THE PROLIFERATION OF PUBLIC-PRIVATE PARTNERSHIPS:
HOW TO PROTECT YOUR ENTITY AND REAP THE BENEFITS

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Problematic public-private partnerships usually result from non-technical challenges that arise in the working relationship. Lack of executive and project leadership, insurmountable communication issues or deficiencies in planning and defined processes can create barriers to collaboration.

As a result of public sector fiscal stress, the challenges of protecting the public’s coffers while adequately providing for the diverse needs of the citizenry, are becoming increasingly complex. One of the fallouts of decreased revenue is the proliferation of public-private partnerships. Such collaborative agreements, often born of necessity as a result of fiscal crisis or natural disasters, can prove to be valuable mechanisms by which myriad community needs may be met. Even such timely public policy issues as public safety have been subject to public-private partnerships (PPPs). However, while PPPs are considered to be an attractive way to transfer certain duties and responsibilities to the private sector, there exists no guarantees that the risks inherent in the undertaking are likewise transferred. This article is designed to assist the public risk manager in insuring that their PPPs contain sound risk management principles.

PPPs: THE BASICS
To belabor the obvious, a PPP is defined 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. These cooperative ventures most commonly come about as a result of a body politics’ desire to look to a private entity to provide services traditionally performed by government. The most common agreement consists of the public entity funding the provision of services by a private entity with the private entity assuming substantial financial, technological and operational risks in the performance of the service. Some PPPs take the form of a design-build-finance-operate plan. Under such a plan, the government specifies the services it wants the private sector to deliver, then the private partner designs and builds a dedicated asset for that purpose, finances its construction, assumes the risk, and subsequently operates the asset and provides the services deriving from it. This contrasts with traditional public investment, where the government contracts with the private sector to build an asset, but the design and financing is provided by the government. Such plans are commonly used for new school or public building construction. However, the PPP upon which such plans are based, often fail to provide sufficient risk transfer or avoidance language, necessitating that the risk manager be involved at the very formative stages of the process.

POLITICAL CHALLENGES
It has been said that a successful partnership between the public and private sectors depends on all of the people involved with the project.

Problematic public-private partnerships usually result from non-technical challenges that arise in the working relationship. Lack of executive and project leadership, insurmountable communication issues or deficiencies in planning and defined processes can create barriers to collaboration. Add to the aforementioned challenges the tendency on the part of some individuals to politicize the PPP process, and another layer of challenge appears. PPPs are popular with elected officials who are under constant pressure from citizens, businesses and investors who are increasingly
The Proliferation of Public-Private Partnerships

Depending upon the service, the government may have to develop the expertise needed to effectively monitor the activities of the private entity. For instance, rather than relying upon private sector accounting processes, the government should insist that fiscal accounting and reporting processes and procedures conform to generally accepted government auditing standards, either their own, or those promulgated by Congress in the form of the U.S. Generally Accepted Accounting Principles (US GAAP).

It is likewise important to distinguish a PPP from your garden-variety contracts that merely serve to purchase goods or services, and as such, contain standard, boilerplate language and are often in use system-wide.

Rarely are there one size fits all PPPs. PPPs that lack a vision and clearly defined objectives and outcomes diminish the chances of achieving the desired level of performance, control and capability that prompted its creation in the first place.

IDENTIFYING THE COSTS OF PPPs

When considering the PPP option, public entities must compare the cost of public investment and government provision of services with the cost of services provided by a PPP. Since risk transfer is key to the increased efficiency of PPPs, the government wants to relieve itself of risks that it believes the private sector can manage better than the government. To do this, the risk manager is often called upon to assess and price these risks, so that management is aware of what it must pay the private sector to assume them. The risk manager will most likely also be called upon to distinguish between project-specific risk and financial risk. In its most basic form, project-specific risk reflects variations in outcomes for individual projects or groups of related projects. For instance, if a public entity is desirous of undertaking a major road project, specific risks could derive demanding the same high level of service they are receiving from the private sector entities with whom they contract. Further, private firms are attractive to policy makers due to the commonly accepted belief that the private sector exemplifies efficiency and expertise, brought about by the competitive market forces in which they operate. The catch-phrase, “run government more like a business” often serves as the catalyst for PPPs.

Depending upon a private entity’s standing in the community, some elected officials are inclined to create PPPs without entering into formal contracts with the private provider. This is especially true if the private entity is a not-for-profit philanthropic organization or a faith-based entity. The risk manager is well-advised to resist such suggestions whenever possible. An agreement that clearly and concisely outlines the duties, responsibilities, lines of authority and liabilities of the contracting parties should be reduced to writing like any other contract. This insures enforceability, transfer of risk, remedies for breach of contract and venue, i.e. in which court a conflict will be litigated. Further, due to the reluctance on the part of some elected officials to litigate against not-for-profit or faith-based organizations, a written contract affords you the opportunity to insert a mandatory mediation or arbitration clause prior to a lawsuit being filed. Such clauses often serve to mollify both the private entity and politicians.

IDENTIFYING THE RISKS OF PPPs

From the government’s perspective, under the ideal type of PPP, the public sector relinquishes control to the private sector entity and the private sector assumes most or all of the risk. One of the basic mistakes some public entities make when entering into PPPs however, is the misnomer that, once finalized, the government divests itself of the responsibility of insuring the service contracted for is timely and professionally provided.
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from an interrupted supply of building materials, labor or subcontractor problems, or obstruction by environmental groups. Financial risks, on the other hand, involve the variability in the government’s revenue stream, i.e. costs, fees, ad valorem taxes collected, interest rates, exchange rates and other factors affecting PPP financing costs, which are beyond the control of either party to the PPP. 3

THE RISK MANAGER AND THE PPP
As has been alluded to earlier, any lack of leadership or project expertise can adversely affect the effectiveness of the PPP. As such, the risk manager should make every effort to assist management in understanding the nuances of the manner in which the private sector operates. Further, the risk manager should ensure the public entity’s strategic plans, missions, goals and objectives are shared with the private sector. Further, the risk manager must inculcate in her or his organization that PPPs are not a panacea for all that ails government and as such, not to have unrealistic expectations of the private sector’s expertise and abilities.

The risk manager must be an integral part of the PPP process from inception, to execution, to ongoing activities. By assessing the risk, and remaining involved in the crafting of the agreement that serves to transfer the risk, the risk manager is in a position to assist the entity in deriving all the benefits of the PPP while minimizing the risks often inherent in such agreements. 4

END NOTES:
1. The Canadian Council for Public-Private Partnerships (see www.pppcouncil.ca/aboutppp.htm)
2. Public-Private Partnerships: Prepared by the Fiscal Affairs Department (in consultation with other departments, the World Bank) by Teresa Ter-Minassian, 2004
4. Note: US GAAP is not codified as law, although the U.S. Securities and Exchange Commission (SEC) requires that it be followed in financial reporting by publicly traded companies.
5. See: Managing Contingent Liabilities in Public-Private Partnerships Practice in Australia, Chile, and South America, Edited by: Mayya Revzina, External Affairs, Office of the Publisher, The World Bank, 1818 H Street NW, Washington, DC, 20433 - USA

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