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P3s AND THE CANADIAN EXPERIENCE WITH
RISK MANAGEMENT
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RISK

P3s AND THE CANADIAN EXPERIENCES WITH RISK MANAGEMENT

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Canadian experience and expertise in Public-Private Partnerships (P3s) is growing and the world is taking notice. For example, two British Columbia P3s, the Canada Line rapid transit system and the Britannia Mine Water Treatment Plant, are receiving both national and international acclaim. Over the past 25 years, P3s have become a popular method for Canadian federal, provincial, and municipal infrastructure projects to be delivered. Recently, the P3 model has been adopted by various developed and developing countries, including the U.S.A., Spain, Korea, India, and Germany, who are seeking an alternative procurement model to meet modern public infrastructure demands. Increasingly,

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international P3 projects are seeking leadership from Canadian organizations with procurement, financing, legal, and technical expertise. The Canadian approach has been to build on the experiences in the UK, Europe, and Australia, and improve where possible.

I. P4: PRIMER ON PUBLIC PRIVATE PARTNERSHIPS

A P3 is a method for governments to deliver public service infrastructure projects through partnerships between the public and private sector, in which risk and responsibility are shared. The Canadian Council for Public Private Partnerships defines P3s as a “cooperative venture between the public and private sectors, built on the expertise of each partner that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards.”

A P3 involves a private party selected to design, build, finance, maintain, and sometimes operate, a public facility for the government. This usually involves a private party leasing or licensing assets from a public authority for an extended period and taking the responsibility for the infrastructure during the period. The newly built assets are returned to the public sector at the end of the term. P3s can yield attractive benefits by promoting effective value added risk allocation, on time and on budget project completion, economic growth, and improving operating efficiencies and safety measures. Governments can transfer certain risks to the private sector, where they are best managed.

Increasing the value for money proposition for infrastructure services is a major component of the P3 model advantage. By way of illustrated example, the Golden Ears Bridge in British Columbia was created to improve the movement of people and goods across the Fraser River. The value for money gained in the Golden Ears Bridge project includes \$6 million to \$10 million in savings to bridge users, \$3.6 billion in user benefits, and reduced revenue risk to the British Columbia government over the term of the concession with the pri-

ivate sector. The Golden Ears Bridge project was a fixed-price, performance-based contract with meaningful allocation of financial, design, construction, and maintenance risk to the private sector.

CANADIAN EXPERIENCES WITH P3S

Since 1992, all levels of Canadian governments have used P3s to deliver public services. In 2002, with the creation of Partnerships BC, British Columbia was a significant catalyst in leading the expanded utilization of the P3 model in Canada. Thereafter, alternative financing structures and new institutions sprang up across the country: Infrastructure Ontario in 2005, the Federal PPP Canada in 2009, Infrastructure Quebec in 2010, and Partnership New Brunswick in 2011. Although it did not create a separate P3 agency, the Alberta government has been an active proponent and user of the P3 model, particularly for transportation and school projects.

Federal, provincial, and municipal governments are making significant funding commitments to P3 projects. The P3 Canada Fund, a federal initiative to administer P3s, has been allocated \$1.26 billion for P3 projects in the 2012 federal Canadian budget. On the provincial level, Partnerships BC completed 12 projects between 2010 and 2011 in areas such as health, corrections, accommodation, and transportation. Since its inception in 2002, it has overseen \$7.5 billion worth of infrastructure projects in British Columbia. In 2011, Infrastructure Quebec was involved in two of the largest Canadian bond-financed P3 projects, the MUHC Glen campus project and the CHUM research centre.

GROWTH OF P3S IN THE WORLD

In developed and developing countries, P3s have become a key method for delivering public services. Figures show that a total of 2,096 P3 projects existed between 1985 and 2004, with a total value of nearly \$887 billion. The public sector recognizes that economic growth needs robust modern infrastructure, which can materialize through P3 initiatives. These initiatives are now accepted internationally as an important mechanism to fund key public sector infrastructure projects. For example, P3s in the U.S. are planned

A LEADING ROLE FOR CANADA

With a significant number of successful P3 projects, and forecasted growth in the application of P3s at all levels of government, Canada is an attractive investment hub and a P3 market leader. Canadian legal and technical experts assist local and international clients in projects in such places as India, Germany, Turkey, the Caribbean, South America and elsewhere. Partnerships BC is exporting its procurement expertise by providing consulting and advisory services to foreign governments. By way of example, with an infrastructure need of \$500 billion over the next 20 years in California, private capital is needed to help fix schools, ports, highways, hospitals, and wastewater treatment plants. The California Government has turned to Partnerships B.C. for guidance. Geoffrey Hamilton, Chief of the Cooperation and Partnerships Section of the United Nations Economic Commission for Europe states, “[P3s] have probably never been higher on the agendas of governments around the world. In discussion on what model countries might follow, many experts suggest Canada as a model of good governance in [P3s].” The vast Canadian successes in managing risks and other essential elements found in P3s positions Canada to continue to establish itself as a global leader in this growing sector.

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for projects for water supply, wastewater treatment, and prisons. In Korea, hospitals, schools, and public housing are developed using the P3 model. Budgetary constraints, changes in social, political, and economic environments, as well as the ease of doing business across international borders, make P3s a desirable and perhaps, even unavoidable, choice for many countries today.

II. RISK ALLOCATION CONSIDERATIONS

P3 projects allow public and private sectors to mutually benefit from sharing risk and obligations. Common risks that require allocation in P3 projects include legal, finance, construction, commercial, political, and environmental risks. No P3 arrangement is exactly the same, but there are some fairly common ways that risk can be allocated efficiently between the public and private sector. For instance, the public owner will often take on the risk of property acquisition, demand risk, risks of new or undisclosed site contaminations, and geotechnical investigations and assessments. The project company, and construction and services contractors, usually take on the risk of engineering design, schedule, cost overruns, utilities coordination, permitting, and some demand risks. They may also be primarily responsible for industrial relations, communicating with local stakeholders, implementing environment management systems, and remediation of any existing or disclosed site contamination.

Most well planned and implemented P3 procurements are effective in properly allocating risk between the public and private sector. Occasionally, and usually due to lack of upfront planning, market testing, and early collaboration with private sector and various stakeholder and user groups, the P3 model may fail to allocate risks in an optimum manner.

When considering how to manage risks, the first step in any partnership or potential partnership is carrying out a thorough investigation and assessment of all identified risks. For example, consider the financial risks that may arise from unfavourable economic conditions of a host country, complex financial structures of P3 projects, and the fluctuation of inflation rates. Political risks come into play when the reliability and creditworthiness of a government is in question or where changes in law and government policies create problems. Political opposition, corruption, and delay in approvals can be significant roadblocks to project development and completion.

The Bangkok Elevated Transport System in Thailand shows us the pitfalls of too much government involvement. In that case, the parties planned to build a 60 kilometre elevated railway system as well as a road through the heart of the city. The concessionaire in that project had the right to collect tolls for 30 years and to develop large stretches of land along the planned route. The project was allegedly terminated by the Thai government due to a mismanaged change control process and a misallocation of risk resulting in a lack of incentive for the government to assist in resolving conflicts.

DESIGN AND CONSTRUCTION RISKS

There are two types of P3 risks that usually dominate: design and construction risks, and demand risks. In the project lifecycle of a typical infrastructure P3, the construction phase is generally thought to be the riskiest. After executing the project documents, it may not be easy to alter risk allocation without increasing the project price. Parties must consider risks related to unclear construction and facility utilization objectives, inexperienced construction contractors, construction site safety issues, construction delays, and quality concerns. P3 participants must consider the potential for labour strikes, pre-existing environmental problems, design changes required by law, labour and materials shortages, and other unexpected construction cost increases.

The Cranbrook Civic Arena Multiplex in Cranbrook, B.C., is an example of a project that faced large unexpected construction costs and delays. This P3 created a new recreational facility with a hockey arena, swimming pools, and other amenities. Unmanaged and unanticipated construction risks were significant factors in the private sector withdrawing from the P3. To mitigate risks involved with the design and construction phase, the key is having rigorous and robust processes, including how to deal with delays, enforcing contracts, and managing unexpected changes within projects.

DEMAND RISK

The second dominant risk, demand risk, is a top level consideration in planning a P3. Typically, the most significant factor in analyzing a project's cash flow, and the related debt repayment scheme, is demand volume. User demand creates the main source of revenue for P3s. The public sector may prefer sharing demand risk with the concessionaire by paying availability fees, providing minimum revenue guarantees, and issuing capital grants.

Many factors impact demand volume. These can be related to the public's opinion of a particular project, user capacity and ability to pay, and amount of user fee. Parties to P3 contracts should determine if there is enough user demand to sustain the project, and whether the fee is prohibitive, especially in light of prevailing, local and regional socio-economic factors.

If projects are founded on unreliable or incorrect demand forecasts, they may not become financially viable and could fail. Apparently, another reason for the failure of the Cranbrook Civic Arena Multiplex was the overly high expectation of demand volume. Before the project failed in 2004, complaints were made regarding concert and special event revenues being far below projections. Overly high demand can also have a negative consequence. When there is more demand than originally calculated, private companies will become profitable sooner than predicted and the public may believe they are overpaying for the service.

III. MANAGING RISKS

Risks are commonly managed through robust procurement



The failed Bangkok Elevated Road and Train System

processes that can outline mechanisms for early issue identification and fact gathering by owner; by meaningful collaborative interaction with the private sector; by meaningful stakeholder engagement; and, by exploring solutions to anticipated problems before contract award. As well, the partnership based model contract that becomes familiar to both the public and private sector is designated to foster win-win solutions rather than confrontation. Risk can also be passed down through contracts that ‘drop down’ risks assumed by the concessionaire on all subcontractors. To tackle cost overruns during the construction period, contingency reserve funds are sometimes used. User guarantees can mitigate the eventuality of insufficient demand.

Another factor in successfully managing risk is selecting the appropriate concessionaire. This requires structured tendering processes and evaluation methods with detailed criteria that clearly outline project objectives and standardize decision-making. The concessionaire should be technically competent, with strong financial backing and managerial experience. In order to attract private investment, reasonable financial incentives and a stable revenue stream are critical.

To ensure appropriate risk management, governments should standardize their P3 procurement process and contract documents to reduce process costs and create some certainty for the private sector to ensure robust competition on all projects. Holding regular meetings between private and public sector partners and maintaining open lines of communication help to close gaps in strategy and resolve issues quickly. Governments should use experienced

staff familiar with P3s as well as experienced P3 consultants with legal and technical expertise.



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