

2012

A critical review of the Spanish
experience in concessions and
PPPs (P3)



Oliva González

MyO Company

29/08/2012

Clearly the aim of any PPP or concession system is to meet a social need for which there are no sufficient budgetary resources. Given such a lack of adequate resources, the need arises to raise private financing. This brings about certain risks, leading to the second basic aim of these systems – risk management.

Any form of management must be responsible, all the more so in this kind of systems. Collaboration between the public and the private parties must, above all, be based on the exercise of responsibility. All perversions of these systems originate from an improper exercise of responsibility.

It is essential to bear in mind that, when a social project is a candidate to being defined and managed through a P3 system, it must be studied in depth. To do so, the **first thing that should be done is to consider it unique**. It is not acceptable to copy from similar projects, a practice that is much more widespread than one would expect. **The project is unique** and should be studied as such. Although a benchmarking study may be carried out, it is the responsibility of the public party to identify all the conditions of a technical, economic, legal, financial, accounting, tax and any other nature which make the project feasible under a P3 structure.

To carry out a good study of the project, one should take into account that this type of systems generate economic growth and competitiveness, due both to the number of players involved (up to 30 in number, or more) and to the multiplying effect on the economy, since they fulfil social needs.

Therefore, **it is essential to conduct a proper study of the kind of bidders it would be desirable to have in the tender process, as well as their composition as a group**. This will subsequently have an impact on the good progress of the project, in all spheres, and will also influence the level of competitiveness reached in the region and in the country.

The case of Spain is a paradigmatic one in this respect. Since proper thought has not been given to the type of bidders and the desirable composition of bidder groups, tender awards – and therefore projects – have been cornered by construction groups, which have short- and medium-term interests rather than long-term ones. This compromises the management of conservation and maintenance, and penalises innovation in technology and in new ways of doing things. In addition, under the argument of the Administration's equity liability, bidders compete through aggressive cuts in the bidding variables, in the knowledge that they will be able to force negotiations on almost any issue that they may have throughout the project's lifetime. The current situation of motorway and dual carriageway concessions in Spain is a perfectly clear example of this type of situation. Out of the total number of concessions put out to tender in the past ten years, 95% have been renegotiated. Indeed, the number may actually be closer to 100%. Hence, there is currently talk of creating a state motorway and dual carriageway enterprise to rescue all the projects currently undergoing bankruptcy and insolvency proceedings.

Another fundamental consideration that must be taken into account when studying a project is the need to **identify all the interest groups involved in the project**, that is, all the groups potentially be affected by the project, regardless of whether such impact is positive or

negative. Then, it is **essential to determine how to generate value for** each and every one of these interest groups. Through a proper, thorough study, it is always possible to find a way to generate value for all. Such value may be monetary or non-monetary, and both options must be considered. Quite often, a lack of demand, or a lack of income, or a delay in the commissioning or the operation of a project arises because the identification of each and every one of these interest groups was not carried out. A paradigmatic case in this respect is that of wind power projects halted by an affected group cutting off access routes, or similar issues.

It is necessary to **identify the form of P3 that best suits the project**. In some cases the best option will involve management by a 100% public company, while in other cases management by a mixed company will be preferable, and in yet others the best option will be management by a private one. It is essential to always bear in mind that managing a project of this nature involves managing a company with thoroughness, solvency and a profit oriented approach. **It is not a question of managing a technical project, but rather of managing a company** frequently with a considerable level of inherent technical complexity.

Performing viability studies, particularly market studies, and determining whether the system should be made dependent on the market or dependent on the level of maintenance and provision of the service also constitutes a **fundamental requirement**. One should avoid asserting that it is better to structure the system based on the provision of the service (availability risk), since the project might well be better suited to management based on demand or market risk. In Spain today the norm is to avoid structuring projects on the basis of demand risk on the pretext that demand risk based projects will be harder to finance. This has led to projects that have been structured in such a way that, when they finally go into operation there is no demand for them, filling the country with a stock of empty infrastructures which, furthermore, must be allocated resources by the public sector, which must meet its availability payment commitments.

As we said at the outset, these projects clearly revolve around risk management. **Such risk management must be impeccable**. This calls for devoting due time and effort to identifying all the various sources and factors of potential risk. Once they have been identified, it is essential to assess which party is capable of supporting and managing them best, in order to design the appropriate allocation mechanisms. In Spain, one of the most serious problems has involved the allocation of risk to the private party. This is a serious mistake, which has seriously overburdened some of the existing projects, both in terms of cost and in terms of the commissioning time.

Once a project's likely success has been established through this system, it is **essential to design the most suitable bidding variables**. Rather than resorting to typical bidding variables, one should consider the variables capable of attracting the kind of bidders that are really good for the tender process and its subsequent award. Typical bidding variables in Spain have in the past – and still do at present - include rate schedules, project timelines, operating fees, or availability payments to be met by the public party. All these variables do nothing but distort the essence of the projects. It is not a question of the service being provided at the lowest possible price (which is desirable on the other hand), but rather of ensuring that the service

provided is the best possible one from all standpoints, including the multiplying effect on the economy.

Besides designing the most suitable bidding variables, it must also be assessed whether it is beneficial to **modify the legal framework affecting the project**. This might apply to the tax legal framework, the accounting legal framework, the company legal framework, the data protection legal framework, and any other legal framework deemed necessary and desirable. The best possible conditions must be created so that the project is optimal from all standpoints. A typical example involves fuel tax when talking about motorway and dual carriageway projects. It should also be borne in mind that the bidding specifications and the draft contract have a contractual nature and form part of the legal framework of the project. Taking into account that such projects must be carried out at the private party's risk and peril and assure them a certain profitability, it is essential to pay proper attention to every single detail of these documents.

Last, but not least, it is essential to put in place **thorough control mechanisms over the management being carried out**, from start to finish. It is typical in Spain for concessionaire companies to submit their service and economic-financial reports on a monthly basis. It is no use for them to be submitted if there is not an exhaustive control and an even more exhaustive analysis by the public party. There are many well-known cases in which the companies operating the projects are undergoing insolvency proceedings and technically bankrupt, and the public party does not find out until it is almost too late. Oversight and control are of the utmost importance. It is essential to make the appropriate enquiries and put in place suitable control mechanisms to avoid major deviations. It is essential to establish penalty mechanisms in case the deviations between estimated forecasts and the actual outcome are significant, provided that they are attributable to a dysfunction in the exercise of responsibility by the private party.

The greater the number of control and supervision mechanisms, or better still, the greater the number of system self-regulation mechanisms introduced during the project design phase, the more perfect the system will be, and the fewer the perversions that will arise. Managing a project of this nature means appealing to both the public and the private party's responsibility at its utmost level. And if such responsibility is not exercised skilfully, a suitable system must be designed to detect, warn about, penalise and correct this. It is essential to safeguard the social need, and skilful exercise of responsibility should be a must.