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Public Private Partnerships

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C O N T E N T S

Executive Summary

1. According to the Efficiency Unit of the Government, Public Private Partnerships (PPPs) are *"arrangements where the public and private sectors both bring their complementary skills to a project, with varying levels of involvement and responsibility, for the purpose of providing public services or projects"*. Popular forms of PPPs include Build-Operate-Transfer (BOT), Build-Own-Operate, Buy-Build-Operate, Design-Build-Finance-Operate (also known as Private Finance Initiative (PFI)) and Design-Build-Operate. Please refer to Appendix I for details on the various forms of PPPs.

2. Hong Kong is at an early stage in its adoption of PPPs, and only the BOT approach has been adopted in the development of a few major infrastructures, such as the cross-harbour tunnels and other tunnels. However, several projects under development are adopting other forms of PPPs, in particular PFI. The authority responsible for promoting the adoption of PPPs is the Efficiency Unit which has published *An Introductory Guide to Public Private Partnerships* presenting the basic concepts and addressing the major issues relating to PPPs. PPP projects requiring financial support from the Government must obtain the approval from both the Government and the Legislative Council. A PPP project is overseen by the Intelligent Client Team formed under the procuring authority.

3. In the United Kingdom, private sector involvement in the provision of public facilities or services began in 1979. The authorities responsible for formulating and promoting PPP policies, and assisting local councils in implementing these policies are HM Treasury, Partnerships UK and the Public Private Partnership Programme respectively. Guidelines are available for both the procurement of and the provision of incentives for Private Finance Initiative projects. PPP projects requiring financial support from the government must obtain the approval from both the sponsoring department and the interdepartmental Project Review Group. Whilst a PPP project is overseen by the procuring authority, its development and the commitment of resources are scrutinized by Parliament.

4. In the United States, PPPs have been used for the delivery of public facilities and services for over 200 years. The authority responsible for advocating and facilitating the formation of PPPs at the federal, state and local levels is the National Council for Public Private Partnerships. Although there are no federal guidelines for PPPs, some states and government agencies have developed their own guidelines for PPPs. To finance a PPP project in the United States, it requires the enactment of relevant legislation defining the upper limit of the amount of funds that can be made available to the procuring authority. Whilst the PPP project is overseen by the procuring authority, the relevant legislature monitors its delivery through the budgeting process. Legislatures at all levels also have responsibilities to scrutinize PPP policies and the financial arrangements of PPP programmes.

5. In New Zealand, the Local Government Act enacted in 2002 requires individual local councils to adopt a PPP policy. Unlike the United Kingdom and the United States, there is no specific authority responsible for the promotion of PPPs. In any event, the Local Government Act empowers a local council to develop a PPP project as well as to determine the nature and scope of its commitment of resources to the project. For PPP projects requiring financial support from the government, a written agreement between the local council and the private sector entity must be in place, specifying all terms and conditions of the partnership. A PPP project is overseen by the local council, and the progress of the project is being monitored through reporting on the implementation of the long-term community plan of the local council.

Public Private Partnerships

Chapter 1 - Introduction

1.1 Background

1.1.1 The Panel on Planning, Lands and Works (PLW Panel) and the Panel on Home Affairs (HA Panel) of the Legislative Council (LegCo) at their joint meeting on 25 November 2003 requested the Research and Library Services Division (RLSD) to conduct a research on the experience of overseas jurisdictions in delivering public facilities and services using the Public Private Partnership (PPP) approach. The Panels, in particular, wish to look into the role of the overseas legislatures in monitoring the delivery of public facilities and services under PPPs.

1.1.2 At the meeting of the PLW Panel on 27 January 2004, Panel Members noted that whilst RLSD's research on PPP was concerned with policies on how public works projects were to be procured and thus fell under the purview of the PLW Panel, there were a wide range of public works projects straddling across different policy areas. The PLW Panel agreed to continue to take the lead in the research and to invite non-Panel Members to join the discussion when the research report was presented to the Panel.

1.2 Scope of research

1.2.1 RLSD proposes to study the regulatory framework of PPPs in the United Kingdom (UK), the United States (US) and New Zealand. In all of the three places under study, there are no specific authorities established for regulating PPPs. In the UK, public facilities and services delivered through PPPs are monitored by individual sponsoring departments the responsibilities of which are, in turn, overseen by parliamentary select committees. In the US, infrastructures established under PPPs are regulated by individual public utility commissions at the state level, while PPP projects relating to the supply of gas and power are regulated by the Federal Energy Regulatory Commission at the federal level. These regulatory agencies are accountable to individual departments, and thus are indirectly subject to Congressional scrutiny. In New Zealand, there is a formal PPP policy established under the Local Government Act, and PPPs for local facilities and services are monitored by local councils.

1.3 Methodology

1.3.1 This research adopts a desk research method, which involves Internet research, literature review, documentation analysis and correspondence with relevant authorities.

Chapter 2 - Overview of Public Private Partnerships

2. Definition and common characteristics

2.1.1 According to the Efficiency Unit (EU) of the Government, PPPs are *"arrangements where the public and private sectors both bring their complementary skills to a project, with varying levels of involvement and responsibility, for the purpose of providing public services or projects".*[1]

2.1.2 A PPP commonly has a combination of all or some of the following characteristics:

(a) the public agency defines the quality and quantity of services, and the timeframe in which the services are to be delivered;

(b) the private sector entity is responsible for delivering the defined services, while the public agency is involved in regulation and procurement of such services;

(c) the long-term relationship involved is normally between 10 and 30 years;

(d) responsibilities and risks involved in the relationship are allocated to the party best able to manage them;

(e) the private sector entity finances the project and recoups its investment from charges or payments made during the life of the contract;

(f) the private sector entity is encouraged to make use of its innovation and flexibility to deliver quality and cost-effective services throughout the project lifecycle; and

(g) the different functions of design, construction, operation and maintenance are integrated.

[1] Government of the Hong Kong Special Administrative Region, Efficiency Unit. (2004) Available from: http://www.info.gov.hk/eu/english/psi/psi_ppp/psi_ppp.html [Accessed 21 April 2004].

2.2 Merits of public private partnerships

2.2.1 PPPs can take different forms to meet the specific needs of individual cases. According to EU, merits of PPPs include[2]:

(a) allowing the public agency to concentrate on its core competencies;

(b) creating economic growth, employment and investment opportunities;

(c) realizing better exploitation of public assets, data and intellectual property;

(d) reducing lifecycle costs of a project;

(e) providing opportunities for new sources of revenue;

(f) bearing less risks of cost overruns and project delays;

(g) achieving substantial improvement in the quality of public facilities and services;

(h) achieving better allocation of risks;

(i) spreading the public capital investment over the life of a project;

(j) utilizing the skills and experience, access to technology, and innovation of the private sector for better delivery of public services;

(k) bringing commercial disciplines into the provision of public services;

(l) maintaining a small government and a lean civil service; and

(m) enhancing unity of responsibilities for delivering services.

[2] Government of the Hong Kong Special Administrative Region, Efficiency Unit. (2004) Available from: http://www.info.gov.hk/eu/english/psi/psi_ppp/psi_ppp_why.html [Accessed 21 April 2004].

2.3 Demerits of public private partnerships

2.3.1 Listed below are potential problems of PPPs as suggested by EU[3]:

(a) loss of public control;

(b) inadequate accountability of the private sector entity to the public;

(c) unreliable levels of service;

(d) lack of flexibility, especially over the longer term;

(e) disruption of service, and costs incurred by the public agency when step-in rights are exercised;

(f) inappropriate allocation of risks between the public and the private sectors;

(g) the private sector entity escaping liability through liquidation and use of the status of a limited liability company;

(h) higher costs due to limited competition if qualified PPP contractors are not available;

(i) greater difficulty and higher cost in removing an unsatisfactory contractor;

(j) higher private financing costs; and

(k) greater secrecy and lack of transparency resulting in benefits not being shared with the public agency.

2.4 Types of public private partnerships

2.4.1 A PPP can be established in one of the various forms available, including Build-Operate-Transfer, Build-Own-Operate, Buy-Build-Operate, Design-Build-Finance-Operate (commonly known as Private Finance Initiative (PFI)) and Design-Build-Operate. Appendix I provides details on the various forms of PPPs. This report mainly discusses PFI which involves the use of private financing to fund the construction of facilities and/or the purchases of assets, for the purpose of providing services.

[3] Government of the Hong Kong Special Administrative Region, Efficiency Unit. (2003) *An Introductory Guide to Public Private Partnerships*.

2.5 Conventional government procurements

2.5.1 Both conventional government procurements and PPPs require a public agency to start by:

(a) establishing the need for a facility and related services;

(b) identifying a likely location for the facility and related services; and

(c) considering affordability and value-for-money issues.

2.5.2 Conventional procurement of a public facility is through the design-bid-build approach. Under this approach, design is carried out independently of the construction process, and the part on construction is awarded to a qualified bidder with the lowest price. The role of a public agency is to inspect and maintain the public facility.

2.5.3 The objective of the design-bid-build approach is to minimize risk to a contractor by defining all requirements of a project and eliminating most of the unknown conditions. Any errors and omissions in the plans or unforeseen work are the responsibility of the public agency. Quality is sought through prescriptive plans and specifications coupled with construction oversight and inspection by the public agency. Cost control is attained through competitive bidding.

Chapter 3 - Hong Kong

3.1 Background

3.1.1 According to EU, Hong Kong is at the relatively early stage in its adoption of PPPs, and only the Build-Operate-Transfer approach has been adopted in the development of a few major infrastructures, such as the cross-harbour tunnels and other tunnels. However, several projects under development are adopting other forms of PPPs, in particular PFI, and they are listed below:

(a) Tourism-related projects such as the former Marine Police Headquarters, the Central Police Station, Victoria Prison and the former Central Magistracy and the Tung Chung Cable Car Project;[4]

(b) Cyberport[5];

(c) Asia World-Expo (AWE)[6]; and

(d) West Kowloon Cultural District (WKCD)[7].

3.2 Government policies on private sector involvement

3.2.1 Over the past few years, the Chief Executive in his Policy Address and successive Financial Secretaries in their Budget Speeches have reiterated the Government's ongoing commitment to involving the private sector in the provision of public facilities and services to encourage innovation, enhance productivity and speed up project and service delivery, in order to provide better and more efficient services as well as increase opportunities for investment in Hong Kong. In this connection, bureaux/departments are encouraged to involve the private sector in delivering public facilities and services.

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4 Please refer to Appendix II for the funding arrangements and the involvement of the Legislative Council in these projects.

5 Please refer to Appendix III for the funding arrangements and the involvement of the Legislative Council in this project.

6 Please refer to Appendix IV for the funding arrangements and the involvement of the Legislative Council in this project.

7 WKCD is a waterfront site at the southern tip of the West Kowloon Reclamation for the development of a performance venue. Please refer to Appendix V for the involvement of the Legislative Council in this project.

3.2.2 The Government is actively reviewing and exploring possibilities to deliver public works projects managed by the works departments through PPPs, with a view to bringing about more benefits to both the Government and the public. For example, the Government has identified two cultural and recreation projects to be delivered by the PPP approach,[8] and has briefed the HA Panel on the features of the approach. In addition, it is exploring the use of the PPP approach to deliver the proposed in-situ reprovisioning of Sha Tin Water Treatment Works. The Government has completed a feasibility study on the proposed project, and has briefed the PLW Panel and sought their views for the way forward.

3.2.3 EU published *An Introductory Guide to Public Private Partnerships* (*Introductory Guide*) in August 2003, presenting the basic concepts and addressing the major issues relating to PPPs for the civil service and the private sector to enhance their understanding of the approach.

3.3 Responsible authority

3.3.1 In general, EU is responsible for assisting bureaux and departments to use PPPs in the delivery of public facilities and services. It helps:

(a) alleviate difficulties in undertaking PPP projects;

(b) achieve better outcomes from PPP projects through the application of appropriate service delivery methodologies and processes; and

(c) reduce project timelines and costs through the dissemination of good practices.

8 The two projects are (a) a leisure and cultural centre in Kwun Tong; and (b) an ice sports centre, a tenpin bowling centre and a town park in Tseung Kwan O.

3.3.2 EU provides the following services to bureaux and departments to help them identify and implement PPP opportunities:

(a) feasibility and business case studies;
(b) re-engineering/performance improvement services to facilitate private sector involvement decisions;
(c) project planning, scoping studies and implementation planning;
(d) development of service specifications;
(e) development of tender evaluation criteria;
(f) due diligence checks;
(g) establishment of contract administration and relationship management regimes;
(h) organization of training courses, seminars and experience sharing sessions; and
(i) help desk services.

3.4 Selection of a Public Private Partnership partner

3.4.1 The *Introductory Guide* provides steps for a bureau or department to follow in selecting a PPP partner. These steps include:

(a) requesting for an Expression of Interest from the private sector;
(b) conducting an initial assessment of private sector entities that have submitted an Expression of Interest;
(c) publishing notices of PPP opportunities in newspapers and *Gazette*, and on Internet to invite proposals from pre-qualified private sector entities;
(d) conducting an initial assessment of proposals;
(e) excluding proposals not meeting requirements;
(f) negotiating with conforming bidders to achieve improvements to bids whilst under competitive pressure;
(g) selecting preferred bidders to enter into detailed, fully negotiated contract documents;
(h) requesting the best and final offer; and
(i) recommending the preferred bidder to the relevant bid evaluation committee[9].

9 The bid evaluation committee is composed of departmental staff as well as technical and financial experts.

3.4.2 The procuring authority should establish clear selection and assessment criteria and procedural guidelines to reduce corruption risk.

3.5 Treatment of unsolicited proposals

3.5.1 According to the *Introductory Guide*, a private sector entity may bring projects to the Government on an unsolicited basis. However, a competitive bidding process is required to demonstrate value-for-money and to guarantee probity.

3.5.2 Under certain circumstances, the Government may grant a private sector entity, on a non-competitive basis, an exclusive mandate to fully develop a proposal brought to the Government on an unsolicited basis. However, such circumstances are rare, for example, where the intellectual property in the proposal is of such outstanding value that a competitive market for the service does not exist. In that event, the procuring authority has to satisfy the criteria of good value-for-money and no alternative means to deliver the same facility or service.

3.6 Public consultation

3.6.1 The *Introductory Guide* stipulates that the level of consultation for a PPP project should be the same as that for a conventional procurement. The procuring authority should explain the project to interested and affected parties. District Councils and other statutory and non-statutory bodies should also be consulted. Where the use of a PPP will result in transfer of existing services to a private sector entity, all stakeholders need to be consulted.

3.7 Financial arrangements

3.7.1 For PPPs requiring government support, the *Introductory Guide* stipulates that the procuring department should submit via its policy bureau a bid for funds through the Resource Allocation Exercise[10]. For capital costs, the bureau should secure capital funding under the Capital Works Reserve Fund (CWRF)[11]. For costs required during the operation phase, the bureau should confirm whether it can absorb the recurrent expenses. The bureau should submit a PPP proposal, having regard to the staff, land and financial implications, to the Policy Committee[12], or the Executive Council[13] where appropriate, for approval. Specifically, the proposal to the Policy Committee/Executive Council needs to set out not only the costs involved, but also, in consultation with the Financial Services and the Treasury Bureau, an assessment of whether and how the proposal may deviate from the budgetary expenditure guidelines, and whether revenue will be diverted to the private sector or otherwise hypothecated.

3.7.2 After obtaining approval from the Policy Committee or the Executive Council, the procuring authority should consult the relevant LegCo Panel on the proposed project. Thereafter, the procuring authority should submit the proposal to the Public Works Subcommittee (PWSC)[14] for consideration, and then to the Finance Committee (FC)[15] for funding approval.

3.7.3 A financially free-standing project does not require financial approval from LegCo. For example, the tourism-related projects and the Tung Chung Cable Car project described in paragraph 3.1.1 have not put in any funding proposals to both PWSC and FC. On the other hand, for projects where the Government intends to grant land for less than the paid-up market value, the *Introductory Guide* states that the procuring authority should consult LegCo.

[10] The Resource Allocation Exercise is an annual exercise which determines the amount of new money to be allocated to Directors of Bureaux. The Resource Allocation Exercise covers both recurrent and capital expenditure.

[11] CWRF is used to finance the Government's Public Works Programme, the development, purchase and installation of major systems and equipment as well as capital subvention building projects. It also provides funds for the acquisition of land, and the payment of redemption money in respect of land exchange entitlements. Premium income received from land transactions is credited to CWRF.

[12] The Policy Committee, chaired by the Chief Secretary for Administration, comprises Directors of Bureaux to consider major policy issues.

[13] The Executive Council is an organ for assisting the Chief Executive in policy-making.

[14] PWSC examines and makes recommendations to FC on the Government's expenditure proposals under CWRF for projects in the Public Works Programme and building projects carried out by or on behalf of subvented organizations.

[15] FC scrutinizes and approves public expenditure proposals put forward by the Government.

3.8 Performance monitoring and contract enforcement

3.8.1 A PPP project is overseen by an Intelligent Client Team formed under the procuring authority. The Intelligent Client Team is composed of the staff of the procuring authority, architects, engineers of various specializations, lawyers and financial advisors. It may contain individuals from both within and outside the Government. The composition may change according to needs at different stages of the project. According to EU, Hong Kong is at an early stage in developing PPP projects, hence there has not been any project which has entered into the stage of forming an Intelligent Client Team. EU indicates that EU itself will join the Intelligent Client Team if situation requires.

3.8.2 Staff from related works departments should be invited to join the Intelligent Client Team. They act as technical advisors and assist in drawing up the output specifications, setting performance standards and advising on work practices. These works departments may also assist in terms of playing a regulatory and monitoring role throughout the contract period.

3.8.3 During the course of performance monitoring, the procuring authority should:

(a) have physical access to the facility at all reasonable times;

(b) have access to the accounts and other records;

(c) require the private partner to conduct user-satisfaction surveys;

(d) require publication of periodic reports on contractual performance; and

(e) conduct audit performance.

3.8.4 The procuring authority should maintain close and regular contact with the private partner throughout the life of the contract. Potential problems should be identified early and acted upon. If problems appear to be serious and/or persistent, the issue should be elevated to the top management. If problems still persist, the matter may need to be brought to the attention of the lenders[16] of the private partner whose stakes are at risk.

[16] Due to the scale and risks involved in a PPP project, a consortium is usually formed to manage and finance the project. While some private sector entities invest in the equity of the project so as to secure the major contractual roles, the majority of the financing comes from third-party lenders.

3.8.5 To ensure that the performance is up to standard or to provide insurance for sub-standard performance, the procuring authority may request the private partner to provide performance bonds, bank or parent company guarantees or warranties with subcontractors and a liquidated damages clause in the contract. Where appropriate, the procuring authority may be entitled to make deductions from the payments to the private partner in the event of poor performance or non-availability of the facility.

3.8.6 In case of serious failure to perform, the contract may be terminated and the private partner removed from the site. This would be subject to any step-in rights as provided in the contract for the lenders to rectify the problems and/or to replace the private partner.

3.8.7 The procuring authority should proceed with legal action, as appropriate, to recover from the defaulting private partner the costs incurred in rectifying defects, and in the maintenance and management of the facility.

3.8.8 To protect against the event that the private partner goes bankrupt and cannot complete the project, the PPP contract should be structured so that the assets related to the project would revert to the procuring authority.

3.9 Role of the legislature in monitoring the delivery of public facilities and services under public private partnerships

3.9.1 For PPP projects that incur long-term financial commitments, the procuring authority is required to secure approval from FC of LegCo for the funding commitment.

3.9.2 For projects where the Government intends to grant land for less than the paid-up market value, the procuring authority should consult LegCo in accordance with the *Introductory Guide*.

3.9.3 Although a financially free-standing project does not require formal legislative or financial approval from LegCo, the *Introductory Guide* stipulates that the procuring authority is advised to seek LegCo support as most PPP contracts are lengthy and of relatively high value.

Chapter 4 - The United Kingdom

4.1 Background

4.1.1 In the UK, the involvement of the private sector in the provision of public facilities or services began in 1979 in the form of privatization. In some cases, privatization was successful, leading to a reduction in costs and prices and an increase in efficiency. In other cases, however, privatization resulted in safeguarding the interest of some stakeholders at the expense of others. For example, businesses were sold for less than their full values, prices were not set at affordable levels, and services did not meet the expectation of consumers.

4.1.2 To address the deficiencies of privatization as well as the incapacity of both the central and local governments in financing all public works projects, the Labour Party (the then opposition party) produced a paper in 1994 entitled *Financing Infrastructure Investment*, demonstrating that a constructive relationship between the public and private sectors would help the UK deliver quality and best-value public facilities and services. Shortly after the Labour Party took office in 1997, it commissioned Sir Malcolm Bates, an industrialist, to identify obstacles in delivering public facilities and services using the PPP approach, in particular the PFI model (where a private sector entity designs, builds, finances and operates the project), and to make proposals to streamline the procurement process. The recommendations resulting from the study were as follows:

(a) to create a taskforce within HM Treasury to support departments assessing PFI projects before procurement commences;

(b) to establish a standard PFI contract to reduce costs and the time involved in contract negotiation;

(c) to prioritize projects in accordance with the principle of cost-effectiveness; and

(d) to share experience in this regard.

4.1.3 In this connection, HM Treasury established a taskforce in 1997, which oversaw the following:

(a) prospects for achieving value-for-money by adopting PFI;

(b) facilities and services being procured and their payment methods; and

(c) chances of negotiating a deal within a reasonable time-scale.

4.1.4 In 2000, HM Treasury replaced the taskforce with Partnerships UK following the second review on PFI carried out by Sir Malcolm Bates. Partnerships UK took forward and expanded the work of the taskforce, and further supported the development of PFI for the public sector.

4.1.5 Various studies have been undertaken to demonstrate the benefits of using PFI. For example, a review conducted by the taskforce in 1999 showed that the average value-for-money savings from using the PFI approach was some 17%.[17] The National Audit Office (NAO)[18] reviewed several PFI projects and found them to be value-for-money.

4.1.6 In 2003-04, 11% of public investment in the UK was under PFI, while the remaining 89% was carried out through other forms of procurement.[19] PFI projects cover a wide range of services, such as council housing refurbishment, schools, the police, fire and magistrates' court services, care and respite homes, IT systems, leisure centres and waste management.

4.2 Responsible authorities

<u>HM Treasury</u>

4.2.1 HM Treasury is accountable for the overall PPP policy and approval framework. An interdepartmental Project Review Group (PRG) has been established to oversee the approval process for PFI projects of local authorities that require government support. PRG is chaired by the Office of Government Commerce (OGC)[20], with members drawn from various departments[21]. PRG meetings are attended by Partnerships UK and the Public Private Partnership Programme (4Ps).

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17 *Public Private Partnership Programme*. (2004) Available from: .http://www.4ps.co.uk/general_faq.htm#Value%20for%20Money [Accessed 8 April 2004].

18 NAO scrutinizes public spending on behalf of Parliament. NAO audits the accounts of all government departments and agencies as well as a wide range of other public bodies, and reports to Parliament on the economy, efficiency and effectiveness with which government bodies have used public money.

19 HM Treasury. (2003). *PFI: Meeting the Investment Challenge*.

20 OGC is an independent office of HM Treasury reporting to the Chief Secretary. It is responsible for a wide-ranging programme which focuses on improving the efficiency and effectiveness of the central government procurement. OGC has an important role in developing and promoting private sector involvement across the public sector.

21 These departments include the Department of the Environment, Transport and the Regions, the Department for Education and Employment, the Department of Health, Home Office and the Lord Chancellor's Department.

4.2.2 PRG provides:

(a) early assurance to local authorities of the availability of funding and the conditions attached to such funding before they commit to the procurement process;

(b) clear indication to the private sector of the projects which will attract funding from the central government, enabling them to focus on projects that have a good prospect of success; and

(c) procedures to disseminate information about projects of local authorities so that lessons can be learned to improve the development of new projects.

PRG also monitors the progress of approved projects.

<u>Partnerships UK</u>

4.2.3 HM Treasury established Partnerships UK, the successor to the Treasury taskforce, with the aim of increasing investment in public services by using private sector resources. Partnerships UK is a private sector company with HM Treasury holding a substantial minority stake. It provides the public sector with the private sector expertise and resources needed to build better partnerships and to help the public sector achieve:

(a) fast and efficient development and procurement of PPPs;

(b) competent PPPs that build stable relationships with the private sector;

(c) savings in development costs; and

(d) best value-for-money.

4.2.4 Partnerships UK also works with 4Ps on projects of local authorities. It provides development and bridging finance or other forms of capital support where these financing alternatives are not readily available from established financial markets.

Public Private Partnership Programme

4.2.5 4Ps, a local government agency funded by government grant and accountable to a Board appointed by the Local Government Association, supports local authorities developing and delivering PPP projects. The functions of 4Ps are as follows:

(a) identifying and assisting local authorities in delivering projects in key policy areas, which can be used as models by the less experienced local authorities through the dissemination of appropriate case studies, best practice guides and guidance materials;

(b) lobbying the government to remove legal and financial controls which constrain PPPs;

(c) assisting local authorities and the private sector in identifying opportunities for investment and helping local authorities initiate relevant PPP projects;

(d) creating and maintaining a database of contacts, contracts and projects which can be used as a central resource bank by stakeholders;

(e) providing training to local authorities and the private sector on PPPs in terms of principles and process; and

(f) assisting the Audit Commission[22] in providing clear guidance on PPP projects to external auditors.

4.2.6 4Ps also supports local authorities in securing public funds for their projects. It produces procurement packs for all key service areas and leads the work with government departments on the standardization of local authorities' PFI contracts. It also produces case studies and guidance notes for PPP projects.

4.3 Selection of a Public Private Partnership partner

4.3.1 In 2001, the Audit Commission published a specific guideline for the management of PFI procurement in its management paper *Building for the Future*, which was followed by the *National Procurement Strategy for Local Government in England* published by the Office of the Deputy Prime Minister[23] in 2003. These two documents set out the basic framework of the procurement process in the UK, following the public procurement directives of the European Union.

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[22] The Audit Commission is an independent public body responsible for ensuring that public money is spent economically, efficiently, and effectively on the local government, housing, health and criminal justice services.

[23] The Office of the Deputy Prime Minister was created as a central government department in May 2002. It is responsible for policies on housing, planning, devolution, regional and local government and the fire service. It also takes responsibility for the Social Exclusion Unit, the Neighbourhood Renewal Unit and the Government Offices for the Regions.

4.3.2 Listed below are procedures involved in the procurement process in the UK, in particular, when the PFI approach applies. The procuring department should:

(a) advertise the project in the Official Journal of the European Communities[24] and other relevant government publications;
(b) conduct industry briefings to provide information on the project, such as scope of the project, specification, funding and selection criteria, for interested bidders to assist their decision in putting forward their bids;
(c) compile a list of potential bidders;
(d) select short-listed bidders by inviting potential bidders to complete a pre-qualification questionnaire to assess their capacity, such as their financial situation and professional expertise, in delivering the project; and/or to submit an Outline Business Case[25] to assess their ideas as well as their understanding of the project;
(e) obtain approval from the management of the procuring department regarding the results of the short-listed exercise in step (d);
(f) prepare a Statement of Requirement listing all output requirements and a draft contract;
(g) provide a detailed Public Sector Comparator[26] to short-listed bidders listing both the technical characteristics and the estimated costs of other alternatives proposed by the procuring authority;
(h) issue an Invitation to Negotiate to short-listed bidders and invite them to submit a Final Business Case[27];
(i) assess the Final Business Case and ensure that interests of the procuring authority are protected in case of project failure;
(j) select a preferred bidder;
(k) negotiate the final contract with the selected bidder;
(l) place the contract with the selected bidder;
(m) send a contract award notice to the Official Journal of the European Communities no later than 48 days after the date on which the contract is placed, and announce the placement of contract in other relevant government publications; and
(n) debrief unsuccessful bidders.

24 The Official Journal of the European Communities contains information on specialized resources, and provides a platform where purchasers may publish tender notices and suppliers may search for business opportunities.

25 An Outline Business Case contains information on the service implications, the business justification and the cost of the project. It is a common practice to appoint financial and technical advisers to assist with the preparation of the Outline Business Case.

26 A Public Sector Comparator is defined as the cost of the conventionally funded, deliverable and affordable solution to the output requirements. It includes the full cost of the best value-for-money conventional procurement option, plus its ongoing operation, support maintenance and ultimate disposal.

27 A Final Business Case provides information on (a) the provider; (b) the term of the contract; (c) the expected investment regime included in the contract; (d) the estimated economic benefits and non-economic benefits of the project; (e) the quality of the service delivery arrangements; and (f) a summary of the performance standards and targets agreed with the provider. Assessment of the Final Business Case should seek the advice from relevant authorities and NAO.

4.3.3 The aforementioned process may take 12 months to two years to complete.[28] As this process is preceded by a period of investment appraisal and followed by a 12-month to two-year construction period, the whole project may take three to four years to complete before it can commence operation.

4.3.4 Accordingly, the UK government has developed standardized PFI contracts with a view to:

(a) reducing the period of the entire process and costs of negotiation;

(b) promoting a common understanding of the main risks encountered in a standard PFI project; and

(c) allowing consistency of approach and pricing across a range of similar projects without detracting from their ability to cater for specific needs.

4.3.5 The government is committed to improving the effectiveness of the public sector in all kinds of procurement, in particular, in PFI procurement. In a document entitled *PFI: Meeting the Investment Challenge* published by HM Treasury in 2003, HM Treasury undertook to conduct a research on:

(a) evaluation of PFI bids conducted by the public sector; and

(b) management of PFI projects to ensure that (i) they offer in practice the flexibility built into standardized PFI contracts; and (ii) authorities are equipped to manage their contracts effectively, particularly when termination or exercise of step-in rights is required.

HM Treasury expects the research and consultation exercise to be completed in 2004.

[28] Audit Commission. (2001) *Building for the Future, PFI Management Paper*. Available from: http://www.audit-commission.gov.uk/reports/AC-REPORT.asp?CategoryID=&ProdID=2DEA4286-58A0-4d5a-A2DA-3DE70F2CEEC3&SectionID=toc#. [Accessed 26 February 2004].

4.3.6 In addition to the actions taken by the government to improve the procurement process, the government is also consulting the public regarding the changes in the procurement directives of the European Union which were amended in April 2004. As discussed in paragraph 4.3.1, the directives of the European Union affect the basic framework of the procurement process in the UK. According to the new directives, one of the principles of awarding a contract is on the basis of transparency. As such, a community should:

(a) draw up procedures for contract awarding so as to ensure compliance to the guiding principles;

(b) guarantee the opening-up of public procurement to competition;

(c) publicize the procurement process by traditional means of communication in addition to electronic means;

(d) ensure the means of communication used in one municipal are compatible with those used in other municipals;

(e) inform potential bidders the criteria and arrangement of selection as well as the weighting of the selection criteria;

(f) ensure verification of the suitability of bidders are carried out in a transparent manner; and

(g) provide sufficient time for potential bidders to prepare their bids.

4.4 Treatment of unsolicited proposals

4.4.1 A private sector entity may identify or try to create a potential need for some facilities or services. Some proposals may be "half-baked" or fully developed, while other proposals may be just wild ideas. If a proposal provides channels of improving services, reducing costs and creating employment, the procuring authority may:

(a) treat the proposal as an integral part of the early supplier involvement and inform the proponent of the developing requirements;

(b) invite the proponent to participate in an early design contest;

(c) advertise the requirements of the potential project, but make sure that the intellectual property of the proponent is not jeopardized, and encourage the unsolicited proponent to bid; or

(d) use single tender action if the proposal is unique and relevant conditions permit use of the negotiated procedure without call for competition.

4.4.2 If the business of the proponent is small or the proponent is under resource constraint to bid for a substantial contract, the procuring authority may either:

(a) allow the proponent to secure licensing rights or a share in intellectual property right so that other providers can be engaged; or

(b) with the consent of the proponent, advertise two separate requirements as follows: (i) procure a creative partner to work alongside; and (ii) support a larger contractor for the main contract.

4.4.3 If the unsolicited proposal is of greater value-for-money than the existing contract, the procuring authority can encourage its prime contractor to consider subcontracting to the proponent.

4.5 Public consultation

4.5.1 Since the government considers that it is important to gain the commitment of the local community to a proposed PPP project, public consultation is usually carried out. A procuring authority may look up the guidelines on public consultation entitled *Connecting with Users and Citizens* published by the Audit Commission in 2002 for key characteristics of successful communication and consultation with the public.

4.6 Financial arrangements

4.6.1 Each year, the central government announces the overall value of PFI projects that are likely to receive financial support in the following financial year. A local authority must first seek approval from its sponsoring department in the event that a project requires financial support from the government. Financial support includes funds for construction and commitments for recurrent expenses.

4.6.2 The procuring authority should assess the PFI project in the context of a wider options appraisal. It should also estimate the costs and benefits of all available procurement options and benchmark the project with a Public Sector Comparator. The options appraisal should be included in the Outline Business Case for submission to the sponsoring department.

4.6.3 The sponsoring department scrutinizes the Outline Business Case and other supporting documents. If the Outline Business Case meets the following criteria:

(a) value-for-money;

(b) requirements of the capital finance regulations;

(c) national policy objectives; and

(d) project assessment considerations of PRG,

the sponsoring department will put forward the project to PRG. If PRG confirms that the project is value-for-money, financial support will be given.

4.6.4 This appraisal exercise ensures the procuring authority the availability of funding before it enters into the procurement exercise. It also gives interested private sector entities an indication that the project has secured funding support from the central government.

4.6.5 As regards the transfer of government assets, such as land or properties, for the development of a PFI project, the procuring authority usually requires the private partner to pay for the asset at the face value. Examples include the sale of the Royal Dockyards at Devonport and Rosyth by the Ministry of Defence in 1997 and the transfer of all property estates across the UK to a private sector consortium by the Department of Social Security in 1998.

4.7 Performance monitoring and contract enforcement

4.7.1 Individual authorities must carry out best value reviews of its functions over a five-year cycle. In carrying out these reviews, they must:

(a) challenge the fundamental basis of service provision;

(b) demonstrate that the service is competitive;

(c) consult with local communities and ensure that their aspirations are reflected in future priorities and target for service improvements; and

(d) compare service performance with standards achieved by other organizations in both the public and private sectors.

4.7.2 A procuring authority should ensure that the performance of a private partner complies with relevant statutory performance indicators, targets and standards. The procuring authority may set local performance standards and benchmark the performance of the private partner with that of similar organizations. It should also request the private partner to deliver measurable improvements in service quality during the contracting period.

4.7.3 The procuring authority is obliged to ensure the ongoing delivery of public services. In the event that a private partner fails to deliver the project on schedule or provide quality services as originally specified, the procuring authority should withhold payments made to the private partner concerned.

4.7.4 In the event that the private partner consistently fails to deliver services up to the standard originally specified and the private partner has failed to remedy this deficiency, the PFI contract will go into default, giving the procuring authority the right to terminate the contract and step in to ensure continuity of service delivery. Under such circumstances, the project will be reverted to public ownership, including the assets and staff necessary to continue to deliver the service. Compensation will only be granted to the private partner for the true value of assets less any rectification costs. In extreme cases, it could result in no compensation payment. At the end, the procuring authority may either take over ownership of the project or put the project out to tender again.

4.7.5 Even when there is no default, the procuring authority retains the right to step in to take over the operation of the facilities or services being provided by the private partner if the procuring authority determines that:

(a) there is a serious risk to the health or safety of the public;

(b) there is a serious risk to the environment;

(c) the project may have implications for national security; or

(d) it has to exercise its statutory responsibilities.

4.7.6 In the *PFI: Meeting the Investment Challenge*, the government indicates that it is committed to keep the monitoring of and reporting on the progress of PFI investment programmes transparent. Since 1997, the Financial Statement and Budget Report has included:

(a) record of future payments contracted for by each PFI project; and

(b) capital value of contracts signed to date and in procurement.

4.7.7 The government plans to publish, on an annual basis, a comprehensive statement on the progress of the PFI programme. This includes the complete record of transactions committed to in the previous year, the record of projects that have been completed in the current year and their performance against expectations, and a statement on potential projects by sector.

4.7.8 Since a PFI contract usually lasts for 10-30 years, it is important for the procuring authority to retain flexibility in delivering services. According to *PFI: Meeting the Investment Challenge*, the procuring authority:

(a) has a right to change any aspect of the facility or service provision, subject to the agreement with the private partner on cost; and

(b) should ensure that value-for-money is maintained. If the procuring authority decides to change output specifications, and such change exceeds £100,000 (HK$1,273,000)[29] in value, the procuring authority should request a competitive tender for the works involved to ensure the outcome is value-for-money.

4.7.9 If a dispute arises concerning the above process, it can be handled through a dispute resolution procedure, which involves an independent expert agreed by both parties and producing binding results. However, if the procuring authority remains dissatisfied, or the scale of change goes beyond the scope of allowable changes originally specified in the contract, the procuring authority can terminate the full contract.

4.8 Checks and balances of regulation of public private partnerships

4.8.1 Both NAO and the Public Accounts Committee[30] (PAC) conduct systematic reviews of the PPP policy and other aspects of the PPP programme. They also investigate, report and make recommendations based on significant individual PPP projects.

[29] The average exchange rate of Pound Sterling to Hong Kong Dollar for 2003 was £1=HK$12.73. Source: *Government of the Hong Kong Special Administrative Region, Census and Statistics Department*. (2004) Available from: http://www.info.gov.hk/censtatd/eng/hkstat/fas/money_finance/exrate_std_index.html [Accessed 4 May 2004].

[30] PAC is appointed by the House of Commons to "*examine the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit*".

4.8.2 NAO is the primary body responsible for assessing the PPP programme. It audits the procurement policy, the conduct of procurement, and the cost-effectiveness of selected individual projects. It also audits the balance sheet treatment of PPP projects contracted by individual departments and submits value-for-money reports to Parliament.

4.8.3 PAC follows up reports produced by NAO with hearings and reports of their own, placing government policies and activities under parliamentary scrutiny, and making recommendations on policy areas. In 2003, PAC published a report entitled *Delivering Better Value for Money from the Private Finance Initiative*, consolidating the findings obtained by both NAO and PAC from some key PFI projects. Please refer to Appendix VI for these findings.

4.8.4 In addition to NAO and PAC, the Audit Commission is responsible for auditing the public money spent on PPP projects commissioned by local authorities, health as well as criminal justice organizations. An assessment of the decision making process and the control framework surrounding the procurement decision is central to this audit.

4.9 Role of Parliament in monitoring the delivery of public facilities and services under public private partnerships

4.9.1 PPP projects all require long-term spending commitments. They have an impact on future public spending plans. In this connection, Parliament must be fully informed of the extent of the estimated commitments. HM Treasury provides summary tables of the estimated PPP commitments to Parliament twice a year. Guidelines are produced by Partnerships UK to ensure that Parliament is fully informed of:

(a) extent of the existing commitments;

(b) forthcoming commitments;

(c) payment mechanism;

(d) change of service clauses;

(e) termination arrangements contained in the contract; and

(f) contingent liabilities.

4.9.2 Individual departments may develop, in conjunction with HM Treasury, their own PPP models. Under such circumstances, the procuring department should deposit a copy of the sample project agreement showing the specific PPP approach in the Parliamentary Libraries for public reference.

4.10 Incentives for innovation

4.10.1 According to the guideline entitled *Capturing Innovation* produced by OGC, innovation from the private sector should be encouraged throughout the procurement and contract lifecycle. Listed below are some practices for encouraging innovation from the private sector:

Improving communication with private sector entities

4.10.2 To give the private sector confidence to invest in projects meeting the public sector's long-term needs, a report entitled *Increasing Competition and Improving Long-Term Capacity Planning* published by OGC in 2003 recommends individual authorities to improve two-way communications with the private sector. To capture the potential for innovative solution to enhance outcomes, individual authorities should consult with private sector entities and provide relevant information to them so that they can:

(a) help shape output requirements;

(b) provide feedback on feasibility and affordability; and

(c) gear up to be able to respond to future procurements.

Organizing design contests

4.10.3 If a procuring authority is looking for a new design for a facility, it can run an early design contest. The procuring authority should try to secure or share intellectual property rights and the right to license construction. In some cases, the procuring authority pays for several or all contest outputs so that it can use all the good ideas. In other cases, the procuring authority awards a service contract to encourage further development of the winning design.

Providing ownership of intellectual property

4.10.4 The OGC guideline recommends that intellectual property rights should ultimately rest with the party who is best able to exploit it. However, such an assignment may serve as a dampener to competition. In any event, the procuring authority should develop measures to safeguard intellectual property of the unsolicited proposal so that future innovation initiatives will not be discouraged.

Chapter 5 - The United States

5.1 Background

5.1.1 In the US, PPPs have been used for the delivery of public facilities and services for over 200 years. Much of the early infrastructure for transportation, water and electricity was developed with private sector resources. However, during the Great Depression, many private sector entities went bankrupt, and the provision and maintenance of public facilities and services were taken over by the government. In addition, the government was active in boosting the economy by means of public works projects during that period.

5.1.2 In the 1980s, the Republican government took an ideological cue from the UK and made privatization a legitimate public policy. In 1992, despite the fact that there was a change of government from Republican to Democrat, the reform programme continued to place strong emphasis on PPPs.

5.1.3 In 1998, the US Council of State Governments conducted a survey on the reasons for using PPPs for the delivery of public facilities and services. The findings were as follows[31]:

(a)	Cost savings[32]	41%
(b)	Lack of in-house personnel and expertise	33%
(c)	Lack of state support of political leadership	31%
(d)	Flexibility and less red tape	24%
(e)	Speedy implementation	21%
(f)	Increased innovations	20%
(g)	High quality of service	19%

[31] Seader, David L. (2002) *The United States' Experience with Outsourcing, Privatization and Public Private Partnerships*. Available from: http://www.ncppp.org/resources/papers/seader_usexperience.pdf [Accessed 2 April 2004].

[32] In the US, public private partnerships usually bring in 10-20% savings over the conventional government procurement system. In some cases, savings could be as high as 40%. Source: Seader, David L. (2002) *The United States' Experience with Outsourcing, Privatization and Public Private Partnerships*. Available from: http://www.ncppp.org/resources/papers/seader_usexperience.pdf [Accessed 2 April 2004].

5.1.4 In 2001, the Republican took over the White House again, and announced its intention to reduce the federal workforce by 600 000 through outsourcing and PPPs.[33] The government also ordered 50% of its commercial activities conducted by federal agencies be reviewed for possible outsourcing.[34]

5.1.5 The government believes that, with demand for public facilities and services far exceeds the capability of government budgets, the adoption of PPPs enables governments of all levels to provide quality facilities and services without increasing taxes or fees and charges.

5.1.6 PPPs have been used in a wide variety of programmes and projects. At present, 23 out of 65 basic municipal services are provided in the form of PPPs.[35] For example, school districts are forming partnerships with private sector entities to build schools in communities where school buildings are dilapidated and inadequate to meet the growing student population. States are turning to PPPs to help address the traffic congestion and physical deterioration problems of the roadways. They also develop PPPs to extend fibre optic lines to sparsely-populated regions. Local governments use the PPP approach to improve and operate water and wastewater facilities to meet the mandates of the federal Safe Drinking Water Act. City governments are employing PPPs to handle paperwork and crime reporting chores.

5.2 Responsible authority

5.2.1 The National Council for Public Private Partnerships (NCPPP) is responsible for advocating and facilitating the formation of PPPs at the federal, state and local levels. Established in 1985, NCPPP is a non-profit-making organization. Membership of NCPPP includes private sector entities, public agencies, non-profit-making organizations and the general public. Listed below are major functions of NCPPP:

(a) advocating and facilitating appropriate private sector involvement and participation in the delivery of public facilities and services;
(b) identifying, sponsoring, supporting, participating in and promoting research into the use of PPPs;
(c) providing a forum for the co-ordination and exchange of information relating to the use of PPPs;
(d) analyzing pertinent legislation;
(e) educating members and the public the benefits of the use of PPPs; and
(f) engaging in promotional activities of PPPs.

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33 Seader, David L. (2002) *The United States' Experience with Outsourcing, Privatization and Public Private Partnerships.* Available from: http://www.ncppp.org/resources/papers/seader_usexperience.pdf [Accessed 2 April 2004].

34 National Council for Public Private Partnerships. (2002) *For the Good of the People: Using Public Private Partnerships to Meet America's Essential Needs.* Available from: http://www.ncppp.org/presskit/ncpppwhitepaper.pdf [Accessed 6 April 2004].

35 National Council for Public Private Partnerships. (2004). Available from http://www.ncppp.org/presskit/topten.html [Accessed 6 April 2004].

5.2.2 NCPPP creates various special-purpose institutes based upon the common interests of particular sets of members either by industry or by legislative issue. Examples of these institutes include the Real Estate Institute[36], Transportation Institute[37] and Water Institute[38].

5.3 Selection of a Public Private Partnership partner

5.3.1 In the US, individual states have a high level of autonomy in government procurement and contractual practices. As such, public facilities and services are delivered and financed through various forms, including PPPs. Although the federal government has issued general procurement policies and guidelines, there are no specific guidelines for PPPs in spite of the government's support and promotion of PPPs. Accordingly, some states (such as the State of Virginia) have developed their own guidelines for PPPs, while some government agencies (such as the Office of Child Support Enforcement) have developed guidelines for PPPs relating to a specific policy area or programme.

5.3.2 In general, with regard to partner selection, a procuring authority should create a contract bidding exercise in which private sector entities can compete fairly against one another. Bids solicitation and partner selection can be conducted using the Request for Proposal (RFP) process.

5.3.3 The RFP process is a negotiable procurement process which provides flexibility for both the procuring authority and the private sector entity. To address concerns of stakeholders and accommodate the objective of the project, the procuring authority may send a draft RFP to interested parties and hold pre-bid conferences to solicit their input. In this connection, the procuring authority can foster competition in the process of solicitation, while the responses to a RFP are an indication of the market's ability to meet the specific requirements of the procuring authority.

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[36] The Real Estate Institute provides a forum for members with interests in the use of public private partnerships for real estate development and value optimization of under-utilized government-owned land. It provides an Advisory Service Programme for public officials, develops educational materials, and participates in conferences to promote real estate partnerships as well as the best practices in the real estate industry.

[37] The Transportation Institute provides a forum for members with interests in the use of public private partnerships for the development of transportation projects. It serves as the principal resource in conducting a series of workshops under a contract with the US Department of Transportation. The Transportation Institute also serves as the voice of NCPPP in presenting transportation-related policy concepts to increase opportunities for the use of public private partnerships at the federal, state and local levels.

[38] The Water Institute provides a forum for members with interests in the use of public private partnerships for the design, building, operation and/or maintenance of water and wastewater systems. It conducts seminars and workshops for public sector officials on topics such as full cost accounting, best practices in the development of public private partnerships and related subjects.

5.3.4 While individual states or local governments have their own requirements for a specific project, there are 12 elements they commonly consider for a RFP:

(a) nature of the facility or the service and the overall objectives of the contract;

(b) overview of the policy or programme, the legislative and administrative framework and the existing problems;

(c) specific duties to be performed and the expected outcomes;

(d) length of the contract and options for renewal;

(e) list and schedule of relevant information to be delivered to the private partner;

(f) performance standards, monitoring mechanism and process for implementing corrective actions;

(g) terms of payment, basis for incentives and/or penalties for inadequate performance or lack of compliance;

(h) general contractual requirements;

(i) special contractual requirements;

(j) technical expertise and corporate profile of the bidder;

(k) contacts of the procuring authority and schedule for the RFP; and

(l) process of evaluation and award.

5.3.5 An evaluation committee is usually formed to undertake a full evaluation of responses to the RFP in detail. It will select a private sector entity among the respondents for contract negotiation. In the event of a state agency, it must seek the approval of the Governor or the relevant Cabinet-level Secretary before entering into a comprehensive agreement with the selected partner.

5.4 Treatment of unsolicited proposals

5.4.1 From time to time, a public agency may publicize its needs and encourage interested parties to submit proposals subject to the terms and conditions of a particular act or policy initiative. If the public agency accepts these proposals for conceptual-phase consideration, it should place a notice[39] on its procurement web site, and in public areas regularly used for posting public notices, newspapers or periodicals of general circulation in the affected jurisdictions for at least 45 days to allow potential competitors to prepare proposals. The public agency may charge those private sector entities who have submitted proposals a project proposal review fee.[40] In the event that the public agency determines that an original proposal is unsuccessful, the public agency may reimburse the private sector entity concerned, in whole or in part, for the costs incurred in the review process.

5.5 Public consultation

5.5.1 Some state legislation mandates public involvement in all government programmes, and the public can suggest improvements to the plans and designs of both public and private development projects. Some local governments conduct public consultation on their comprehensive plans which show general development goals and priorities, and identify potential locations for future development projects. Other local governments work closely with the community to define goals of a particular development and to establish design guidelines for the site prior to the solicitation of a private partner. This exercise not only ensures that a proposal can meet the needs of the community, but also reduces the risk to a private sector entity during the design review and approval process. In any event, a procuring authority frequently uses public notices to inform the public of pending PPPs for new developments as well as public hearings to obtain input from the community.

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[39] The notice should state that the public agency (a) has received and accepted an unsolicited proposal under a specific act; (b) intends to evaluate the proposal; (c) may negotiate a comprehensive agreement with the proponent based on the proposal; and (d) will accept for simultaneous consideration any competing proposals that comply with the procedures adopted by the public agency and the provision of the act. The notice should also summarize the proposed qualifying project, and identify the proposed locations. The public agency makes copies of unsolicited proposals available upon request, subject to the provision of the Freedom of Information Act, except to the extent that they are related to (a) confidential proprietary information submitted to the jurisdiction under a promise of confidentiality or (b) memoranda, working papers or other records relating to the proposals if making public such records would adversely affect the financial interest of the state or the private sector entity or the bargaining position of either party.

[40] For example, the Department of Transport of the State of Virginia charges US$50,000 (HK$389,350) for projects over US$50 million (HK$389 million) and US$25,000 (HK$194,675) for projects under US$50 million (HK$389 million). Some 20% of the fee is paid with the conceptual proposal and 80% with a detailed proposal.

5.6 Financial arrangements

5.6.1 To finance a public programme, no matter whether it is a PPP project, relevant legislation is enacted defining the upper limit of the amount of funds that can be made available to a procuring authority. In some cases, the defined amount does not require further legislative action because a special budget authority is established to approve the funds according to the provisions of the legislation. In other cases, however, passage of an appropriation act is required. In this connection, Congress makes available the amount that can actually be used for the programme. This amount may be equal to or lower than the originally approved level of funding. It is at this point that the programme can proceed.

5.6.2 In general, the government considers that PPPs deliver quality facilities and services in a cost-effective manner. Private sector entities are able to practise cost efficiencies while they also have the opportunity to generate other income, which helps reduce or finance the recurrent expenditure. Other sources of financing the recurrent expenditure of a PPP project are government appropriations, user fees, depreciation and other tax credits. For example, the Union Station in Washington DC uses retail rents to pay for the operation of the facility and debt maintenance.

5.6.3 In the event that there is a transfer of ownership of government assets, such as land, to a private sector entity, relevant legislation or an Executive Order is required to define the transfer price distribution and recoupment priorities. In general, the government has no role in the financial support, management or oversight of the asset after it is transferred. However, if the asset is transferred to a private sector entity in an industry with monopolistic characteristics, the government may regulate certain aspects of the business, such as utility rates.

5.7 Performance monitoring and contract enforcement

5.7.1 PPP contracts are written with strict performance criteria for cost, quality, compliance and customer service. In this connection, a procuring authority should closely monitor the performance of a private sector entity to ensure that work is carried out as stipulated in the contract. The procuring authority can make use of periodic reports, reviews and audits as well as the number of complaints handled to monitor the performance of the PPP project.

Contractor reports

5.7.2 A contractor report details the extent of a project delivered, benchmarks the work with its output requirements, provides information on expenditures, and presents problems encountered and any necessary contract adjustments.

Reviews and audits

5.7.3 Reviews and audits involve inspections of a public facility or records of a private partner. Some projects such as the maintenance of a public facility requires spot checks, while other projects such as the collection of fees and charges require financial audits.

Complaints

5.7.4 In some cases, a procuring authority handles complaints directly. In other cases, a private partner handles complaints and summarizes them in a contractor report. Under the latter circumstance, the procuring authority should conduct customer satisfaction surveys to check the performance of the PPP project.

5.7.5 Most PPP contracts include penalties in the form of reimbursement reductions in the event that a private partner is not in compliance with the requirements. Most states require the private partner to submit a corrective action plan within 30 to 60 days if an audit reveals deficiencies**.** If the private partner fails to submit the corrective action plan on time, 10% of each subsequent monthly payment is withheld until the plan is submitted. Further penalties may accrue when the private partner fails to correct deficiencies within the corrective action period. The amount is 15% in the first month with an additional 10% for each month the deficiencies persist[41].

5.7.6 The procuring authority may adopt one or more of the following alternatives to prevent or reduce service disruption in the event that a private partner fails to deliver:

(a) negotiating a contingency contract during the procurement exercise: this contract binds a second contractor to deliver in the event that the primary contractor cannot or does not perform;

(b) placing a partial contract with existing contractors: if a service is delivered according to geographic locations, and different contractors are employed, failure of one contractor can be met by extension of service of contractors in other locations; or

(c) sharing the delivery of service between a procuring authority and a private partner: this alternative is similar to partial contracting, except that some portion of the service is delivered by the procuring authority. In this connection, the procuring authority maintains in-house expertise and does not become overly dependent on the private partner for service delivery.

[41] US Department of Health and Human Services, Office of Child Support Enforcement. (1997) *A Guide to Developing Public Private Partnerships in Child Support Enforcement*. Available from: http://www.acf.dhhs.gov/programs/cse/rpt/pvt/ch7.htm [Accessed 24 March 2004].

5.8 Checks and balances of regulation of public private partnerships

5.8.1 A private sector entity involved in PPPs has to bear a very high level of public accountability. It must answer to the procuring authority, various regulators, congressional oversight committees, the media, and the general public.

5.8.2 In the US, maintaining confidence of the public is the prime concern of governments at all levels. Nothing will erode that confidence more quickly than deterioration in public service delivery. Therefore, all levels of governments have a vested interest in ensuring the performance of their private partners. The private partners also have a strong interest in preserving the confidence of the procuring authority as well as protecting their reputations.

5.9 Role of the legislature in monitoring the delivery of public facilities and services under public private partnerships

5.9.1 In the US, a policy initiative is established by legislation, and the way the initiative is carried out depends on factors such as efficiency level, cost effectiveness, accountability and political considerations. Accordingly, the legislatures at all levels have responsibilities to scrutinize the policy initiative and its financial arrangements, no matter whether it is implemented through PPPs.

5.9.2 Another way the legislatures can monitor the delivery of public facilities and services is through the budgeting process, in which the legislatures are involved in resources allocation as well as policy formulation and evaluation.

5.9.3 The state legislatures have unlimited power to change the budget proposed by the executive branch in all states except three. Maryland, Nebraska and West Virginia limit the power of the legislature to increase or decrease budget items. The Maryland Legislature may decrease but not increase appropriations proposed by the executive branch. It may not reallocate funds among programmes as well. For the Nebraska Legislature, a three-fifths vote is required to increase the governor's recommended appropriations, but a majority vote is required to reject or decrease them. In West Virginia, the Legislature may not delete any item within the budget.

5.9.4 The state legislatures can also give the secretary concerned the obligation of administering the cap on the amount of private activity bonds, a means of financing for PPPs, as well as issuing guidelines for doing so.

5.9.5 Although a budget becomes effective after legislative enactment and executive approval, many states allow revisions to be made in their budgets without the involvement of the entire legislature. As most of the state legislatures are not in session throughout the year and some legislatures meet only for a few months every other year, requiring legislative consent for every change in a budget would impose delays to the implementation of a programme. In this connection, many legislatures make supplemental appropriations for current-year budgets, depending on needs that develop in the course of the fiscal year. About half of the states have procedures to address such funding needs when the legislature is not in session. These states can make open-ended or "sum-sufficient" appropriations, which fund regular or formula-driven obligations such as contributions to state retirement funds or foundation aid to schools.[42]

5.10 Incentives for innovation

5.10.1 The federal government encourages private participation in the delivery of public facilities and services through the provision of financial incentives as stipulated in the legislation. For example, the Safe, Accountable, Flexible and Efficient Transportation Equity Act of 2003 makes some provisions on innovative financing. The Safe, Accountable, Flexible and Efficient Transportation Equity Act of 2003:

(a) allows both the state and local governments to issue tax-exempt private activity bonds to finance eligible highway projects;

(b) increases accessibility of more highway projects to financing by reducing the project threshold of the Transportation Infrastructure Finance and Innovation Act 1998 programme[43] from US$100 million (HK$788 million)[44] to US$50 million (HK$389 million);

(c) permits states to establish user charges on federal-aid highways, provided that the funds are re-invested in the facility and the charges are established as part of the programme to manage congestion or improve air quality; and

(d) allows the introduction of a variable toll pricing programme for alleviating congestion and reducing emissions.

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42 National Conference of State Legislatures. (2004) *Legislative Budget Procedures: A Guide to Appropriations and Budget Processes in the States, Commonwealths and Territories*. Available from: http://www.ncsl.org/programs/fiscal/lbp98sum.htm [Accessed 7 April 2004].

43 The Transportation Infrastructure Finance and Innovation Act programme provides secured loans, loan guarantees, and lines of credit from the federal government for surface transportation infrastructure projects of national or regional significance.

44 The average exchange rate of US Dollar to Hong Kong Dollar for 2003 was US$1=HK$7.787. Source: *Government of the Hong Kong Special Administrative Region, Census and Statistics Department.* (2004) Available from: http://www.info.gov.hk/censtatd/eng/hkstat/fas/money_finance/exrate_std_index.html [Accessed 4 May 2004].

5.10.2 Government agencies or state governments may provide financial incentives for meeting the requirements of a contract. For example, the US Department of Education contracts with 17 collection agencies to bring in money from delinquent school loans. The private contractors get a flat fee of 27% of every loan they recover.[45]

5.10.3 In some cases, such as the first US transcontinental railroad, the federal government granted lands to a private sector entity for residential and/or commercial development. Congress chartered the creation of a private company. The private company then issued stock to raise the capital required for construction of the railways. When the project was completed, federal lands adjacent to the tracks were granted to the private company for private development, enlarging the financial base which provided a better return to investors.

[45] National Council for Public Private Partnerships. (2002) *For the Good of the People: Using Public Private Partnerships to Meet America's Essential Needs.* Available from: http://www.ncppp.org/presskit/ncpppwhitepaper.pdf [Accessed 6 April 2004].

Chapter 6 – New Zealand

6.1 Background

6.1.1 In New Zealand, there had been no formal PPP policy for the public infrastructure until the current government took office in 1999. The main reasons were that the public sector infrastructure investment programme had been modest and the need for access to private capital had been limited prior to 1999.

6.1.2 In 2002, the government enacted the Local Government Act. The Local Government Act requires individual local councils, which are the local administrative and legislative bodies[46] comprising a mayor and elected councillors, to adopt a policy on PPPs to promote or achieve their priorities and desired outcomes, and make efficient use of their resources. As a result, the local councils have included the policy in their long-term council community plans. In accordance with the Local Government Act, the PPP policy will be reviewed three years after its implementation.

6.2 Policy on public private partnerships

6.2.1 According to the PPP policy for the local councils, a PPP for a public works project should:

(a) go through a competitive tendering process[47], with an emphasis on transparency and disclosure of the process and outcomes, acknowledging the need to protect commercial confidentiality where appropriate;
(b) be assessed against the public interest in terms of effectiveness, accountability and transparency, together with the need to ensure equity for disadvantaged groups, access by the public, and compliance with consumer laws as well as privacy rights;
(c) specify measurable performance standards;
(d) allocate risk between partners, with consequential financial effect;
(e) monitor output by both the public and private partners;
(f) include a mechanism for delivering ongoing value-for-money; and
(g) define rules for withdrawal from a partnership.

[46] The role and functions of a local council include: (a) setting strategic policy directions; (b) preparing annual plans, budgets, financial strategies, polices and plans; (c) acting on behalf of the central government; and (d) overseeing the delivery of services.

[47] A procuring department must notify the Industry Capability Network, a database maintained by the New Zealand Trade and Enterprise, of its intention to procure public facilities or services over NZ$50,000 (HK$245,000). In addition, all public calls for tendering or registration of interest are required to be listed in the Government Electronic Tenders Service. The Government Electronic Tenders Service is an online Industry Capability Network service to New Zealand and Australian businesses and regional economic development agencies. It informs them of opportunities to bid for, or register interest in, supply to government agencies in New Zealand and Australia.

6.3 Responsible authority

6.3.1 Unlike the UK and the US, there is no specific authority responsible for the promotion of PPPs.

6.4 Public consultation

6.4.1 Before a final decision is made to commit funding or other resources to a PPP project, a local council should consult key stakeholders and the public. Depending on the circumstances, this may take the form of telephone surveys, focus groups, public meetings, questionnaires to ratepayers and feedback opportunities on the Council's web site.

6.4.2 Information provided to the public to enhance their understanding of the proposed PPP project includes:

(a) objective of the proposed PPP project;
(b) outcomes to be achieved;
(c) private sector entity involved;
(d) financial arrangements for the partnership;
(e) risk sharing arrangements that are involved; and
(f) term of the PPP project.

6.5 Financial arrangements

6.5.1 Provision of local council resources to a PPP project is generally in the form of an investment, loan or loan guarantee. As a condition of providing funding or other resources to a PPP project, a local council requires a private sector entity to enter into a written agreement recording the terms of the arrangement, and stating clearly:

(a) objectives of the PPP project;
(b) responsibilities and obligations of all partners;
(c) details of the agreement of both the council and the private sector entity to provide funding or other resources to the PPP project;
(d) expectations of the local council in relation to the specified outcomes as well as the target performance measures;
(e) requirements of the local council in relation to monitoring and reporting of performance; and
(f) consequences of non-performance by the private partner.

6.6 Performance monitoring and contract enforcement

6.6.1 PPPs established for local facilities and services are overseen by individual local councils. The local council assesses, monitors and reports on the progress of the project. Reporting on the progress of the project is through reporting on the implementation of the long-term community plan of the local council.

6.7 Role of the local council in monitoring the delivery of public facilities and services under public private partnerships

6.7.1 In New Zealand, the local councils are accountable for their plans and programmes. Under the Local Government Act, the local councils are subject to planning and management disciplines including:

(a) preparing annual plans and budgets in consultation with their communities;

(b) reporting annually on performance in relation to plans; and

(c) preparing long-term financial strategies including funding, borrowing management and investment policies.

6.7.2 In this connection, a local council can form PPPs as long as such exercise is deemed to be of benefit to the community. It can also determine the nature and scope of any commitment of resources to a PPP project.

Chapter 7 - Analysis

7.1 Introduction

7.1.1 This analysis looks into the extent of control of a PPP project by both governments and legislatures in respect of the performance and financial arrangements. The transparency of the selection of a PPP partner, public consultation exercise and treatment of an unsolicited proposal are discussed. Incentive plans to encourage innovation as well as private participation in the delivery of public facilities and services are also examined.

7.2 Extent of control by the government

Performance

7.2.1 In both the UK and the US, a procuring authority is accountable for the performance of a PPP project. In this connection, the procuring authority is responsible for establishing performance standards for the project and ensuring that the output meets the established standards. If a private partner does not perform up to standard, the procuring authority can either withhold or reduce payments to the private partner. If the private partner continues to fail to perform, the procuring authority can take over the project or engage another private sector entity to deliver the project.

7.2.2 In the UK, the procuring authority may retain the right to take over the operation of a facility or service if the procuring authority determines that the health or the safety of the public is jeopardized.

7.2.3 In New Zealand, a local council, which is also a procuring authority, is responsible for assessing and monitoring the performance of a PPP project, and reporting the progress in its long-term council community plans which are available to the public.

7.2.4 In Hong Kong, a procuring authority monitors the performance of a PPP project through an in-house team, the Intelligent Client Team. To ensure that the performance is up to standard or to provide insurance for sub-standard performance, the procuring authority may request a private partner to provide performance bonds, bank or parent company guarantees or warrantees with subcontractors, and a liquidated damages clause in the contract. The procuring authority may also reduce payments to the private partner in case of poor performance or terminate the contract if the private partner continues to fail to perform. The procuring authority may proceed with legal action to recover from the private partner the costs incurred in rectifying defects, maintenance and management of a facility. As Hong Kong is at a relatively early stage in implementing PPPs, there has not been any study showing the effectiveness of the monitoring mechanism of a PPP project adopted by the Government.

Financial arrangements

7.2.5 In the three places under study, only the UK government has control on the allocation of public resources for a PPP project. In the US, the state legislatures have control on such arrangements. In New Zealand, a local council, which is also a procuring authority, controls the provision of public resources for a PPP project.

7.2.6 In the UK, a PPP project requiring financial support from the government must first seek approval from the sponsoring department. If the sponsoring department confirms that the Outline Business Case meets the criteria of achieving value-for-money, capital finance regulations, national policy objectives and project assessment considerations of PRG (an interdepartmental review group established under HM Treasury), it will submit the case to PRG. If PRG confirms that the project is value-for-money, financial support will be given. For PPP projects which are financially free-standing, no scrutiny by PRG is required.

7.2.7 In Hong Kong, if a PPP project requires financial support from the Government, the procuring authority must bid for funds through the Resource Allocation Exercise. Upon obtaining approval from the Policy Committee or the Executive Council, the procuring authority should consult the relevant LegCo Panel on the proposed project. Thereafter, the procuring authority should submit the proposal to PWSC, and then to FC for funding approval. In this connection, a PPP project requiring financial support from the Government must seek the approval of both the Government and LegCo.

7.2.8 If other forms of government support, land in particular, are required for a PPP project in Hong Kong, the Government would ensure their availability before commencement of the procurement process. In the event that the PPP project requires re-zoning of land, approval from the Town Planning Board must be sought.

7.3 Extent of control by the legislature

Policy on public private partnerships

7.3.1 In both the US and New Zealand, policy initiatives are established by legislation. In this connection, all policy initiatives are presented to the respective legislatures for detailed scrutiny.

7.3.2 In the UK, PAC, appointed by the House of Commons, examines the accounts of selected PPP projects, scrutinizes PPP policies and activities, and makes recommendations on the policies.

7.3.3 In Hong Kong, LegCo is informed of the policy on private sector participation, including PPPs, in the Policy Address by the Chief Executive and the Budget Speeches by the Financial Secretaries. Despite the fact that there have been discussions on the various features of PPPs by the relevant LegCo Panels, such as the HA Panel and the PLW Panel, no thorough discussion has taken place in LegCo on the general policy issues relating to PPP as a mode of government procurement.

Performance

7.3.4 In the UK, a procuring authority is accountable for the performance of a PPP project, of which the responsibilities are overseen by Parliament.

7.3.5 In the US, the state legislatures monitor the delivery of public facilities and services through their budgeting process, in which the efficiency and effectiveness of a policy and its related programmes, including PPPs, are evaluated.

7.3.6 In New Zealand, the local councils report the progress of all PPP projects annually on their long-term community plans, which are made available to the public.

7.3.7 In Hong Kong, although a financially free-standing project does not require formal legislative or financial approval from LegCo, a procuring authority usually reports to the relevant Panels on its establishment and progress and seeks support from LegCo as most PPP projects are lengthy and of relatively high value. This practice is in line with policies on accountability and transparency.

Financial arrangements

7.3.8 In the three overseas places under study, the legislature plays a significant role in the allocation of public resources for PPP projects which require government support.

7.3.9 In the UK, guidelines are produced by Partnerships UK to ensure that Parliament is fully informed of the extent of existing and forthcoming PPP commitments, the payment mechanism, any changes to service clauses, the termination arrangements and contingent liabilities. Such information is provided by HM Treasury to Parliament twice a year. A copy of specific PPP model agreements is deposited in the Parliamentary Libraries for public reference.

7.3.10 In the US, the state legislatures have full control on allocation of resources for PPP projects because public financing of projects requires the enactment of a law, which defines the upper limit of the amount of funds available to a procuring authority. In some cases, a special budget authority is established for approving the funds in accordance with the provisions of the legislation. In other cases, further enactment of an appropriation act is required. In addition, the state legislatures can control resources allocation for PPP projects through their budgeting process. Procedures are in place to address various funding needs when the legislatures are not in session.

7.3.11 In New Zealand, the local councils develop annual plans and budgets for their respective communities. In this connection, they determine the scope of commitment of resources to PPP projects.

7.3.12 In Hong Kong, if a PPP project requires financial support from the Government, a procuring authority must submit via its policy bureau a bid for funds through the Resource Allocation Exercise. The procuring authority must seek the approval of FC for funding of a facility. However, if the PPP project is financially free-standing, it is not subject to the scrutiny of PWSC and FC. For example, no funding proposals in relation to the Tung Chung Cable Car project and the heritage buildings preservation project have been submitted to PWSC and FC for approval.

7.4 Transparency

Selection of a Public Private Partnership partner

7.4.1 In the three overseas places under study, all PPP opportunities are communicated to the public through either advertising in relevant publications or pre-bid conferences. Output requirements are listed to assist interested parties in putting in their bids.

7.4.2 In the UK, a procuring authority advertises a PPP project in the Official Journal of the European Communities and other relevant government publications. It also conducts industry briefings to provide potential bidders with further information to assist them in submitting their bids for the project. The procuring authority also prepares a Statement of Requirement listing all output requirements and provides a detailed Public Sector Comparator to short-listed bidders to enable them understand details of the project. Once a contract is awarded, the procuring authority must publicize the result in the Official Journal of the European Communities and other relevant government publications. The procuring authority also debriefs unsuccessful bidders.

7.4.3 In the US, a procuring authority sends a draft RFP to interested parties and holds pre-bid conferences to solicit input when it is planning for a PPP project. Through both channels, concerns of stakeholders are addressed while objectives of the project are communicated to the public. The draft RFP also stipulates the evaluation and contract award process for the project.

7.4.4 In New Zealand, the policy on PPPs stipulates that a PPP for public works projects should go through a competitive tendering process, with an emphasis on transparency and disclosure of the process and outcomes.

7.4.5 In Hong Kong, the *Introductory Guide* stipulates that the Government should publish notices of PPP opportunities in newspapers and *Gazette*, and on Internet inviting interested parties to submit proposals. Alternatively, the Government may invite pre-qualified or short-listed private entities identified in the Expression of Interest exercise to submit proposals. Based upon the *Introductory Guide*, the procuring authority should establish clear selection and assessment criteria and procedural guidelines to reduce corruption risk.

Public consultation

7.4.6 In all the places under study, the governments conduct public consultation before the commencement of a procurement process.

7.4.7 In the UK, the Audit Commission provides guidance on public consultation as regards government projects, including PPP projects.

7.4.8 In some US states, legislation mandates public involvement in the departmental process on a PPP project, while other states consult their communities on a particular development project as well as design guidelines. A procuring authority is required to inform the public of pending PPP projects through public notices, and obtain input from the community through public hearings.

7.4.9 In New Zealand, the local council is required to consult stakeholders and the public on the PPP project it proposes. The local council should provide the public with information on the objective, outcomes, financial arrangements, the term of the contract and the private sector entity involved.

7.4.10 In Hong Kong, the *Introductory Guide* stipulates that a procuring authority should explain the project to interested and affected parties. Consultation should also be conducted amongst District Councils, statutory and non-statutory bodies.

Treatment of an unsolicited proposal

7.4.11 Based on the value-for-money principle, most unsolicited PPP proposals in the UK and the US are publicized so as to allow interested parties to put in their bids. The two governments have adopted measures to ensure that intellectual property is not jeopardized, especially if the unsolicited proposal is unique and of outstanding value, so that future innovation initiatives will not be discouraged.

7.4.12 In the UK, a procuring authority may invite an unsolicited proponent to participate in an early design contest, or advertise the requirements of a potential PPP project and encourage the unsolicited proponent to bid, or use single tender action in the event that the unsolicited proposal is unique. The procuring authority may also allow a small business proponent to secure licensing rights from or share in intellectual property right with other providers.

7.4.13 In the US, if a procuring authority accepts an unsolicited proposal for conceptual-phase consideration, it is required to publicize the case on its procurement web site, and in public areas and relevant publications for at least 45 days so that potential competitors can prepare proposals.

7.4.14 In Hong Kong, the *Introductory Guide* stipulates that unsolicited proposals should go through a competitive bidding process to demonstrate value-for-money and to guarantee probity. In the event that the intellectual property in the proposal is of such a novelty value that a competitive market for the service does not exist, the *Introductory Guide* states that the Government may grant a private sector entity an exclusive mandate to fully develop a project.

7.5 Incentives for innovation and participation in Public Private Partnership projects

7.5.1 In the UK, OGC publishes guidelines on capturing innovation from the private sector to enhance efficiency and cost-effectiveness in delivering public facilities and services. The guidelines recommend that the government should improve communications with private sector entities so that they can help shape output requirements, provide feedback on feasibility and affordability, and gear up to be able to respond to future procurements. The government is also advised to organize design contests to secure new design and ideas. OGC recommends a procuring authority to develop measures to safeguard intellectual property of any unsolicited proposals so that future innovation initiatives will not be discouraged.

7.5.2 In the US, governments of all levels encourage PPPs for the delivery of public facilities and services through the enactment of laws. Some governments provide financial incentives, such as tax-exemption for issuance of private activity bonds, reduction in the threshold of capital financing, and permission for the establishment of user charges. Some governments also grant lands to a private sector entity for residential and/or commercial development.

7.5.3 In Hong Kong, there is no specific policy on the encouragement of innovation from the private sector. There is also no incentive programme similar to those in the US for PPPs. Nonetheless, the Government has conducted concept competition to capture new design and ideas for some large developments, for example, the southern tip of the West Kowloon Reclamation. However, there is no conspicuous linkage between winning a competition and obtaining the eventual development right of the project.

Appendix I

Types of Public Private Partnerships

A.I.1 According to the information shown on the web site of the US Government Accounting Office, a PPP can be established in the following forms, namely:

Build-Develop-Operate

A.I.2 A private sector entity leases or buys an existing facility from a public agency, invests its own capital to renovate, modernize or expand the facility and then operates it under a contract with the public agency.

Build-Operate-Transfer / Build-Transfer-Operate

A.I.3 A private sector entity builds a facility to the specifications as required by a public agency, operates the facility for a specified time period under a contract or franchise agreement with the public agency, and transfers it to the public agency at the end of the specified period. The private sector entity usually provides all or part of the financing, and the contract is structured to be of sufficient length to enable the private sector entity to realize a reasonable profit.

A.I.4 The Build-Operate-Transfer approach is often appealing to a host government because it allows the government to:

(a) minimize its capital costs under a limited budget;
(b) take advantage of operational efficiencies regularly associated with private sector participation; and
(c) encourage outside investment and introduce new or improved technology.

A.I.5 The Build-Transfer-Operate model is similar to the Build-Operate-Transfer model except that the transfer of the facility to the public agency takes place at the time that construction is completed, instead of at the end of the franchise period.

Build-Own-Operate

A.I.6 A private sector entity constructs and operates a facility for performing public services without transferring ownership of the facility to a public agency. This type of arrangement works well when there is a strong and ongoing market for a service. Some private sector entities prefer the absence of a transfer component so that they can maximize their return on investment.

Appendix I (cont'd)

Buy-Build-Operate

A.I.7 This arrangement is a form of asset sale that includes the rehabilitation or expansion of an existing facility. A public agency sells the asset to a private sector entity, which makes the improvements necessary to operate the facility in a more cost-effective manner.

Design-Build

A.I.8 A private sector entity designs and builds a public facility for a public agency. The public agency owns the assets and has the responsibility for the operation and maintenance. A simple design-build approach creates a single point of responsibility for design and construction, which can speed up delivery of the project.

Design-Build-Finance-Operate

A.I.9 The Design-Build-Finance-Operate model is also known as the Private Finance Initiative in the UK. A private sector entity designs, builds and finances the project. Public sector staff may be transferred to the private sector entity to deliver the service. The public agency has to pay an annual fee to the private sector entity under a long-term operating contract for the service.

Design-Build-Maintain

A.I.10 Design-Build-Maintain is similar to Design-Build except that the maintenance of a facility becomes the responsibility of the private sector entity.

Design-Build-Operate

A.I.11 While a public agency maintains the title and provides the recurrent financing of a project, a private sector entity is engaged for the design, construction and operation of the project. The Design-Build-Operate approach allows continuity of the private sector involvement. It also facilitates private sector financing in the form of user fees. Design-Build-Operate is one of the more popular PPP approaches for the delivery of water and sewage treatment system in the US.

Appendix I (cont'd)

Developer Finance

A.I.12 A private sector entity finances the construction or expansion of a public facility in exchange for the right to build residential housing, commercial stores, and/or industrial facilities at the site. The private sector entity contributes capital and operates the facilities under the oversight of the government, while gaining the right to use the facilities and receiving income from user fees.

Operations, Maintenance and Management Services Contract

A.I.13 A public agency retains the greatest degree of control over its services and facilities when a private sector entity participates through a service contract. In general, the longer the contract term, the greater the opportunity for increased private investment because more time is available for the private sector entity to earn a profit. Through competitive bidding of the contract, the public can benefit from reduction in delivery costs and improved service quality.

Tax-exempt Lease

A.I.14 A public agency finances its capital assets or facilities by borrowing funds from a private sector entity or a financial institution. The private sector entity acquires title to the asset, but then transfers it to the public agency either at the beginning or end of the lease term. The portion of the lease payment used to pay interest on the capital investment is tax-exempt in the US.

Turnkey Transaction

A.I.15 A public agency enters into a contract with a private sector entity for the design and construction of a facility in accordance with specified performance standards and criteria. The private sector entity commits to build the facility for a fixed price and absorbs the construction risk of meeting that price commitment. Financing and ownership of the facility rest with either the public agency or the private sector entity.

Appendix II

Funding arrangements and involvement of the Legislative Council in the Tourism-related Projects and the Tung Chung Cable Car Project

Tourism-related Projects

Former Marine Police Headquarters

A.II.1 The renovation of the former Marine Police Headquarters is the first project to engage the private sector in preserving and developing buildings of historic significance into a heritage tourism facility. The project was awarded to Flying Snow Limited in May 2003 on a 50-year land grant. The Government had briefed the Panel on Economic Services regarding the project before putting it out to tender. As the project does not require Government funding, no proposal has been submitted to PWSC and FC of LegCo.

Central Police Station, Victoria Prison and the former Central Magistracy

A.II.2 The Central Police Station, Victoria Prison and the former Central Magistracy are other heritage tourism attractions that the Government has decided to involve the private sector to preserve, restore and develop as one project. The Government plans to put the project out to tender in 2004. The successful proponent will be granted a 50-year land lease. The Government has again briefed the Panel on Economic Services on the project. As this project does not require Government funding, no proposal has been submitted to PWSC and FC of LegCo.

Tung Chung Cable Car Project

A.II.3 The Tung Chung Cable Car Project is a 30-year franchise granted to the MTR Corporation Limited (MTRCL) in 2002 for the finance, design, construction, operation and maintenance of the cable car system on a Build-Operate-Transfer basis.

A.II.4 Based on an implementation framework approved by the Executive Council, the Government issued a Project Brief to invite detailed proposals for the project in 2001. The Government received three proposals and then short-listed two proponents, including MTRCL, for further negotiations in January 2002.

Appendix II (cont'd)

A.II.5 In July 2002, the Government entered into a Provisional Agreement with MTRCL. The Provisional Agreement provides the basis for MTRCL to commence work on the project before the Government grants the franchise to the company. The preliminary work performed by MTRCL under the Provisional Agreement includes developing a suitable design for the Tung Chung cable car system and its ancillary developments, carrying out requisite environmental and technical studies, and completing the necessary statutory procedures.

A.II.6 The Tung Chung Cable Car Bill was introduced into LegCo on 12 February 2003. The Bill was to provide a legal framework for the grant of the franchise. The Bill also set out the rights and obligations of the franchisee during the franchise period. The Bill was enacted on 28 May 2003.

A.II.7 The detailed provisions relating to the construction and operation of the cable car system are governed by a Project Agreement signed between MTRCL and the Government on 19 November 2003.

A.II.8 The Panel on Economic Services was consulted on the project a few times between February 2001 and July 2002, and was briefed on the Bill on 25 November 2002. As the construction of the cable car system and the related developments did not require Government funding, no funding proposal for the purpose was submitted to PWSC and FC of LegCo. Nonetheless, to support the cable car system and related developments in Ngong Ping, FC, on the recommendation of PWSC, approved in April 2003 a commitment of HK$235.3 million for the construction of various infrastructure facilities.

Sources: Economic Development and Labour Bureau, Tourism Commission. (2002) *Legislative Council Brief: Tung Chung Cable Car Project*.
Economic Development and Labour Bureau. (2003) *Legislative Council Brief: Central Police Station, Victoria Prison and the Former Central Magistracy - A Heritage and Tourism Concept*. LC Paper No. CB(1)1495/02-03(01).
Legislative Council Secretariat. (2004) *Paper for Panel on Planning, Lands and Works and Panel on Home Affairs*. LC Paper No. LS47/03-04.

Appendix III

Funding arrangements and involvement of the Legislative Council in the Cyberport Project

A.III.1 The Cyberport project, comprising a Cyberport Portion and an ancillary Residential Portion, was undertaken by the Government in co-operation with the Pacific Century Group in 1999. The Cyberport Portion aims to create a strategic cluster of leading information technology and information services companies and a group of professional information technology / information services talents in Hong Kong while the Residential Portion aims to generate revenue to support the project.

A.III.2 Under the relevant Project Agreement, the developer, the Pacific Century Group, is responsible for the provision and procurement of funds to meet all project expenses. The Government's capital contribution is the value of the land for the Residential Portion at the time of grant of development right to the developer. The developer is required to hand back to the Government, through a company set up for the purpose, the completed Cyberport Portion and to sell the units in the Residential Portion in the open market. The developer is entitled to receive a share of the surplus sales proceeds to be derived from the sale of the residential units. The rental income and any other income to be generated from the Cyberport Portion belong to the Government.

A.III.3 The relevant Panels of LegCo had been consulted on the Cyberport development before the Government signed the Project Agreement with the developer. No funding proposal in respect of the design and construction of the Cyberport development was submitted to PWSC and FC of LegCo for approval. However, for the construction of roads, drains, waterworks and other essential infrastructure to support the Cyberport developments, funds from CWRF of HK$964 million and HK$231.8 million were obtained in May 1999 and May 2000 respectively, after going through LegCo with approval by FC.

Sources: Legislative Council Secretariat. (2003) *Cyberport*. Background brief submitted to the Panel on Information Technology and Broadcasting. LC Paper No. CB(1)2214/02-03(02).
Legislative Council Secretariat. (2004) *Paper for the Panel on Planning, Lands and Works and the Panel on Home Affairs*. LC Paper No. LS47/03-04.

Appendix IV

Funding arrangements and involvement of the Legislative Council in the Asia World-Expo Project

A.IV.1 The Asia World-Expo (AWE, formerly known as the International Exhibition Centre), situated at the Hong Kong International Airport, is jointly financed and owned by three entities, namely the Government, the Airport Authority (AA) and a private sector consortium.[48] While the Government and the private sector consortium pay for the construction costs, AA provides the land for the venue. The private sector consortium is also responsible for the design, construction, management and operation of AWE.

A.IV.2 Phase one of AWE will provide 66 000 sq m of exhibition space and will be completed for full operation in the first quarter of 2006. AWE can be further expanded to 100 000 sq m of exhibition space in response to market demand. Soft opening of AWE is scheduled for the end of 2005.

A.IV.3 The construction cost of the first phase is estimated to be some HK$2.3 billion. While the Government will fund 85% of the total construction cost up to HK$2 billion, the private sector consortium will fund the remaining 15%.

A.IV.4 In November 2001, the Panel on Commerce and Industry (C&I Panel) endorsed the proposal to establish a new international exhibition centre at Chek Lap Kok. At a FC meeting held in December 2001, Members enquired on some aspects of the project, and the Government addressed concerns of the Members in January 2002. In April 2002, the Government reported to the C&I Panel on an international road show of meetings conducted with key exhibition centre operators in the first quarter of 2002. In July of the same year, the Government and AA invited expression of interest from the private sector for this project. More than 10 submissions were received. At the meeting of the C&I Panel held on 9 December 2002, Members supported the AWE project. On 20 December 2002, FC approved a commitment to inject HK$2 billion from the Capital Investment Fund to partly finance the construction cost of AWE. On 28 February 2003, the Government and AA invited tenders for the project. On 23 August 2003, the Government, AA and the private sector consortium entered into a joint venture agreement for the design, construction and operation of AWE. On 12 July 2004, the C&I Panel met with the Government and deputations to discuss the role of parties involved in the operation of AWE.

[48] The private sector consortium consists of three entities, namely Dragages Hong Kong Limited, Yu Ming Investments Limited and Yu Ming Investment Management Limited.

Appendix IV (cont'd)

Sources: *Minutes of Meeting of the Panel on Commerce and Industry of the Legislative Council*. (2004) 12 July. LC Paper No. CB(1)2489/03-04.

Legislative Council Secretariat. (2004) *Updated Information Note on the Asia World-Expo.* Paper for the Panel on Commerce and Industry. LC Paper No. CB(1)2334/03-04.

Commerce, Industry and Technology Bureau / Invest Hong Kong. (2003) *International Exhibition Centre at the Hong Kong International Airport*. Paper submitted to the Panel on Commerce and Industry of the Legislative Council in August 2003. LC Paper No. CB(1)2372/02-03(01).

Commerce, Industry and Technology Bureau / Invest Hong Kong. (2002) *Proposed International Exhibition Centre at Chek Lap Kok*. Paper submitted to the Panel on Commerce and Industry of the Legislative Council in November 2002. LC Paper No. CB(1)426/02-03(03).

Appendix V

Involvement of the Legislative Council in the West Kowloon Cultural District

A.V.1 WKCD is a waterfront site of 40 hectares at the southern tip of the West Kowloon Reclamation (WKR).

A.V.2 In October 1998, the Chief Executive announced in his Policy Address that the Government was planning for a new, state-of-the-art performance venue on WKR. In November 1999, the Chief Executive in Council ordered that the use of the southern tip of WKR should be fundamentally reviewed to facilitate the development of a world-class integrated arts, cultural and entertainment district. The Government decided to hold an open concept competition to enlist the help of local and overseas professionals.

A.V.3 In November 1999, the Government briefed both the PLW Panel and the Panel on Home Affairs on the project. In December 1999, the Government issued a note to FC to explain its decision to review the land use of the southern portion of WKR and the deletion of part of a road and infrastructure works contract for that area.

A.V.4 On 9 March 2000, the Government briefed the PLW Panel on the holding of an open competition for WKR. There was no linkage between the competition and the eventual development right of the area, and the Government would not be bound in any way to develop WKR in accordance with the winning design. The Panel was advised that there were divided views among the development industry and relevant professionals on whether the development right of WKR should be granted to one developer.

A.V.5 In April 2001, the Government launched an open Concept Competition to invite conceptual plans for the development of WKCD, and received a total of 161 entries from local and overseas participants. The first prize was awarded to Foster and Partners (Foster scheme). The PLW Panel was informed of the outcome in April 2002.

A.V.6 In July 2003, the Government briefed the PLW Panel on its intention to issue an Invitation For Proposals for the development of WKCD. The Invitation For Proposals was launched in September 2003. The successful proponent will be required to plan, design, finance, construct, procure, fit out and complete WKCD and subsequently operate, maintain and manage the core art and cultural facilities for a period of 30 years. A land grant of the site for a term of 50 years in favour of the successful proponent will be executed at such time as the Government considers appropriate after the execution of the project agreement. Five submissions were received when the Invitation for Proposals for the development of WKCD closed on 19 June 2004.

Source: Legislative Council Secretariat. (2003) *West Kowloon Cultural District*. Background brief submitted to the Panel on Planning, Lands and Works and the Panel on Home Affairs. LC Paper No. CB(1)161/03-04.

Appendix VI

Summary of Findings Obtained and Lessons Learned from some Key PFI Projects in the United Kingdom

Listed below are a summary of findings and lessons learned relating to the management of some key PFI projects in the UK by PAC:

<u>Selection of a Public Private Partnership partner</u>

Procuring authorities may not follow guidelines and best practices

A.VI.1 Although there are guidelines for the management of PFI procurement, a procuring authority may not follow the guidelines. For example, it was observed that some PFI projects involved only one bidder. However, according to both the best practices and the guidelines, competition is essential to achieve value-for-money. As such, a procuring authority should survey the market to look for potential bidders. If too few bidders are interested in the proposal, which may be due to problems with the design of the project, the procuring authority should consider redesigning the project. In any event, a single preferred bidder should not be chosen prematurely or before outstanding issues have been resolved.

Complexity of financial modelling affects the accuracy of the Public Sector Comparator

A.VI.2 During the process of procurement, short-listed bidders are provided with a Public Sector Comparator listing both the technical characteristics and the estimated costs of other alternatives. Nonetheless, there is a concern on the accuracy of the Public Sector Comparator because of the complexity of financial modelling involved and the reliability of forecasting. Inaccuracy of the Public Sector Comparator may distort the results of the bidding.

<u>Financial arrangements</u>

Cash payment of PFI projects may be higher than that of conventionally-financed projects

A.VI.3 A procuring authority should assess a PFI project in the context of a wider options appraisal. Not requiring money up front to meet the initial capital costs as well as keeping debt off the public sector balance sheet create a strong incentive for the procuring authority to adopt the PFI approach. However, PAC found that in many PFI projects, the cash payments involved in financing the project thereafter were higher than those in an equivalent conventionally-financed project.

Appendix VI (cont'd)

Procuring authorities may plough on with poor deals

A.VI.4 According to PAC, a procuring authority should not stop the appraisal of alternative options to ensure value-for-money. The procuring authority should not plough on with a poor deal just because it has spent time and effort on the procurement exercise. It should be prepared to start the procurement again if an alternative solution may provide better value-for-money.

Breakdown of the costs of financing is unclear

A.VI.5 The costs of financing a project are essential components of a contract. However, PAC found that the breakdown of these costs were often unclear. A procuring authority should ensure the costs of private finance are transparent so that they can be compared to those of other financing options.

Procuring authorities do not set or adhere to the budget

A.VI.6 Owing to the complexity of a PFI project, a procuring authority should set a realistic budget, taking into account the costs of contract negotiation and administration. In particular, PAC found that in one PFI deal, the cost of procurement was eleven-fold of the initial budget. In the event when a procuring authority requires advisers to assist in assessing the PFI deal, it should ensure that reasonable budgets are set and adhere to. PAC found that in another PFI deal, the cost of legal advice was overrun from an initial estimate of £70,000 to £2.3 million.

<u>Contract enforcement</u>

Lack of a contract monitoring mechanism

A.VI.7 For a PFI project, an appropriate mechanism, such as benchmarking, market testing or open book accounting, should be in place to ensure that value-for-money is maintained over the lifetime of the project. According to PAC, only half of the projects surveyed had these mechanisms in place. Over one in five procuring authorities indicated that there was a decline in value-for-money in their PFI projects after they had entered into the agreement with the private partner, with high prices for additional services a key area of concern.

A.VI.8 PAC suggested that the provisions in long-term contracts should allow for flexibility in view of changing circumstances. Such changes include alterations in services covered by the original specification, introduction of new services, or amendments to performance measurement arrangements. As such, a procuring authority should ensure that changes in procedures are not abused as a covert means for private partners to increase profit margins.

Appendix VI (cont'd)

Procuring authorities may bail out their private partners due to the fear of costly litigation

A.VI.9 Although a procuring authority has the right to terminate a contract in the event that its private partner consistently fails to deliver services up to the standards originally specified, the procuring authority tends to bail out the private partner because of the fear of costly litigation and counter claims by the private partner.

Services provided by a private partner may not be up to the required standards

A.VI.10 Most contracts allow a procuring authority to withhold payments made to its private partner in the event that the latter fails to deliver the project on schedule or provide quality services as originally specified. PAC found that 58% of the procuring authorities conducting performance review made deductions from payments to PFI partners owing to this reason. This situation suggested that many procuring authorities were not receiving services which were up to standard. PAC explained that if bids were priced on the assumption that the actual performance would fall short of the specified level, the private partner might not have a strong incentive to perform as required.

Procuring authorities may not have any up-to-date contingency plans

A.VI.11 An essential public service needs to continue its operation even if a private partner fails to deliver. As such, a procuring authority should take into account the possible consequences and prepare a contingency plan in the event that the private partner fails to deliver. PAC found that in some PFI projects, the procuring authority did not have any up-to-date contingency plans, which put itself in a difficult position.

Insufficient training for staff managing PFI projects

A.VI.12 Effective management requires a thorough understanding of the project and the contractual arrangements, and an ability to build effective relationships with the private partner. However, PAC found that some procuring authorities provided little or no training on contract management for their staff. As a result, even when the right contractual framework was put in place, the procuring authority might not be able to optimize the benefits.

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