PPP PROJECTS—THE RISK DEBATE

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Since the early 1990s, Australian State governments have been active in delivering public–private partnerships (PPP) projects. This results from a paradigm shift in the way that governments view the role of the private sector in providing public infrastructure and related services.

Such infrastructure may be 'economic infrastructure', where users are charged directly for use (such as power, water, transport, etc) or 'social infrastructure', where the government essentially funds use through payments to the relevant private sector entity (such as with schools, hospitals, prisons, etc).

Each State and Territory in Australia has developed its own PPP policy. In New South Wales that policy is 'Working with Government: Guidelines for Privately Financed Projects, 2001'.

In simplest terms, the goal of the PPP model is to 'assist the public sector to deliver infrastructure in a more cost effective manner (whilst retaining control of core services) with significant input from the private sector' (Bremen in The Arbitrator and Mediator, 2002). A central underlying factor is that the PPP must offer value for money.

Needless–to–say, when assessing value for money, a critical issue for the respective parties involved in development of a PPP, is that of risk transfer. The Victorian PPP policy (Partnerships Victoria, 2000), states that:

Value for money is maximised by allocating risk optimally. In very general terms, this means allocating each risk to the party best able to manage that risk. In theory, this reduces individual risk premiums and the overall cost of the project, because the party in the best position to manage a particular risk should be able to do so at the lowest cost.

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The debate on risk allocation in PPPs in ongoing. The perception amongst many in the private sector is that governments utilise their bargaining power to transfer risks to the private sector that cannot reasonably be managed by them. Put another way, it is often argued that the private sector is required to take on too much risk for too little reward.

A significant risk for the private sector at the preliminary stages of development of a PPP, are the tendering costs. In preparing its bid, the bidding entity must take into account the objectives of the government's, its financiers, and its own interests, and legal fees alone comprise a significant portion of the tender costs. The obvious risk for the bidding entity is that it may fail in its bid and hence the substantial expense outlay of the tendering process is lost.

Every project is of course different in terms of an appropriate risk allocation. However, in general terms, parties involved in the development of a PPP should be particularly mindful of the following risks:

(a) risks in the design, construction and commissioning of the facility;

(b) completion and delay risks;

(c) performance risks;

(d) management and upgrade of the facility;

(e) step–in and termination risks;

(f) geotechnical conditions;

(g) refinancing risks;

(h) insurance risks;

(i) changes in law;

(j) renegotiation clauses;

(k) planning approvals;

(l) heritage or artefact risks;

(m) force majeure events.

Needless–to–say, the above list is not exhaustive and it is not the intent of this article to analyse each of these risks in detail. However, parties should, at the very least, be aware of the potentially significant financial consequences of accepting an unreasonable allocation of risk in relation to the issues listed.

The Spencer Street Station project in Melbourne is perhaps the most recent illustrative example of the potential consequences when project risks are not properly assessed.

The project is well known, and was subject to intense media scrutiny during mid 2004 and beyond. The project involved certain construction and upgrading works at the Spencer Street Station, for the Victorian Government.

The Station was to remain operational at all times, and as such, pursuant to the project agreement, the builder was entitled to carry out construction work over the railway tracks only during very limited timeframes at night. The results of this restriction were massive delays to the construction work, with commensurate cost blow-outs. There was significant political pressure on the players

In contractual terms, it appears that the government of Victoria had successfully transferred the major portion of project risk to the private sector consortium. Ultimately, a compromise was negotiated. However, the lesson learnt is that an inappropriate assessment and allocation of risk in such projects often comes at a high price for all parties involved.

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