of which may be represented by the risk register. Therefore, disclosing the information in the risk register eliminates the need to provide the same information directly in the matrix.

• In practical terms, the description of the risks may contain a large amount of textual information. The inclusion of this information in the risk matrix may make the risk matrix cumbersome and inconvenient for the end user.

• The risk matrix may include risks that are similar in nature, but arise during different project stages (for example, exchange risk and approval risk).

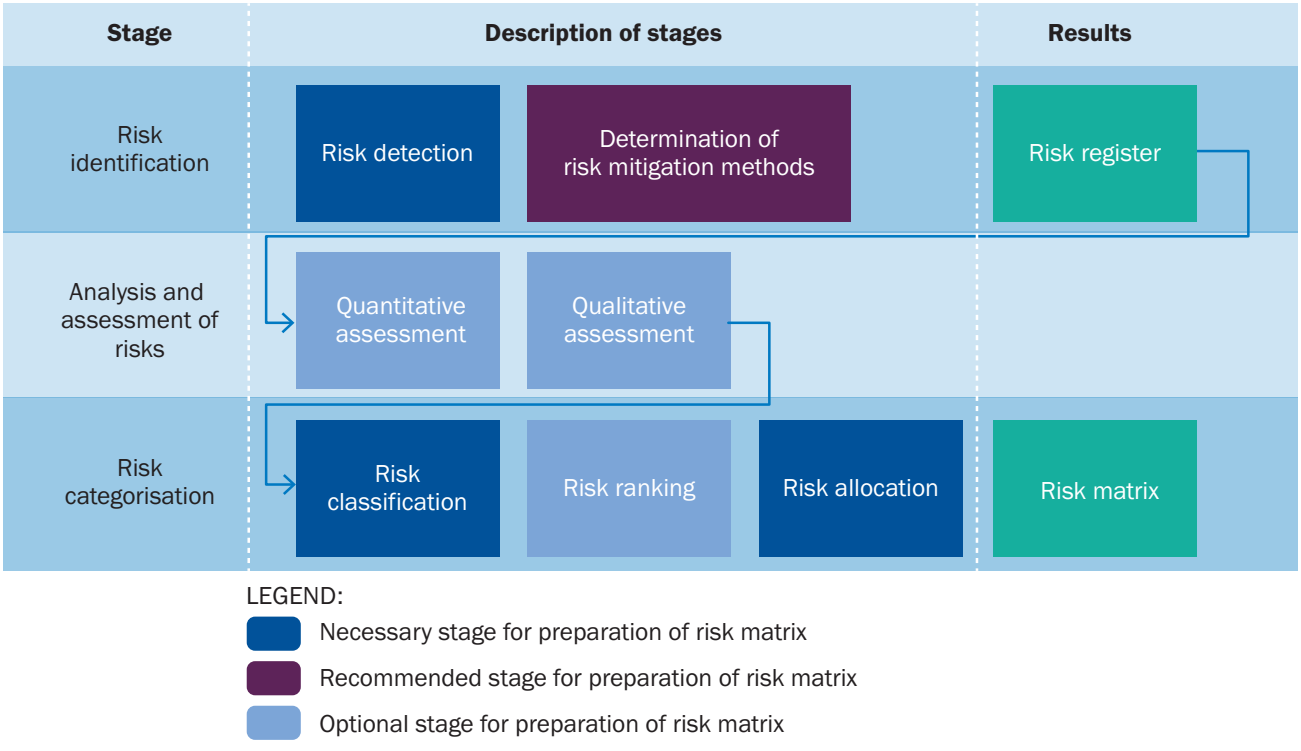


Chart 1. Stages of the formation of the risk matrix of a PPP project

The role of the risk matrix associated with the PPP project is to serve as a useful check against the draft PPP agreement to make sure that resources are efficiently allocated and appropriate risk management mechanisms are in place to reduce the likelihood and/or impact of the identified risks.

In the initial stages of a project, the potential private partners may be given a brief version of the risk matrix (not detailed, developed by the public partner for internal purposes). This enables prospective parties to understand the main risks of the PPP project from the earliest stages. It also provides a basis for future risk-sharing negotiations, helping to streamline a sometimes lengthy negotiation process.

Specific and basic project risks can be discussed in detail by the public and private partners during the negotiation process within the framework of commercial close.

1.2 Description of the procedures required for the compilation of the risk matrix

Identification of risks and determination of risk mitigation methods

Risk identification (detection) is a preliminary stage during the preparation of the register and the risk matrix. Risk identification methodology includes the following procedures:

- determination of the type of input data used to identify risks
- description of risk identification tools and methods
- description of the type of output data during the identification of risks.

The following may be used as input data for the identification of risks:

- existing documentation for the PPP project
- laws and regulations applicable to the project
- macroeconomic information (such as exchange rate dynamics and interest rate dynamics)
- information on the indicators of the expected volume of the provided services that are specific to the project (for instance, traffic density for highways, the number of visits to hospitals, appointments in an outpatient department)
- information on the risks identified during the implementation of similar projects.

The main tool used to identify risks is expert assessment, which can be obtained through group meetings, interviews with experts and detailed reports.

Risk mitigation methods are determined within the framework of the four main risk management strategies:

- risk avoidance (establishment of requirements of the private partner, revision of project tasks)
- risk reduction (for example, implementation of risk management actions, provisioning)
- assumption of risks (control over the level of assumed risk)
- risk transfer (insurance, hedging).

An assessment of risk mitigation tools is not required to draw up the risk matrix, but is advisable to increase the effectiveness of the project risk management process. See section 3 for an example of a standard risk matrix, including risk management recommendations.

The risk list or risk register may be used as output data in the risk identification process. It is advisable to use the risk register as the final document because it includes not only the set of risks themselves, but also a description of these risks.

Analysis and risk assessment – general approach

This stage is not always used in the development of the risk matrix. It is required if risks need to be ranked (determination of the likelihood of the occurrence of the risk event in a ranking and the extent of their impact on the PPP project). The risk analysis and assessment is performed using two main methods: qualitative and quantitative.

Qualitative methods consist of the expert evaluation method, whereby risk events and risk impact extents are divided into several groups depending on the likelihood of occurrence and impact (from low to very high).

Quantitative methods involve the measurement of risks in monetary terms and are represented by sensitivity analysis, scenario analysis and the Monte Carlo method. It should be noted that at the current stage of PPP market development in Commonwealth of Independent States (CIS) countries, there is no extensive base of historical data concerning the likelihood of risk occurrence and the impact of risks on implemented projects. Quantitative methods are used mainly in the context of value-for-money analysis. It is very rare (but not unheard of) that these are needed to determine the risk allocation in the PPP arrangement.

A detailed methodology of the risk assessment is given in the document PPP project appraisal guidelines.

Risk classification

The risk classification involves:

- categorisation by function (for example, technical, financial, legal or other risks)
- categorisation by main project stage (design, construction, operation).

1.3 Risk allocation approach

Risk allocation approach

The allocation of risks between project partners is a key aspect of a PPP project. This allocation has an impact on:

- the feasibility of implementation (for example, the allocation of a number of risks to the private partner may render it impossible to implement the project from a financial perspective – that is, the sponsoring entities will not be able to take on all the risks of the special-purpose vehicle and also to provide funding for the project)
- benefits from the implementation of the PPP project both for the public partner (based on the value-for-money model) and the private partner (the public partner may cover some of the risks)
- the required rate of return of the private partner (risk premium).

Project risks can be divided into three categories:

- transferred to the private partner ("transferred risks")
- retained by the public partner ("retained risks")
- joint risks ("shared risks").

It is important to maintain a balance of interests of both partners in the risk-allocation process. The main rule of risk allocation according to international practice is that the risk be assumed by the partner that can effectively manage it. If it is difficult to determine the partner that can effectively manage the risk, the risk can be shared between the partners.

This logic is confirmed by established practice: in PPP projects, construction and maintenance risks are in essence transferred to the private partner, as it is responsible for directly implementing this work. In this case, the transfer of risk to the private partner should incentivise private partners to apply innovative approaches in the PPP framework and also provide quality services, keeping costs under control.

The allocation of an insignificant volume of risk to the private partner may render the project of little use to the public partner. The allocation of excessive risks to the private partner (for example, risks that the public partner can effectively manage) may result in excessive risk premiums required by the private partner, thereby adversely affecting the "price-quality" ratio.

The public partner usually assumes the risks that arise due to circumstances under its (or the government's) direct (or indirect) control. These risks may include:

- risks related to the preparation of the preliminary design and tender documentation
- risks related to the acquisition of land
- risks related to the preparation of a construction site and the relocation of key utility networks
- risks related to future changes in the contractual terms caused by the public partner (variation orders)
- risks related to amendments to legislation.

Principles governing the compilation of the risk matrix

The principles governing the compilation of the risk matrix are given below:

- Different projects have different opportunities for risk allocation between the partners.

- Successful negotiations concerning the transfer of risks require a clear understanding by the public partner of the risks noted in the bid submissions, their key impact on the willingness of the private partner to provide services under the contract and on the cost of financing, and also the benefit of the money that is spent in connection with the allocation of the risks. That is why all risks must be identified and assessed.

- In sectors where the private partner has full rights of possession, control and sole responsibility, the private partner should be encouraged to assume all the risks it can manage more efficiently than the public partner. If the public partner wants to have responsibility for and control over the provision of services under the contract and at the same time try to reallocate a significant amount of risks to the private partner, the private partner will very likely demand more remuneration for its services.

- The optimal allocation of risks between the private and public partners incentivises the private partner to provide services on time and at a reasonable price, using more innovative decisions. Regarding the transfer of risks from the public partner to the private partner, where the private partner only provides services under the contract, the private partner will typically have better control over the outputs from such service provision than the public partner.

The risk allocation table ("risk matrix") should show each partner's share of the identified risk and how the aggregate risk is split. The share should be expressed in percentages. If percentage calculations are impossible, simple notes on the specific partner assuming the risk can be used.

2. Standard risk register

Basic and specific risks

As a rule, the risks considered in preparing the risk register and risk matrix may differ from project to project, depending on the economic sector and industry. A certain number of risks are common to all projects, however. These include:

- land purchase and site risk
- environmental and social risk
- design risk
- construction risk
- completion risk
- performance (quality)/price risk
- resource/input risk
- demand/utilisation risk
- maintenance risk
- force majeure
- exchange rate and interest rate risk
- insurance risk
- political risk
- regulatory risk/change in law risk
- inflation risk
- disruptive technology risk
- early termination risk.

Note, though, that the ways in which they are described, allocated and mitigated will differ from project to project. In addition to the basic risks, there are specific risks that require special attention during the preparation of the risk matrix, as shown in the examples below.

Projects in the health and education sectors:

- risk of ineffective cooperation with other hospitals (health sector)

- risk of ineffective interaction between the operator and the maintenance company (health sector)

- risk of failure to receive the required licence for the provision of services (health sector)

- risk of insufficient coordination on the use of another type of equipment in the event of a change in technology (health sector)

- risk of possible changes in the profile of the medical institution (health sector)

- risk of ineffective interaction with the providers of catering services, waste sterilisation (health sector)

- risk of a lack of long-term guarantees of service demand levels (health, education sectors)

- coordination risk involved in opportunities to provide additional (non-core) services (health, education sectors).

Risks in the energy sector (based on the example of the electricity sector):

- risk that the transmission grid is not ready and the required grid infrastructure is not available: the facilities required for the connection of the power station to the energy system may be not commissioned on time, rendering operation of the power station impossible, or such facilities may be calculated based on a low transmission volume, which may lead to a marked increase in tariffs

• risk associated with payment collection: failure to receive payments (undue receipt) from the buyers of the electricity

• risk of insufficient water levels, wind or solar activity for the operation of the power station on the basis of renewable energy

• risk of interruptions in the functioning of the facilities, taking into account the social importance of the sector.

Risks in the utility sector (based on the example of the recycling sector):

• coordination risk arising from possible failure to obtain recycling licences required for certain types of waste

• risk associated with organising an efficient waste-sorting process.

Risks in the transport sector (based on the example of roads):

• revenue risk: decrease in toll payments received

• risk of an increase in road maintenance costs due to higher-than-planned traffic density

• risk of road use by overloaded vehicles

• risk of the need to build bridges, tunnels or additional road junctions that are not specified in the design documentation near the facility.

Standard risk register

The following pages contain the standard risk register, which includes the risks that may occur during the preparation and implementation of the investment project.

Risk register		
Risk		**Description**
1.	**Design risks**	
1.1.	Risks of the coordination of project documentation, technical conditions	Risk the approval is denied, or the approval time of the design documentation and/or the technical conditions is increased due to the owners of the utility networks (utility lines) or the risk of changes in technical conditions caused by the owners of the utility networks (utility lines).
1.2.	Risk of an increase in the design time frame	The risk of changes to the project implementation time frame due to a delay in implementation of the design work.
1.3.	Risks related to engineering surveys	During the development of the working documentation and performance of an additional engineering survey, the discovery of mineral deposits, archaeological artefacts, utility networks and/or utility lines, contamination of the soil and/or the ground (groundwater), cemeteries (including burial of human remains) and/or military assets (including explosives and/or ammunition) in the ground (soil, groundwater), the mismatch of the relief with the design documentation data or other deviations from previously identified qualitative characteristics of the ground and other data previously conducted engineering surveys are possible. These mismatches may result the need for clarification of the adopted design and technological solutions. The introduction of the aforementioned changes associated with the additional time and financial costs for project partners and (depending on the detected deviations compared with the results of previously conducted engineering surveys) may render project implementation impossible.
1.4.	Risk of an increase in the cost of the construction of the asset according to the design results	The risk of changes in the cost of the project identified at the design stage.

Risk register		
Risk		**Description**
1.5.	Delay in the preparation of working documentation	The risk of delays in the preparation of the working documentation by the public partner and technical engineer.
1.6.	Changes in design and construction standards during construction	If the initial project documentation contained deficiencies, the private partner assumes the responsibility. If the changes were implemented on the public partner's instructions, the public partner covers the risk. The risk of any changes to laws affecting the design and construction of projects.
2.	**Land risks**	
2.1.	Delay in (impossibility of) obtaining the land required for the construction of the asset	Delays in obtaining or an inability to acquire the land needed to start building the asset. As a result, the private partner is entitled to demand compensation for additional costs and also an increase in the construction time frame within the framework established for exceptional circumstances.
2.2.	Inflated value of the acquired land necessary for the construction of the asset	The risk that the land required for the construction of the asset in accordance with the design documentation will be acquired at an inflated price.
2.3.	Errors in land-use documentation	The risk of a detection of errors, inaccuracies and/or mismatch of the results of the completed land and cadastral works with design documentation and/or area planning documentation, including the comments of the public authorities, which in turn may lead to an increase in the time frame for the provision of the land to the private partner.
2.4.	Delay in the receipt of permits or approvals that impact the project implementation time frame	Failure to obtain, or a delay in the receipt or repeal of permits/approvals that affect the project implementation time frame, including permits/approvals related to environmental and hygiene issues.
2.5.	Safety of the construction site	Risk of injury to contractors.
2.6	Third-party interference	The risk of the unauthorised intervention of third parties during preparation of the construction site.
2.7	Risks of preparing the land	Risks associated with preparation of the construction site, including the relocation of the utility lines, the provision of all the necessary infrastructure and change in the permitted purpose of land plot use. Risks related to the identification of hidden defects in the land plots and other extraordinary factors.
3.	**Construction risks**	
3.1.	Provision and control of the quality of construction works	The risk of poor performance in the construction work.
3.2.	Compliance with construction standards and specifications	The risk of non-compliance with the specification defined in the design documentation, and state standards and requirements on construction works in accordance with technical regulations, as well as applicable regulatory and technical acts.

Risk register		
Risk		**Description**
3.3.	Increase in expenditure and delays for reasons that differ from reasons under which compensation is paid in exceptional circumstances	The risk of an increase in expenses from the agreed level due to factors that do not imply any compensation for this increase (to the private partner at the expense of the public partner within the framework established for exceptional circumstances).
3.4.	Delays in the receipt of permits and approvals	Failure to obtain, delay in the receipt of, repeal of permits/ approvals that have an impact on the project implementation time frame.
3.5.	Delays due to changes caused by the public partner	The risk of non-compliance with the project implementation time frame due to changes in project specifications initiated by the public partner.
3.6.	Delay as a result of changes caused by the private partner	The risk of non-compliance of the implementation time frame of the project due to changes in the project specifications initiated by the private partner.
3.7.	Labour disputes	The risk of dissatisfaction among the public partner's employees, subcontractors and other project participants (where applicable), which might affect project implementation parameters due to the working conditions and level of wages and salaries.
3.8.	Availability of labour and material resources	The risk of the lack of the necessary project implementation resources.
3.9.	Project management risk, integration, delays	The risk of ineffective project management.
3.10.	Damage to the PPP asset	The risk of damage to the PPP asset during construction.
3.11.	Harm to a third party	The risk of the need to compensate a third party for damage caused during construction.
3.12.	Damage to utility lines	The risk of damage to the utility lines of third parties during construction.
3.13.	Sufficiency of insurance coverage	The risk that insurance coverage will not be sufficient to compensate for the damage to the property by third parties or damage during the construction and installation works.
3.14.	Bankruptcy of the subcontractor	The risk of the subcontractor's default due to bankruptcy.
3.15.	Latent defects in new infrastructure and declared defects in existing infrastructure	The risk of hidden defects in the infrastructure caused by the contractor (for example, due to violations of construction technology), which may occur during or at the end of the period of the agreement.
3.16.	Pollution of water, air and soil that was not known in advance	The risk of environmental pollution caused by the contractor in the construction and maintenance stages.
3.17.	Patent infringement	The risk of a violation of the owner's rights if patent-pending technology is used during construction.
3.18.	Material deficiencies	The risk of defective construction materials, products and structures used during construction.
3.19.	Occupational health and safety	The risk of industrial injuries and accidents during construction of the asset.

Risk register		
Risk		**Description**
3.20.	Construction safety	The risk of non-compliance with security standards during construction of the asset.
3.21.	Disputes between designers/ contractors/professional team	The risk of disputes among project participants that lead to inappropriate project implementation, delays in implementation and additional costs to the parties (among other things, in connection with the resolution of disputes between the parties).
4.	**Force majeure**	
4.1.	Force majeure	The impact of extraordinary circumstances that are beyond the control of the parties, such as weather events (for example, natural disasters, severe weather conditions, abnormal frost or showers), political events (for example, war, civil unrest, terrorist attacks, drastic changes in law) or health phenomena (pandemics, radioactive materials, chemical and bacteriological pollution).
5.	**Revenue Risk**	
5.1.	Collection risk (revenue receipt)	The risk of a decrease in revenue due to a decline in collections/ payments/rates and changes in demand regarding use of the asset compared with forecasts.
5.2.	Decrease in revenue due to the poor quality of the utility services provided	The risk of a decrease in revenue due to the poor quality of the services provided by utilities.
6.	**Operating risks**	
6.1.	Increase in maintenance costs due to the large volume of services provided (above the planned level)	Maintenance costs are above the predicted level because of unexpectedly high usage that could, for example, be the result of low rates charged to users, stimulating over-consumption.
6.2.	Incorrect forecasts and an increase in operating expenditure	Excessive project costs due to errors in forecasts made at the initial project implementation stage.
6.3.	Actual operating expenses exceed forecast expenses	The risk that the private partner underestimated maintenance costs at the time the tender offer was submitted (except for macroeconomic factors).
6.4.	Premature equipment wear	Depreciation of equipment before the end of its normal period of use.
6.5.	Availability of labour and material resources	The partner implementing the project has all the material and human resources required for successful implementation of the project.
6.6.	Relationship with subcontractors	Stable relationships with subcontractors that discharge all their obligations on time and to standard.
6.7.	Changes in the specifications of the services provided caused by the public partner	Changes in the developed design documentation by the public partner (design and technical solutions) resulting in additional financial and time costs for the project.
6.8.	Damage to a third party	Damage caused to a non-project third party during the project implementation process.

Risk register		
Risk		**Description**
6.9.	Damage to or destruction of the asset	The risk that a third party may cause severe or irreparable damage to the project, and also the risk of the loss of the asset. Such damage can result in an increase in both the time frame and project implementation costs or the loss of the asset.
6.10.	Pollution of water, air, soil	Environmental pollution caused by the contractor during the maintenance stage.
6.11.	Compliance with standards on the transfer of PPP assets	The risk that the private partner will transfer the facility in a condition that does not meet technical and economic indicators and that the public partner will be forced to carry out major repairs.
6.12.	Occupational health and safety	The risk of injuries.
6.13.	Receipt and maintenance of licences in accordance with legislation	Failure to obtain, a delay in the receipt of or the repeal of permits/approvals that have an impact on the project implementation time frame, including permits/approvals relating to environmental and hygiene issues.
6.14.	Labour disputes	The risk of dissatisfaction among the private partner`s employees, subcontractors and other project participants (where applicable) due to working conditions and level of wages and salaries.
6.15.	Vandalism	Acts of vandalism with respect to the asset or related infrastructure.
7.	**Financial, exchange rate and inflation risks**	
7.1.	Risk of changes in interest rates, other financing terms	The risk that a change in interest rates will affect the cost of borrowing and the overall financial viability of the project.
7.2.	Fundraising risk	The risk of the inability to attract the required amount of financing. Note: As part of the preparation of a detailed risk matrix, it is necessary to take into account all the financing methods used (equity/debt financing co-financing of construction by the public partner). Detailed risk allocation depends on the planned type of financing.
7.3.	Exchange risk	The risk of unfavourable changes in the exchange rate in the case of debt and revenue denominated in different currencies.
7.4.	Inflation affecting construction costs	The increase in the cost of the construction materials and works in nominal terms due to inflation.
7.5.	Inflation affecting operating costs	Increase in maintenance costs in nominal terms due to inflation.
7.6.	Risk of an extension in the time frame to attain financial close	The risk of extension of the negotiation period for the provision of necessary financing for a PPP project (financial close). Due to the increase in the time frame, some negative consequences may arise both for the private and public partners (such as postponement of the start of the construction, increase in the total cost of the project or increase in the cost of financing for the PPP project).

Risk register		
Risk		**Description**
8.	**Tax risks**	
8.1.	Amendments to current tax legislation and applicable tax rates and fees	A risk of amendments to legislation with respect to tax payments and fees, as well as changes to customs duties.
8.2.	Interpretation of tax legislation by the state authorities	Interpretation of the tax norms by the tax authorities that are unfavourable for the private partner (for example, restrictions on compensation or offset of value added tax on the expenses assumed by the private partner using the funds received as public funding under the PPP).
9.	**Legal risks**	
9.1.	General and discriminatory amendments to legislation, applicable standards	The risk that amendments to legislation may have a direct or indirect negative effect on the private partner and that these changes do not affect (affect slightly) other parties (including other private partners/parties implementing similar projects) or disproportionally affect the private partner compared with the private partners/parties implementing similar concession projects.
9.2.	Competition process risk	The risk of a challenge to the legitimacy of the results of the competitive process (which also challenges the legitimacy of the PPP project itself, postpones its implementation and can affect the nature of the competitive process).
9.3.	Amendments to the legal framework in urban planning	The risk that urban planning restrictions imposed after the date of the submission of the tender proposal by the private partner might prevent the private partner from implementing the project in accordance with the tender proposal if the occurrence of a risk causes a delay in the construction (reconstruction) or increases the costs of the private partner significantly.
10.	**Default risk**	
10.1.	PPP termination	The risk that the public or private partner will be unable to fulfil their obligations under the agreement.
11.	**Strategic risks**	
11.1	Changes in the shareholder structure of the private partner	Changes in the structure of shareholder participation or control with respect to the private partner that results in a weakening of its financial stability and/or qualification (experience). The conflict between the shareholders (participants) of the private partner due to the formation and activities of its management bodies.
11.2	Conflict of interest among the shareholders of the private partner	The risk of disputes between special-purpose vehicle shareholders regarding the adoption of decisions concerning implementation of the project at the maintenance stage.

3. Standard risk matrix

Risk allocation matrix				
Risk		Impact of the risk	Risk allocation	
			Public partner	Private partner
1.	**Design risks**			
1.1.	Risks of the coordination of project documentation, technical conditions	Increase in construction costs	Possible	Possible
1.2.	Risk of an increase in design period	Increase in construction costs	Possible	Possible
1.3.	Risks related to engineering surveys	Increase in construction costs	Possible	Possible
1.4.	Risk of an increase in the construction cost of the asset according to the design results	Increase in construction costs	Possible	Possible
1.5.	Delay in the preparation of the working documentation needed for construction	Increase in construction costs		Yes
1.6.	Changes in design and construction standards during construction	Increase in construction costs	Possible	Possible
2.	**Land risks**			
2.1.	Delay in (impossibility of) obtaining the land with rights of way that are necessary for the construction of the asset	Increase in construction costs	Yes	
2.2.	Inflated value of the land acquired for the construction of the asset	Increase in construction costs	Yes	
2.3.	Errors in legal land-use documentation (such as ownership and zoning)	Increase in construction costs and potential liabilities	Yes	

	Joint	Comments
		Risk allocation depends on the responsibility of the partners that design and carry out all the necessary engineering surveys. When the public partner has completed the design and all necessary engineering surveys and transferred the materials to the private partner according to the tender results, the private partner is responsible for some of these risks, but the public partner would typically retain some of the risks associated with any defects in the surveys and results.
		Risk allocation depends on the responsibility of the partners that design and carry out all the necessary engineering surveys. When the public partner has completed the design and all necessary engineering surveys and transferred the materials to the private partner according to the tender results, the private partner is responsible for some of these risks, but the public partner would typically retain some of the risks associated with any defects in the surveys and results.
		Risk allocation depends on the responsibility of the partners that design and carry out all the necessary engineering surveys. When the public partner has completed the design and all necessary engineering surveys and transferred the materials to the private partner according to the tender results, the private partner is responsible for some of these risks, but the public partner also typically retains some risks associated with any defects in the surveys and results.
		When the design is the private partner`s responsibility, the construction cost of the final asset must be agreed with the public partner.
		As a rule, it is the private partner`s risk. The private partner will be released from responsibility if construction is postponed due to an unreasonable delay in approval by the public partner.
	Possible	The private partner will be responsible if the initial design documentation has deficiencies and was its responsibility. If the changes occurred due to the demands of the public partner, the private partner will not assume the risk.
		If the right of way is necessary to implement the work, this risk is the public partner`s responsibility.
		As a rule, it is the public partner’s risk because the public partner is usually responsible for providing the land.
		As a rule, it is the public partner’s risk if the public partner is responsible for preparing this documentation.

Risk allocation matrix				
Risk		Impact of the risk	Risk allocation	
			Public partner	Private partner
2.4.	Delay in the receipt of permits or approvals that affect implementation of the project time frame	Increase in construction costs		
2.5.	Safety of the construction site	Higher construction costs and potential liabilities case sudy		Yes
2.6.	Land preparation risks	Higher construction costs	Possible (most common)	Possible
2.7.	Hidden defects in the site	Higher construction costs	Yes	Possible
3.	**Construction risks**			
3.1.	Ensuring and managing the quality of the construction work	Higher construction costs/increase in the construction time frame		Yes
3.2.	Compliance with the construction standards and specifications	Higher construction costs/increase in the construction time frame		Yes
3.3.	Cost overruns and delays for reasons that do not entitle the private partner to the payment of compensation	Higher construction costs/increase in the construction time frame		Yes
3.4.	Delay in obtaining permits and approvals	Higher construction costs/increase in the construction time frame	Possible	Yes
3.5.	Delays due to changes caused by the public partner	Higher construction and operating costs and increase in the construction time frame	Yes	
3.6.	Delay as a result of changes caused by the private partner	Higher construction and operating costs/increase in the construction time frame		Yes
3.7.	Labour disputes	Higher construction costs/increase in the construction time frame		Yes
3.8.	Availability of labour and material resources	Higher construction costs/increase in the construction time frame		Yes
3.9.	Project management risk, integration, delays	Higher construction costs/increase in the construction time frame		Yes
3.10.	Damage to the PPP asset	Higher construction costs/increase in the construction time frame		Yes

	Joint	Comments
	Yes	Both public and private partners must usually make reasonable efforts to obtain permits, and the public partner must typically provide reasonable assistance. A situation when the public authorities perform wrongful acts or fail to act may be considered separately.
		Responsibility of the private partner.
		This risk depends on who is responsible for the land preparation under the agreement and also the specifics of particular work, taking into account the risk that other facilities not identified as part of the project have been discovered. The principle of materiality can also be applied. For example, the private partner may cover immaterial costs.
		As a rule, this is the public partner's risk. The principle of materiality can also be applied, for example, and the private partner may cover immaterial costs.
		Private partner's responsibility.
		Note: - standards – requirements of the public authorities - specifications – project requirements
		Private partner's responsibility.
		This depends on the reasons for the delay. As a rule, it is the private partner's responsibility to make timely applications. The private partner and public partner must make reasonable efforts to obtain permits, and the public partner must provide reasonable assistance. The private partner may not be considered responsible if the public authorities perform wrongful acts or fail to act.
		The private partner should be compensated for the additional cost and time involved. It usually also has a right of veto if safety and design guarantees may be compromised by the change. The public partner may also have to cover the additional capital cost required (co-financing of construction by the public partner).
		The public partner is usually entitled to the right of veto in case of any non-fulfilment of its requirements or inconsistency with the PPP agreement.
		Private partner's risk if the disputes did not arise in the political sphere.
		Private partner's risk if there was no government intervention. Risk of import, customs clearance and monopoly supply should be taken into account.
		It is assumed that project management is the private partner's responsibility. The risk may be shared if the construction of the project assets depends on work performed by the public partner.
		Can be insured. The private partner may also seek compensation from third parties. The state assumes responsibility if the damage is caused by the state during the performance of its PPP duties. The state reimburses losses over and above the insured amount.

Risk allocation matrix				
Risk		Impact of the risk	Risk allocation	
			Public partner	Private partner
3.11.	Damage to third-party property	Higher construction costs/increase in the construction time frame		Yes
3.12.	Damage to utility supplies	Higher construction costs/increase in the construction time frame		Yes
3.13.	Sufficiency of insurance coverage	Higher construction costs/increase in the construction time frame		Yes
3.14.	Bankruptcy of subcontractor	Higher construction costs/increase in the construction time frame		Yes
3.15.	Latent defects in new infrastructure and known defects in existing infrastructure	Higher construction and operating costs if there is an increase in the construction time frame		Yes
3.16.	Pollution of water, air, soil that was not known in advance	Higher construction costs/increase in the construction time frame		Yes
3.17.	Patent infringement	Higher construction costs/increase in the construction time frame		Yes
3.18.	Material deficiencies	Higher construction costs/increase in the construction time frame		Yes
3.19.	Occupational health and safety	Higher construction costs/increase in the construction time frame		Yes
3.20.	Construction safety	Higher construction costs/increase in the construction time frame		Yes
3.22.	Disputes between designers/ contractors/the professional team	Higher construction costs/ increase in the construction time frame		Yes
4.	**Force majeure**			
4.1.	Force majeure	Higher construction costs/increase in the construction time frame	Possible	Yes
5.	**Operating risks**			
5.1.	Increase in maintenance costs due to higher-than-expected volume of services provided	Increase in operating costs	Possible	Possible
5.2.	Incorrect private partner forecasts and resulting increase in operating costs	Increase in operating costs		Yes
5.3.	Actual operating costs exceed forecast costs	Increase in operating costs		Yes
5.4.	Early wear and tear of equipment	Increase in operating costs	Possible	Yes
5.5.	Availability of labour and material resources	Increase in operating costs		Yes
5.6.	Relationship with subcontractors	Increase in operating costs		Yes

	Joint	Comments
		Can be insured. Private partner's risk if there was no intervention by the public partner.
		In some jurisdictions, the public partner signs agreements with utility providers for the use of their supply and passes the benefits of this agreement on to the private partner. In other jurisdictions, only the utility provider has the right to work with its utility supply.
	Possible	International practice shows that the public partner assumes the risk that insurance may not be available at commercial rates or that certain risks may not be insured.
		Private partner's responsibility.
		The private partner must rectify defects. If hidden defects are not detected within a few years of maintenance, there is a risk that the defects may not be rectified under the contract with the construction subcontractor.
		Hazardous waste must be discharged under the supervision of the relevant authorities.
		If the public partner does not have a patent or licence for the construction technology being used, then it is the private partner's risk
		Private partner's responsibility.
		Private partner's responsibility.
		It is the private partner's responsibility to provide guarantees to subcontractors.
		A 'turnkey' construction contract is often used, not least to meet lenders' typical expectations. Other approaches are possible, but this risk would remain the private partner's.
		Depends to some extent on whether the risk can be insured. On some projects, such risks are partly assumed by the public partner.
	Possible	The risk is shared in the case of an access-fee mechanism for consumers that provides partial protection from the risk.
		The private partner is responsible for accurately costing its own operating resource needs with realistic budget forecasts.
		If inflation is higher than expected, payment availability/rates will usually be indexed. In other cases, the private partner assumes the risk.
		The private partner is typically responsible for this risk.
		As a rule, this is the private partner's risk.
		As a rule, this is the private partner's risk.

Risk allocation matrix				
Risk		Impact of the risk	Risk allocation	
			Public partner	Private partner
5.7.	Changes in the specifications of the provided services introduced by the public partner	Increase in operating costs	Yes	
5.8.	Damage to third-party property	Increase in operating costs		Yes
5.9.	Damage to or destruction of the asset	Increase in operating costs		Yes
5.10.	Pollution of water, air, soil	Increase in operating costs		Yes
5.11.	Compliance with the standards governing the transfer of PPP assets to the public partner	Cost of rectification/ increase in the costs of the operating cycle		Yes
5.12.	Occupational health and safety	Increase in operating costs		Yes
5.13.	Receipt and maintenance of licences and permits in accordance with legislation	Increase in operating costs	Possible	Yes
5.14.	Labour disputes	Increase in operating costs		Yes
5.15.	Vandalism	Increase in operating costs		Yes
6.	**Financial, exchange rate and inflation risks**			
6.1.	Risk of changes in interest rates	Increase in the costs of the operating cycle		Yes
6.2.	Fundraising risk	Inability to fund (or delay in funding) the project/ increase in the costs of the operating cycle (on a re-financing)		Yes
6.3.	Exchange rate risk	Higher construction costs and increase in the costs of the operating cycle		Possible
6.4.	Inflation affecting construction costs	Increase in construction costs		Yes
6.5.	Inflation affecting operating costs	Increase in operating costs		Yes

	Joint	Comments
		The public partner must reimburse the decrease in income or increase in costs.
		Can be insured. As a rule, this is the private partner's risk if the damage is not attributable to the public partner.
		As a rule, this is the private partner`s risk if the fault is not attributable to the public partner. Can be insured against, as can third-party damage.
		The private partner's risk if it is responsible for the damage. If the event is beyond the private partner's control, then the insurance cover of the third party that caused the damage should apply.
		The conditions governing the transfer of the asset at the end of the PPP agreement must be specified in the agreement. A provision requiring a deposit or bank guarantee at the time of transfer of the PPP asset may be included in the PPP.
		Private partner's responsibility.
	Possible	Depends on the reason for any refusal to issue or update a licence or permit. Private partner's risk if it fails to comply with any applicable conditions. Public partner's risk if there is no justifiable reason for withholding it.
		As a rule, this is the private partner's risk.
		As a rule, this is the private partner's risk.
	Possible	As a rule, the private partner assumes the interest rate change risk. The risk can be shared if a variable interest rate is used. This can be mitigated against by using a fixed rate.
	Possible	As a rule, the private partner is responsible for raising private funds. The public partner may be responsible for public funding if it is provided.
	Possible	The risk of unfavourable changes in the exchange rate where debt or other costs and revenue are denominated in different currencies. The risk of an increase in the cost of imported equipment, for example. As a rule, this is the responsibility of the private partner, which will arrange funding in the appropriate currency. In certain cases, the public partner may assume the exchange rate risk, in whole or part.
	Possible	The increase in the cost of construction materials and work in nominal terms due to inflation. As a rule, the risk is assigned to the private partner. Depending on the construction period and the size of the risk, the risk can be shared (that is, it may be treated as an exceptional event).
	Possible	The increase in the maintenance cost in nominal terms due to inflation. As a rule, within the framework of the agreed payment mechanism in the form of availability payments, the public partner assumes the risk to the extent of the increase in Consumer Price Index (CPI) while the private partner assumes the risk above CPI inflation.

Risk allocation matrix				
Risk		Impact of the risk	Risk allocation	
			Public partner	Private partner
6.6.	Risk of an extension of the time frame for the attainment of financial close	Higher construction costs, increase in the cost of financing, project timeline shift		Possible
7.	**Tax risks**			
7.1.	Amendments to current tax legislation and applicable tax rates and fees	Increase in operating costs	Yes	Possible
7.2.	Interpretation of tax legislation by the state authorities	Increase in operating costs	Yes	Possible
8.	**Tax risks**			
8.1.	General and discriminatory amendments to legislation, applicable standards	Increase in operating costs	Yes	Yes
8.2.	Risks of the competitive process (lengthy negotiations, inefficiencies and ineffectiveness in the process and so on)	Project timeline shift, higher construction costs, increase in the cost of financing		
8.3.	Risk of amendments to urban planning legislation	Higher construction costs/increase in the construction time frame	Yes	
9.	**Default risk**			
9.1.	PPP termination	State budget/lenders and investors returns	Yes	Yes
10.	**Default risk**			
10.1.	Changes in the shareholder structure of the private partner			Yes
10.2.	Conflict of interest among the shareholders of the private partner			Yes

Notice:

Possible – Risk allocation among the partners depends on the cause of the risks and also the commercial agreements of the partners (risk-sharing).
Yes – One of the partner assumes responsibility for the risk occurrence.

	Joint	Comments
	Possible	On the one hand, the private partner assumes responsibility for achieving financial close within the time frame stipulated in the PPP agreement/tender documents. On the other hand, violation of the time frame for financial close can be caused by factors beyond the control of the private partner (such as macroeconomic tightening and limited access to the financial markets). In the latter case, both the private and public partners can assume the risk.
	Possible	In some circumstances, private partners can expect appropriate compensation as they do not control this factor. Private companies generally bear the risk of changes to a country's tax regime.
	Possible	In some circumstances, private partners can expect appropriate compensation as they do not control this factor. Private companies generally bear the risk of changes to a country's tax regime. Qualitative and detailed analysis of the project's tax environment must be performed during design preparation.
	Possible	The private partner may seek to share the risk with the public partner in the event of certain general amendments to legislation. In case of discriminatory changes, the public partner assumes the full risk and must pay compensation. It is possible for the risks of amendments to legislation to be regulated by PPP law.
	Possible	Risk allocation depends on the reason for contesting the legitimacy of the tendering process.
		In case of amendments to urban planning legislation, which were unknown at the date of the submission of the bids, the public partner will reimburse the private partner for additional costs (or extend the life of the PPP agreement, within the framework of exceptional events).
	Yes	It is necessary to consider instances of the termination of the PPP caused by the public partner, private partner and force majeure circumstances. In mature market conditions, the private partner will receive compensation after the resale of the project to another private partner. In an unstable market situation, it is unclear how creditors will receive the repayment of senior debt or what amount.
		The need to obtain the approval of the public partner for a change in the shareholder structure before the end of construction should be considered. Restrictions on the specialisations of any new investor might be established.
		Pre-tender and tender documents must contain provisions on the management structure of the private partner.

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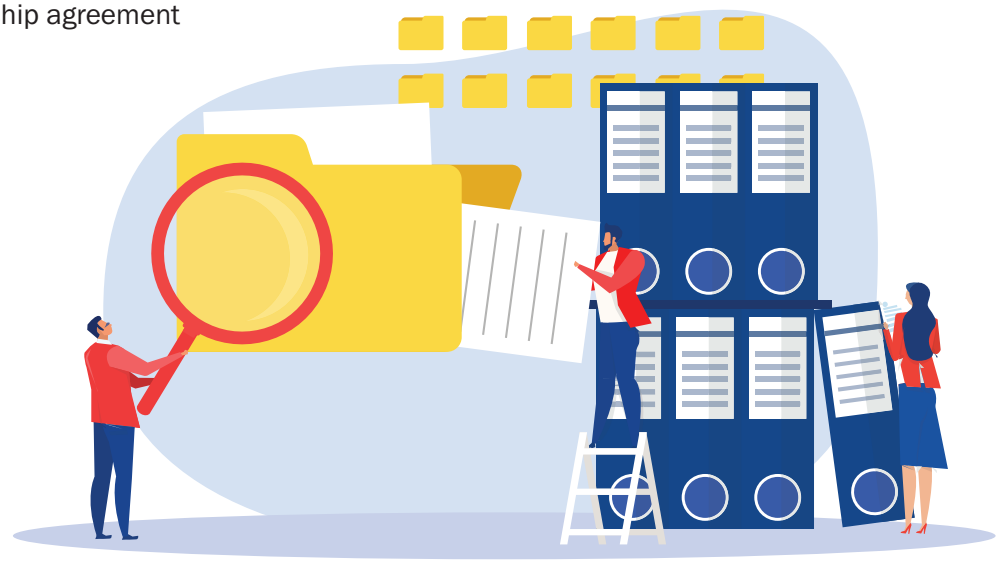
Chapter 8.
Annotated recommendations on monitoring the quality of service and output of PPP projects

Acronyms

KPI Key performance indicator
PPP Public-private partnership
PPPA Public-private partnership agreement



1. Description of and general principles for monitoring the implementation of a PPP project

Public-private partnership (PPP) project implementation monitoring is a regular assessment process used to verify compliance of the services provided by a private partner with the required standards and to determine actions relating to instances where they have been violated. The monitoring of project implementation includes the following tasks, which are usually stipulated in a PPP agreement (PPPA):

- analysis of the specific indicators of the functional characteristics of an asset carried out by a private party
- review of oversight and quality assurance procedures applied by a private partner to confirm their effectiveness
- independent monitoring carried out by a public partner to control the reliability and validity of the private partner's monitoring systems
- independent assessment of the monitoring tools to confirm their accuracy.

The PPPA should also stipulate the terms governing oversight of implementation of the PPP project carried out by the public partner and the contractual consequences (financial and other) of default of the private partner's obligations.

When project implementation is traditionally carried out (via public procurement), monitoring by the public entity includes direct sampling, analysis and determination of compliance with target key performance indicator (KPI) parameters. When project implementation is carried out under PPPs, the procedures governing monitoring and control of service quality will be included in the duties of the private partner. In this case, the public partner will have the right to verify independently information about the results of project implementation provided by the private partner.

The project implementation monitoring levels include:

- Self-regulation of the private partner through its own monitoring system
- Assessment of the private partner's monitoring and quality-control systems by the public partner, including the right to conduct scheduled and unscheduled inspections
- The ability of users and other independent parties to report functioning problems

The level of service requirements the private partner should achieve for the proper functioning of the asset is determined in the specification of the final results prepared by the authority. The objectives established for preparing the final specifications are as follows:

- documentation of the public partner's requirements for the asset's service levels and quality

• formation of the underlying principles for monitoring the quality of service and functioning of the asset.

Both objectives must be determined before signing the agreement with the private partner.

Unlike the indicators and technical specifications governing the project's implementation, the specifications of the final results that determine the required level of functioning of the asset are prepared in accordance with the users' needs.

Without an effective project implementation monitoring system, the public partner will not have access to the relevant data on the private partner's work, making it difficult to identify potential threats to reaching objectives at an early stage.

An effective monitoring strategy is based on the following elements:

• The public partner understands the objectives of state participation in the project. The established KPIs serve as the basis for monitoring implementation and consequently must reflect the wider strategic goals and required project implementation outputs.

• The public partner understands the business processes undertaken by the private partner – for instance, the arrangements and processes governing its use of funding, and the functioning of the private partner's internal control system.

• The public partner monitors the private partner's quality performance indicators.

• The public partner assesses on a regular basis the quality of the private partner's work by analysing established KPIs.

• Based on analysis of monitoring data, adjustments can be made to manage risks and improve the value-for-money ratio.

Effective monitoring of the implementation of a PPP project is possible when there is access to necessary information, on the basis of which it is possible to make suitable decisions on how to minimise emerging risks.

Consequences of a poorly organised PPP project implementation monitoring process include:

• Failure to monitor construction quality may result in defects in the asset's functioning in the long term.

• Failure to monitor appropriate maintenance of the equipment (the asset) may increase the public partner's costs at the end of the effective term of the PPPA (after the transfer of the asset).

• Failure to organise clear communication during project implementation may result in ambiguity as regards limits on the responsibilities of the private and public partners.

• Lack of independent verification or validation of data provided by the private partner may result in an inability to identify and attribute defective work, as well as accurately give payment for services.

• The lack of a prompt dispute resolution system may result in protracted conflict and obstruct successful implementation of the project.

2. Recommendations on how to monitor the results of PPP project implementation

The public partner is required to monitor implementation of the PPP agreement at all project stages, especially at the asset design stage, as the efficacy and reliability of the final asset will be contingent on the quality of the design. Such monitoring is carried out with the use of a design quality management plan and construction quality management plan. Both of these plans are developed by the private partner and provided to the competent authority for review. It should be noted, however, for the critical output KPIs (the key ones upon which payment is based) the public authority may specify detailed procedures in the draft contract. As the private partner independently develops the design and quality management plans, the approach is unique for each project.

All the plans must contain some basic components. These include a description of important monitoring procedures, such as technical analysis and review of the asset. Unlike the operating and maintenance stages of the monitoring process, the design and construction monitoring process includes a combination of both monitoring and simulation tools. The public authority usually sets a number of intermediate design and construction milestones. To encourage the private partner to perform its work on time, the public partner may determine specific amounts of remuneration to be released upon certain completion points. The public authority confirms these milestones individually or with the involvement of third parties.

The monitoring plan at different stages of PPP project implementation should include the following procedures:

• **Preparation stage:** Preliminary assessment of KPIs for the construction and operating stages, establishment of acceptable limits of any deviations from agreed levels and identification of measures to prevent or mitigate them.

• **Construction stage:** Analysis of archived KPIs (from past projects or guidance documents) and adjustment of KPIs for the operating stage (for the specific project), taking into account the required outputs. The organisational structure of the design process includes the following monitoring elements (with the inclusion of corresponding KPIs):

design and construction schedule

quality management system audit

design process quality management plan

construction process quality management plan

asset safety check

asset design and construction programme

inspection of the completed construction works (including data on compliance with technical KPIs)

intermediate results of key milestones during the design and construction stage

management and planning system

design requirements

periodic reports on the current stage of the work

financial reports (including comparison of actual and budget/forecast indicators).

• **Operating stage:** Analysis of achieved KPIs on a regular basis, paired with identification of the reasons for any deviations from key indicators and determination of the affected factors and adjustment options, taking into account possible changes to the terms of the PPPA. The organisational structure of the operating process includes the following monitoring elements (with the inclusion of corresponding KPIs):

internal control system of the private partner

operating process of the regular assessment programme

quality management plans and manuals

regular meetings and reports

quality control (for example, the quality of the surface and the condition of the highway drainage system)

joint report (of both the public and private partners) on the operation of the asset

asset management plan

medium-term management plan

adoption of emergency measures and safety management plan

environment controls

KPI analysis process

reports on user service and claims handling

list of independent inspectors and auditors

data management system regarding the operation of the asset

financial reports (including comparison of actual and budget/forecast indicators).

• **Post-project stage:** Analysis of achieved KPIs, substantiation of the nature and structure of continued operation of the project asset and/or its further development/refinement, preparation of proposals for implementing future projects.

The sources of information for the purposes of conducting monitoring procedures include reports and data provided by the private partner, which are reviewed by the public partner.

Respective types of reporting mechanisms are described below:

• The basic characteristics of the reporting data relating to implementation of the PPP project provided by the private partner (accuracy, completeness and reliability) should be stipulated in the PPP agreement. The private partner must provide reports on project outputs on a regular basis. The periodicity of these reports depends on the specifics of a particular project. These reports must contain sufficient information to calculate the payment for the services provided by the private partner (where applicable) and include the number of instances of established KPI violations for the reporting period and information about each violation. The private partner's authorised representative has to confirm the accuracy of the information in a document in the agreed format that is included in the submitted reports on project implementation.

• The public partner may also independently monitor and check the effectiveness of project implementation. In this case, the public partner will cover the cost of such monitoring with the exception of the situations stipulated in the PPPA (for example, when the audit shows that the private partner has provided the wrong information). These sources of information include:

user satisfaction survey regarding the asset

audit

scheduled and unscheduled inspections

feedback of asset users concerning compliance with the agreed quality standards of the asset and the

services provided by the private partner

Access is granted to the information required for monitoring purposes on the basis of the following basic principles:

• The private partner must provide and ensure free access to any data regarding project implementation after the submission of a reasonable request by the public partner.

• It is also necessary to set the period during which copies of all information, documents and data regarding the monitoring system will be kept safe (the recommended period is at least seven years.

• The private partner is required to provide the necessary assistance and access to data in accordance with the requests of the public partner based on the implementation monitoring rights established in the PPP agreement.

Independent experts must conduct any audit of project implementation. The public partner determines the applicable procedure and the terms and conditions of their involvement. Throughout the audit process, if a partner provides monitoring data that contain any inaccuracies, are incomplete or incorrect, then it should:

• correct the errors, release an updated version of the corresponding report or data, and take measures to eliminate defects in the monitoring system which resulted in the errors

• make appropriate adjustments to the subsequent payments for the services if the inaccuracy in the report affected the amount of such payments in the reporting period.

Fraud or perjury during an audit should constitute an instance of default on its obligations by the private partner and may result in the termination of the PPPA.

Regarding the attainment of KPIs established for the monitoring process, it is advisable to apply the following approaches:

• Deduct payments or impose penalties if the quality falls short of target (which should be set at the optimal quality).[1]

• Demand the rectification of shortcomings in the functioning of the asset or in the quality of the services provided by the private partner within the period established in the PPP agreement (with the right to retain, reduce or even terminate payments to the private partner throughout this period).

• Apply fines due to the private partner's non-compliance with the KPIs.

• Transfer temporary operational control of the project to the state in certain circumstances (such as threat to lives and health, the environment, national security).

• Terminate the PPPA if the private partner fundamentally defaults on its obligations.

Powers of the responsible public authority in relation to PPP project implementation must include:

• Control over the operation of the infrastructure asset implemented by the respective sectoral authorities. These authorities monitor the project within the framework of their powers (in particular, regulating tariffs and monitoring the service quality of the asset). It is advisable for respective sectoral authorities to coordinate decisions that have an impact on project implementation (in particular, regarding income and expenses) or implementation of the PPPA.

• Monitoring of the implementation of the PPPA and the agreed KPIs of the project that was to be performed by the private partner:

The competent public body responsible for PPP development in the state (or public body responsible for monitoring the implementation of a PPP agreement). This institution monitors PPP projects and aggregates the information on project implementation, ensuring its compliance with the applicable KPIs. An officer vested with the functions of a PPP project curator may be appointed at this institution. In accordance with international practice, to be successful in this role, the curator must:[2]

a) have managerial competencies
b) have team support – in other words, the presence of staff competent in various aspects of the work within their team
c) have sufficient scope of authority and influence on the curated project
d) participate in the implementation of the PPP project from the preparatory works stage
e) organise a unified PPP project database (this is also recommended, to eliminate the adverse impact

[1] It is advisable to use a payment mechanism that encourages the provision of high-level services (functional characteristics of the asset) by a private party only to the extent that it is required by the asset's users to avoid overstating payments at an unreasonably high service quality (unrelated to a corresponding increase in utility for users).

[2] To improve the decision-making in specialised areas during the implementation of the PPP project, independent expert entities can be used.

of personnel changes that are likely during a long period of project implementation)

Authorised public entity responsible for public financing and budgeting and controlling the expenditure of budget funds and review of their efficiency.

Authorised public entity/ies of the relevant administrative-territorial units (where applicable).

It is advisable to coordinate monitoring of PPP project implementation when structuring the project and preparing the PPPA. Applicable procedures are based on respective laws and regulations and also on the provisions of the PPPA. It is necessary to define the respective monitoring powers and responsibilities of the various public authorities involved in project implementation. It is also advisable for parties to agree/approve the procedure for cooperation between the private partner and public entities.

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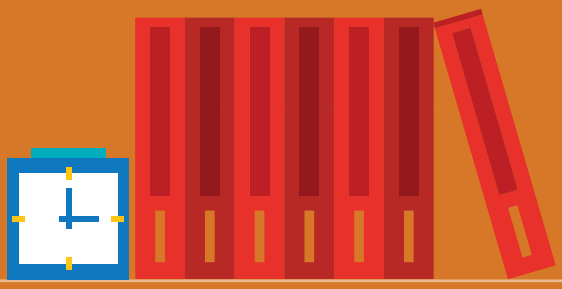

Chapter 9.
PPP project appraisal guidelines

Glossary

BBCR	Budget benefit-cost ratio
BIRR	Budget internal rate of return
BNPV	Budget net present value
CF	Cash flow
CFADS	Cash flow available for debt service
DPBP	Discounted payback period
DSCR	Debt service coverage ratio
DSRA	Debt service reserve account
EBCR	Economic benefit-cost ratio
EIRR	Economic internal rate of return
ENPV	Economic net present value
FCFE	Free cash flow to equity
FCFF	Free cash flow to firm
FPI	Financial performance indicator
IRR	Internal rate of return
KPI	Key performance indicator
LLCR	Loan life coverage ratio
NPV	Net present value
PBP	Payback period
PLCR	Project life coverage ratio
PPP	Public-private partnership
PV	Present value
SDR	Social discount rate
TV	Terminal value
WACC	Weighted average cost of capital

1. General provisions

Purpose, objectives and structure

This methodology for appraising a public-private partnership (PPP) project (hereinafter, the methodology) has been developed for public entities responsible for preparing and implementing projects designed to meet public needs through the development of public infrastructure (hereinafter, the competent authority) in CIS countries. The methodology aims to systematically facilitate the creation of common tools to analyse and select the most effective and cost-efficient projects and methods for their implementation, standardise selection procedures for implementing the most effective and cost-efficient projects and increase the transparency and objectivity of the project appraisal process.

The methodology deals only with financial and economic/social aspects. In a full feasibility study and a full appraisal, many other aspects should be examined and assessed in addition – for example, technical, legal, institutional and environmental aspects.

At the same time, for the purpose of implementing the procedures specified in the methodology, the competent authority may engage consulting companies and experts. Investors preparing to invest in a PPP project and other market participants and experts can also use the methodology.

This methodology can be used to assess the appropriateness and efficacy of implementing an infrastructure project via a PPP. This methodology is not suited to traditional public procurement (government contracts) or an assessment of whether a particular project would best be implemented as a PPP or a public-sector investment (a public-sector comparator).

This methodology covers the following aspects of comparative evaluation:

- the criteria used to assess the effectiveness and cost-efficiency of alternative projects and ways to implement them
- the procedure for evaluating and selecting the most effective and cost-efficient form of project implementation from the perspective of meeting the needs of society and optimising state costs
- the methodology for establishing performance evaluation criteria and calculating the value-for-money ratio of various project implementation methods.

In the absence of alternative projects, the methodology can be used to analyse one project and its implementation forms, once the competent authority has established the absolute values of criteria for passing the relevant stages of analysis. Public infrastructure refers to a set of buildings, structures, equipment and systems that are intended to provide socially significant (publicly consumed) services to the public, generally financed by the central government budget.

Within the framework of the methodology, public infrastructure mainly includes the following:

- transport infrastructure assets (roads, railways, river and sea ports, airports, aerodromes and public transport infrastructure)
- social infrastructure assets (items of public health, public welfare, culture, sports and education)
- utility infrastructure assets (water supply and sanitation facilities, facilities to use or dispose of solid domestic waste)
- energy infrastructure facilities (production facilities, transmission and distribution of electric power, heat and gas supply, outdoor lighting of communal areas)
- communication facilities.

Basic terms and definitions used in the methodology

Risk analysis – identification and assessment of all risks that might affect the attainment of the projects' investment objectives within the allotted budget and time.

Investments – cash, monetary funds, loans, shares, securities, other property (including property rights) and other rights that have a monetary or financial value, invested in commercial and/or other activities aimed at generating a profit and/or the receipt of other benefits.

Investment project – a set of actions (work, services, acquisitions, management operations and decisions) aimed at attaining investment objectives.

An investment project aimed at the development of public infrastructure (hereinafter referred to as a

project in the methodology) – a set of actions (work, services, acquisitions, management operations and decisions) designed to create/modernise/renovate public infrastructure facilities to meet the needs of society.

Project initiator – an entity that elaborated a proposal for the implementation of a project and that can be either a private partner or a specialist authority.

A PPP as defined by the Model PPP Law for CIS countries – a legal partnership between a public partner, on the one hand, and a private partner, on the other, based on the pooling of resources and the allocation of risks on the basis of a public-private partnership agreement or a concession agreement concluded for a certain period.

A PPP project as defined by the Model PPP Law for CIS countries – an investment project planned for joint implementation by the public and private partner according to the principles of public-private partnership.

Public procurement (public purchases) – the acquisition by the state, funded from the central government/ federal budget, of goods/work/services for the purposes of implementing an investment project.

Cost of capital – the cost of funds needed to finance an investment project, defined as the weighted average cost of the sources within the overall funding structure.

The competent authority – a public entity that has been authorised by the state to fulfil the obligations of the public partner in the PPP project and is also responsible for the analysis and preparation for the implementation of projects aimed at satisfying the public's needs through the development of public infrastructure.

2. Assessing the effectiveness and cost-efficiency of an investment project

As defined by the Model PPP Law for CIS countries, all PPP projects have to be assessed before the selection of the private partner starts. That said, it is widely accepted that some standards can be lowered for smaller-scale PPP projects, as there is less at stake for either party, yet there can still be significant potential benefits. In terms of project appraisal this means the use of simplified methods and procedures for smaller-scale (less costly) PPP projects. The methods used have to be proportional to the cost of the PPP project. For example, many countries have cost thresholds below which it is not necessary to carry out a full-blown cost benefit analysis; instead, a simpler multi-criteria appraisal would be used.

Best practice has established a set of criteria that make it possible to identify the most effective and cost-efficient infrastructure project from the various proposals available (subject to the satisfaction of certain societal needs) and also the preferred implementation mechanism. These performance criteria groupings are outlined below:

I. Criteria reflecting the financial efficacy of the project (including credit sustainability indicators). These are used to assess the attractiveness of the project for investors, where the values of these criteria demonstrate the extent to which the project is likely to be feasible for them; that is, whether the investors' costs will be covered and whether the return of and on the borrowings is sufficiently reliable.

II. Criteria reflecting the social and economic feasibility of the project. These criteria are used to assess the social and economic efficacy and impact of the project in monetary terms (in the context of cost-benefit analysis).

III. Criteria characterising budgetary feasibility (including the adequacy of the public partner's resources and acceptability of budgetary commitments). This group of criteria is used to assess the efficacy of project implementation from the perspective of the use of central government/federal budget funds by comparing cash outflows/budget inflows.

It is advisable to evaluate an investment project from the perspective of the above criteria in a number of stages, which are associated with protracted calculations of certain criteria. These stages constitute strategic and complex analyses:

- Strategic analysis is carried out during the early stages: when determining the main characteristics/ indicators of the project, as well as the preliminary verification of the project's feasibility. At this appraisal stage, projects are selected that meet the requisite needs of society. The constraints that affect the project's feasibility are also analysed. In addition, possible project implementation forms are identified.

- A complex analysis consists of a more detailed assessment and is performed to select the preferred project/projects from a list of alternatives. A final choice on the form of project implementation is made, taking into account analysis of the value-for-money ratio.

At the same time, in the case of each investment project, irrespective of the preferred form of implementation, it is advisable to conduct a risk analysis at all preparation stages.

Note: The following indicators and procedures for conducting the strategic and complex review are recommended for all major projects. The proportionality principle is applicable to small-scale or simpler PPP projects from the perspective of depth of analysis. A high-level review is also applicable depending on the level of PPP development in the country.

Chart 2.1 illustrates when strategic and complex analyses should be performed as part of the investment project implementation process through a PPP.

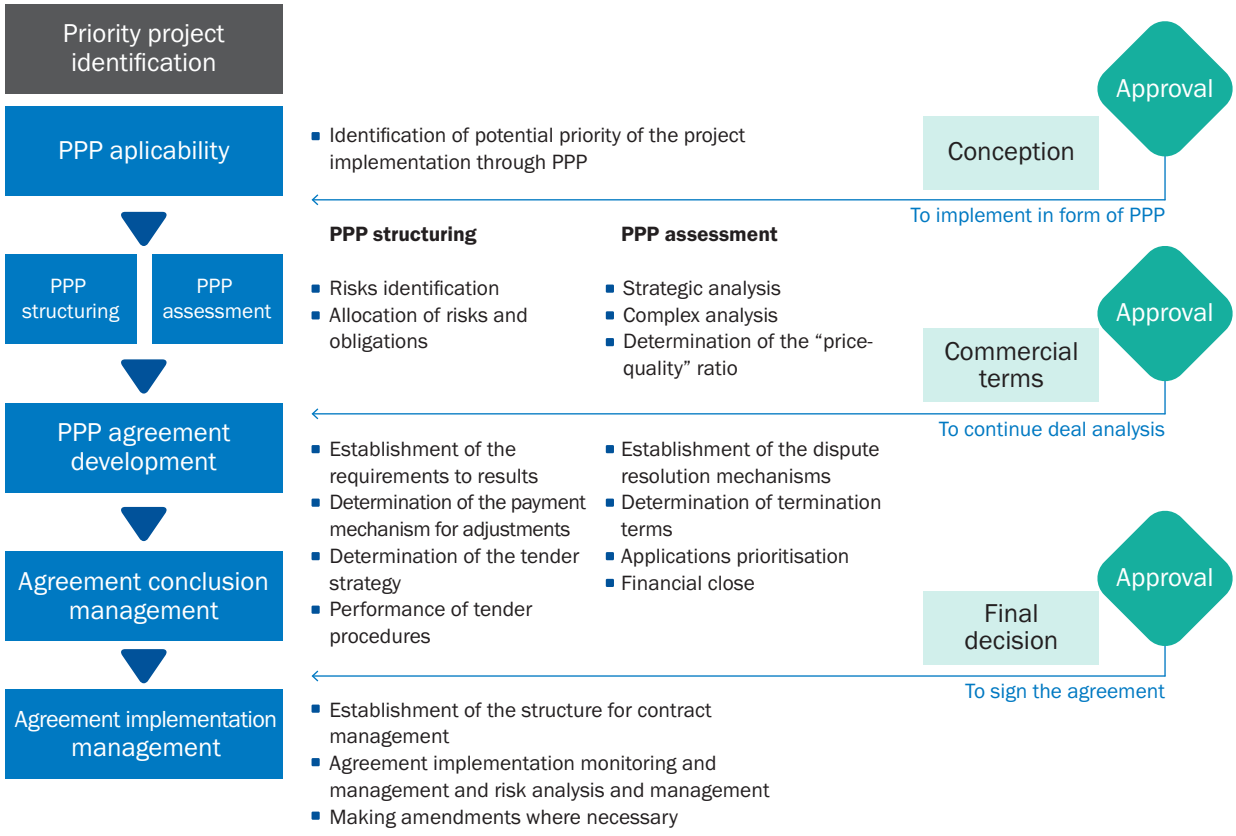

Chart 2.1 Investment project implementation process through a PPP

Chart 2.2 demonstrates the process for appraising investment projects by the public partner at the selection stage and subsequent selection of the form of project implementation that is expected to be financed, in whole or in part, from the central government/federal budget.

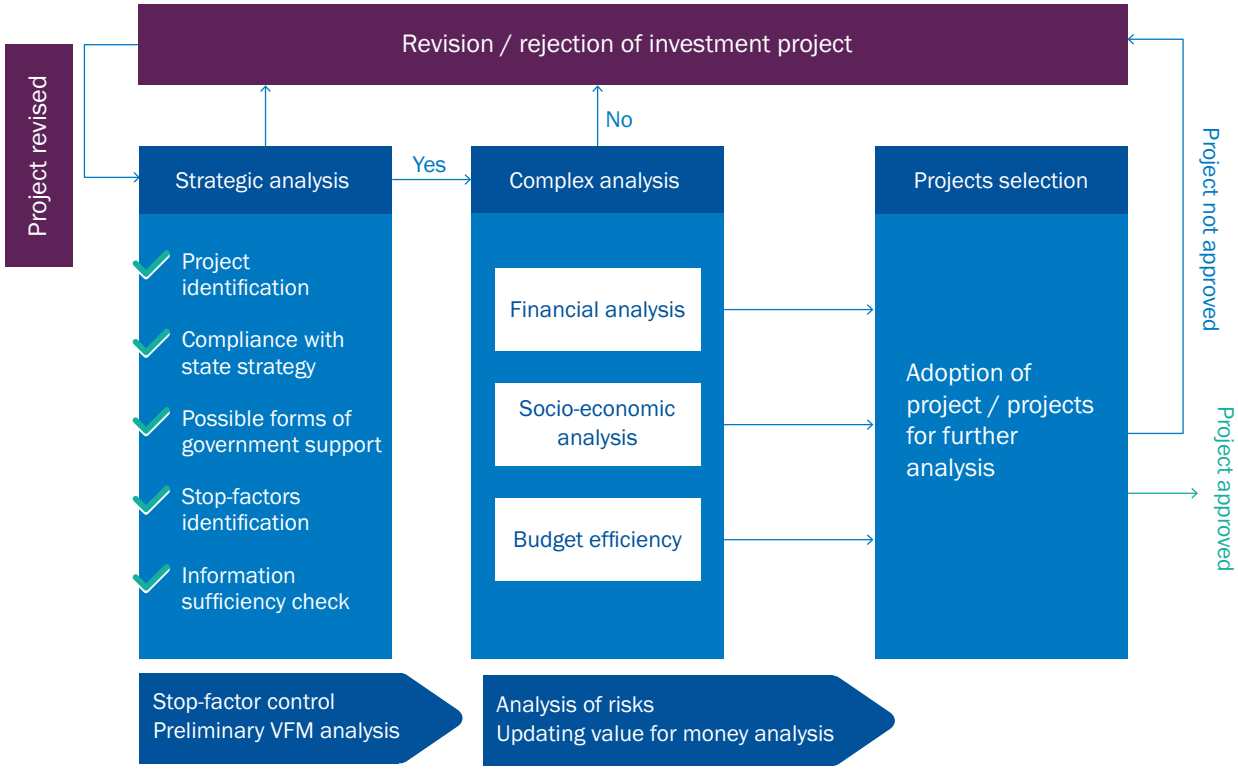

Chart 2.2 Project appraisal and selection

3. Strategic analysis

Strategic analysis looks at investment projects aimed at stopping any further appraisal of projects that will not yield commercial, social or economic benefits, or from which it is anticipated that the benefit will be comparatively lower than alternative projects. This approach means the public partner will not waste time and financial resources developing projects that will not yield any benefits to society. At the same time, a prerequisite to strategic analysis is determining the needs to be resolved by implementing a potential investment project. This is carried out by assessing the social and economic needs of the state, regions or society and by assessing the gaps in existing infrastructure. Needs may vary by sector (for examples, see Annex 1).

During a strategic analysis, the public sector assesses a set of reasonable options for addressing an infrastructure development task (identified by the analysis of needs) that meets the state's requirements for final outputs, then selects the optimal solutions for a more detailed study accordingly.

The strategic analysis includes the following steps:

Step 1. Identification of the project, assuming the following:

- The project is clearly defined as an independent item for analysis.

- The project objectives are clearly articulated and showcase the benefits of implementing the project, including the public, social and economic significance of the project for meeting the formulated needs of the state, regions or society. The establishment of the investment project's objectives should be based on the goal of substantiating the social and economic needs of the state, regions and society. The project's objectives should have the following characteristics: distinctiveness, specificity, measurability, attainability, relevance and a time frame for attainment of the goal.

- The project can form an integral part of a larger investment project (in this case, it should be reviewed as such).

• Alternative implementation options and projects aimed at achieving the same goals may be identified.

Step 2. Verification of compliance with the long- and medium-term planning documents of the state and/or an administrative-territorial division (depending on the project level/scope), assuming that the investment project:

• complies with the development areas and principles set out within the framework of planning documents (including development concepts, medium- and long-term strategies, social and economic development programmes, investment programmes and state and industry development plans)

• provides a comprehensive approach to the resolution of a specific problem and satisfaction of established needs in relation to corresponding programme activities

• is included in one or more relevant policy document(s) (optional) and is substantiated in terms of its expected social and economic impact, and structured according to the methodology.

Step 3. Analysis of the options/alternatives. In this stage, alternative ways of meeting the needs of government and society within the framework of the proposed project are analysed, together with possible options for the organisational and legal scheme for implementing the project through a preliminary evaluation of the value-for-money ratio.

Options are analysed, irrespective of the availability or lack of alternative projects. The number of options depends on the project's specifics. To determine the implementation options, the following are performed:

• identification of the criteria for selecting project implementation options

• study of the best-practice implementation of similar projects

• identification of the full list of possible project implementation methods (for example, assessment of various technological solutions, structures and types of financing, project implementation periods, site location)

• assessment of the payment mechanism options (for instance, to ensure a return on investment for private partners and to meet public and private partners' financial obligations as part of the project implementation options via a PPP, and also the possible allocation of key risks of the PPP project)

• determination of the minimum number of actions the public partner can perform to attract the minimum threshold amount of resources for feasible implementation of the project.

Based on the complete list of project implementation options, a shortlist of options is drawn up after the feasibility or reasonableness of each option is assessed, along with the adequacy of the resources to implement each option, including financial, labour, material and technical resources. The elaborated list of project implementation options is further analysed as separate projects during subsequent stages according to the methodology. The decision to choose an option for project implementation is based on the application of key performance indicators (KPIs), taking into account the appraisal of alternative projects.

Stage 4. Determination of the form of state support for the project, assuming identification of the required amount and form for financing the project, funded from the central government/federal budget. In this case, the final decision on the form of state support and, accordingly, the overall form of project implementation, is made based on analysis of the value-for-money ratio. As part of the strategic analysis, a preliminary value-for-money analysis can be performed on the basis of both qualitative and quantitative criteria. A detailed methodology for estimating the value-for-money ratio is set out in the Value-for-Money Matrix report.

Stage 5. Identification of the project's stop factors. This stage involves identification and analysis of the possible project stop factors, which are internal constraints (controlled by the project's participants) and external constraints (outside the control of participants) inherent in the project under consideration, which pose a significant threat to its successful implementation. Successful implementation of the project involves achieving project objectives while respecting the agreed implementation timeframe and investment volumes.

The process of identifying stop factors is carried out in the following sequence:

• **Step 1.** Identify potential constraints on the successful implementation of the project. The main project limitations can be divided into groups (technical, economic, commercial, political, organisational and financial).

• **Step 2.** Determine the extent of project limitations during its preparation. The elaboration of limitations implies a detailed description of the project, conducting (where necessary) special studies and assessing effective mechanisms to neutralise/minimise the negative impact. The limitation is deemed to be mitigated if it does not represent an obstacle to successful implementation of the project.

• **Step 3.** Identify "stop factors". A restriction is deemed to be a stop factor if it was not taken into account during the preparation of the project and poses a significant threat to the successful implementation of the contemplated project. A checklist of key questions can be used to identify stop factors. An example of such a checklist is provided in Appendix 2.

Stage 6. Confirmation that the relevant project documentation has been prepared at that stage. The following documentation (among other things) is required for the strategic analysis:

• a preliminary feasibility study of the project

• a preliminary financial model, taking into account the different financing options in accordance with standard requirements (the financial model requirements are provided in Appendix 3).

Drafting of an opinion. After all the stages of the strategic analysis have been completed, an opinion is formed on the strategic analysis of the proposed project and its results. On this basis, one of the following decisions is taken:

• accept the project for discussion at the next stage of the project appraisal – the complex analysis stage

• send the project for revision and completion to the initiator and subsequent re-examination at the strategic analysis stage

• reject the project.

Consequently, the strategic analysis results in a list of rejected projects, projects sent for revision and projects accepted for complex analysis. As part of the strategic analysis, a preliminary assessment of social and economic efficacy may be performed.

Note: The strategic analysis may partially overlap with the analysis of qualitative criteria in the context of the value-for-money ratio analysis. At the same time, the value-for-money ratio analysis does not entail an appraisal of the investment project from the perspective of the efficacy of the use of public funds. Accordingly, in the context of the value-for-money ratio analysis, it is assumed that the decision on the targeted use of public funds had already been made as part of the investment project appraisal, and the highest priority at this stage of project preparation is the choice of an effective and cost-efficient implementation method.

4. Complex analysis

4.1 Evaluation of financial efficacy

Analysis of initial data and assumptions. The initial data and assumptions are analysed to obtain sufficient confidence in their reasonableness and relevance. This includes verification of their compliance with the sources of information used in the preparation of the project and a comparison with data obtained from alternative sources. The key categories of input data and assumptions, as well as recommended ways to verify them, are described below.

Key categories of input data and assumptions to be analysed within this task:

• macroeconomic assumptions

• factors determining revenue

• demand for the services/infrastructure

• capital expenditures

• variable operating costs

• fixed operating costs

• working capital requirements

• tax assumptions

• assumptions on financing terms.

Based on the results of the analysis, it is necessary to confirm the reasonableness and validity of the initial data and assumptions. If there are any inaccuracies in the initial data or the assumptions underlying them, the project is sent for revision.

Calculation of financial performance indicators.
The calculation of the performance indicators of the project's financial efficacy (financial performance indicators) is based on cash-flow projections according to the submitted financial model and includes the following financial efficacy and credit sustainability indicators:[1]

I. Financial performance

• Net present value (NPV) is calculated by discounting free cash flows from the project using a discount rate equal to the projected weighted average cost of capital of the project:

$$NPV = \sum_{n=1}^{N} \frac{FCFF_n}{\prod_{i=1}^{n}(1+WACC_i)} + \frac{TV_N}{\prod_{i=1}^{N}(1+WACC_i)}$$, where

FCFF – free cash flow to firm

n – year number of the forecast period (for free cash flows)

i – year number of the forecast period (for the discount rate)

N – number of years in the forecast period

TV_N – terminal value (final cash flow)

WACC – weighted average cost of capital, calculated using the formula:

$$WACC = K_d * (1-t) * \frac{D}{V} + K_s * \frac{E}{V}$$, where:

K_s – required return on equity for the investor

K_d – required borrowing interest rate before taxes

t – corporate income tax rate

E – value of the equity capital

D – amount of borrowing

V – amount of the invested capital (internal funds and borrowing)

• The internal rate of return (IRR) is calculated as the discount rate at which the NPV of the project is zero.

• The payback period (PBP) is calculated using the following formula:

PBP= the lowest value of t at which

$\sum_{t=1}^{T} CF_t > CF_0$, where

T – number of periods

t – specific period

CF_t – cash flow for t period

CF_0 – amount of initial investment in the zero period

• The discounted payback period (DPBP) is calculated using the following formula:

DPBP= the lowest value of t at which

$\sum_{t=1}^{T} CF_t/(1+r)^t > CF_0$, where

t – number of periods

CF_t – cash flow for t period

CF_0 – amount of initial investment in the zero period

r – discount rate

We recommend calculating financial performance indicators for both the project as a whole and for the project's participants and/or shareholders.

The PPP project specifics should be taken into account when calculating financial performance indicators, in particular, the payment mechanism. For example, the financial performance of the project for investors can be ensured through an availability payment mechanism (if the public partner makes a certain payment that provides a return on the investments of a private partner).

In addition, the specifics of the PPP project will usually stipulate a certain period for the agreement; in this case, cash-flow projections to analyse the project's efficacy for the private partner/investors will be based on the period of the agreement.

Performance criteria: NPV ≥ 0, IRR ≥ discount rate, payback period – an acceptable number of years for each project.

II. Credit sustainability

• The debt service coverage ratio (DSCR)[2] for a specific period is calculated using the following formula:

$$DSCR = \frac{CFADS}{P+I}$$, where

[1] Two types of financial performance indicator can be calculated, depending on the type of cash flow used: using the cash flow of the project, which is placed at the disposal of the creditors and shareholders (FCFF), the financial performance indicators of the project as a whole are calculated; using the cash flow available to shareholders (free cash flow to equity, or FCFE), the relevant financial performance indicators are calculated only for shareholders. In this case, it is necessary to apply the discount rate sequentially, depending on the flows: for FCFF, WACC; for FCFE, the cost of equity.

[2] The DSCR, LLCR and PLCR indicators are calculated for projects and project implementation options that involve debt funding and constitute a subgroup of financial performance indicators.

Cash flow available for debt service (CFADS) – cash flow available to service senior debt in this period

P + I – amount of senior debt service payments in this period (P – payment of principal, I – payment of interest)

• The loan life coverage ratio (LLCR) is calculated using the following formula:

$$LLCR = \frac{CFADS(NPV_I) + DSRA}{D}$$, where

CFADS (NPV_I) – net present value of future cash flows available to service debt for the period until the debt is fully repaid, discounted at the cost of debt

DSRA – debt service reserve account at the end of this period

D – loan balance at the date relating to the NPV

• The project life coverage ratio (PLCR) is calculated using the following formula:

$$PLCR = \frac{CFADS(NPV_P) + DSRA}{D}$$

CFADS (NPV_p) – net present value of future cash flows available to service debt throughout the project period,[3] discounted at the cost of debt

DSRA – debt service reserve account at the end of the period

D – loan balance at the date relating to the NPV

Efficacy criteria: indicators are specific for each project and depend on the financing structure, the project's risk level, and the requirements of funding organisations.

Note: When calculating key indicators, the financial inefficiency of the project can be identified (NPV <0, IRR is lower than the level of the required profitability, lack of return on investment, etc.) At the same time, according to the results of the analysis, a decision to reject the project should not be made on this basis only, taking into account the specifics of the projects contemplated as part of the methodology (the focus of projects on meeting social and economic needs). These indicators are taken into account accordingly in further analysis aimed at selecting the most effective and cost-efficient project (with the highest positive NPV or the lowest negative NPV) within the framework of the proposed alternatives and implementation options.

4.2 Social and economic appraisal

The social and economic analysis (cost-benefit analysis) assesses the contribution of the project to the welfare of the region, country or society as a whole. As a rule, this assessment involves determining the net economic/social benefit of project implementation and is conducted based on various qualitative and quantitative-qualitative criteria. An indicative list of potential social and economic benefits (in accordance with the needs of society) for the implementation of infrastructure projects in various sectors of the economy is provided in Appendix 1.

The social and economic analysis concept complements the financial analysis and facilitates a more complete and broad evaluation of the project's benefits for the state and society: both direct and indirect cash flows related to the implementation of the project are taken into account.

The social and economic analyses consist of the following stages:

- monetisation of non-market effects
- discounting of costs and benefits
- calculation of additional indirect effects
- calculation of economic efficacy indicators.

The **monetisation of non-market effects** is applied to project implementation outputs that cannot be measured directly. However, their monetary value can be identified. Regarding the monetary value of the overall social and economic benefits of the project, consumers' "willingness to pay" can be applied. One way willingness to pay is calculated is by multiplying the average value of willingness to pay by the total number of potential users. Alternatively, a disaggregated analysis can be done looking at the willingness to pay of different types of consumer and then adding them up; willingness to pay can differ markedly for different groups. This indicator is added to the cash flows of the project as a socioeconomic component used to calculate the efficacy of expenditure.

Discounting of costs and benefits. Within the framework of the social and economic analysis, a social discount rate (SDR) is applied as the discount rate, which shows how the future benefits and costs associated with the project can be discounted to the current date, taking into account social effects. The SDR may differ from the financial discount rate.

[3] In the relevant project/financing agreement, the deadline for CFADS accounting may be set before the end of the project to calculate this indicator.

In the case of SDR[4], there are several different methodologies, involving the following[5]:

- the cost of borrowing for the state
- the social time preference rate (society's preference for immediate use over future use)
- the opportunity cost of capital (the forgone benefit of investing resources in the project rather than the market)
- variable rates during the project implementation period (reduction in the rate during the forecast period to significantly increase the impact of the project on future generations).

The methodology to calculate the rate may differ, but the rate should be applied consistently to all projects and implementation options. The state authorities can set a single rate for the analysis of projects.

Calculation of additional indirect effects. To assess social and economic effects that cannot be monetised, a technique of ranking and weighting may be used: each alternative project and selected implementation option is assigned a rank based on the expected deviation of the social and economic impacts of the project from the basic scenario (the current situation) on a common scale (for example, from -4, which corresponds to the effect of a value that is much worse than the value for the basic scenario, up to 4, which corresponds to the effect of a value that is much better than the value for the basic scenario). To integrate estimates of additional indirect effects into the final results of the analysis, each effect is assigned a weighting based on its significance (the value of the impact).

Calculation of economic efficacy indicators. The following key indicators are used for the social and economic appraisal of a project:

- Economic net present value (ENPV) – the amount of the discounted value of future benefits and costs, taking into account monetised social and economic effects and the application of SDR as a discount rate.

$$ENPV = \sum_{t=0}^{n} a_t S_t = \frac{S_0}{(1+i)^0} + \frac{S_1}{(1+i)^1} + \ldots + \frac{S_n}{(1+i)^n}$$, where

S_t – net economic flow of the project during the period of time t

a_t – discount factor at the time period t

i – discount rate (SDR)

- Economic internal rate of return (EIRR) – discount rate where the ENPV equals 0 (zero).

$$0 = \sum_{t=0}^{n} \frac{S_t}{(1+EIRR)^t}$$

- Economic benefit-cost ratio (EBCR) – ratio of the present value (PV) of future social benefits to the PV of costs, taking into account monetised social and economic effects.

$$\frac{B}{C} = \frac{PV(B)}{PV(C)}$$, where

PV(B) – present value of benefits

PV(C) – present value of costs

Efficacy criteria: ENPV ≥ 0, EIRR ≥ SDR, B/C ≥ 1.

The relationship between the analysis of financial and social and economic efficacy as part of the complex analysis is presented below.

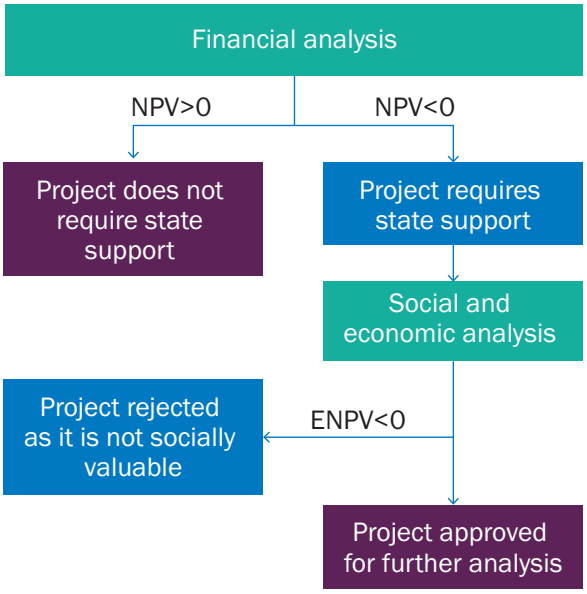

Chart 4.1 Financial and social and economic appraisal

Note: When using this structure, it is important to take into account the specifics of PPP projects. For example, a project structured with the use of availability payments will have a positive level of financial efficacy for private partners. At the same time, the availability payment itself can be considered a form of state support.

[4] The indicative level of SDR, in constant price terms, for developing countries is 8-15 per cent and for developed countries 3-7 per cent.

[5] A single rate can also be set for the analysis of all projects that pass the respective approval procedure.

4.3 Assessment of budget efficacy

This appraisal stage involves analysis of the appropriateness of state participation in the project, based on an increase in the burden on the central government/federal budget. In analysing budget efficacy, both the direct and indirect budgetary impact should be considered.

Direct effects are associated with direct cash flows from the project to the central government/ federal budget. Direct effects include an increase in budget revenue attributable to tax revenues from the project during the investment and operating stages. Direct tax revenues to budgets of various levels directly relate to the implementation of the investment project. An estimate of public receipts is made on the basis of cash flows under the investment project in the investment and operating stages, based on legislation in effect and on current rates and the procedure for calculating tax deductions to the budgets at various levels.

During analysis of the direct effects, the specifics of the PPP project (in particular, the payment mechanism) should be taken into account. For example, if the project includes an availability payment mechanism (if the public partner makes a certain payment ensuring a return on investment), such payments to the private partner should be considered direct costs/outflows of budget funds. It is also important to consider if the implementation of the PPP project could generate revenue, or a portion of it, that could be allocated to budgets at various levels.

Indirect effects are associated with changes in the incomes/expenditures of budget funds caused by the impact of the project on external organisations and the public:

• the direct financing of enterprises participating in the implementation of the project

• a change in tax revenues from enterprises whose activities depend on the project being implemented

• payments to individuals made redundant as a result of implementation of the project

• the allocation of funds from the budget for the relocation and employment of citizens due to implementation of the project

• budget savings on the payment of benefits in the event of the implementation of projects that create jobs in regions with low economic activity and high unemployment.

The cash flows analysed within the framework of estimating budget efficacy include the following:

• Inflow of budget funds

- the revenue or a proportion of the project proceeds (if such a mechanism is stipulated by the project)
- direct and indirect inflows from taxes, excises, duties, levies and deductions to extrabudgetary funds established by legislation in effect (currently valid and enforceable)
- income from licensing, competitions and tenders for the construction and operation of facilities stipulated by the project
- payments to repay credits and loans issued from the budget to project participants
- payments for repaying tax credits (with tax holidays)
- dividends on state-owned shares and other securities issued in connection with implementation of the project
- the residual value of state-owned assets at the end of the project period.

• Outflow of budget funds

- costs related to building infrastructure
- costs related to the preparation of land plots used for the project
- equity injections from the budget
- the provision of budgetary funds in the form of investment loans
- granting of budget funds on a cost-free basis (subsidy), the disbursement of capital grants for PPP projects
- payment for access to the infrastructure facility (if such a mechanism is envisaged by the project)
- budget subsidies related to the implementation of a certain pricing policy and compliance with certain social priorities
- tax privileges in the form of reduced taxes and fees.

KPIs used as part of the analysis of the budget efficacy of a project include:

• budget net present value (BNPV) – calculated using a similar formula to that for calculating NPV to estimate financial efficacy, using budget cash flows and a corresponding discount rate

• budget internal rate of return (BIIR) – calculated using the same formula for calculating IRR for the estimate of financial efficacy and using the NPV of the budget

• budget-benefit cost ratio (BBCR) – the ratio of income received to incurred cost

$BBCR = \frac{\sum_{n=0}^{N} DCF_{pos,n} + DTV_{pos,N}}{\sum_{n=0}^{N} DCF_{neg,n} + DTV_{neg,N}}$, where

n – number of the forecast period (for free cash flows)

N – number of periods

$DCF_{pos,n}$ – discounted positive cash flow of the budget per period n

$DCF_{neg,n}$ – discounted negative cash flow of the budget per period n

$DTV_{pos,N}$ – discounted terminal value of the positive cash flow of the budget per year N

$DTV_{neg,N}$ – discounted terminal value of the negative cash flow of the budget per year N

- the particular efficacy of a project is calculated as the ratio of BNPV to the initial budget investments in the project
- the discounted payback period is calculated using the same DPBP calculation formula to estimate financial efficacy, using budget cash flows and the corresponding discount rate.

Due to the specifics of a PPP project related to a specific project agreement term, it is advisable to calculate budget efficacy both with and without the terminal value (in other words, to take into account the present value of all cash flows beyond the explicit forecast period). When calculating the terminal value, the specifics of the PPP project should be taken into account. For example, if the PPP asset is transferred to the public partner, the forecast cash flows should be adjusted.

Regarding the discount rate, it is advisable to use the rate of return on long-term government borrowings (bonds). If the bonds are not marketable or if there is no active bond market, other sources can be used to determine the discount rate that will reflect the cost of debt for the government (for example, calculation based on Eurobonds, Damodaran data and others).[6]

4.4 Risk analysis

It should be noted that there are at least five different reasons to conduct a PPP-related risk analysis, which can require some differences in the methods used and the type and application of results obtained.

Reasons to conduct a risk analysis include:

- understanding how to allocate risks to the different parties in the PPP arrangement
- incorporating certain risks into the base-case cash flows of the PPP financial model
- carrying out a public sector comparator analysis
- understanding the impacts of various risks on the financial cash flows (stress tests, determination of needed debt service cover ratio, gearing level and so on)
- understanding (in likelihood and impact) the risks that have been allocated to public-sector entities by the agreements and devising mitigation measures ahead of time.

Irrespective of the form of project implementation, the project preparation procedures consist of elements of risk analysis at each stage. This involves the preparation of a risk register and elaboration of respective risk management strategies. When considering the implementation of a project through a PPP, a more detailed risk analysis is envisaged and a more detailed register and risk matrix is prepared. This analysis involves determining the risk value and sharing the responsibilities for specific risks between the private and public partners.

The main result of the risk identification and registration process is the creation of a risk register. The main objective is to identify aspects of the potential project that are most likely to affect overall costs and the quality of project implementation and to identify the partner (public or private) that can most efficiently manage a particular risk.

The transfer of a particular risk to the private partner is associated with two main types of cost: additional compensation to the private sector (the risk premium included in the price of the private party's bid) and a loss of flexibility with respect to a change in the service specification during the effective term of the contract. An efficient risk allocation process is established to manage any excess benefits from the transfer of risk, expressed in reduced costs and improvements in the quality of the services provided based on declared costs.

Identifying risks and risk mitigation methods

Identifying risks is a preliminary stage in the compilation of a register and risk matrix. The risk identification procedure consists of the following:

- determination of the type of input data used to identify risks
- description of the tools and methods used to identify risks
- determination of the type of output data when identifying risks.

[6] Damodaran data are data and analyses provided on the website of Professor Aswath Damodaran of the Stern School of Business at New York University. See: https://pages.stern.nyu.edu/~adamodar/New_Home_Page/home.htm.

The following can be used as input data for risk identification:

- existing PPP project documentation
- legislative acts and other regulatory frameworks applicable to the project
- macroeconomic information (exchange rate and interest rate dynamics)
- information on the project-specific indicators of the estimated volume of provided services (traffic density for roads, the number of hospital visits, appointments at polyclinics for healthcare projects)
- information about the risks identified during the implementation of similar projects.

The key tool for identifying risk is an expert assessment, which can be obtained through group meetings, as part of an interview with appraisers and/or from a detailed study.

Risk mitigation methods are identified as part of four main risk management strategies:

- avoidance (establishment of requirements for a private partner, review of project tasks)
- mitigation (for example, implementation of risk management activities to identify and establish provisions reducing the likelihood and impact of risks)
- assumption of risks (control of the level of the assumed risk)
- transfer (insurance, hedging).

Evaluating risk mitigation methods is not mandatory for the compilation of the risk matrix, but is recommended to improve the efficacy of a project's risk management process.[7] In the case of output data, as part of the risk identification process, it is advisable to use a risk register that includes a set of risks and also a brief description of those risks.

Risk assessment

This stage makes it possible to rank risks (to determine the likelihood of the occurrence of a risk and the degree of its impact on the PPP project). Risk analysis and assessment is performed via two main methods: qualitative and quantitative.

- Qualitative methods include expert assessments in which risk events and the degree of risk exposure are divided into a number of groups, depending on the likelihood of their occurrence and the degree of impact (from low to very high).
- Quantitative methods involve measurement of the risk value in monetary terms and comprise a sensitivity analysis and scenario analysis, sometimes using the Monte Carlo simulation method. At the same time, please note that at the current PPP market development stage in CIS countries, there is no extensive base of historical data on the likelihood of the occurrence/degree of the impact of risks on projects being implemented.

In a qualitative analysis, the biggest risks are identified. These are characterised by the greatest likelihood of occurrence and the greatest deviation caused to certain cost items/revenues/financial indicators for the project as a whole. In a qualitative analysis of risk importance, it is advisable to use a risk impact matrix (see Chart 5.1). This will increase the visibility of risks and assist risk management decisions by helping to prioritise risks, develop mitigation strategies, allocate resources and monitor progress.

Risk event	**Risk impact**				
	Immaterial	Minor	Moderate	Significant	Critical
Almost impossible					
Unlikely					
Even odds (50:50)					
Likely					
Almost certain					

Chart. 5.1 Risk impact matrix

[7] An example of a typical risk matrix, including recommendations on risk management, is provided in the report Risk Allocation Matrix.

To determine the quantitative risk assessment, a risk analysis is performed in terms of the impact on cost items and project revenues, as well as on the financial indicators of the project as a whole. The impact of risks on costs and revenue items is determined in the form of expected deviations in actual values (as a result of a risk event) from planned values. Determination of the deviation in cost items and project revenues as a result of the risk event is a quantitative assessment and is performed for the most significant project risks as a whole.

In quantitative risk assessment, the following methods are used:

- sensitivity analysis
- scenario analysis
- Monte Carlo simulation.

The method should be chosen based on the type of risk and its main characteristics. The primary goal of quantitative assessment of PPP project risks is to determine the level of sustainability of the financial forecasts on the main PPP project risks.

Under the sensitivity analysis method, some inputs and assumptions (sensitivity factors) of the financial model are subject to change within the given range. The impact of these changes on financial indicators (for example, financial ratios) is then evaluated. At the same time, the sensitivity factor is changed with a certain step (for example, 5 per cent or 20 per cent) while the other parameters remain fixed.

Examples of sensitivity factors for a PPP project include:

- CAPEX
- operating costs
- inflation rate
- cost of financing
- project milestones.

The importance of risk is determined by how much it affects the resulting indicators (for instance, the amount of payments from the public partner, IRR, DSCR, budget efficacy indicators) when the parameter that characterises the risk changes.

The range of sensitivity factors is selected using expert opinion based on expected or possible deviations in the actual values of sensitivity factors from respective inputs in the financial model.

The Monte Carlo simulation is based on the stochastic nature of the sensitivity factors (each possible value of the sensitivity factors has its own probability), on the one hand, and on the calculation of a significant number of results of the financial model, on the other. Based on the results, the probability distribution of the cost/duration of the PPP project is built. This method makes it possible to analyse the impact of simultaneous changes of several parameters on the resulting investment indicators of the PPP project.

Risk-sharing (allocation) approach

Project risk allocation can be divided into three categories:

- risk transferred to a private investor
- risk retained by a public partner
- shared risk.

The basic principle of risk allocation is that the risk is assumed by the partner that is most able to manage it. The sharing of a risk between the partners is an option when it is difficult to determine which partner would manage it most efficiently.

Risk sharing and the construction of a risk matrix are described in detail in the Risk allocation matrix report.

Risk analysis results. Based on the results of the risk analysis, a risk allocation matrix should be prepared and, in response, appropriate risk management actions should be decided, including how risks should be allocated in the PPP agreement. It should be noted that it is possible to prepare a risk allocation matrix without any quantitative analysis.

Assessing the value-for-money ratio within the framework of the complex analysis

As part of the complex analysis, it is advisable to perform a complex value-for-money analysis on the basis of both qualitative and quantitative criteria. A brief description of this analysis is given below, and the detailed methodology for assessing the value-for-money ratio is set out in the Value-for-money matrix report.

4.5 Results of the complex analysis

After completing all the stages of the complex analysis, an opinion is drawn up on the project under consideration and one of the following decisions is taken, based on the results of the analysis:

- If positive results are obtained for each of the three criteria (financial, social and economic and budget efficacy) and the project is deemed bankable, technically feasible and compliant from a legal and regulatory perspective, the project is approved for implementation.

- When assessing the results of the analysis, the purpose and intended outcome of projects should be considered. For example, in the case of certain social projects, negative results are acceptable for one or two criteria, provided the result of the social and economic efficacy criterion is positive in terms of the benefits provided to society.

- If negative results are obtained for each of the three criteria, the project is rejected or sent back for modifications/revisions.

- During the assessment of a project, due consideration should be paid to the results of the risk analysis, their significance, the allocation of risks between project participants and the extent of the development of the risk management plan.

- When choosing a project/projects and the form of implementation, the resources available to the public partner should be taken into account, along with the capabilities/resources of the private partner.

- As part of a complex analysis, it is advisable to rely on the results of the value-for-money assessment, taking into account the forecasts of the financial model under consideration.

5. Assessment of the value-for-money ratio

A value-for-money analysis is carried out as part of the following stages:

- the assessment of qualitative criteria (preliminary stage) to determine the applicability of PPP as a method of project implementation

- a quantitative assessment, including cost projections for different project implementation methods

- the evaluation of qualitative criteria (final stage) to analyse bids received.

Qualitative assessment of the value-for-money ratio

Depending on the implementation stage, there are two areas within the qualitative criteria assessment:

I. determination of the applicability of PPP as a project implementation method

This analysis serves as the basis for the adoption of a decision to conduct a more detailed quantitative assessment. The project implementation methods that will be deemed unsuitable for this project according to the preliminary testing results can be excluded from further analysis at an early stage, thereby saving considerable resources. The project selection process is divided into two stages: exclusion and selection.

II. analysis and comparison of qualitative criteria of received bids

The qualitative characteristics of the bids of a private partner are taken into account when determining the value-for-money ratio of a PPP. The benefits to the state are not always the same from project to project and can include the following: completion of the project in a shorter period; innovations in the design, construction and materials used; improved quality of service delivery; higher return on investments; increased project revenues; and the level of experience/resources of the private partner required for compliance with the conditions for providing services throughout the life of a facility. This qualitative assessment stage is usually carried out after a quantitative analysis.

Quantitative assessment of the value-for-money ratio

The following indicators are determined for various project implementation structures to quantify the value-for-money ratio:

I. costs related to the establishment and operation of the asset

II. other project implementation costs

III. adjustment for competitive neutrality

IV. assessment of risks and their allocation as part of the value-for-money ratio analysis

V. financing costs

VI. approach to determining the discount rate.

The detailed methodology for assessing the value-for-money ratio is set out in the Value-for-money ratio matrix report.

Appendices

Appendix 1. Indicative list of public needs, based on the example of several sectors (expected social and economic effects of the project)

Transport

- savings on travel time
- savings of the owner of infrastructure and vehicles
- increase in passenger traffic
- reduction in the accident rate
- reduction in environmental pollution
- cargo turnover growth
- resource savings (passengers, shippers)

Power

- increased supply of electricity to meet growing demand or to supply consumers that previously had no access to electricity
- reduced energy costs, increased energy efficiency
- increased reliability of the electricity supply
- reduced power losses
- reduced harmful emissions

Healthcare

- increased life expectancy
- reduced length of hospital stays
- reduced disability payments
- improved quality of life for the public

Appendix 2. Example of a checklist of key questions to identify stop factors

1. What is the technical complexity and level of innovation of the project under consideration?

2. What is the planned location of the asset?

3. What specific requirements have been established for land plots?

4. What is the experience of the project team (both of the public and private partners) in implementing similar projects?

5. Are there market restrictions affecting the product?

6. What are the resource base restrictions?

7. What is the scope for efficient risk management and risk minimisation?

8. What are the project preparation and implementation time frames?

9. What is the level of market competition?

10. What type of technology is expected to be used: new or tested?

11. Can technical requirements on direct outputs/ services be established?

Appendix 3. Basic requirements of the financial model

The financial model of the project is developed in accordance with the following requirements:

- The financial model should be built in Microsoft Excel.
- It should contain a minimum number of macros.
- The information should be presented in a particular sequence: first input data (on a separate sheet), then calculations (the calculation sheets must not contain values without formulae or within formulae) and finally the output data.
- The financial model should use the simplest formulae; complex formulae should be broken down into components in different cells.
- No part of the financial model should be concealed, protected, blocked or otherwise inaccessible for viewing. All formula codes must be visible.
- Cash flows for the years of project implementation should be calculated based on the prices of respective years, taking into account the projected macroeconomic indicators.
- The financial model should contain a sufficient degree of detail. In other words, it should contain breakdowns by main types of work/service, periods, income and cost items, and so on (as applicable).
- The financial model should comply with the principles of uniformity and consistency regarding calculations/formatting.
- The financial model should allow for changes in the initial assumptions and automatically adjust financial projections should such changes arise.
- The financial model should facilitate a sensitivity analysis of the results of the financial forecast in the event of changes to the key assumptions (initial data) of the model throughout the forecast period.

Approximate structure of the financial model:

I. Input data

- planning time frame
- macroeconomic and industry assumptions
- prerequisites for the volume of capital investments
- operating requirements
- financing requirements

• tax assumptions

• other assumptions

II. Calculations

• revenue

- forecast of the sales volumes of products

- price forecasts for sales/tariffs

• cost of production

- forecast of variable expenses

- forecast of fixed expenses

• administrative and management expenses

- administrative expenses

- marketing expenses

- selling expenses

- other operating expenses

• working capital

- forecast of working capital demand

• property, plant and equipment and capital investments

- calculation of the book value of property, plant and equipment, as well as depreciation and capital investments

• calculation of the payment mechanism (where applicable)

• financing

• forecast of financial needs, taking into account different sources of financing

• discount rate

III. Results

• financial statements:

- income statement

- balance sheet

- cash flow statemen

• KPIs

- profitability ratios

- debt burden ratios

- other ratios

• cash flows, financial, budget and socioeconomic efficacy indicators

- calculation of the NPV of cash flows

- calculation of the internal rate of return

- calculation of the payback period

• sensitivity and scenarios

- sensitivity analysis of the project (NPV and IRR totals) to changes in the main requirements

- scenario analysis

Chapter 10. Dispute resolution recommendations and related matters

1. General

1.1 The long-term and complex nature of public-private partnership (PPP) arrangements means that PPP agreements (PPPAs) tend to be somewhat incomplete. Where this creates room for differences in interpretation, disputes can arise. PPPs are also large-scale projects that inevitably have some exposure to changing circumstances and the occurrence of unforeseen risks. This, too, can lead to disagreements and disputes. Defining an appropriate dispute resolution process helps ensure that disputes are resolved quickly and efficiently, without interruption of service. Dispute resolution mechanisms can and should be built into PPPAs.

1.2 The legal basis for settling disputes is an important consideration in implementing PPP projects. Private parties feel encouraged to participate in domestic and international PPP projects when they have the confidence that any disputes between or among public partner(s), other strategic government agencies or private partner(s) can be resolved fairly, reliably and efficiently.

1.3 When drafting the dispute resolution process in a PPPA, it is important to check with legal experts to ensure that the provisions are appropriate and enforceable in the relevant Commonwealth of Independent States (CIS) member country. The dispute resolution process in the PPPA may also need to be consistent with the requirements of treaties entered into by the CIS member country – for instance, conventions on the resolution of disputes between investors and states, such as the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington, 1965). These requirements should be identified during legal due diligence for the project.

1.4 The legal framework for dispute resolution may be embodied in the CIS member country's legal instruments, rules and procedures. The legal instruments may include the PPP law containing enabling provisions and/or specialised laws. Moreover, international dispute resolution mechanisms should be included and take into account other provisions and recommendations stipulated by international conventions and treaties[1] into which the CIS member country has entered. These must be considered international treaties, such as bilateral investment treaties, and can enable a private partner to bring a claim against a public authority independent of any dispute mechanism stipulated in the PPPA. These treaties often grant substantive rights and protections (for example, the right to fair and equitable treatment), the breach of which can give rise to arbitration before an international tribunal.[2] The PPPA shall unambiguously stipulate dispute resolution procedures and provide detailed regulation of such procedures, as may be required depending on its type. Internal contractual mechanisms (such as expert determination/ mediation/panel arrangements) may need to be regulated in some detail, for example, while external systems that contain their own complete procedures (such as arbitration or court proceedings) would, of course, not be.

1.5 Possible mechanisms for dispute resolution are:

- negotiations / amicable settlement
- mediation and other alternative dispute resolution mechanisms not prohibited by the legislation of the CIS member state
- litigation
- arbitration (including international arbitration).

1.6 PPPAs should provide for the first point of dispute resolution being negotiation between key senior employees of each party. These parties are likely to see the bigger picture of the ongoing relationship, so be ready to come up with solutions. These arrangements are usually only intended to filter the serious disputes from the less serious ones. They are, therefore, not sufficient as standalone arrangements, and other forms of dispute resolution should be followed if they fail. They also depend on each party coming to the table. They have the advantage of providing fast, low-cost, flexible solutions that are within the control of the parties.

[1] Such as the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington, 1965); the CIS Convention on Settling Disputes Related to Commercial Activities (Kiev, 1992); the CIS Convention on Legal Assistance and Legal Relations in Civil, Family and Criminal Matters (Minsk, 1993); Convention on Protection of Investor's Rights (Moscow, 1997); the Convention on the Resolution of Civil Disputes Arising From the Relation of Economic and Scientific-Technical Cooperation (Moscow, 1972); the United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration (1985); and the Rules of Arbitration of the United Nations Economic Commission for Europe (1966).

[2] For example, see Micula v Romania (International Centre for Settlement of Investment Disputes [ICSID] Case No. ARB/05/20), where, independent of the PPPA, a claim was brought against the public authority under the Romania-Sweden bilateral investment treaty (2002) for breach of fair and equitable treatment for repealing a tax incentive scheme that had been in effect under the PPPA. The compensation (later disputed) was €178 million.

1.7 Generally, disputes from domestic and minor PPP projects fall under the jurisdiction of the courts of a judicial system. Major PPP projects with involvement of international and foreign investors are, as a rule of thumb, subject to international arbitration. It is recommended that the legislation of each CIS member country allow parties to set out alternative dispute resolution mechanisms in the PPPA.

1.8 Parties to PPP projects are encouraged to involve an ombudsman to protect the rights of investors and/or entrepreneurs in dispute resolution procedures where they are available under the local PPP system. As part of the resolution of disputes in the field of PPP, the ombudsman can facilitate the pre-trial resolution of conflicts by coordinating the parties during negotiations and facilitating the transfer of the dispute to the mediation procedure (if there is one).

1.9 The private party should have the right to file complaints and appeals to the ombudsman, and these must be considered. This is one way to prevent the occurrence of disputes between the parties to PPP projects. Once the complaint has been considered, the ombudsman can send proposals on the adoption, amendment, suspension or cancellation of regulatory legal acts, provide opinions on draft regulatory legal acts (including taking relevant issues to court), and request and receive information.

1.10 If the dispute was considered in the court of the respondent state in accordance with procedure specified in the PPPA, the rule according to which this dispute cannot be re-referred to other arbitration bodies should be taken into account.

2. Arbitration

2.1 The legislation of the CIS member country should provide the possibility of settling disputes under international arbitration systems[3] (in accordance with international treaties of the CIS member country) that are neutral, impartial, professional, competent, independent of any other organisations or public bodies, and consist of highly experienced arbitrators. On the one hand, recourse to international arbitration (where an effective and appropriate domestic arbitration system is unavailable) will allow the parties to PPPAs to benefit from reliable, impartial decisions, relevant professional expertise, speed of process and international conventions on the enforcement of international arbitration awards. On the other hand, the parties should understand that the arbitration process usually takes considerable money and time, so may not be suitable for smaller-scale projects. It also frequently results in a "split-down-the-middle" compromise approach to outcomes (in contrast with courts, which can be much more one-sided and uncompromising when deemed appropriate). To speed up this process, they can envisage simplified procedures of international arbitration, such as an expert determination process or a summary determination.

2.2 The parties should have an option to choose arbitrators, including foreign arbitrators, even where the arbitration is to be domestic. The CIS member country's laws should permit the participation of qualified and international arbitrators.

2.3 Arbitration has certain advantages over judicial systems:

- the parties choose their tribunal
- arbitration can offer greater assurance of a fair and competent decision, involving arbitrators with appropriate expertise
- parties can appoint people with relevant, specific skills – in the field of law and other sectors (financial, economic, technical) in situations where special knowledge is required
- arbitration proceedings can be more flexible and, therefore, more efficient – for example, it is possible to have documents-only arbitration with no oral hearing
- a final decision can often be reached more quickly because the right to appeal an award may be narrower than the right to appeal a judge's decision
- arbitration awards are more easily enforced in other jurisdictions than court rulings as most countries entered into the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).

2.4 International commercial arbitration should be allowed in national law – that is, it should permit independent third-party arbitrators to resolve disputes in a neutral location to facilitate foreign investment in a project. In particular, the law should allow a public partner to agree to submit itself to arbitration in a PPPA.

[3] For example, the International Chamber of Commerce, the London Court of International Arbitration, ICSID, the Arbitration Institute of the Stockholm Chamber of Commerce and UNCITRAL.

3. Litigation

3.1 Litigation, in the sense of resolution of a dispute through the courts of a judicial system, has numerous specific features that must be considered while implementing an investor-friendly PPP framework:

• The court system of the CIS member country should be efficient and rapid. The government is advised to take measures to address the potential for delaying the dispute resolution in respect of a PPP project, such as making sure to establish clear and comprehensive PPP contracts that set out the rights and obligations of the parties, as well as the scope and standards of the project. Additionally, as PPPs have high social importance, a qualified judge should always be selected to solve disputes quickly and to a high professional standard.

• The court system should not be expensive. High-quality justice should be available for each PPP project, regardless of its cost. The court should be able to resolve low-cost disputes as well as high-value ones.

• Each bidder in tendering procedures should be vested with suitable remedial rights to challenge failures to act on the part of the public partner or other public authority in accordance with those procedures or its other statutory obligations relating to them (including the relevant administrative procedures).

• The judiciary should be sufficiently independent from the government to make the private partner comfortable that fair and impartial redress will be available.

• If the CIS member country has a separate system of administrative courts for dealing with disputes with government entities, its government is encouraged to ensure that the administrative court is accessible to individual contractors, including those involving foreign investors. The burden of proof for a person bringing the claim should be no higher than a reasonable judicial standard.

• Judgments should be promptly enforceable.

4. Mediation and other alternative dispute resolution mechanisms

4.1 Mediation is a non-binding procedure in which an impartial third party – the conciliator or the mediator – helps the parties to a dispute reach a mutually satisfactory and agreed settlement of the dispute.

4.2 A mediator may help to formulate alternatives and help the parties to clarify how those alternatives fit in with each party's goals and how they might work. A mediator also serves as a conduit for information between the parties, especially where the parties have difficulty communicating directly with one another.

4.3 In mediation, a neutral third party shall be appointed to resolve a dispute by helping the parties to settle their disagreements. A mediator typically acts as a facilitator, helping the parties identify the best possible negotiated solution or settlement (the disputing parties will largely develop the solution themselves). A conciliator has a neutral but more active role, also proposing solutions and settlement terms.

4.4 The typical process for mediation might be as follows:

• The party that believes the PPPA has been violated should refer the dispute to the identified mediator in writing, with a copy to the other party. This reference should describe the nature of the dispute, the quantum in dispute (if any) and the relief or remedy deemed suitable.

• The mediator shall use their best efforts to conclude the mediation within a certain number of days.

• If no resolution can be reached through mutual discussion or mediation within the set number of days, the matter should be referred to litigation or arbitration.

5. Use of experts

5.1 Experts are qualified specialists used to help resolve questions or disputes by providing their binding or non-binding (depending on the form of their participation) opinions from specific areas of knowledge.

5.2 Parties to the PPPA may use experts in various ways. While a party is preparing a claim, it may need essential technical or financial expertise that only the engaged counsel can provide. Such experts may advise parties during arbitration procedures and review the opinions of appointed experts or interrogate them during hearings. The parties shall be free to involve experts in this way as professional advisers at any point in relation to any subject they choose.

5.3 Experts can be proposed or selected by the parties and appointed by the arbitrators in arbitration procedures. The role of these experts is to provide the arbitrators with their expert opinion and evidence on questions from their special area of expertise in the form of an expert report and, if required, testimony at hearings. Expert determination can also be used to help make decisions about very specific modifications to the PPP agreement, such as the calculation of an amount or replacement of an index, without the need for arbitration proceedings at all.

5.4 When the parties cannot agree on a single expert, each can appoint their own expert and the two experts shall work together to issue one jointly developed opinion on questions posed. This approach can be useful when the experts appointed by each party have conflicting responses to the same questions. In any case, arbitration decides the final issue of the appointment of experts. It is recommended that independent experts who can provide an objective and transparent position should be involved.

5.5 Another effective way to overcome parties' conflicts is for the arbitrators themselves to appoint an expert. This can be done in addition to or instead of experts appointed by the parties. In this case, arbitrators will have to deal with possible differences between expert opinions.

5.6 Another option is expert determination, using an impartial expert to make a decision on some aspect(s) of the issue in dispute. This can be a rapid, simple and inexpensive way to settle a technical or non-technical question without or before any arbitration.

5.7 Expert determination may be used if the subject of a dispute is technical rather than legal (for example, closing accounts in an agreement) in CIS countries where expert determination is legally feasible.[4] The parties may include a split clause in the PPPA that refers some types of dispute arising from the agreement to one method of dispute resolution (for example, international dispute resolution for all legal disputes) and another dispute resolution mechanism for another type of dispute (for example, domestic expert determination for technical issues such as the application of accounting rules). In this case, the expert's opinion is usually binding on the parties (though the parties shall decide this for themselves). In the context of PPPs, the appointment of an independent certifier to verify that the project's progress during the construction phase satisfies the agreed objectives, including payment sums and performance standards, is an example of expert determination. The use of expert determination reduces delays arising from disputes.

5.8 Participants in arbitration proceedings (including experts themselves) should aim to develop effective and cooperative approaches when dealing with experts, show flexibility and be open to discussion.

[4] This is not always the case for various reasons, such as political/legal uncertainty. For instance, in 2015, the Ukrainian Supreme Court was involved in a wave of bilateral investment treaty claims by Ukrainian state-owned entities against Russia. See Everest Estate LLC et al. v The Russian Federation, PCA Case No 2015-36; PJSC Ukrnafta v The Russian Federation, PCA Case No 2015-34; Stabil LLC et al. v The Russian Federation, PCA Case No 2015-35; Limited Liability Company Lugzor et al. v The Russian Federation, PCA Case No 2015-29; PJSC CB PrivatBank and Finance Company Finilon LLC v The Russian Federation, PCA Case No 2015-21 and Aeroport Belbek LLC and Mr. Igor Valeriecich Kolomoisky v The Russian Federation, PCA Case No 2015-07.

Annex 1.
The lifecycle of a PPP project

Annex 1: The lifecycle of a PPP project[1]

Stage 1: Identifying PPP projects

Steps	Aim	Potential methods
Identify priority public investment projects	To identify public investment projects that address clearly identified socioeconomic objectives	The processes and methodology used by governments vary; identification of priority public investment projects can include setting out sector/infrastructure strategies/ objectives, analyses of the project options' ability to meet identified objectives, feasibility and cost-benefit analyses, and prioritisation of projects within the government's overall public investment budget
Screen for PPP potential	To establish – based on the available information – whether the project provides better value if implemented as a PPP rather than through traditional public procurement[2]	Analyses can include the scale of the project, opportunities for risk transfer/risk allocation, potential barriers to project implementation, availability of resources and market capability and appetite
Build an initial PPP pipeline	To identify which projects to develop first from the pipeline of PPP projects created through the screening process	Measure projects against an additional criterion to decide which to develop, first taking into account the level of development of projects, the project's ability to respond directly to identified needs and which projects have the highest likelihood of success

Stage 2: Appraising potential PPP projects

Steps	Aim	Potential methods
Assess preliminary PPP structure and design[3]	To know what the PPP project is (in terms of PPP aspects) in a preliminary way, to assess feasibility	Appraisal of the PPP aspects
Assess project feasibility and economic viability	To determine whether the project provides environmental and/ or social benefits, is technically feasible in the medium term and represents the best cost-benefit option for achieving the intended results	Economic viability analysis, feasibility analysis (technical feasibility studies, legal due diligence, environmental and social impact assessments)
Assess commercial/ financial viability	To determine whether the project can attract sponsors and lenders and make sufficient revenue	Financial analysis (constructing a financial model for a project and assessing its cash flows, returns and financial stability)

[1] These tables and their categories are based on the World Bank (2017), PPP Reference Guide 3.0, Module 3, Washington, DC.

[2] This screening is done at various times, depending on where in the government's broader public investment management process a project is identified as a potential PPP. It then follows a PPP-specific process. The definitive screening for PPP suitability may take place during the appraisal stage, rather than before it.

[3] Most of the aspects covered in the next stages (PPP structure and design) are addressed and appraised in a preliminary way in stage 2.

Steps	Aim	Potential methods
Assess value for money of the PPP	To determine whether developing the project as a PPP is the best value for money compared with traditional public procurement (or other options)	Qualitative value-for-money analysis; in, some cases, quantitative value-for-money assessment (comparison of the PPP option against a public-sector comparator)
Assess fiscal implication	To determine whether the project fits into the government's central budget and does not impact its broader public investment aims	Project financial model (to estimate the value of direct fiscal commitment and the cost of contingent liabilities)
Assess project management capabilities	To confirm the contracting agency has the capacity and resources to prepare, tender and manage the contract during its term	Appraisal of the current capacity of the procuring authority and any future needs

Stage 3: Structuring PPP projects[4]

Steps	Aim	Potential methods
Identify risk	To identify any risk factors that could have a negative impact on the project's value (for some or all stakeholders	Risk register
Allocate risk	The allocation of risk creates incentives for the parties to manage risk well, resulting in better value for money	Risk allocation matrices
Translate risk allocation into contract structure	To allocate responsibilities and risks together	Payment mechanisms following on from the allocation of functions and risks

Stage 4: Designing PPP contracts

Steps	Aim	Potential methods
Set performance requirements	To outline in the PPP contract what is expected in terms of quality, asset type(s) and services to be provided by the private partner and assign detailed responsibilities for each party	The PPP contract should set out: output requirements, how performance will be monitored, consequences for failure to reach performance targets (specifying penalty payments and payment deductions for poor performance and outlining a performance warning procedure) and step-in rights for the public party
Establish payment mechanism	To define how the private partner to the PPP will be remunerated	The core elements of the payment mechanism can include user charges collected by the private partner, government payments to the private party, bonuses or penalties

[4] Stage 3 and stage 4 are typically integrated process with substantial iteration, but for clarity purposes they are separated here.

Steps	Aim	Potential methods
Establish adjustment mechanisms	To establish well-defined guidelines and limits for change	For example, this can include financial equilibrium clauses that entitle an operator to modify key financial terms of the contract to offset the impact of certain uncontrollable events
Detail the dispute resolution mechanisms	To ensure disputes are resolved quickly and effectively without severely impacting the project	These mechanisms can be outlined in the PPP contracts and include mediation, conciliation, expert determination, international arbitration, recourse to a sector regulator and, in some cases, involvement of the judicial system (courts)
Detail the termination provisions	To outline termination of the PPP, contract close, asset handover or early termination provisions	The contract term and asset handover and provisions for early termination (alongside any relevant compensation payment) are typically defined in the PPP contract

Stage 5: Managing PPP transaction

Steps	Aim	Potential methods
Decide procurement strategy	To identify the procurement strategy that offers the best value for money solution to the project objectives and select a competent firm to implement this	The process and criteria for selecting the PPP contractor. This can include the pre-qualification process, the bid process, the process for negotiation with bidders and the basis for reward
Market PPP	To interest prospective bidders (as well as potential lenders and subcontractors)	This involves advertising the launch of the PPP tender process, following government requirements
Identify qualified bidders	To identify qualified bidders to be invited to submit proposals (Note: not all countries do this in advance – some assess qualification as part of the open bidding process)	This includes preparing and issuing a request for qualifications and then selecting qualified firms or consortia
Manage bid process	To select a preferred bidder	This includes preparing and issuing a request for proposals, interacting with bidders as they prepare proposals, evaluating bids received to select a preferred bidder and finalising the contract with the bidder
Reach closure	To achieve contract effectiveness and financial closure	The commercial and financial close stage is achieved when all the project and financing agreements have been signed, all conditions on those agreements have been met and the private party to the PPP can begin to draw down the financing to initiate work on the project

Stage 6: Managing PPP contracts

Steps	Aim	Potential methods
Establish contract management structures	To ensure the asset delivers a high-standard service in line with the contract, with payments or penalties being made accordingly	This usually involves appointing a specifically designated PPP contract manager (or management team) within the implementing agency, as well as establishing roles for other entities within government to help manage the PPP
Monitor PPP delivery and risk	To ensure contractual risk allocations are maintained and the parties are properly managing respective risks	This involves establishing reporting mechanisms to monitor risk and project delivery throughout the PPP cycle
Manage contract expiry and asset hand back	To ensure the required outputs for the contract have been achieved and the hand-back provisions are met	The hand-back provisions should be clearly outlined in the contract, which should include how asset quality will be defined and assessed, whether a payment will be made on asset handover and how much

Annex 2.
Compensation on termination

1. General provisions

1.1 All terms and definitions in this annex have the meaning given in Appendix 1 (definitions) to the agreement, unless otherwise specified in the text of this application.

1.2 Upon termination, the grantor agrees to pay compensation to the concessionaire in the manner and under the conditions specified in this appendix, with the individual features found in the direct agreement with donors.

[The composition of compensation upon termination is determined in accordance with the requirements of applicable law, funding agencies and commercial agreements on specific projects.]

2. Compensation for termination of the agreement before the date of financial close

2.1 In the event of termination of the agreement before the date of financial close on grounds related to the grantor, the grantor shall pay compensation to the concessionaire upon termination for the confirmed reasonable expenses of the concessionaire related to the concessionaire's performance of its obligations to achieve financial close.

2.2 In the event of termination of the agreement before the date of financial close on grounds related to the concessionaire, the concessionaire shall reimburse the grantor for reasonable and documented expenses arising from the non-occurrence of the date of financial close.

2.3 In the event of termination of the agreement before the date of financial close due to the occurrence of a force majeure event or other circumstances not due to the fault of any of the parties, the grantor shall pay the concessionaire compensation upon termination of 50 per cent of the reasonable and confirmed expenses of the concessionaire related to the concessionaire's fulfilment of obligations to achieve financial close.

3. Compensation for termination of the agreement after the date of financial close

3.1 In the event of termination of the agreement after the date of financial close on grounds related to the grantor and in connection with the occurrence of a special circumstance, the grantor shall pay the concessionaire compensation upon termination of:

(a) the amount of the principal debt raised by the concessionaire under the debt financing under the principal financing agreements, as well as the amount of interest on the principal debt

(b) the amount of fines, penalties, commissions and any other payments due to the financing entity under the basic financing agreements

(c) the amount of equity financing raised by the concessionaire, as well as the amount of interest, forfeits, fines, penalties and other payments payable by the concessionaire for equity financing, including the internal yield of investors, calculated using the following formula:

$S = D + P_{eq}$

where:

S is the amount provided for in paragraph c) subclause 3.1 Clause 3 of this appendix

D is the amount of equity financing attracted by the concessionaire

P_{eq} is the amount of interest, penalties, fines and other payments to be paid by the concessionaire in relation to equity financing, including the internal income of the investors

(d) the amount of expenses accrued by the concessionaire in payments to employees of the concessionaire in connection with dismissal for reasons related to the termination of the agreement

(e) the amount of expenses accrued by the concessionaire for the payment of losses and penalties in connection with the early termination of agreements with counterparties of the concessionaire concluded in order to fulfil the concessionaire's obligations under the agreement, including the concessionaire's expenses to compensate the contractor for materials purchased but not used, as well as structures fabricated but not mounted in accordance with the contract

(f) the amount of costs for the demobilisation and conservation of the object of the agreement (in the event that, on the date of termination of the agreement, work is carried out on [construction/ reconstruction]).

3.2 In the event of termination of the agreement after the date of financial close on grounds relating to the concessionaire, the grantor shall pay the concessionaire compensation upon termination in the following amounts:

(a) the amount of principal debt raised by the concessionaire by way of debt financing under the principal financing agreements, as well as the amount of interest on the principal debt

(b) the amount of fines, penalties, commissions and any other payments due to the financing entity under the basic financing agreements

(c) the amount of costs for the demobilisation and conservation of the object of the agreement (in the event that, on the date of termination of the agreement, work is carried out on [construction/ reconstruction]).

3.3 In the event of termination of the agreement after the date of financial close due to the occurrence of a force majeure event, the grantor shall pay the concessionaire compensation of:

(a) the amount of the principal debt raised by the concessionaire by way of debt financing under the principal financing agreements, as well as the amount of interest on the principal debt

(b) the amount of fines, penalties, commissions and any other payments due to the financing entity under the basic financing agreements;

(c) [[●] per cent] the amount of equity financing raised by the concessionaire, as well as the amount of interest, penalties, fines and other costs payable by the concessionaire for equity financing, including the internal yield of investors, calculated using the following formula:

$S = D + P_{eq}$

where:

S is the amount provided for in paragraph c) subclause 3.1 Clause 3 of this appendix

D is the amount of equity financing attracted by the concessionaire

P_{eq} is the amount of interest, penalties, fines and other payments to be paid by the concessionaire in relation to equity financing, including the internal income of the investors

(d) the amount of expenses of the concessionaire on payments to employees of the concessionaire in connection with dismissal for reasons related to the termination of the agreement

(e) the amount of expenses of the concessionaire for the payment of losses and penalties in connection with the early termination of agreements with the counterparties of the concessionaire concluded to fulfil the concessionaire's obligations, including the concessionaire's expenses to compensate the contractor for materials purchased but not used, as well as structures fabricated but not mounted in accordance with the contract

(f) the amount of costs for the demobilisation and conservation of the object of the agreement (in the event that, on the date of termination of the agreement, work is carried out on [construction/reconstruction]).

4. Compensation upon termination by agreement of the parties

4.1 The composition and amount of compensation at the termination of the concession agreement by agreement of the parties is defined in such agreement between the parties to terminate the concession agreement, but in any case not be less than [●].

5. The calculation of the amount of compensation on termination and the procedure for making payments

[Parties may determine more detailed procedures to calculate compensation on termination, including in respect of any of the parties to implement the corresponding calculation and in what time frame, as well as the terms and procedure for payment of compensation on termination. Additional conditions may also be incorporated into the direct agreements with donors.]

5.1 [●].