Executive summary

Background

Public Private Partnerships (PPPs) are complex financing structures involving substantial transaction costs, with the legal documentation alone often consisting of several hundred pages. Despite the care taken in preparing PPPs, renegotiation is a common occurrence and can have an impact on value for money. It is not clear, however, whether this reflects the impossibility of any contract to foresee every eventuality or is usually the result of more mundane explanations.

At this ITF Roundtable held in October 2014 in Washington, D.C. renowned experts from 12 countries reviewed the outcomes and risks most often associated with renegotiation in practice. They also examined alternatives available for addressing uncertainty and incompleteness in contracts, elements for maximizing the chances of renegotiation delivering net welfare benefits, and the economic welfare impacts where termination and bankruptcy is preferred to renegotiation.

Findings

While contracts can never cover all eventualities, they can cover a very wide range. Foreseeable risks can be allocated between the contracting parties. Unforeseen risks can be mitigated through contractual procedures for dealing with changed circumstances. One of these mechanisms is renegotiation.

When renegotiations occur, it is crucial is that the spirit of the contract is maintained. If the contracting parties are allowed to renege on promises given at contract signature, the purpose of the PPP contract is defeated. The experience of India and the state of Florida in the United States show that it is possible to avoid renegotiations in the early years after signing. The general experience in Latin America and elsewhere has been different.

Some PPPs and traditional procurement contracts can be subject to similar forms of strategic behaviour from bidders. Selection with the lowest bid as the principal criterion can lead to over-aggressive bids, unsustainable offers and, ultimately, renegotiation. The real possibility of bankruptcy, demonstrated through contract terminations, is thus essential to the market discipline and efficiencies that PPPs are expected to bring.

In some cases, renegotiation of a PPP can benefit all sides. Government-led or unsolicited proposals from existing concessionaires to extend or bundle old contracts with new ones can resolve difficult co-ordination and planning issues, for instance. Since other forms of private capital involvement exist, the governments can explore comparative advantages and weaknesses of these instruments in relation to PPPs when they seek large-scale financing of transport infrastructure from capital markets.

Policy insights

Use renegotiation of PPPs only in exceptional cases

Preventing renegotiation is as important as renegotiating it properly. Routine renegotiation of PPPs signals a weakness in contracts or tolerance toward opportunistic behaviour. Renegotiation clauses create the risk of strategic bidding which ought to be countered by a clear policy which reserves renegotiation for exceptional circumstances and establishes contract termination (and ultimately bankruptcy) as the default.

Use an independent jury to assess whether the outcome of a PPP is what parties might have been expected to negotiate had they foreseen a change that has occurred.

Selecting jury members can be challenging and the judgement of a jury may be subject may be questioning or even judicial review. However, establishing such a procedure increases transparency and the likelihood of mutual agreement on revised terms.

Consider to task an independent body with determining when renegotiation of a PPP is legitimate

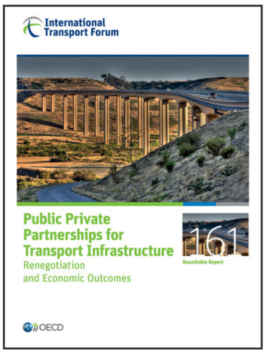
A supervisory board or regulatory agency separate from the contracting authority with the power to determine, or to advise on, whether a renegotiation is in order can be a worthwhile safeguard.

Include reputation and demonstrated competence in selection criteria for a PPP

The application of the lowest bid as the principal selection criteria for contracts, PPPs can be subject to over-aggressive bids and unsustainable offers that can ultimately require renegotiation.

Compare advantages and weaknesses of PPPs versus other forms of private capital

Numerous ways of bringing private capital into an infrastructure project exist and governments would do well to explore their comparative advantages and weaknesses in relation to PPPs when they seek large-scale financing of transport infrastructure from capital markets.



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