

KEY CONSIDERATIONS FOR SUCCESSFUL PUBLIC-PRIVATE PARTNERSHIPS IN NIGERIA

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Public-Private Partnerships (PPPs) enable government and private entities to collaboratively develop and manage essential services and infrastructure across key sectors like transportation, power/electricity, healthcare, and education. By leveraging private sector expertise, innovation and resources, PPPs provide an effective alternative to traditional funding which typically rely on taxes and borrowing.¹ This article explores the key principles and the typical structural arrangements that define these partnerships. By exploring these principles, we can better understand how PPPs facilitate a balanced distribution of responsibilities and rewards between the public and private sectors, leading to successful and sustainable infrastructure projects.

THE TREND TOWARDS PPPs IN NIGERIA

The recent constitutional amendment marked a significant policy shift by enabling all 36 Nigerian states to generate, transmit, and distribute electricity, even within the national grid areas, and manage their railway systems. Previously, such powers were exclusively held by the federal government.

With the ability to independently manage their electricity and transportation infrastructures, states are now well-positioned to explore opportunities for private sector investment, particularly through PPPs. This shift is likely to lead to an increase in PPPs at the subnational level. As such, understanding and implementing the best practices in PPPs becomes crucial for states aiming to capitalize on these new opportunities for infrastructural development.

Principles governing PPPs.

The success of PPPs relies heavily on well-defined principles, structures, and agreements that ensure effective collaboration between the public and private partners. Here, we discuss several fundamental principles that underpin these partnerships.

(a) Risk Identification and Sharing/Allocation

Risk is an inherent component of any project finance. Risk has been defined as “uncertainty in regard to cost, loss, or damage”² One of the cornerstone principles of PPPs is the appropriate allocation of risks between the public and private sectors. As project participants are exposed

¹ See our previous article on ‘Understanding Public-Private Partnerships in Nigeria’ - <https://www.mondaq.com/article/1469288>

² C. Hardy, Risk and Risk-Bearing 1 (1923)

to diverse risk factors, a major cause of project failures in project finance is the inappropriate allocation of risks to the various parties in the project.³ The guiding rule is that risks should be allocated to the party that is best equipped to assess, mitigate, and manage them effectively.⁴ This principle encourages efficiency and accountability in several ways. Risks in project finance come in different phases of the project. A few are discussed below:

- **Development & Construction Risks:** In most PPP arrangements, the private sector often handles significant risks in development and construction phases, including delays in obtaining permits, public opposition.⁵ Construction phase risks including design and building risks, cost overruns, and time delays. This allocation is based on the private sector's expertise in managing complex projects and its ability to innovate solutions.
- **Operating Risks:** These involve the project's ability to cover debt service, operating costs, and equity returns, influenced by factors like raw material scarcity, demand fluctuations, market volatility, inflation, currency changes, technical failures, and political changes. These risks are borne by the project company and loan lenders. For instance, the Abuja-Kaduna Rail Line illustrates PPP challenges, particularly with fair risk distribution in maintenance and security of infrastructure within a volatile region, necessitating continual revisions to risk and fare management to preserve financial viability and achieve service objectives.
- **Exogenous Risks:** These are external risks beyond the control of both parties, like natural disasters. Here, risk-sharing might involve insurance schemes or contingent government support, ensuring that such risks do not unduly burden one party.
- **Financial Risks:** Financial risks such as fluctuations in exchange and interest rates, volatility in world prices, inflation and the imposition of new tariffs will also figure high on the lenders' list of concerns. Fluctuations in the exchange rate can affect the net cash flow of the project throughout both the construction and the operation stages. To protect it, constant vigilance and adjustment is needed in the composition of assets and liabilities.

³ Ahmad Kreydieh, Risk Management in B.O.T Project Financing, P. 17 (1996).

⁴ <https://www.iisd.org/system/files/publications/risk-allocation-ppp-maximizing-value-for-money-discussion-paper.pdf>

⁵Project Finance: Identification, Allocation and Mitigation of Risk Factors: <https://www.mondaq.com/nigeria/project-financeppp-pfi/1177538/project-finance-identification-allocation-and-mitigation-of-risk-factors>.

- **Political Risks:** It involves the possibility of sudden government changes that could disrupt project continuity. They include unexpected government actions leading to defaults or diminished returns for fund providers. Potential risks encompass breaches of contractual agreements, expropriation, regulatory changes, price controls, and exchange restrictions. Government assurances against expropriation and central bank commitments to maintain foreign exchange availability are crucial mitigating factors.

Effective risk management in PPPs is crucial and requires that risks are not only clearly defined and identified but also equitably distributed across all parties. This clarity is essential to prevent conflicts over contracts, particularly when unexpected issues arise. Without clear contractual guidelines for risk apportionment, private partners may be hesitant to assume poorly defined or unpredictable risks.⁶

(b) Profit Sharing

Profit sharing addresses how the financial benefits of a PPP project are divided between the public and private sectors, fostering a balanced partnership:

- **User Fees/Charges:** In many PPP models, the private sector recovers its investment and earns profit through fees paid by the end-users of the service, such as tolls on roads or fees in utilities.⁷ This method aligns the private sector's incentives with the continuous quality and availability of the service.
- **Revenue-Based Payment:** This approach caps the total revenue that the private entity can earn. If revenues exceed a predefined limit, the excess is typically returned to the public sector.⁸ This mechanism helps balance profit motives with public service goals.
- **Government Pays Model:** Here, the government compensates the private sector directly for providing services.⁹ This model is often used in sectors where user charges are impractical or would restrict access, such as in essential healthcare services or public education. Payments can be structured as fixed payments, performance-based payments, or a combination thereof, depending on project specifics.

(c) Special Purpose Vehicle (SPV)

⁶ <https://legalinstruments.oecd.org/public/doc/275/275.en.pdf>

⁷ This may be coupled with government payments, such as subsidies to the investor or for services provided to low-income users.

⁸ <https://www.managementstudyguide.com/payment-mechanisms-in-public-private-partnerships.htm>

⁹ <https://investmentpolicy.unctad.org/pages/27/what-are-ppps#:~:text=PPPs%20also%20vary%20depending%20on,distribution%20fees%2C%20etc>

The establishment of a SPV is a common practice in PPPs. This legally independent entity, created specifically for the PPP project, serves multiple purposes:

- **Financial and Legal Isolation:** The SPV isolates the financial and operational aspects of the project from the parent company, reducing risk and enhancing creditworthiness.
- **Project Management and Operations:** It allows for more focused and effective project management and operations, with dedicated resources and personnel that do not overlap with the broader activities of the parent company.
- **Stakeholder Engagement:** An SPV facilitates clearer and more structured interactions with stakeholders, including financiers, government entities, and service users, thereby improving transparency and trust.

(d) Tenure

PPP contracts typically have longer durations than traditional public infrastructure projects to allow the private sector adequate time to recover investments and achieve returns. This extended tenure supports:

- **Long-Term Financial Planning:** Longer contract durations allow for more sustainable financial planning and investment recovery.
- **Operational Stability:** It ensures operational stability and service continuity, which is essential for infrastructure projects like roads, hospitals, and schools.
- **Continuous Improvement and Maintenance:** The extended timeframe motivates the private sector to maintain and potentially improve the infrastructure, as their ongoing revenue depends on the continuing functionality and quality of the service provided. For example, the Lagos State "Medical Park Project" is structured as a 30-year partnership, allowing ample time for the private entity to manage the facility and recoup its investment while providing quality health services.

Beyond the Contract: Building Blocks for Effective PPPs

While contractual agreements are crucial, the success of PPPs also hinges on a robust, transparent regulatory framework. Successful PPPs require clear, transparent, and enforced regulations, with governments upholding open governance principles to ensure accessible information and equitable decision-making.

This framework should be devoid of unnecessary bureaucratic barriers, facilitating entry rather than deterring it. Reducing administrative hurdles and consistently reviewing both new and existing regulations are key to fostering a regulatory environment that embodies the principles of good governance. Sometimes, this requires harmonizing approval processes across different government levels to remove obstacles that impede PPP execution, thus enhancing project value and reducing business costs.¹⁰

Moreover, adherence to the rule of law, as well as the protection of property rights and contractual rights, are fundamental. These principles not only highlight the stability and reliability of the regulatory environment but also reinforce the foundations necessary for the private sector's active participation in infrastructure development. By building a strong regulatory framework, governments can enhance the effectiveness and attractiveness of PPPs, ensuring that these partnerships achieve their goals and deliver substantial public benefits.

Evaluating Fit: When Are PPPs Right for Infrastructure Projects?

Not all infrastructure projects are ideal for PPPs. To determine their suitability, governments should evaluate critical factors including:

- **Comparative Costs Analysis:** Assess the lifetime costs of finance, construction, and operation across different procurement options.
- **Risk Definition and Measurement:** Ensure the project's risks can be clearly defined, identified, and measured for effective risk management.
- **Risk Transfer Feasibility:** Evaluate whether the right types of risks can be transferred to the private sector without compromising value for money.
- **Risk Allocation:** Decide if potential partners are willing to accept both demand and availability risks.
- **Impact on Stakeholders:** Consider any potential impacts on other stakeholders, including workers and local communities.
- **Historical Data and Contingent Liabilities:** Review risks and historical data on similar projects and identify any contingent liabilities.
- **Private Sector Capability and Appetite:** Examine the risk appetite and track record of potential private partners in managing similar projects.

¹⁰ <https://legalinstruments.oecd.org/public/doc/275/275.en.pdf>

- **Market Conditions and Interest:** Analyze the level of competition and market interest to ensure robust competition that can deliver value for money.
- **Quantifiable Trade-offs and Project Specifications:** Check if risks, costs, and quality trade-offs can be managed and if project outputs can be clearly specified upfront.
- **Project Scale and Payment Structure:** Determine if the project size justifies the transaction costs and assess who will make payments to the private partner, considering the sustainability of revenue streams from end-user charges.

A thorough evaluation of these factors helps governments decide if PPPs are suitable, aligning with strategic goals for optimal public benefit.

Maximizing Public-Private Synergies in Infrastructure Development

PPPs remain crucial in developing Nigeria's infrastructure, underscored by recent constitutional amendments empowering states. This trend necessitates a deep and practical understanding of PPP principles to ensure both success and sustainability. Given these new opportunities, it is essential for state governments to consult with legal and policy experts who can provide guidance through the evolving PPP landscape. For detailed guidance on developing and implementing effective PPP frameworks, visit us at www.scp-law.com or contact us via email at info@scp-law.com.