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10Questions:

PUBLIC-PRIVATE PARTNERSHIP OPPORTUNITIES IN THE US

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FW speaks with Teno A. West at Pannone Lopes Devereaux & West LLC about the benefits, trends and obstacles surrounding public-private partnerships (PPPs) in the US.

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FW: What is a public-private partnership in general? What marketplace trends and challenges caused PPPs to become popular in the US and internationally?

West: PPPs are contractual agreements between government agencies — in the US, a federal, state or local agency — and private entities. Here they work together to provide a government service, typically infrastructure-related utilities such as water, sewer and solid waste. But you see them in a lot of other areas also; for instance we're seeing them now in transportation, bridges, highways, light rail, even office buildings, city halls and stadiums. It is a model that sees private and public agencies working together to provide a public service which in the past was provided exclusively by the government. There is definitely an increase in PPPs in the infrastructure industry. In the current economic climate, there is even more of a push for private involvement in delivering these types of traditional public projects, because of the financial issues that local, state and federal governments are facing. The private sector takes some of the risk that traditionally the public had, and can undertake the project on a much more cost efficient basis. I think this trend will continue, although it's in its infancy in the US compared to other parts of the world.

FW: What are the major benefits of public-private partnerships?

West: The major benefit of a public-private partnership is in getting the private entities involved to deliver a product more efficiently, more cost effectively, and with improved service. The private entity has the expertise to provide the service; it is their focus, it is what they were created for – be it a water company, a solid waste company or a transportation company. PPPs also move us away from some of the traditional delivery models that we see in the US. Many of our public works and infrastructure projects are currently completed on a low bid basis; they are not negotiated deals. Public-private partnerships allow governments to get the best contractual arrangement and the best company or vendor to provide the service. They are not low bid arrangements, and they allow the government to get the best value.

FW: What types of projects can be done through public-private partnerships? Can you give an example of a large scale PPP that resulted in consumer satisfaction and/or one which addressed environmental concerns of the public?

West: In the past PPPs have concentrated on water, sewer and solid waste projects, as well as toll roads, light rail, bridges, city halls and other civic centres. But we are also seeing some emerging or advanced technologies, which lend themselves to the public-private partnership model. The private company takes much of the risk, since they are new technologies that have not seen widespread commercial use in the US. We have worked on a number of these projects, including one in Rockland County, in the Metropolitan New York area. It was the first public-private partnership waste water plant in the state, an advanced waste water treatment facility which actually treats the waste water to near drinking water standards. In structuring the deal as a negotiated PPP, you strive to achieve a win-win for both sides.

FW: What are the differences between a public-private partnership and the way public entities typically complete their public projects?

West: Most public works projects in the US are designed by the government and put out for bidding. The lowest responsible bidder is awarded the contract, then typically if there is an operational component, the facility will be operated by government employees. That is the traditional model. When you move into the public-private partnership arena, you move a dimension away from that model into one of best value procurement. Here you have a 'request for a proposal' process, and you may have a request for qualifications. Pre-qualified proposers are requested to submit proposals, and from these you select the most advantageous proposal and then negotiate a contract. That is very different from the traditional low bid approach, and in some US states it is still not widely accepted. If you look at the different procurement laws in these states, there are three or four different themes on a state to state basis. Some states have general legislation for alternative project delivery approaches. New York has general legislation for solid waste facilities that can be structured on a PPP procurement basis, but for waste water, for example, it is required to have special legislation enacted. Other states are similar; you need special legislation for each public-private partnership project. So you have to factor that into your project schedule. You need to be familiar with what is involved in actually developing a project in that state, right from the initial procurement all the way through to the end.

FW: Why and what types of project delivery methods are typically employed for public-private partnerships?

West: Traditionally, such public-private partnership projects are awarded on a structured 'design-build-operate', or 'design-build-operate-transfer', or 'design-build-operate-finance' basis. Whether you can have contracts awarded on such a procurement approach varies from state to state. More and more states allow it. You need to find out what procurement process you actually have to engage in, and how you get to that point. Mostly it comes down to a timing issue — how quickly can you move the procurement along based on your need to actually get the procurement under way in the first place? Is there a special law that needs to be enacted or not? Are there any special local requirements? You need to factor such considerations into the process.

FW: How is risk allocated in public-private partnerships?

West: Risk is always a big issue in public-private partnerships. You should not structure a deal that asks either party to take a risk it cannot manage. If the government is looking for the private entity to take a risk that should really be borne by the government, they should not shift that risk onto the private entity. If the private entity is not in a position to manage that risk, the result is that you will pay an insurance premium for a risk the government should have retained. The basic framework on setting up the risk structure is that the private entity takes the performance risk, the design and construction risk, the risk of completing the project on time, the risk of obtaining certain construction permits, and often sometimes operational permits. You may have them take certain financing risks if it is going to be a truly privately financed project. There is certain risk that the market is simply less willing to take, and this needs to be respected — for instance subsurface risk, the risk of the regulatory agencies, and so on. If the government wants the private entity to account for such risks, which sometimes they will do, it will come at a premium in the pricing.

FW: What types of financing mechanisms are available for public-private partnerships? Is there one that is more popular than another? How important is it to have legal counsel in preparing these mechanisms?

West: We are seeing more interest in private financing on traditional public projects, especially on a local level with water and sewer, and on large toll roads. A waste water project in California was privately financed within the last few years, but such projects are still few and far between. In the US, municipal bonds have traditionally financed public works projects and that is still the primary revenue source. There is interest out there in setting up more private investment in these projects, and in having the government truly partnering up with some equity interest in the project. This interest is based on the general financial conditions of the local governments and how they can attract more private investment. It is not something you typically see in the US at present. What is difficult in terms of true private investment is the sale: the concept of selling a public asset in the US is still in its infancy. Local governments and taxpayers struggle with that concept.

FW: What is the difference in rule-making for PPP across the globe? What is generally required? In the US, is there special state or local legislation generally required for public-private partnerships?

West: What someone in Europe would think of as privatisation is probably not the model we have in the US. It is not truly selling to a private company and it is not a complete private investment. A long term contract in the US is 20 years – not the 50 or 60 years that might be required for a full privatisation. Local governments still have an issue with letting go of a key infrastructure asset for that long. Taxpayers (or voters) also have an issue with this, as they enjoy having a sense of ownership of an asset, and some types of assets even more than others, such as water systems. There is a trend to try to shift away from that thinking, and we should see a more global privatisation structure in the US. In most states you would require some form of legislation to adopt these full privatisation structures. Current laws are designed to provide for what has been happening in the United States for the last 100 years, which is geared towards government owned and operated infrastructure.
To introduce a more creative form of public-private partnerships will take even more legislation in most states.

FW: What are the biggest obstacles to use of public-private partnerships?

West: The biggest obstacle to public-private partnerships is the loss of control; the idea of letting go of a public asset. How will this affect rates in the future? Will people be held hostage by a private owner? Currently the model is structured with a private entity designing, building, operating and managing the project, and performing a better service than has been provided in the past. But the government still owns the asset, and is very much involved in setting the rates associated with the asset. Moving from this model to a fuller privatisation model, where the private entity owns the asset and is separated from the government, is still some distance down the road.

FW: Will the need for public-private partnerships increase? Why? Will international companies doing work in partnership with the public sector become more common?

West: I think demand for public-private partnerships will be driven by necessity. The hybrid model of government ownership and private operation started off as a necessity, and then proved to be the best approach for delivering the service. I think the fuller public-private partnership model will eventually prove itself in the same way. A lot of international companies are coming into the US and bringing with them a more international privatisation approach. They continue to work to make the US a market where they can do business. The hybrid model will continue to grow and then we will eventually see, based on necessity, a shift to the fuller privatisation approach. This trend will take the involvement of international companies, and the expertise they have in providing such services to drive that model. ■