

European PPP Expertise Centre • European PPP Expertise Centre

# Managing PPPs during their contract life

## Guidance for sound management





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## Introduction

This report deals with the “operational management” of PPPs. Operational management is here taken to mean **the management of a PPP by a public contracting authority (the Authority) from signature until the end of the contract life**. Operational management therefore:

- comprises:
  - the activities relating to “**contract management**”, i.e. the on-going administration of the PPP contract;
  - certain activities of the overall “**project management**”, such as those arising from (i) the responsibilities retained by the Authority under the PPP arrangement and (ii) possible changes in the requirements during the life of the project; and
- takes place both during the **construction** and the **service delivery** phases of the PPP project.

### Why is the issue important?

Experience has shown that **services outsourced to a private sector party require as much, if not more, management by the grantor of the contract than those provided in-house**. This is in particular true of PPP contracts, which, although output-driven, require considerable management efforts on the part of the Authority.

Sound operational management is therefore **crucial to the success of a PPP**.<sup>1</sup> Failure to adequately manage the project will inevitably erode its value-for-money and may ultimately undermine its objectives. There are many reasons for this and they have to do with the main characteristics of PPP projects, which typically:

- involve long-term agreements where deviations, even slight, can have a significant cumulative positive or negative effect on the project outcome over time;
- most often involve complex projects, where it is difficult to foresee all possible future events at the outset and in which it is important for the Authority to maintain some room for manoeuvre; and
- are generally designed around performance outputs that imply close monitoring during operation to ensure that the project delivers on its promises and, ultimately, value for money.

Furthermore, the PPP contract (through which project risks are shared at the start of the relationship between the Authority and its private partner) is at the heart of the relationship between the parties. The **initial allocation of risks must be managed over the whole life of the project** in order to:

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<sup>1</sup> For further detail see for instance Ipsos MORI, “Investigating the performance of operational PFI contracts”, 2008.

- clarify and/or modify it when unforeseen risks or consequences of those risks arise;
- ensure that the private partner bears the risks it is required to bear and mitigates them adequately; and
- monitor and manage effectively the risks borne by the Authority.

Operational management is a way for the Authority to **protect its contractual position** throughout the life of the contract. If things start to go wrong in a PPP, as may sometimes happen in complex projects even if they are conventionally procured and managed, the Authority will have to act to protect the project's value for money and its own interests. Proper project monitoring enables the Authority to develop a detailed understanding of the project issues and show the private partner that it is an informed and vigilant counterparty.

**Once a PPP contract has been signed, opportunities for public expenditure savings often arise over its lifespan.** Savings can be achieved and, better still, shared between the parties, only through proper monitoring by the Authority. At a time of economic crisis and public money scarcity, these savings may enable Authorities to release financial resources that can be usefully reinvested in other activities or projects.

Finally, operational management is important because a project is rarely undertaken in complete isolation from other PPP initiatives. Engaging in the operational management of existing PPPs is key to identifying improvements that could be made in future contracts and therefore **creates a virtuous cycle**.

### Rationale for the report

Experience shows that the public entities involved in PPPs tend to focus on procurement issues leading to contract signature. Authorities are inclined to assume that the PPP contract will take care of itself once it has been signed and/or once the project has been completed. To ensure that PPPs deliver their promised benefits over the long run, the Authorities **“deal” focus need to shift to a long-term “management” culture.**

**EPEC guidance** on the matter will hopefully raise awareness and reinforce the ability of Authorities to (i) plan their own operational management strategy and (ii) execute it without missing out any important steps that they will not be able to make up for.

Even though most operational management activities will only be carried out during the project's operational phase, a management strategy needs to be produced in advance. To be effective, **this strategy should be worked on when the PPP contract is drawn up and finalised before the contract is signed.** By setting out the key issues to be taken into account for a sound operational management, this EPEC report may help those concerned to define a management strategy early on in the life of the project.

Finally, Authority staff in charge of a PPP project may need arguments to explain to those higher up the decision-making chain that they will have to mobilise human and financial resources throughout the life of the PPP contract. With that in mind, this report is intended to **provide information on what is involved in operational management and therefore help justify this long-term resource provision.**

## Scope, structure and methodology the report

This report covers the key issues of operational management using a **practical approach**. In order to do this, the report:

- presents the main activities and processes to be carried out at each of the main stages of contract procurement and implementation;
- brings together some of the specific examples of good practice and lessons to be learned from existing PPP projects, to make them available to a greater number of Authorities;
- explores, insofar as possible, how central PPP units can promote and contribute to efficient operational management; and
- includes an annex listing additional references that provide further information on operational management topics.

To draw up best practice and provide guidance, EPEC has:

- relied extensively on **publicly available material**, **interviews** with PPP contract managers and **exchanges with EPEC Members**; and
- reviewed the **experience accumulated** in a number of countries (e.g. the UK, France, Australia).

This report follows a **topic-based approach**. Ten key topics have been identified and divided into two sections, following a chronological approach in the project cycle:

- **designing** the operational management role (Section 1); and
- **performing** the operational management role (Section 2).



## Section 1

### Designing the operational management role

Operational management should be approached **proactively** rather than reactively **throughout the project lifecycle**.

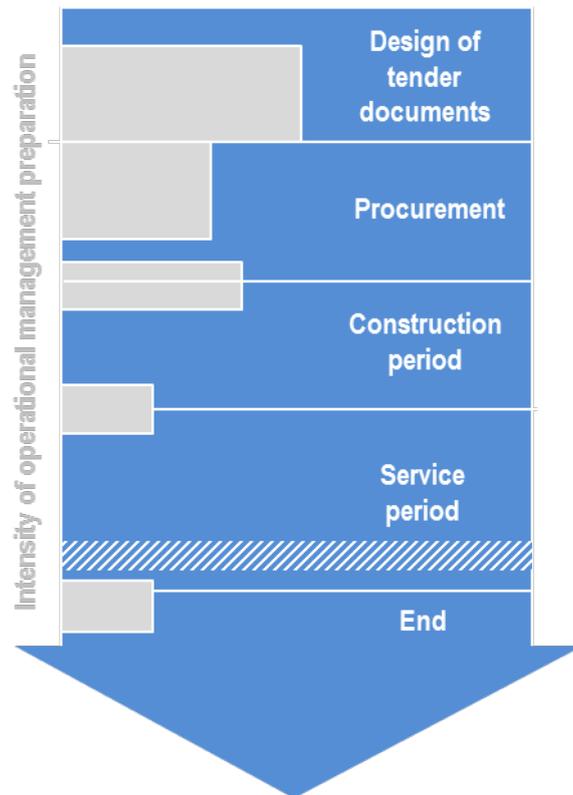
This means that **steps should be taken to prepare for operational management prior to contract signature as well as on a regular basis during the life of the contract before the actual operational management tasks are carried out**. Indeed, operational management will not be effective if the Authority waits for the needs to arise without, for example, thinking about the most appropriate way to perform the tasks and gather the necessary information. Unless the contractual, organisational and human/budgetary resource aspects of operational management are properly planned from the outset, results are unlikely to be satisfactory doing contract operation.

This first section of the report focusses on **the preparation for the operational management role**. It addresses six key topics:

- Involving an appropriate number of skilled people at the right time is probably the main driver of success. **Topic 1** deals with establishing the Authority's operational management team;
- To ensure that the operational management team operates in an efficient way, **Topic 2** looks at how to establish robust and effective project governance;
- Once properly organised and positioned in relation to all the project's stakeholders, the operational management team needs to rely on a range of suitable tools, including:
  - a clear and comprehensive PPP contract (**Topic 3**);
  - a user-friendly contract management manual (**Topic 4**)
  - an effective set of information management tools (**Topic 5**); and
  - a financial model able to meet operational management requirements (**Topic 6**).

Figure 1 below illustrates how the preparatory tasks fit into the lifecycle of a typical PPP contract.

**Figure 1 - Critical stages in the preparation of the operational management tasks**



## Topic 1 - Establishing the operational management team

### Key questions for the Authority

When considering setting up the team which will be in charge of operational management, the Authority will have to ask itself a series of questions, such as:

- When to design, recruit and set up the team?
- What are the most suitable structure and size for the team?
- What competencies and skills are required?
- How can such skills be acquired and maintained over the long run?

### Acting early (“the early bird catches the worm”)

#### Project preparation and procurement

The human resources issue should be considered from the very beginning of project preparation and in particular during the procurement process.

The **cost** for the Authority of managing/monitoring the future project and PPP contract **must be taken into account in the ex-ante studies** which compare the value for money of different procurement scenarios. To make an objective comparison, the Authority needs to use realistic assumptions in terms of the number of people, level of qualifications and salaries in both the publicly procured and PPP scenarios. This means that the studies require a sound preliminary understanding of the operational management activities.

Moreover, the **provisions of the PPP contract should aim to define as precisely and pragmatically as possible the interactions between the parties**. This will be facilitated if representatives of the team who will eventually be involved in the management can participate in the drafting/negotiations of the contract. The resulting arrangements are likely to be more pragmatic and user-friendly.

The Authority should **ensure that sound comprehensive requirements for the operational period are included in the draft contract** sent to the bidders and discussed with them during the procurement process. This is particularly beneficial where the project is procured through a competitive dialogue. The advantages of doing so are that the Authority (i) can take the lead and ensure that the bids include arrangements that fit with their strategy and (ii) can limit the risk of having to renegotiate the relevant provisions of the contract at the beginning of the contract life.

Involving some of the operational management staff at this stage will help to **ensure that at least during the initial stage of the life of the contract some people will remember the genesis of the arrangements**. Having such knowledge is important, especially (i) in case of disagreement on the interpretation of a provision of the contract (i.e. focusing on the spirit as opposed to the letter) and (ii) to ensure that members of the operational management team are fully aware of the contract's background. It also provides a way of training team members in what their future responsibilities will entail.

Finally, the Authority should ensure that the contract manager (i.e. the person at the Authority eventually in charge of managing the PPP contract once signed, see below), is in place and sufficiently well prepared before the contract is signed so that they take advantage of the dialogue/negotiations with the private partner to **start building the future partnership**.

#### Involving operational managers in the procurement process

To the extent possible, the **project director who is in charge for the preparation and procurement phases of the project should have some understanding of operational management** or should be able to rely on operational management practitioners.

The full operational management team doesn't need to be appointed at the procurement stage, but the Authority should consider a "ramp-up" period, during which those responsible for implementation of the contract gradually take over from those involved in the procurement process.

#### Capitalising on procurement

As noted above, it is important to **ensure that the history of the procurement phase is available throughout the life of the contract**. This can be achieved by (i) minuting important meetings and archiving the key versions of the project documents/contracts and (ii) retaining the project director and/or other key employees in charge of the procurement phase for the early years of the contract life.

### Competency, responsibility, flexibility and continuity

#### A multidisciplinary task

A PPP requires the Authority to mobilise a wide range of skills to ensure that it is properly managed, for example:

- **Technical:** Has the facility been designed and built in accordance with the contract? Will maintenance be sufficient to ensure an adequate performance level over time?
- **Administrative:** Has the private partner fulfilled its obligations regarding information provision? Are the Authority payments adjusted for inflation and performance in accordance with the contract?
- **Legal:** Are the contractual obligations properly interpreted in practice? Does a specific change in law or regulation qualify as a compensation event for the private partner?
- **Financial:** What is the financial impact of a refinancing proposal made by the private partner?
- **Communication:** How should the Authority inform end-users about a change in the services being provided?
- **Insurance:** Is the original insurance cover still adequate for the project? Does the Authority's insurance policy overlap with that of the private partner?

### A tailor-made approach

The number and profile of the staff forming the operational management team must be **matched to the characteristics and environment of each project**, taking into account, in particular:

- the size of the project and whether the project facilities are situated in different locations;
- the sector, scope and complexity of the services to be provided by the private partner;
- the resources already deployed by the Authority in the management of other similar services (in-house or outsourced) to create synergies; and
- whether the project is part of a wider programme within which certain functions could be shared on a multi-contract basis.

At the very least, a **contract manager with a versatile profile and some project management skills** (in planning, risk assessment, negotiation, etc.) should be appointed and be identified internally and externally as being responsible for following up the contract on behalf of the Authority.

The **operational management team** will often include:

- a **contract manager** as head of the unit, acting as the Authority's representative in dealings with the private partner;
- one (or more) **service performance manager(s)**, whose role will be to monitor the provision and quality of the services on a day-to-day basis; and
- a person in charge of **administrative support**, who will deal with the administration of the legal and financial aspects of the contract.

When appointing staff, the Authority should pay attention to **the risk of conflicts of interest arising between its team and the private partner**. Where possible, it may be useful to stipulate in the employment contract of any team staff that they may not accept a job offered by the private partner for a certain period of time after the end of their contract with the Authority.

### Fostering flexibility and sharing the workload

The operational management workload will vary during the life of the contract and therefore the team needs to be both proportionate and flexible enough to meet its obligations. Some activities will have to be performed on a day-to-day basis, some on a periodic basis and others on an *ad hoc* basis.

It is therefore good practice to have a core team consisting of as few full-time staff as possible to perform the day-to-day work. **Then, to keep costs down, while, at the same time, retaining maximum flexibility, the core team should rely on external resources** to assist with the remaining responsibilities through:

- **agreements with other departments** within the Authority to provide skills that the team cannot justify internalising on a full time basis;
- **agreements with a central task force** (possibly the national PPP unit) to exchange information with other Authorities (benchmarking), design and

implement training programmes, share good practice, develop common tools, etc; and

- **framework contracts with advisory firms** to provide additional capacity and/or specialised expertise where necessary.

A sound way of appointing advisers is to enter into contracts under **framework agreements**. This approach provides:

- **flexibility and a rapid response** as it ensures that people are available quickly, without the need for a lengthy procurement procedure; and
- **relevance** as advisers would not have to start from scratch for each new issue raised by the Authority.

The first of such framework agreements could be additional parts of the agreements signed to provide assistance during the PPP procurement phase. This encourages advisers to work for the future success of the project. Typically framework agreements are put out to tender on a regular basis (e.g. every three years). Ideally, they will contain a pricing structure combining fixed/capped prices for specific predetermined tasks (e.g. periodic reviews, updating of the financial model) with daily rates to cater for unexpected contingencies.

**Where an Authority is involved in a number of PPP contracts, it is good practice to have a single team to manage all of them**, as it will (i) enable knowledge to be shared between projects, (ii) make best use of limited human and financial resources (i.e. economies of scale) and (iii) facilitate the application of best practice across all of the Authority's projects.

#### Consistency and continuity

The long-term nature of most PPPs requires an operational management strategy that relies on **continuity and consistency** and avoids disruption in monitoring the contract. To provide the required continuity, the Authority should:

- ensure that the **team is properly organised and managed** as this will encourage people to stay for a long time;
- introduce and regularly update a **succession plan**, taking into account internal promotion and skills improvement to create momentum within the team;
- adopt procedures ensuring that the performance of **tasks does not rely solely on particular individuals** (see also Topic 4 below on the operational management manual); and
- organise **management and transfer** of knowledge (see also Topic 5 below on information and data tools).

In addition, ensuring continuity means securing long-term funding for the team. It is therefore important to draw up a **multi-annual budget for operational management activities**, to communicate the importance of the issue effectively to budgetary decision-makers and to obtain, where possible, a formal commitment from those further up the decision-making chain.

### Initial and on-going training

The need for training **depends on the initial skills and knowledge of the team members.**

It is often **easier to rely on staff with strong/relevant “technical” skills** and train them on operational management skills than to train staff with an administrative background on technical matters.

The management team will have to present a united front in its dealings with the private partner, which means that **they must share a common view and approach to operational management.** It is therefore useful to provide the team with initial training, at least on matters such as the principles of operational management, project management, negotiation skills and communication.

**A dedicated training session on the specific PPP contract they will have to manage and the operational management manual** may also be valuable to ensure that all members of the team have a sound understanding of the contractual arrangements and how things are organised within the Authority. This training session should take place at the beginning of the contract life, just after signature.

Depending on the initial knowledge of each member of staff and the complexity of the project, additional training may be necessary, especially on the legal aspects, use of the financial model and performance monitoring.

Experience shows that there is often an imbalance between the single-project focus of an Authority’s contract manager and the ability of private sector operators to capitalise on their know-how and experience across different projects. It is therefore important to **facilitate as much as possible the sharing of experience among public executives in charge of operational management.**

Without needing to be actively involved in the operational management of projects, **national PPP units have a useful role to play (i) in building knowledge and know-how platforms and (ii) as a facilitator of experience-sharing activities at both national and international levels.** In practice, this may consist of establishing common training programmes, centralising key technical and financial data across projects, and sharing models of documents such as job descriptions or the terms of reference for the procurement of advisers.

**Box 1****The contract manager according to 4Ps (UK)<sup>2</sup>**Skills, attitude and experience

- Demonstrates strong leadership skills
- Has good people skills (interpersonal and management)
- Has a partnering 'win: win' ethos for relationship management
- Has a positive outlook and attitude and is proactive
- Demonstrates effective negotiating skills
- Is able to manage relationships successfully and resolve conflict
- Is able to manage users and their demands
- Is able to work effectively with a team
- Is able to plan resource requirements effectively
- Exercises good judgement, based on experience and sound analysis
- Has experience in managing complex services
- Has experience in performing contract monitoring
- Can establish processes for monitoring performance
- Has the ability to anticipate and respond to future business needs
- Possesses well-developed analytical skills
- Has good organisational and QA skills
- Has a realistic and practical approach to change and innovation
- Is able to develop strategies to meet changing contractual needs
- Is able to apply contract management procedures
- Is able to evaluate and control expenditure

Knowledge

- Relationship management
- Partnership working
- Managing a team
- Developing a team
- Service monitoring processes and the data required to do so
- Output specifications and performance measurement systems
- End-user requirements (e.g. the requirements of schools)
- Procurement processes
- Government accounting principles
- Benchmarking/market testing the private sector and its business drivers
- Changes and developments in the relevant service markets

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<sup>2</sup> From "A guide to contract management for FI and PPP projects", 4Ps, 2007.

## Topic 2 - Defining the operational management governance

Governance here refers to **the coordination of the roles of the various project stakeholders and the internal organisation of responsibilities within the Authority.**

### Key questions for the Authority

Defining appropriate governance for the PPP project as early as possible is a fundamental part of an effective operational management strategy. The Authority will have to ask itself:

- Have all the project stakeholders been clearly identified?
- How should stakeholders be involved in the operational management process?
- How can a clear decision-making process within the Authority be established?
- How can a sound working relationship with the private partner be established and maintained?

### Getting a broad understanding of the project environment<sup>3</sup>

#### Mapping the project stakeholders

In a PPP project, the number of parties involved or affected is typically large. For instance:

- In hospital projects, in addition to the various departments of the Authority, the stakeholders will often include the national health administration, the medical staff (e.g. doctors, nurses, aides), the hospital administration staff, the local authority in charge of the site on which the hospital will be built, the local residents, future patients and environmental groups; and
- In motorway projects, beyond the Authority itself (which will typically be the ministry of transport), stakeholders often comprise other ministries (e.g. finance, environment), the local authorities affected by the road itinerary, the land owners, the local residents, the rail authority in case the project crosses a rail line and the bodies in charge of water, gas and power infrastructure.

#### Involving stakeholders from the outset and on a regular basis throughout the life of the contract

The interaction between the Authority and the stakeholders can be complex. Finding an appropriate way to involve the different kinds of stakeholders is a delicate matter, as the Authority has to carefully manage their expectations, interests and concerns.

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<sup>3</sup> For further information, see HM Treasury "Project Governance: a guidance note for public sector projects", November 2007.

Early identification and organisation of relationships with stakeholders at the very beginning of a project (e.g. project preparation) is clearly good practice. Experience shows that, to speed things up and avoid protracted discussions, proper stakeholder consultations are often neglected. This is a missed opportunity as stakeholders can help to adequately define the project service specifications (e.g. setting the target performance, defining under/over performance) and assess the quality of the service delivery during the operating period. In certain cases, it may be even be valuable to involve, during the tender process, certain stakeholders in the assessment of technical aspects of the bids.

In projects where the Authority itself is not the end-user, it is often useful to **establish a “trialogue” that includes users**, rather than a mere dialogue between the Authority and the private sector.

Authorities should bear in mind that **inadequate consultation of stakeholders can lead to delays in the implementation of the project or make operational management challenging**. It can lead to certain risks being underestimated or limit the ability of both the Authority and private partner to mitigate certain sensitive risks, such as:

- administrative risks (e.g. land acquisition, construction permits);
- the risk of local residents and communities objecting to the project (e.g. “not in my back yard” effect); and
- the risk of the operational staff (e.g. the teachers in the case of a school project) objecting to the project.

A **database of key contacts** should be established at the outset of the project and be regularly updated during the life of the contract. This will help develop appropriate communication throughout the project life.

#### Adapting communication tools to each target group

Throughout the contract life, stakeholders may be consulted through various means:

- **one-to-one interviews** or small group meetings should be encouraged with all the key people within the Authority or other public bodies;
- **focus groups** can be used for small groups of people with whom the Authority would be willing to establish two-way communication by informing them of the project’s features and output and gathering their feedback. Typically, focus groups are used with those living in or close to the area affected by the project, or with a sample of users, to carry out a qualitative assessment of their expectations and feelings; and
- **surveys** are an appropriate solution for gathering feedback from a large population of end-users (e.g. hospital patients).

#### Managing the communication with the stakeholders

The Authority should seek to **manage the risk of inappropriate communication with the project stakeholders** during the life of the contract. The design/construction phase of a project is often the most delicate. Opponents to the project may seek to obstruct its construction and provide a focal point for criticism among the local communities. It is good practice to appoint an experienced person or company

to design and implement a sound communication strategy toward stakeholders. The communication strategy will typically include awareness campaigns (e.g. Why this project? How is construction progressing? What mitigation measures were adopted?) and crisis communication procedures. A dedicated website is often used to disseminate key/controlled messages.

## A clear information and decision-making chain within the Authority

### Enabling sound choices to be made quickly

**Effective operational management requires the Authority to take many decisions**, sometimes difficult ones, quickly. To do so, decision-makers need to be properly informed on a regular basis.

The terms of a PPP contract typically contain time limits within which the Authority has to perform the tasks for which it is responsible. For instance, there may be deadlines for validating documents submitted by the private partner (e.g. periodic reports) or for giving feedback on its proposals (e.g. a change in the specifications of a service to be provided). **This implies a prompt response from the Authority to analyse the issue and activate the right level of decision-making.** This is only possible if accountability and decision-making has been previously defined.

### Integration with the internal governance of the Authority

The operational management role should be designed bearing in mind the environment in which the project exists. Operational management should **take into account the Authority's existing internal rules and constraints** (e.g. the management chain, the time needed to organise meetings). Working relationships will probably have to be developed with a number of departments within the Authority.

The internal Authority governance for operational management may be derived from the governance established for the procurement phase (e.g. dialogue committees, project management board).

The Authority may adopt a committee-based approach, which could rely on (see figure 2 below for an example of governance arrangements):

- a “**steering committee**”, responsible for the main strategic decisions, which will include representatives of the Authority's departments involved in the project and, at least, the head of the operational management team; and
- a “**management committee**”, responsible for the on-going monitoring of the contract, which will include members of the operational management team, the contract manager and the head of the department that is the most relevant to the project.

It is important for the Authority to formally **appoint one or more contact persons** who will represent it and act on its behalf when dealing with the private partner.

## Developing the partnership

The importance of **establishing an effective partnership** with the private partner based on transparency, openness, mutual respect and co-operation cannot be overstated.

This is a matter for both the entities and people concerned. As continuity and personal commitment are important in a relationship, the Authority should **aim to limit staff turnover in its team**. Members of the operational management team need to understand that the relationship is crucial and **adopt a constructive and empathetic attitude towards the private partner**, bearing in mind however that the private partner may opportunistically exploit the trust placed in it.

It is important for the Authority to establish channels for **communication and co-operation with the private partner on a regular basis at the operational level**. The PPP contract should provide for such a mechanism that will enable both parties to share information, discuss their views on project progress, overcome misunderstandings and pre-empt disputes.

For example, the arrangements which are typically put in place under the PPP contract include:

- weekly operational meetings;
- monthly operational management committee meetings; and
- quarterly partnership committee meetings.<sup>4</sup>

It is also important to **establish interface at different hierarchical levels** in order to (i) overcome any personal animosity that might arise between members of the Authority and private partner teams involved on a day-to-day basis and (ii) prevent the day-to-day “technical” relationship from being affected by possible conflicts at a more strategic level.

**Figure 2 – Example of internal governance arrangements for the Authority**



<sup>4</sup> For example, in Ireland, monthly operational meetings are typically held between the operational management team and the private partner representatives. These are supplemented by *ad hoc* operational meetings if and when required. In addition, a high level annual meeting is held with the private partner’s board representative.

## Box 2

### Case study on the operational management for French prisons

Under the auspices of the French Ministry of Justice, the “*Mission Gestion Déléguée*” (the Unit) manages 22 contracts involving 51 prisons throughout the country (which represent 27% of the total number of prisons and 50% of the total number of prison places). These contracts<sup>5</sup> often include the design, financing and construction of new prisons (or large-scale renovation of existing prisons), in addition to a wide range of services such as catering, “hard” and “soft” maintenance, vocational training for prisoners, heating system management and transporting prisoners to and from courts or other prisons. They have been entered into with five different major consortia. The contracts managed by the Unit account for 36% (EUR 400 million) of the annual prisons department’s budget of the Ministry of Justice. The **operational management is organised on three levels.**

1 - The central Unit is made up of eight people: the head of the Unit, five administrative and financial advisers (each in charge of specific contracts) and two technical advisers (for hard maintenance and catering). The role of the Unit comprises:

- managing the entire network of task forces and local teams (see below);
- procuring PPP contracts (in support of the Ministry’s PPP unit);
- managing contracts with external technical, legal or financial consultants where necessary;
- interpreting the terms of the contracts;
- ensuring the budgetary management of contracts;
- serving as a platform to collect and share information within the network;
- designing and provide dedicated training sessions at regional and prison level;
- visiting the local teams on regular basis; and
- maintaining relationships with the private partner groups (quarterly meetings).

2 - Ten regional taskforces. These have on average two full-time equivalent staff per task force, with mainly administrative skills. Their role is mainly to:

- offer legal and technical support to individual prisons; help interpret the contracts;
- validate the performance penalties to be applied to the private partners; and
- implement budgets and make payments.

3 - Fifty one dedicated local teams within each prison. These typically have one or two full-time equivalent staff per prison, with mainly technical and administrative skills. Their role is to:

- monitor the performance of the private partners on a daily basis;
- record failures via an IT platform;
- follow-up on the resolution of failures;
- determine the penalties to be applied to the private partner; and
- attend monthly meetings with operational representatives of the private partner.

**A dedicated training programme has been designed** to improve the ability of all operational management stakeholders to perform their tasks. This programme relies on:

- basic courses under the auspices of the National School of Prisons Administration (mainly for new recruits aware of contractual issues);
- advanced courses developed by the Unit for staff working within the regional task forces and local teams in prisons; and
- for the Unit’s staff, courses provided by an external trainer, to date mainly focused on negotiating issues.

<sup>5</sup> The scope of the contracts varies. They all include “soft” services, but only six cover the construction of new buildings.



## Topic 3 - The PPP contract: the main operational management tool

### Key questions for the Authority

The PPP contract sets out the basic rights and obligations of the parties during the construction and operating phase of the project. As a result, it should be the main operational management tool for the Authority. When drawing up or managing the contract, the Authority will have to ask itself a number of questions, including:

- Has enough attention been paid to operational management issues?
- What key operational management issues need to be tackled in the contract?
- How to ensure that the payment mechanism will work in practice?
- How to ensure that the Authority retains a degree of flexibility regarding the scope of the services to be provided, whilst keeping the private partner at risk?

### The contract may suffer from “transaction myopia”

**The PPP contract documentation (the “contract bible”) is invariably voluminous and complex.** It is drawn up in stages, from the drafting of the tender documents to financial close. It is the result of lengthy discussions and negotiations that take place during the procurement and closing phases and is meant to set the partnership framework on many aspects such as technical and financial matters.

**Many PPP contracts focus primarily on financial, legal and construction matters** and leave little room for more practical operational management issues. This can be explained by the fact that (i) financial and/or legal experts generally lead the team of advisers, (ii) technical advisers are often more concerned with and experienced in construction aspects and (iii) contract signature and financial close are seen as the most pressing goals of the procurement phase, while the operational phase appears to be a long way off.

### Imprinting the contract with an operational management culture

When drafting the proposed contract and negotiating it with the bidders, the Authority should **pay particular attention to the operational management provisions**, to ensure that they are coherent, precise and comprehensive. The main provisions are typically as follows:

- the planning, execution and monitoring of design and construction;
- requirements regarding the appointment of key staff;
- the performance objectives and how to measure them, including clear output indicators;
- the planning, execution and monitoring of maintenance;
- the payment mechanism, including performance incentives and continuous improvement measures;

- the management of refinancing opportunities, including the profit-sharing mechanism;
- information provision requirements;
- reporting made to the Authority;
- the management of minor and major changes;
- expiry or termination of the contract; and
- the prevention and resolution of disputes.

It is good practice to involve the technical adviser and possibly the contract manager in the preparation of the contract, so that the legal adviser is not left to their own devices in drafting a document that gives undue emphasis to the legal aspects.

### A sound payment mechanism

A sound payment mechanism is, together with the risk allocation, at the heart of the PPP contract. Because contract performance mainly concerns the operational aspects, it is important to **ensure that the mechanism specified in the contract can be applied in practice** for effective, trouble-free operational management. Again, this issue should be addressed prior to contract signature, ideally during the procurement phase.

The payment mechanism should incentivise the private partner to deliver the right level of performance, without unnecessary and costly over-performance, and penalise it if it fails to do so.

In “**Authority-pays**” contracts, the most common arrangement is a regular payment which is conditional upon the availability of the project facilities or services, with deductions being made for poor performance/unavailability. Designing the payment mechanism is a very delicate exercise that involves a **three-pronged approach** relying on: (i) performance indicators; (ii) the initial targets for those indicators and regular measurement during the operational phase; and (iii) the link between those indicators and the appropriate payment deductions.

To be efficient, the payment mechanism should:

- be built on **the performance requirements of each specific service**, translated into a reasonable number of measurable indicators;
- be based on **clear and pre-defined performance measurement methods** that are not subject to subjectivity or bargaining;
- include **reasonably ambitious performance targets**, possibly dynamic, to ensure that incentives are maintained throughout the contract;
- be as **simple** as possible;
- contain **deductions and penalties that are commensurate with the level of underperformance** (use of periodic and overall thresholds, and an escalator mechanism to penalise repeated underperformance); and
- not jeopardise the **financial robustness or bankability** of the contract.

In “**user-pay**” PPPs, where the private partner is typically remunerated via user payments, the situation is often simpler because **the economic logic of the contract inherently contains an incentive mechanism**: if the private partner

underperforms, it will face reduced demand and be penalised by a corresponding loss of revenue. However, some penalties may be contractually defined and applied to the private partner if:<sup>6</sup>

- it fails to comply with a **contractual obligation** (e.g. provide information on time); and
- its **performance falls short of an indicator** which the Authority wishes to specifically focus on (e.g. asset maintenance).

**Partnering in the design of the payment mechanism during the procurement phase** should lessen the likelihood of the private partner overestimating the risk of deductions/penalties and fully factoring them into the proposed level of regular payments, and of the Authority using possible future deductions as a budgetary adjustment variable.

In the interests of good governance during the operational phase, the Authority should endeavour to limit the risk of team members misapplying contract provisions (e.g. imposing or waiving penalties inappropriately).

### Proper use of deductions and penalties: demanding but fair

Provided that the payment mechanism has been adequately designed, the Authority should **apply it in full to provide the private partner with a real incentive to perform**. The value for money of the service provided very much depends on the ability of the Authority to **maintain fair but effective pressure on the private partner**. The Authority should explain at the outset that deductions and/or penalties are not meant to be punitive but simply a way to ensure the proper delivery of the services.

That said, **the Authority may in certain circumstances decide not to enforce its contractual right to impose a deduction or a penalty if it considers that there is an overriding interest** for it not to do so. This applies in particular where, despite a clearly worded contract, it is impossible to establish precisely what the private partner should be held liable for. In such cases, the Authority should inform the private partner of its decision not to enforce its contractual right (and motivate its decision) so that the private partner understands that the Authority's inaction is deliberate and the grounds are clarified should similar circumstances arise again.

### Retaining some flexibility

Because PPPs involve long-term agreements dealing with generally complex projects, it is impossible to foresee all the possible future events that may arise during the life of the contract. Although it is important to seek to identify, assess and allocate risks in a way which covers most future scenarios, there is always a **temptation to draw up a contract that is excessively complex and will in**

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<sup>6</sup> In respect of penalties, the Authority should consider whether it needs to require the private partner to provide some financial support (e.g. guarantee, reserve account) to make sure that penalties will indeed be paid.

**practice be very cumbersome and costly to manage.** Moreover, complex and detailed contractual provisions do not always preclude lengthy discussions about how those provisions should be interpreted.

**To ensure that a contract is easily manageable throughout its life and will subsequently deliver value for money, some flexibility should be introduced.** Here, however, there are a few things to avoid, such as:

- if the **contract provisions are too flexible**, risks that need to be transferred to the private partner may in fact not be fully transferred or may not be transferred in a sufficiently robust manner; and
- if, on the other hand, the **provisions are too rigid**, the Authority will be penalised should it face the opportunity, during the life of the contract, to obtain better value for money by making changes to the services provided (e.g. adapt a school building to changes in educational requirements) or by unlocking efficiencies (e.g. refinancing, renegotiation of an insurance policy).

Ways of ensuring that the contract retains a certain degree of flexibility include:

- during the procurement phase, gather **details on the cost structure and the economics of the project**. In the event of future negotiations on, for example, adjusting the scope of the services, this will provide a solid basis for discussion;
- similarly, again during the procurement phase, ask the private partner to **commit to unit prices** for marginal items of works or services;
- insert provisions on **sharing profits/savings** in the contract, not only where they depend on the efficiency of the private partner (e.g. refinancing opportunity, change in the law or technological improvement offering possible savings); and
- leave open in the contract certain matters to be specified or updated later on during the life of the contract. More often than not, this can be done through **periodic reviews**. For example, with regard to the maintenance of the project assets, an overall budget may be agreed between the parties at contract signature but the actual scheduling of the required maintenance works may be carried out through multi-year programmes agreed on a periodic basis (see Topic 8 below).

Finally, it should be made possible, where major changes in requirements are anticipated, but cannot be determined in advance, to **reduce the scope of the contract** or, alternatively, opt for partial early termination for part of the services.

## Topic 4 - Adopting a user-friendly contract management manual

### Key questions for the Authority

Adopting a contract management manual is recognised as good practice. When developing such a tool, the Authority should ask itself:

- What is the purpose of a contract management manual?
- When and how to draft it?
- What should it contain?

### An opportunity to define the management strategy

The contract management manual provides a **road map on how to manage the contract efficiently for all those at the Authority who will be involved in that process, either directly or indirectly**. Clearly, the manual should not substitute the contract which, as stressed in Topic 3, will always remain the “reference” document.

#### A multipurpose document

First of all, the contract management manual should explain clearly, in a reader-friendly style, without legal jargon, **what is expected of the Authority in concrete terms** in order to (i) fulfil its practical obligations to the private partner (i.e. “what do I have to do?”) and (ii) assume its own duties in terms of follow-up and monitoring (i.e. “what do I have to check?”). The manual provides **the Authority with a means of planning and setting out its own organisational arrangements**. These matters are typically not covered in the PPP contract itself as the Authority is often reluctant to share with the private partner information regarding its own arrangements or because it may be inappropriate to set out in a contractual agreement provisions that might be subject to frequent unilateral changes. This is typically the case of internal procedures involving different departments within the Authority’s administration (e.g. operational management team and accounts department for the payment procedure). With respect to projects that involve numerous public stakeholders (e.g. schools, hospitals), the scope of the manual may be broadened to deal with the interaction amongst the key public stakeholders public players.<sup>7</sup>

Secondly, the manual provides **an opportunity to set out the operational management strategy** and, have it approved at the appropriate level of the decision-making chain. In particular, such a strategy will aim to address the specific risks of the project that the Authority needs to manage. For this reason, when drafting the document, the Authority will need to pay particular attention to highlighting the **main**

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<sup>7</sup> In some cases, it may be useful to produce a separate manual dedicated to the users of the facilities (e.g. teachers in a school, doctors in a hospital) describing (i) the general principles of the PPP contract and (ii) the provisions that directly affect them.

**risks of the project** and ensure that the strategy that is about to be agreed will provide all the necessary tools and processes to mitigate those risks.

Finally, the manual will serve as a reference document throughout the life of the contract, **facilitating any handover that may be required between different members of the operational management team.**

#### Who should draft it and when?

It is often better to ask **those who will be in charge of operational management to draft the manual**, in collaboration with the procurement team and legal advisers. This approach has three advantages:

- it ensures that the manual will be drafted in everyday language and be accessible to all those who will subsequently be involved in operational management;
- it encourages information sharing between those involved in the procurement and post contract signature phases; and
- it obliges operational staff to become familiar with the PPP contract and its appendices and acquire both an overview and a detailed understanding of the contents.

Some parts of the manual, especially those dealing with the interface between the Authority and the private partner (e.g. data collection, performance measurement, billing validation process) may **usefully be shared with the private partner** to obtain feedback and ensure that it too will develop a similarly well-co-ordinated organisational set-up.

Initially produced prior to the entry into force of the contract, the manual must be **regularly updated throughout the life of the project** to take account of changes internal to the contract itself (mainly resulting from amendments) and/or in its external environment (e.g. changes in the law, changes in the way in which the Authority is organised). The first version of the manual can focus mainly on design and construction matters, while those relating to the operating period can be developed during the project's construction phase. Likewise, guidance on managing periodic reviews (see Topic 8 below) and the end of the contract (see Topic 10 below) can be produced as progress is made.

#### Clear, modular content

The contract management manual should be **as concise and modular as possible**. In terms of structure, it should combine a topical approach (e.g. organisation of the Authority's team, payment management) with a chronological one, specifying key dates and deadlines. This modular approach will facilitate future updating. Box 3 below presents a possible structure for the manual.

To describe procedures and organisations, the **use of charts should be preferred to lengthy texts**. To make the manual easier to use, some **standard forms and/or document templates** may be prepared and attached as appendices.

The manual **is not, of course, a substitute for the actual PPP contract**. It provides a reference to specific sources in the contract documentation in order to facilitate access to more detailed information or legal background.

**Box 3****Possible content of a contract management manual**Introduction

- Purpose of the document
- Background to the project/contract (origin, commercial structure and objectives key aspects of procurement)

Governance

- Boards and committees
- Communication and information processes
- Decision-making processes
- Delegated powers
- Stakeholder management (including end-users)

Structure of Authority's team

- Organisation chart
- Roles and responsibilities
- Key contacts

Structure of private partner's team

- Organisation chart
- Roles and responsibilities
- Key contacts

Construction period management

- Meetings (type, purpose, frequency, attendance, outputs)
- Key specification requirements
- Data collection, validation and recording
- Reporting
- Accounting aspects (especially balance sheet treatment)
- Risk management process
- Managing changes

Service period management

- Meetings (type, purpose, frequency, attendance, outputs)
- Key specification requirements/performance targets
- Help desk
- Data collection, validation and recording
- Reporting
- Risk management process
- Payment mechanism and process, including budgetary and accounting aspects
- Reviews
- Managing changes
- Dispute resolution

## Topic 5 - Information and data management tools

### Key questions for the Authority

Experience shows that gathering adequate information is fundamental to the operational management process. When thinking about information provision and management, the Authority should ask itself a number of questions, such as:

- How should the information and data management tools be managed?
- What information is necessary to manage a PPP contract properly?
- Which tools are appropriate for managing contractual information?
- To what extent could these tools be shared with the private partner?

### The importance of relevant information/data

Without relevant information, the Authority will be unable to make sound decisions, monitor the private partner's performance, comply with its contractual obligations or manage project-specific risks. In a typical PPP project, most of the information is provided by the private partner. The Authority's role consists mainly of **obtaining this information and verifying that it is accurate and consistent**.

Wherever possible, to limit the cost of operational management for the Authority, it is useful to encourage a combination of **self-assessment** by the private partner with some, rather than a full, external assessment by the Authority: for example, the regular statements of performance used as a basis to calculate payment deductions can be self-generated by the private partner but the Authority has the right to verify the data through random assessments.

### Defining the information scope and transmission process

The Authority should impose on the private partner a **contractual duty to provide regular reports** on how it is performing. The information will typically include:

- **technical items**, such as performance indicators or the maintenance tasks that have been carried out during a given period;
- **financial items**, such as the financial statements of the private partner or a detailed breakdown of user-paid revenues; and
- **legal items**, such as a major change in a sub-contract.

The private partner will sometimes be reluctant to share information with the Authority. It is important for the parties to strike a suitable **balance** such that the Authority:

- **limits its requirements** to what is strictly necessary to fulfil its responsibilities without interfering in the private partner's management or affecting its industrial and commercial property rights and incentives; and
- **is fully able to monitor** the performance of the services. It is in particular important to ensure that relevant information is available throughout the "normal

course” of the contract but also to deal with difficulties that may arise (e.g. force majeure, default by the private partner).

During the contract drafting process, the Authority should be **clear and prescriptive regarding the level of detail, format and deadlines** of the data to be produced by the private partner. Information requirements differ between construction period and service period. However, for both periods, the type of information needed from the private partner should be carefully considered to avoid:

- **requiring too much information, which would be costly to produce and collate** for the private partner and ultimately for the Authority to analyse; and
- **requiring too little information, which would limit** the Authority’s ability to perform its duties.

The “**information package**” provided for in the PPP contract could usefully include:

- **monthly or quarterly scoreboards**, designed to offer, at a glance, an overview of contract performance during the period in question;
- an **annual report**, providing a comprehensive view of all the relevant technical, financial and legal data regarding the performance of the contract during the year that has just ended (see Box 4 below for an example); and
- **real-time data and summary reports** on service performance levels via an IT solution (see below).

**Adhering to the same structure and layout from one period to another is key to streamlining the processing of information** (e.g. analysis of variations). This is particularly important for financial statements. The Authority should also ensure that the format of the information it is provided with is tailored to fit in with the tools used by the contract managers for analysis and monitoring purposes.

**Penalties** may be introduced to incentivise the private partner to comply with its commitments both in terms of timing and the quality of information delivered.

#### Box 4

##### Content of the annual report to be provided by the private partner according to French law on PPP contracts ("*contrats de partenariat*")

In French PPPs, a typical annual report includes the following economic and accounting data:

- The **annual financial statements** regarding the project covered by the contract. This document must set out: (i) the data for the previous year, following the same format for the purposes of comparison and analysis, (ii) the data used for contractual indexation and (iii) precise justification of any costs charged to the contract;
- A presentation of the **economic and accounting methods used to allocate revenue and expenditure** to the financial statements, together with a specific mention of any changes made during the year to the method of calculation and the reasons for making them;
- A statement specifying **any changes in the ownership** of the real estate assets covered by the contract and in the **accounting depreciation schedule**;
- A report on **the situation concerning the other fixed tangible and intangible assets** required to provide the service. This report must be aligned with the tables presenting the amortisation and renewal plans for those assets;
- A statement setting out any other **renewal expenses** incurred during the year;
- A document detailing **any commitments that might have a financial impact** on the contract and the public service to be provided; and
- The **calculation of the economic and financial internal rates of return** on the project and details of **how the value generated has been allocated to remunerate equity and repay debt**.

It also includes a range of indicators, such as:

- Details of the extent to which **performance targets** have been achieved;
- Details of those **parts of the contract's activities which have actually been outsourced to small and medium-sized enterprises**;
- **Any revenues received by the private partner in addition to the regular payments** received from the Authority; and
- The **deductions and penalties** that have been imposed on the partner and those that have actually been paid.

## Using IT solutions to obtain reliable information

Whatever its form (concession, Authority-pays), a PPP contract ultimately aims to deliver an efficient service to a range of end-users. Performance must be closely monitored by the Authority so as to ensure a proper and constant engagement of the private partner. **Most private companies involved in PPPs use IT solutions to manage their activities**, such as Computer Assisted Production Management Systems (“CAPMS”) and/or Computer Assisted Maintenance Management Systems (“CAMMS”). They are used in-house, for example, to monitor a range of technical indicators, plan future operations, assign tasks within the operational teams and keep a record of the works carried out. They are sometimes linked to accounting software to facilitate integrated business unit management. Although generic solutions are available on the market, experience shows that most of these computer tools are designed and/or adapted by each company to fit in with its own way of working.

In this context, it is good practice for the Authority to:

- stress in the tender documents that the Authority expects to have **transparent access** to these tools throughout the life of the contract;
- **discuss during the procurement stage which IT solutions** the bidders are planning to use and the extent to which they can be shared with the Authority (e.g. licensing rights, personal data protection issues);
- request the private partner to **design appropriate IT interfaces**, such as a dedicated web portal, for the Authority; and
- **test-run** the private partner’s IT tools in advance of operations commencement in order to ensure that they are functional.

Clearly, the Authority will need to ensure that there is full consistency between the contractual performance indicator methods it will impose and the IT interfaces that will be adopted. The aim is to **ensure that performance can be measured and monitored using the IT tools** and that **these IT tools generate reliable and accurate data on a regular basis**.

Experienced Authorities, such as those involved in managing a range of contracts, may have developed their own standardised IT platform and will therefore ask candidates to use their tool.

Apart from being useful for monitoring the day-to-day performance, an IT platform can also be employed to:

- **manage the help desk** that will enable the private partner to receive queries from the Authority and end-users;
- **manage payments and calculate the deductions and/or penalties** to be applied; and
- **store and share documents** between parties, such as updated contractual documentation, scoreboards and annual reports.

The Authority should seek to **obtain all the relevant property or user rights** for the IT tools it intends to use to ensure that it will be able to:

- periodically check the reliability of the data production process;
- store key data even after the contract expires (e.g. end-user database, records of maintenance operations); and

- use the tools after the end of the contract.

Finally, it is good practice for the operational management team to **keep a record of all key documents received and sent in a dedicated database** using an electronic document management system.

### Box 5

#### What should be monitored during the construction phase?

The Authority should invest time and resources to ensure that its requirements regarding project construction are met. This is particularly important to prevent the Authority from inheriting poor quality assets should the PPP contract be terminated earlier than scheduled following a default of the private partner.

To varying degrees, construction monitoring typically includes:

- **reviewing and signing off the various construction plans** to check that they are in accordance with the agreed specifications;
- auditing of the private partner's adherence to **design and construction quality plans**;
- attendance at the **works meetings** between the private partner and its contractors;
- involvement in the **completion process** involving the special purpose company and its subcontractors;
- **checks and inspections by independent technical advisers/auditors**;
- **formal acceptance of the facility** by the Authority before operations commence, in accordance with the contract; and
- **financial monitoring** of the construction payments.



## Topic 6 - A financial model for operational management purposes

### Key questions for the Authority

The project's financial model is one of the most important operational management tools for the Authority. When thinking of the use of the financial model, the Authority should ask itself:

- Why is the financial model developed during the procurement phase also useful throughout the life of the PPP contract?
- What are the main differences between the models used before and after closing?
- How to secure and manage a model that meets operational management requirements?

### Different financial models to meet different needs

In the context of a PPP, a financial model is a spreadsheet used to forecast the future cash flow of the project and provide key economic and financial information. It is developed by financial experts as **a major tool for decision-making** for both the Authority and the private partner (e.g. bid assessment, affordability checks, bankability and profitability analysis). Its output is shared with many of the parties involved in the project's financing (e.g. the shareholders of the private partner, lenders).

A number of financial models are typically developed and used at different stages of project implementation. For example:

- At project preparation stage, the Authority generally uses a preliminary financial model to **assess the economic and financial feasibility of the project** (e.g. calculation of the economic internal rate of return, identification of the major economic and financial drivers), forecast its future value for money and help choose the most appropriate procurement mode for implementing the project; and
- During the procurement stage, **each bidder will usually develop its own financial model to forecast the project cash flow** and help it make the most appropriate choices regarding payment mechanism, financing structure, etc. This model is intended, mainly, to satisfy the requirements of sponsors and lenders and is usually focused primarily on financing issues.

### A financial model for operational management purposes

Post contract signature, a financial model is **indispensable** to the Authority to, for example:

- periodically **calculate the payments** due by the Authority to the private partner and estimate future payment commitments. Indeed, in Authority-pays PPPs, the payment amounts (e.g. availability fee) are agreed at contract signature but need

- to be adjusted on a regular basis (e.g. monthly, quarterly) to take into account indexation provisions (i.e. inflation) and performance-related deductions and penalties. Besides, payments need to be adjusted on an *ad hoc* basis when the compensation provisions of the PPP contract allow for it (e.g. delay or additional cost risks not borne by the private partner, force majeure events);
- in user-pay arrangements, periodically **assess the long-term economic and financial sustainability** of the contract. In such contracts, user tariffs are typically adjusted on a regular basis (e.g. to cater for inflation or actual demand) and profit-sharing/profit-capping mechanisms are agreed. Such mechanisms imply regular financial monitoring and projections and therefore use of a robust financial model.
  - **evaluate the impact of changes**. Given their long duration and complexity, most PPP contracts are subject to changes during their lifetime (e.g. refinancing, need for additional capacity, modification of the services scope, see Topic 9 below). The financial model is used to assess the impact of these changes and define the compensation amounts or the revised payment profile;
  - facilitate the **preparation of financial statements** and monitor key financial indicators such as gearing, debt cover ratios and internal rate of return; and
  - **calculate the compensation sums** due by the Authority in the event of an early contract termination (e.g. following a serious default or a mutual desire to terminate the partnership early).

In addition to the standard functions required at preparation and procurement stages, to be fit for operational management, the financial model should enable users to:

- replace forecast values with the **actual values** and reset the assumptions used to update forecasts based on actual data;
- store **key historic data**, both financial and performance-related; and
- perform **financial control analyses**.

### Securing and managing a suitable financial model

The parties to the contract should agree to **share a single financial model for the operational period**. If two models co-exist, there is a high risk that considerable time and energy will be spent on long-drawn-out reconciliation discussions. A single model does not imply agreeing on a single set of assumptions: it is important that either party retains the ability to carry out its own projections for its own purposes.

The preferred option will often be to **ask the private partner to develop the operational management financial model and share it with the Authority**. More often than not, it will already have internal modelling capability and would have developed such a tool for its own purposes anyway. As a result, the Authority should:

- **state in the tender documents** that the transaction model requested at this stage must be sufficiently flexible to be used as a model to meet the requirements of the operational period for both parties; and
- to insert **provisions in the PPP contract** obliging the private partner to: (i) develop an appropriate financial model, (ii) ensure that it is externally audited, (iii) update it regularly during the life of the contract, in particular at the Authority's request and (iv) share it with the Authority on a transparent basis.

The Authority will therefore limit its involvement to that of an “advanced” user, defining its own set of assumptions and analysing the results. This will, however, require the management team to have some expertise in financial modelling, which will often call for the support of a financial adviser (e.g. training the team members).

## Checklist 1 - Designing the operational management role

The checklist below sets out the typical tasks required in preparation for the operational phase.

When?	Which tasks to perform?
<b>During the preparation of the tender documents</b>	<ul style="list-style-type: none"> <li>– Consult future stakeholders (e.g. end-users, supervisory authorities, other government departments, future contract management team) to (i) identify their needs in terms of performance, indicators and target levels and (ii) assess how they will interact with the project.</li> <li>– Design an operational management strategy by answering the following key questions: What information/data will be needed? What governance should be adopted (e.g. steering committee, contract manager, contract management team)? What procedures and tools should be adopted? When? Who will be involved? How much will this cost? Where will funds come from?</li> <li>– Include in the draft PPP contract sent to the bidders all the relevant arrangements relating to output specifications, performance measurement, payment mechanism and information/data collection.</li> <li>– If possible, recruit the future contract manager or task someone to think about operational management issues during procurement.</li> </ul>
<b>At procurement stage</b>	<ul style="list-style-type: none"> <li>– Ask bidders how they will organise themselves to comply with the Authority's wishes and listen to any constructive remarks they may have.</li> <li>– Fine-tune the operational management strategy.</li> <li>– Recruit other contract management team members.</li> <li>– Establish framework agreements to enable external expertise to be called upon.</li> </ul>
<b>Immediately after contract signature and financial close</b>	<ul style="list-style-type: none"> <li>– Fine-tune the contract management manual for the construction period.</li> <li>– Amend the financial model to meet the requirements of the construction period.</li> <li>– Test and start operating the information collection and management system for the construction period.</li> </ul>
<b>Upon project completion and when the service come on stream</b>	<ul style="list-style-type: none"> <li>– Fine-tune the contract management manual for the service period.</li> <li>– Amend the financial model to meet the requirements of the service period.</li> <li>– Test and start operating the information collection and management system for the service period.</li> <li>– Train stakeholders.</li> </ul>
<b>At the end of the contract life</b>	<ul style="list-style-type: none"> <li>– Prepare for the end of the contract by collecting detailed information on the state of the project, the employees needed to continue operation, the financial situation of the project/private partner, etc.</li> <li>– Make all the necessary arrangements to bring the contract to a successful conclusion and ensure that the services continue to be delivered after contract expiry.</li> </ul>

## Section 2

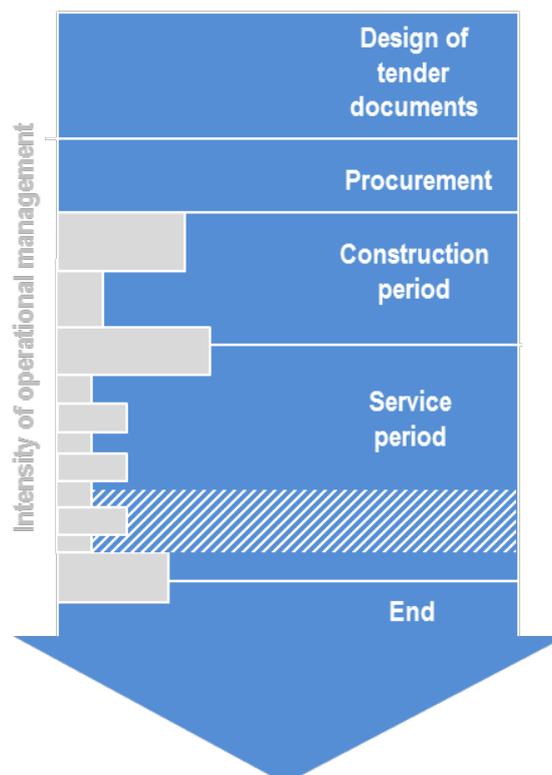
### Performing the operational management role

For the Authority, performing the operational management role will mainly consist of carrying out the tasks defined in the operational management strategy using the tools designed for that purpose (as set out in Section 1). In this context, a series of specific issues will need to be considered, such as:

- How to avoid, insofar as possible, and manage disputes (**Topic 7**);
- How to undertake reviews that will enable regular value for money checks to be made (**Topic 8**);
- How to manage change? (**Topic 9**); and
- How best to prepare for the end of the contract to ensure that the services continue to be properly provided (**Topic 10**).

Figure 3 below illustrates the “intensity” of operational management tasks for the Authority, from contract signature to contract expiry.

**Figure 3 – Performing operational management tasks through the life of the contract**





## Topic 7 - Preventing and managing disputes

### Key questions for the Authority

Experience shows that disputes are not uncommon in PPPs (as they are with other complex contracts between the public and private sectors). As a result, the Authority will need to prevent or limit the occurrence of disputes to the extent possible and manage them appropriately when they arise. The key questions the Authority needs to ask itself are as follows:

- What are the main reasons for disputes to arise?
- How to prevent disputes?
- How to design an effective dispute resolution process?

### The inherent tension between “value” and “money”

Although the parties involved in a PPP should have a common interest in the success of the project, they might have a different understanding of what constitutes success. There will invariably be **an intrinsic tension between the “value” of the services provided to the Authority and the “profit” to be made by the private partner** out of the contract. Because most PPPs extend over the long term, the partnership may at times be overtaken by events (e.g. changes in the project environment or in the project itself) and each party may be tempted to review its initial commitments to protect its own interests. This is when most disputes arise.

### Preventing disputes from arising

As disputes often take considerable time and energy to resolve, they may jeopardise the success of the whole project. Therefore, wherever possible, each party should **do its best, to prevent problems from developing into conflicts**.

To limit the risks of disputes, the parties to the PPP contract should endeavour in particular to:

- ensure that the **wording of the contract is as clear as possible** (see the guidance given under Topic 3); and
- develop and maintain a **constructive partnership relationship** (see the principles set out under Topic 2), by, for example, establishing interfaces at the various hierarchical levels to ensure that appropriate communication channels remain available beyond the day-to-day relationship.

### How to deal with a dispute without jeopardising the project

If, despite the prevention measures above being adopted, disputes arise, the parties should tackle them in accordance with a clearly defined resolution process. This means that **the PPP contract should include a formal dispute resolution process**, which ideally would:

- endeavour to achieve win-win solutions in the interest of the project;

- be clear and simple:
  - to avoid further tension to arise from the interpretation of the dispute resolution procedure itself (e.g. the appointment of an external expert whose opinion will be respected by both parties);
  - to avoid unnecessary expense, either direct (i.e. cost of the resolution process itself) or indirect (i.e. costs resulting from the persistence of the problem);
- include:
  - a range of reconciliation procedures, which are **proportionate to the seriousness of the dispute**;
  - a **hierarchy of resolution procedures** (i.e. from an internal committee for dialogue between the parties, to an external expert's opinion or mediation and, finally, to arbitration or court proceedings) and **mechanisms** (i.e. from adjustment of the Authority payments or tariffs, to relaxation of the performance requirements and termination);
- endeavour to **avoid standstill situations**. In particular, it should:
  - ensure that the parties **continue to meet their contract obligations during the dispute resolution procedure**, without prejudice to their being compensated subsequently depending on the final decision regarding the dispute; and
  - include **fixed time limits within which the parties will be obliged to consult each other** and encouraged to find solutions.

Given the cost of a long-drawn-out dispute resolution procedure and the fact that the ultimate way to end a dispute is to terminate the contract, the private partner's equity investors and lenders will pay close attention to the design of the dispute resolution process. **If this issue is not properly addressed, it may even jeopardise the "bankability" of the contract.**

## Topic 8 - Undertaking periodic reviews

### Key questions for the Authority

Given the long-term nature of most PPPs, the Authority should carry out project and contract reviews on a periodic basis. In doing so, the Authority should focus on a number of questions:

- What is the rationale for undertaking periodic reviews?
- What should be the scope of the reviews and what methodology should be used?
- How to identify and benefit from potential savings?
- What issues are commonly neglected in reviews?

### The need for a periodic project “health check”

The objectives of periodic reviews are twofold:

- They are a way of monitoring the project in order to **assess its overall fitness for purpose** and identify how it can be adapted to a changing environment (e.g. change in the requirements of the Authority, change in the project’s economic or legal frameworks); and
- They are a way of checking whether or not the **private partner is actually delivering the required services** and of evaluating its efficiency in doing so.

Often, reviews will help maintain and/or improve the value for money of the PPP project.

**The timing and scope of the reviews should be considered at the time of contract drafting.** Typically, a full technical, financial and legal review should take place every five years. As mentioned under Topic 3, these reviews may be used to introduce some flexibility, where necessary, within the contract. They may be supplemented or replaced by reviews scheduled on an *ad hoc* basis to identify, for example, causes of persistent underperformance in the service provision or as a result of doubts about the private partner’s good faith in reporting accurately the technical and financial status of the project.

Depending on its particular objectives, a review may be broad in scope and give a **full picture of the contract’s overall performance**. Alternatively, it may be focused on a very specific technical, legal or financial issue (e.g. is the partner actually meeting the maintenance plan agreed between the parties?).

Reviews may be carried out internally by the operational management team itself, but because they may entail a **heavy workload**, they will often be outsourced to external consultants. In addition to their input in terms of extra human resources, **consultants** will typically have experience with a large number of projects, and may therefore add value in the identification of underperformance/wrong-doings and be able to benchmark the project against their own database.

Finally, it is worth bearing in mind that reviews often lead to **contract amendments** (see Topic 9 below).

## Looking for opportunities to make savings<sup>8</sup>

During reviews, any room for potential savings for the Authority should be identified. Savings may arise from:

- Improvements in the **private partner's efficiency** in providing the service, such as deploying fewer resources to achieve the same output by increasing monitoring, reengineering service delivery and motivating employees;
- **Changes in the Authority's requirements**, such as adjusting initially overestimated performance levels, changes in the scope of the services, greater flexibility for the private partner to develop complementary business activities using the facility; and
- **Changes in the project environment**, such as changes in law which may be beneficial to the project (e.g. increase in statutory working hours), lowering the cost of financing, using new technologies (e.g. IT monitoring and management of energy consumption in an old building).

Subject to the wording of the contract, the Authority may be fully entitled to **ask for savings to be shared** where they result from the last two categories referred to above. If savings from an increase in the private partner's efficiency exceed a certain level, the Authority may also seek to claim part of the additional profit.

However, in looking for savings, the Authority must be careful **not to take measures that appear to save costs in the short term but will be detrimental to the value for money over the long run** (e.g. cuts in the maintenance programme, aggressive gain-sharing that would reduce the private partner's incentives to innovate).

With regard to changes in the project environment, the contract may also provide for mechanisms<sup>9</sup> such as:

- "**market testing**", where the private partner is obliged to periodically retender certain services to test their value for money on the market; and
- "**benchmarking**", a process whereby the parties to the contract compare the cost and performance of the services delivered by the private partner with a sample of other comparable service providers.

Such mechanisms are suitable only in countries where the services market is already quite mature and offers a range of comparison sources.

## Identifying and managing refinancing opportunities

During the life of the contract, **the parties may be forced or consider it appropriate to review the financing structure put in place at financial close**. Typically this may arise (i) where the parties have used financing instruments with maturities that are significantly shorter than the duration of the contract (e.g. use of

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<sup>8</sup> For further information, see HM Treasury, "Making savings in operational PFI contracts", July 2011.

<sup>9</sup> For further information see HM Treasury, "Operational Taskforce Note 1: Benchmarking and market testing guidance", October 2006.

“mini-perms” which must be refinanced during the service phase) or (ii) where the general market conditions have changed and become more attractive (e.g. interest rates have fallen and the hedging arrangements do not preclude the private partner from benefiting from this).

A well-drafted contract will incentivise the private partner to seek out refinancing opportunities without having to be called upon to do so by the Authority. However, it may be good practice to use the periodic reviews to check on a regular basis the opportunities available on the financial markets.

When negotiating the provisions on refinancing, the Authority should:

- insist on **being informed** of any opportunity shortly after it has been identified by the private partner;
- make sure that the private partner will submit a **formal request** and that the Authority’s authorisation will have to be obtained prior to taking any action; and
- define the **precise basis for calculating the refinancing gain** to be shared: how to calculate the refinancing gain (e.g. choice of the benchmark indicator), how to share the gain (i.e. what percentage) and how the gain should be “paid” (e.g. as a cash sum, in the form of reduction in the Authority payments).

Finally, it is important to bear in mind that refinancing may apply not only to the debt but also to the **equity component** of the financing structure (e.g. increase the debt to equity gearing).

### Tackling the insurance issue

Insurance matters are often neglected because of their complexity. However, reviewing the insurance arrangements of a PPP is an important risk management task and can be a significant source of savings.

**To avoid any risk of insurance shortfall**, the Authority needs to periodically check whether the overall insurance cover, for both the private partner and itself, encompasses all the intended risks (e.g. adjustment of the insurance policies where new services are added to the contract, check insurance policy expiry dates, availability of insurance cover on the insurance market). As inadequate insurance cover may have serious financial and reputational consequences, the parties will have to find alternative ways of mitigating the risks that are no longer covered by insurance.

Provided that appropriate provisions have been included in the contract, the Authority can also achieve **insurance cost savings** as:

- insurance markets are **volatile** when it comes to pricing risk (e.g. for the same level of cover, the insurance premium may have fallen since the contract was signed);
- the **scope** of the PPP project services may have changed since the contract was signed; and
- the Authority’s own insurance cover or approach to self-insurance may have changed.



## Topic 9 - Managing changes to the project

### Key questions for the Authority

Given the long-term horizon of PPPs, changes to the scope of the project, services or contract terms are not unusual. This raises a number of questions for the Authority, such as:

- How to deal with changes occurring during the life of the contract?
- What are the main events leading to changes?
- How should changes be negotiated and formalised?

### Causes and effects of changes

Typically, **changes to the project can be proposed by either the private partner or the Authority**. The PPP contract should specify how any proposed change is to be submitted by the initiating party, considered by the other party, ultimately approved and when it will enter into force (e.g. form and content of the documents, deadlines).

Many changes arise because the parties are having to deal with unforeseen positive or negative events (e.g. the Authority has underestimated its requirements, the private partner has chosen an inappropriate technical solution that needs to be replaced).

**Most changes take the form of amendments to the initial contract.** It is therefore important that any agreed change is carefully recorded. The Authority should **maintain a full up-to-date version of the contract, including all amendments** made since the contract was signed, to limit any risk of confusion regarding which “version” of the contract prevails. Where necessary, the contract manual should also be updated accordingly.

When dealing with changes, the Authority must bear in mind their cumulative impact since contract signature as these **may form a substantial change to the initial arrangement** and infringe EU procurement rules.

Finally, some changes will require the private partner to incur capital expenditure that will **need to be financed**. The private partner’s original financing package will often not cater for significant/subsequent capital expenditure. It is therefore important that the Authority and the private partner agree at financial close on how future changes will be financed (e.g. up to what point the private partner should be obliged to finance changes).

## Negotiating amendments

Experience shows that in most cases **changes involve a great deal of negotiations between the parties**.<sup>10</sup> Such negotiations will be facilitated if (i) a good partnership relationship has been maintained between the parties from the outset, (ii) there has been regular monitoring by the Authority and (iii) the initial contract provides for sufficient flexibility.

To avoid constant negotiations, it is good practice to **deal with a number of issues at the same time and draw up a single amendment** (e.g. once a year).

For complex changes sought by the private partner, it may be in the interests of the Authority to carry out a forward-looking audit or review of the contract to help it in the negotiations. The assessment of a proposed amendment should be **as comprehensive as possible and not be limited to the direct consequences of the change, to avoid any unforeseen knock-on effect** on other contractual provisions that will subsequently jeopardise the Authority's interests.

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<sup>10</sup> For additional information, see HM Treasury, "Operational Taskforce Note 3: Variations protocol for operational projects", March 2007.

## Topic 10 - Managing the end of the contract

### Key questions for the Authority

“End of the contract” refers to the **early termination**<sup>11</sup> or **natural expiry** of the contract. It will raise a number of questions for the Authority, such as:

- How to bring the contract to a successful conclusion and manage on-going services?
- What are the critical issues involved?
- What tasks should be performed to mitigate the risks involved?

### “Last but not least” issues

In dealing with the end of a PPP contract, the Authority should, in particular:

- **avoid any gap in the service delivery** between the end of the existing contract and the implementation of any new arrangements, which may entail a re-tendering of the contract or providing the services “in-house”;
- **obtain all key information/data** from the outgoing private partner such as to **manage the transition process** effectively (e.g. a fair and competitive re-tendering of the service will require an information level-playing field with the outgoing private partner which may try to retain information for its exclusive use); and
- seek to **protect its interests**, both financial and as ultimate owner of the project assets.

### Tasks to perform to bring the contract to a successful conclusion<sup>12</sup>

To bring the contract to a successful conclusion, the Authority should consider taking the following steps:

- The end of the contract is a long way off when the contract is first negotiated. This makes the drafting of detailed/adequate provisions difficult. It is therefore good practice, a few years before the contract is scheduled to end (or as early as possible in case of early termination) to **review and fine-tune where necessary the end of contract arrangements** to ensure a proper transition;
- **A technical audit**, together with the production of a revised maintenance plan, should be procured early enough before the end of the contract. Such an exercise may be repeated at the end of the contract so that the outcome can be taken into account when tendering any new contracts. This audit could cover both the state of the assets and the terms of employment of the private partner

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<sup>11</sup> For specific guidance on the legal and financial aspects of early termination provisions, please see EPEC's report on “Termination and Force Majeure Provisions in PPP contracts”, March 2013 at: [www.eib.org/epec/resources/Termination\\_Report\\_public\\_version.pdf](http://www.eib.org/epec/resources/Termination_Report_public_version.pdf)

<sup>12</sup> See HM Treasury, “Operational Taskforce Note 4: Planning for a successful exit”, October 2009.

staff. On the latter point, the contractual provisions or, in some countries, the law may require staff to be transferred from the existing operator to the new one (private or public). Detailed personnel information would therefore be needed to inform bidders during a re-tendering process;

- The financial liabilities of the private partner that arise towards the end of the contract (e.g. remedial works) often outweigh the residual project cash flow. Therefore, it is important that the Authority “**secures**” **these liabilities** (e.g. cash reserve obligations, performance bonds). Such undertakings need to be proportional to the financial risks at stake for the Authority and remain in place as long as they exist; and
- The Authority should **ensure that the accounting closure of the contract is fair and comprehensive**, and that the amounts owed by one party to the other are actually disbursed.

## Checklist 2 - Performing the operational management role

The checklist below sets out the typical tasks involved in operational management.

When?	Which tasks to perform?
<p><b>Shortly after contract signature</b></p>	<ul style="list-style-type: none"> <li>– Meet the private partner to start developing a genuine partnership</li> <li>– Continue to consult and communicate with stakeholders</li> <li>– Monitor the fulfilment of conditions governing the disbursement of funds</li> <li>– Check that the facilities are designed in accordance with the requirements of the Authority as expressed in the contract</li> <li>– Provide/help in obtaining all the necessary administrative authorisations for the availability of the land and start of the works</li> </ul>
<p><b>During the construction phase</b></p>	<ul style="list-style-type: none"> <li>– Take part in the regular works meetings (possibly as an observer)</li> <li>– Meet the private partner as often as necessary to maintain a sound relationship</li> <li>– Perform periodic checks on how the works are being carried out (e.g. quality of materials used)</li> <li>– Monitor project implementation progress against the contracted timetable</li> <li>– Communicate with stakeholders</li> <li>– If relevant, ensure that grants are disbursed in accordance with the undertakings given by those providing them</li> <li>– Manage requests for changes (from the private partner or the Authority)</li> <li>– Monitor the actual capital expenditure (assess the effects of inflation, impact of amendments to the initial project, etc.)</li> </ul>
<p><b>Upon completion of the project</b></p>	<ul style="list-style-type: none"> <li>– Meet the private partner as often as necessary to maintain a sound relationship</li> <li>– Verify that the works have been carried out in accordance with the agreed design, test the facilities and check their functionality</li> <li>– Formally accept the project and allow the service to commence, in accordance with the contract</li> <li>– Obtain/help obtain the necessary authorisations for the start of operations</li> <li>– Check that the final instalment of any grant, which is typically disbursed upon completion of the facilities, has been paid</li> <li>– Calculate the payments the Authority will actually need to make on a regular basis (e.g. availability fees) based on the eligible final construction costs (e.g. approved variations, inflation adjustments)</li> </ul>
<p><b>During the day-to-day follow-up of service delivery</b></p>	<ul style="list-style-type: none"> <li>– Meet the private partner as often as necessary to maintain a sound relationship</li> <li>– Monitor the availability of the project facilities and the service performance</li> <li>– Perform a regular check of those risks which were retained by the Authority</li> <li>– Manage requests for changes from the private partner or the</li> </ul>

When?	Which tasks to perform?
	<p>Authority (e.g. refinancing, re-scoping of the services)</p> <ul style="list-style-type: none"> <li>– Manage the payment mechanism (e.g. deductions, bonuses, indexation)</li> <li>– Engage in reviews of the Authority's processes to improve their efficiency</li> </ul>
<b>During the periodic reviews</b>	<ul style="list-style-type: none"> <li>– Appoint an in-house or outsourced team to review the project</li> <li>– Supervise and facilitate the work of the review team</li> <li>– Take any necessary measures arising from the review (e.g. additional audits, contractual amendments, increased monitoring of specific matters)</li> </ul>
<b>Near the end of the contract</b>	<ul style="list-style-type: none"> <li>– Check the physical status of the project facilities and identify any maintenance shortfalls</li> <li>– Design and share an action plan with the private partner which would be carried out in order for the facilities to be at the required quality when the contract will end</li> <li>– Gather the information necessary to retender the contract or switch to a provision in-house</li> <li>– Manage the accounting closure of the contract</li> </ul>

## Annex – Further information

### **A guide to contract management for PFI and PPP projects Public Private Partnership Programme (4Ps) in collaboration with Mott MacDonald (2007)**

**EPEC comment:** A practical document which aims at providing local authorities with a structured approach to the requirements for contract management in PFI and PPP projects.

### **Contract management guide Partnership Victoria: Guidance Material (June 2003)**

**EPEC comment:** A highly advanced guide to contract management which provide the reader with a wide understanding of the issues at stake before proposing a comprehensive contract management approach.

[www.partnerships.vic.gov.au/ca25708500035eb6/0/39cad82d3b722077ca2570c0007d71f2?opendocument](http://www.partnerships.vic.gov.au/ca25708500035eb6/0/39cad82d3b722077ca2570c0007d71f2?opendocument)

### **Investigating the performance of operational PFI contracts Ipsos MORI (2008)**

**EPEC comment:** This report provides a comprehensive review of the performance of PFI projects in their operational phase. It was commissioned by HM Treasury (UK) and contains useful comparative data on how effectively PPP contracts have been managed.

### **Making savings in operational PFI contracts HM Treasury (July 2011)**

**EPEC comment:** A summary of the key areas where PPPs can yield cost savings, as identified in a recent review.

### **Managing complex capital investment programmes utilising private finance HM Treasury/National Audit Office (March 2010)**

**EPEC comment:** A best practice model for managing PPPs, with specific emphasis on improving effectiveness during the operational phase.

### **Operational Taskforce Note 1: Benchmarking and market testing guidance HM Treasury (October 2006)**

**EPEC comment:** This paper forms part of the Operational Taskforce guidance series and provides specific guidance and practical advice regarding variations to PPP contracts at the service delivery stage, as well as additional detail concerning 'Managing Benchmarking and Market Testing'.

**Operational Taskforce Note 2: Project transition guidance  
HM Treasury (March 2007)**

**EPEC comment:** This paper forms part of the Operational Taskforce guidance series and provides specific guidance and practical advice concerning PPPs that are at the service delivery stage, as well as detail on a number of the topics already covered in this paper.

**Operational Taskforce Note 3: Variations protocol for operational projects  
HM Treasury (March 2007)**

**EPEC comment:** This paper forms part of the Operational Taskforce guidance series and provides specific guidance and practical advice concerning variations to PPP contracts at the service delivery stage, as well as additional detail concerning the management of variations.

**Operational Taskforce Note 4: Planning for a successful exit  
HM Treasury (October 2009)**

**EPEC comment:** This paper forms part of the Operational Taskforce guidance series and provides specific guidance and practical advice on ensuring a successful handover of the PPP assets to the public sector at the end of the contract period or if the PPP contract has been terminated early.

**Project Governance: a guidance note for public sector projects  
HM Treasury (November 2007)**

**EPEC comment:** This paper contains guidance and practical advice on establishing the governance arrangements for PPPs.





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