

Public-private partnerships in infrastructure projects

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The government has said it intends to use public-private partnerships (PPPs) to help it achieve its infrastructure development goals. To this end, the previous administration passed the Private Investment in State Undertakings Act (2013) and the current government announced a related strategic plan in 2015.



For PPP projects that fall under the 2013 Act, government work units in charge of a particular project must offer a joint investment agreement with terms approved by the State Enterprise Policy Office and the Policy Board on Allowing Private Entities to Make Joint Investment in the State's Business.

At a minimum, the agreement must specify the period of the project, details of services to be performed, service fees and method of payment, assets of the project company and land ownership, as well as other standard clauses such as force majeure, termination and liquidated damages, guarantee and insurance, and dispute resolution.

It may seem that there is a common contractual framework for each type of project, but in fact the terms of each agreement can vary considerably, depending largely on inherent risk factors.

Demand risk: The demand by end users may be less than what was originally projected. For a motorway or railway, there is always a lot of uncertainty surrounding the degree to which the public will use the new infrastructure. Although technical due diligence will include an assessment of likely demand, it is impossible to predict with absolute certainty.

By contrast, demand for power generation in specific areas tends to be more predictable, as current shortfalls and forecasts for increased energy consumption are more readily apparent. Private parties to energy PPP agreements often mitigate against demand risk by insisting on guaranteed feed-in-tariff rates, or "take-or-pay" terms in the power purchase agreement.

In the concession model -- used in sectors such as upstream petroleum production -- the private entity assumes the majority of the risks in return for a large share of the benefits if the project is successful. This generally includes complete assumption of the demand risk.

By contrast, when the PPP agreement takes the form of an operating and maintenance agreement, the demand risk remains with the public sector while the private entity acts mainly as a service contractor.

In comparison to these more extreme types of PPP arrangements, a "design-build" or "design-build-operate" (DBO) model allows the public sector to maintain ownership while allocating the design and construction tasks to a private entity. If the latter is operating the project, it often does so in exchange for fixed fees while the public sector recoups its costs through pay-as-you-go fees from the public. DBO is a common, though not the only, structure available in toll-road projects.

Other arrangements -- "build-operate-transfer" (BOT), "build-transfer-operate" (BTO) or "build-operate-own" (BOO) -- shift ownership, either temporarily or indefinitely, to the private party. This offers the potential for greater rewards but also greater risk. The private partners in BOT or BOO contracts are generally responsible for financing. Such structures are commonly used in greenfield power generation projects, particularly when the government or a state-owned entity acts as the power purchaser.

According to a report released earlier this year by the Asean Secretariat, the Thai Department of Highways has been reviewing different PPP approaches for tollways. It is aware that tolls collected by private investors under a BTO model may be insufficient to cover the costs of the project, and may not be sufficiently attractive to a prospective investor. On the other hand, a DBO model, or a variant, requires the government to assume a greater degree of risk in the event the highway is underused.

Other risks: Political and regulatory risk often refer to the possibility of expropriation to the detriment of a private investor, or a change in regulations that would adversely affect profitability.

It is difficult to completely mitigate such risks in a PPP agreement, since they are more fundamental to the state's capacity and willingness to promote private investment, particularly with regard to public infrastructure. Thailand has been a model for a number of developing economies, as successive governments have actively encouraged both private investment and PPP projects in general.

Additional risks that both public and private parties may need to consider include environmental, insurance, social, and exchange-rate risk. Since the public sector generally develops the contractual framework prior to offering a tender, it will need to carefully consider which contractual form will best promote the public policy objective while attracting sufficient interest for private investment. Terms that allocate most risks to the private party may be unattractive in some situations, particularly where the potential rewards cannot justify the assumption of such risks.

When properly executed, PPPs can be an efficient means to allocate state resources to promote economic growth and benefit the public. For private investors, the increased use of PPPs in Thailand represents an economic opportunity. Understanding the allocation of risk in PPP agreements and developing strategies to mitigate them are a key components to a successful project.

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