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APPROVING MANAGER

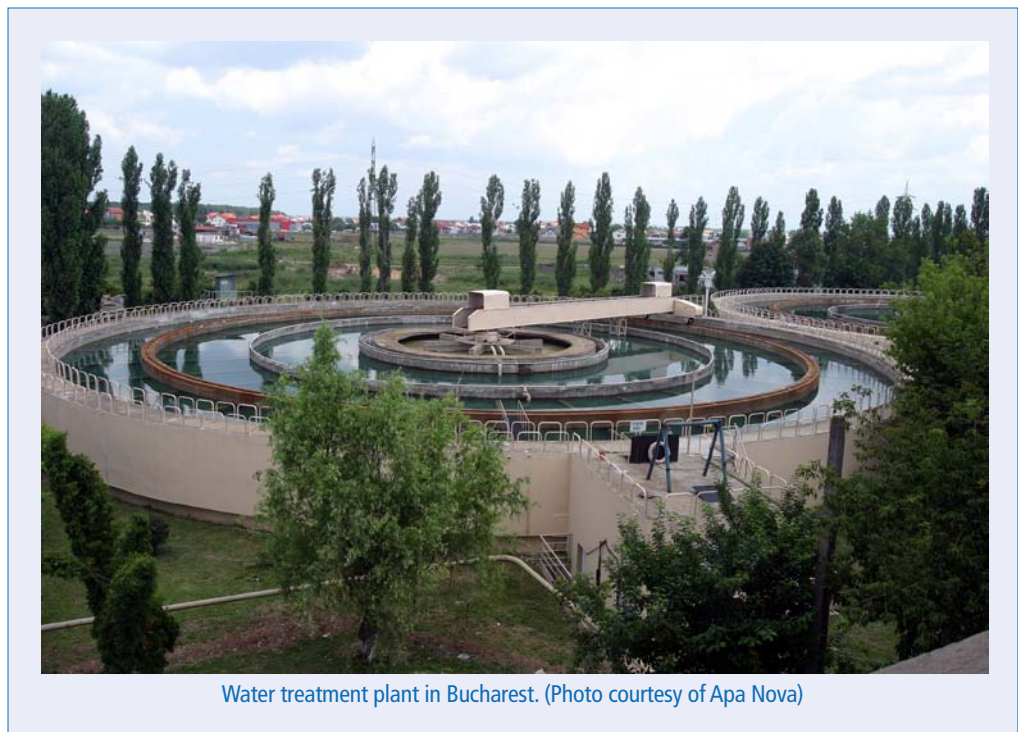
Laurence Carter, Director of the Infrastructure Advisory Department.

SmartLessons

real experiences, real development

Bidding Procedures for Public Private Partnerships—Keep Them Simple and Transparent

IFC's Infrastructure Advisory Services assists governments in structuring and implementing public-private partnerships (PPPs). Since these PPPs are awarded through competitive public tenders, an important component of our work is advising governments on how to structure and conduct bids. This SmartLesson draws on several IFC-managed PPP transactions, and addresses issues encountered by World Bank Group staff who work on PPPs.



Water treatment plant in Bucharest. (Photo courtesy of Apa Nova)

Underlying Principles of PPPs

PPP has become a catch-all phrase for many different types of transactions that involve a government procuring public infrastructure or services from a private (for-profit or not-for-profit) provider. However, we generally differentiate PPPs from other transactions (such as utility privatizations and concessions) on the

basis that PPPs involve some degree of direct government financial support.

At the same time, PPPs differ from traditional public procurement in fundamental ways:

- *Governments purchase outputs/services, rather than inputs (buildings, equipment, supplies, and so on).*

- *Risks associated with service delivery are transferred to the private sector.*
- *The private sector is contractually obliged to provide the services/outputs required in the PPP contract and is penalized for failure to do so.*
- *Private sector participants are long-term investors/operators instead of contractors/suppliers.*

Therefore, client governments must:

- *Think in terms of desired outputs/services/functions, not inputs.*
- *clearly specify the performance obligations.*
- *monitor performance and enforce penalties.*

Lessons Learned in Defining Bidding Procedures

1) Define what the client wants and values most.

Although this seems obvious, the exercise of doing it is beneficial. Client governments typically cite such objectives as controlling costs, attracting qualified bidders, and ensuring high-quality service delivery/infrastructure when implemented. Many think they need complicated bids and bid-evaluation procedures to attain these objectives. However, all they typically need is to:

- *Define and enforce the quality of service delivery/infrastructure by setting performance standards in the PPP contract (uniform for all bidders).*
- *Establish quantitative technical and financial criteria for bid participation, either during a separate prequalification stage in advance of the bid or as the first envelope of the bid (thus ensuring that all bidders are of acceptable quality).*
- *Award the tender to the qualified bidder with the lowest financial bid (for example, PPP payment from the government, average water tariff).*



Water connection construction. (Photo courtesy of Apa Nova)

In the Bucharest water concession transaction, we defined in the contract the water and sanitation targets (coverage and quality) to be progressively achieved through the life of the contract; established quantitative financial and technical criteria for prequalification (see box); and awarded the contract to the bidder that proposed the lowest net present value of the average tariff over the life of the concession (excluding regulated adjustments).

Bucharest Transaction Prequalification Criteria

1. Audited net worth of at least \$175 million
2. Credit rating of at least BBB
3. Capital expenditures of at least \$300 million in water/sewerage systems over the previous five years
4. At least five years' experience in providing water and sanitation services, encompassing:
 - a total served population of at least 1,000,000 inhabitants;
 - at least 70,000 connections;
 - 2,000 kilometers of water mains;
 - 2,000 kilometers of sewer collection pipes;
 - at least one water treatment plant that meets the higher of national or World Health Organization (WHO) standards and has an average daily output greater than 200 million liters per day;
 - at least one wastewater treatment plant providing secondary treatment, meeting national effluent standards, and having an average daily output of at least 86.5 million liters per day (1 cubic meter per second).

2) Tell bidders what you need—not how to do it.

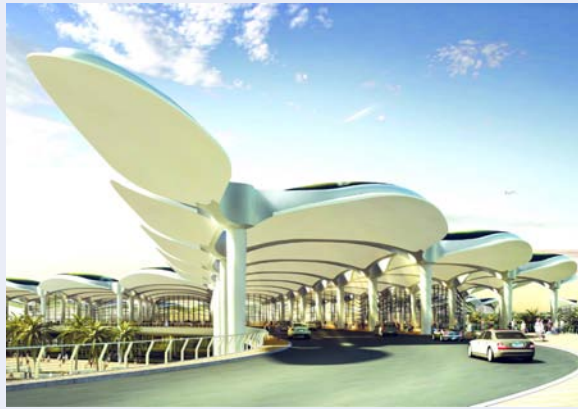
Many government officials (and advisors) want to see and approve all kinds of information from bidders on staffing, supplies, equipment, materials, and so on, thus undermining the basic premise of PPPs: Let the managers (PPP operators) manage.

Of course, the operator should not be free to use shoddy construction materials, dangerous labor practices, or unsafe supplies and equipment. But these areas are best handled through economy-wide regulations, not the specific PPP contract. Where the client still feels it is necessary to approve specific items, such as medical equipment, this should be done after contract award, not during the bid stage, and only for compliance with the output/functional specifications in the contract.

3) Avoid plans and promises.

In some sectors, such as energy or water and sanitation, governments may wish to specify in the bid documents which technologies are acceptable (for example, renewable) and which are not (for example, coal-fired thermal). In the recent New Cairo wastewater treatment PPP, bidders were required to use proven technologies that had been successfully implemented for at least the past 10 years.

To the extent that governments have multiple objectives (beyond achieving the lowest-cost service among qualified bidders), additional requirements and restrictions will likely be included.



Jordanian airport.

Many countries require bidders to submit business, investment, and operating plans for evaluation, and then annex the winner's plans to the PPP contract. Generally, however, we don't favor this practice, because:

- *plans reflect inputs, whereas governments should focus on defining and enforcing outputs, and leave the choice of inputs to the bidders.*
- *plans are difficult for government officials to evaluate, since they have less experience in the business than the bidders do.*
- *bidders' plans are essentially promises and may be difficult to enforce.*
- *the subjectivity involved in evaluating plans, designs, and so on makes the bidding less transparent, more prone to complaints, and susceptible to corruption.*

4) Architectural designs: Don't turn it into a beauty contest.

In our airport and hospital PPPs, we typically ask bidders to submit concept designs (except for the Jordanian airport terminal, where the government provided the design). This requirement reflects clients' desires to ensure that the design meets all functional requirements and is aesthetically acceptable. Functionality is relatively easy to assess, if functional requirements are well specified in the bid documents. But aesthetic qualities are more difficult to articulate, though the request for proposal (RFP) may include phrases such as "consistent with the local architecture." The danger to transparency arises when the evaluation turns into personal preferences about which one "looks nicer." Avoid this to the extent feasible by specifying what types of designs would or would not be acceptable.

Another emerging trend is to consider "green" elements in scoring or ranking designs. But it may be sufficient for the bid documents to simply specify the desired elements required for all bidders. In our current hospital PPP in Mexico, for example, we initially considered evaluating the differences between bidders in various "green" design

aspects. Then we decided it would be easier just to mandate LEED silver certification—thus eliminating the need to assess differences between bidders, and ensuring that the client will achieve its objective regardless of who wins.

5) Sometimes it is useful to evaluate differences between bidders in services/outputs.

This is the case when client governments place added value on specific services/outputs that may differ between bidders. In the Lesotho Hospital PPP, for example, the government considered it important to request from bidders particular medical services they would provide in addition to the essential services specified in the RFP. These were scored and included in the weighted technical and financial scores.

Another alternative is for the government to fix the tariff or PPP payment and then ask for bids on providing the most services for this amount (for example, most new connections for water or electricity; most patients treated). In our recent Ruta del Sol toll road PPP in Colombia, the government asked bidders for Section 3 of the proposed road to include in their bid the number of additional kilometers that would be widened to four lanes. This was scored and combined with the financial bid (present value of revenues per kilometer).

One caveat: This approach may be difficult to enforce if the winning bidder fails to meet its service commitment, particularly if it can cite good reasons. So use this alternative with caution.

PPPs involving property development typically lend themselves to requesting property development plans as part of the tender, since governments generally want to encourage creativity in bids, while retaining some overall review/approval of the proposal. Where this is part of the bid, staff should make an effort to clarify how plans will be evaluated and scored—an important factor not only for the bidders but also for the evaluation team.



Technician at Mexican hospital.

6) Use pass/fail (not points) where possible.

In cases where we do evaluate plans or designs to assess differences between bids, we have to decide whether to use points or pass/fail. If points, these plans are scored and then weighted with the financial proposal, as with the Hajj Terminal in Jordan, Lesotho Hospital, and Liberia power.

Two main concerns with this approach are that the client may not end up with the cheapest proposal (by virtue of the weighting with the technical bids), which may need to be explained to the public; and that it is difficult to set the weights in a way that can accurately estimate how much the client really values price-versus-quality differences.

Pass/fail has the advantage of simplicity. Among those who passed the technical evaluation, the best price wins (without any adjusting of scores). This approach was used in Sections 1 and 2 of the recent Ruta del Sol PPP.

More generally, in discussions with client governments, it is important to understand whether:

- *The client values something that may differ significantly between bidders and should be requested/evaluated.*
- *The client wants to score this on a pass/fail basis or*



Working on a water connection in the Bucharest. (Photo courtesy of Apa Nova)

weighted basis—the latter meaning that the client values it sufficiently to be prepared to trade off a lower price for more of it.

- *The client may even wish to fix the financial parameter (such as PPP payment) and award the bid to the bidder who is ranked highest on a particular technical aspect (for example, most new connections within a specified time frame). This approach may be best when the client is prepared to spend a fixed amount and wants to obtain the highest “value” for this amount with regard to services, outputs, and so on.*

7) Don't evaluate financial bids.

In its PPP transaction advisory work, IFC has traditionally (but not universally) not evaluated financial bids. However, we are seeing increasing examples of such evaluation, in part because of concerns that:

- *as we move into frontier markets, we may encounter less sophisticated bidders who may not understand the business and may make significant errors, which may result in failure to reach financial close or subsequent failure to sustain the contract; or*
- *bidders may intentionally make overly aggressive bids with a view to winning the tender, and then renegotiating later.*

Under our standard approach, rather than evaluating the financial bids, we would argue that:

- *Bidders who don't know the business should be eliminated through application of proper technical/financial prequalification criteria (rather than letting them make unsound bids).*
- *Bidders are responsible for their errors and should either forfeit their bid bond (if they decide before contract signing that they made a mistake) or be required to live with their bid.*
- *Neither IFC nor the government is in a position to judge whether a bid is too (or deliberately) aggressive—indeed, we have seen aggressive bids that seemed unsustainable (such as the 73 percent tariff discount for one-half of the Manila water/sanitation system) but proved otherwise.*
- *Disqualifying the winning bid because it was deemed too aggressive, unsustainable, or in error is probably politically—and possibly legally—difficult, depending on local procurement legislation. Imagine the press coverage that would follow.*

Nevertheless, in the event that the client or team deems it necessary to evaluate financial (and technical) bids, then the rationale, evaluation methodology, and legal citations should be clearly stated in the tender procedures. Moreover, it should be cleared with the political authorities to ensure that they are willing to address publicly why the winning financial bid is disqualified.

8) Don't ask for anything if you don't know how you will use it.

It's amazing how many times transaction lawyers and government officials describe a long laundry list of information that they want bidders to submit—when they don't have a clear idea of how they will use it. In Romania, for example, our lawyers insisted on having bidders submit stamps from various tax and local authorities confirming that they were up-to-date in paying different taxes or even registering their automobiles. We explained that our transaction should not be the vehicle for enforcing all kinds of laws.

A more important issue is the increasingly frequent requirement by governments that bidders submit their financial models. When you ask officials for reasons, they commonly cite two:

- *It allows the government to evaluate the financial bid, to ensure that there are no errors (that the model's results are consistent with the financial bid) and that the cost and other assumptions are consistent with the technical plans (if submitted as part of the bid).*
- *It provides the basis for subsequent adjustment of the contract tariffs or PPP payment, if adjustments are deemed justifiable under contract terms.*

These aspects are quite different, and staff need to clearly understand and articulate the reasons for submission of financial models (if recommended).

Using a bidder's model to evaluate and validate a financial or technical bid has several potential risks and drawbacks. For

example, if there are inconsistencies between the model and the bid, or if the model contains errors, the government must decide whether this is grounds for disqualification (presuming that the bidder is not permitted to adjust either the bid or the model while financial bids are outstanding). Moreover, the criteria for disqualification need to be clearly stated in the tender procedures. Otherwise, the government opens itself up to complaints and negative publicity.

The bidder's lenders are likely in a better position to vet the bidders' model and financial bids. So it may be preferable to require each bidder to submit a letter from a lender indicating conditional intent to finance, or validation of the model.

If the objective is to use the bidder's financial model as a basis for contract adjustment, then it could be submitted by the winning bidder *after* bid award. However, the model may be inconsistent with the winning bid, and the bidder may use that inconsistency as an attempt to renegotiate the winning bid. The best approach to mitigate this risk is to require the winning bidder to have its model audited and validated by an acceptable independent company, and to adjust the model, if necessary, to match the bid.

Conclusion

Bidding can be the most legally contentious and politically damaging aspect of a PPP transaction. It also poses considerable reputational risk for IFC. The process should be designed to be transparent and objective, so as to minimize (and withstand) the possibility of legal challenges (from losing bidders) and criticism from the press, politicians, and, most important, the public.



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