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# Unsolicited Proposals – An Exception to Public Initiation of Infrastructure PPPs

An Analysis of Global Trends and Lessons Learned



WORLD BANK GROUP

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<b>ADB</b>	Asian Development Bank
<b>AfDB</b>	African Development Bank
<b>ALSF</b>	African Legal Services Facility
<b>IDB</b>	Inter-American Development Bank
<b>KFs</b>	Key Factors
<b>MDBs</b>	Multilateral Development Banks
<b>PPI</b>	Private Participation in Infrastructure
<b>PPIAF</b>	Public-Private Infrastructure Advisory Facility
<b>PPPs</b>	Public-Private Partnerships
<b>USP</b>	Unsolicited Proposal
<b>WBG</b>	World Bank Group

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## Executive Summary

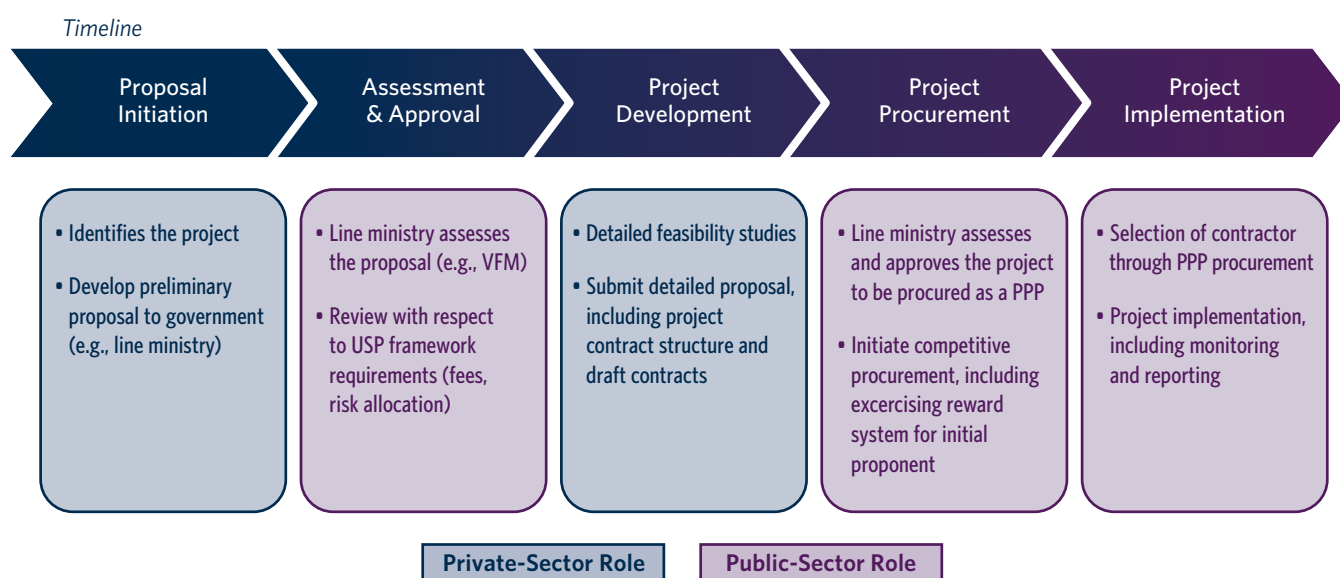
### OVERVIEW

Private-sector participation in infrastructure is most often contracted through regulated and competitive solicited procurement processes. An alternative is a privately initiated process (often referred to as an Unsolicited Proposal (USP)), whereby a private-sector entity reaches out to the government with a proposal to develop an infrastructure project.

This study discusses a series of global trends related to USP processes; lessons learned from the management of such proposals; and some key implications for further considerations. Its overarching objective is to inform the public debate on the provision of infrastructure assets and services initiated through USPs, and more specifically, to help governments and policy makers make informed decisions about their implementation.

This study recommends simple measures that countries could adopt to better manage USPs. These recognize that countries have different levels of capacity to identify, prioritize, prepare and procure projects; competency in public-private partnership (PPP) project implementation; and maturity of their PPP markets and frameworks.

Figure 1: USP Timeline



The study is based on desk research, questionnaires, interviews and expert meetings covering 17 countries on three continents.<sup>2</sup>

<sup>2</sup> The 17 countries were selected based on an assessment of PPP experts from PPIAF, WBG, ADB, AfDB/ALSF, and the IDB/MIF, using pre-established criteria to ensure diversity in terms of the maturity of their PPP legal and institutional frameworks, their PPP market readiness, and availability of data provided by the survey respondents. The main source of data was a combination of desk research and structured questionnaires that were sent to government officials in the selected countries.

## KEY FINDINGS

The most important findings are:

- More countries formally allow USPs now, compared to when the previous study on USPs was prepared by the Public-Private Infrastructure Advisory Facility (PPIAF) in 2007.
- Lack of capacity to identify, prioritize, prepare and procure projects is a key driver for allowing USPs. Additionally, some government officials wrongly believe that USPs can deliver public infrastructure without any cost to the government or public at large, and in some cases, there is also a political belief that USPs are a short cut to creating the necessary infrastructure.
- Projects initiated as USPs face many challenges, ranging from explicit allegations of misuse of public resources, corruption, fraud and poor quality of the resulting infrastructure assets and/or services, to lack of competition for markets (i.e., natural monopolies) and within markets.
- Some governments were able to define a range of practical measures that can be undertaken to improve USP frameworks and project implementation.
- Countries allowing USPs vary widely in terms of their PPP legal and institutional capacities and the maturity of their PPP markets, which affect the strategies that need to be employed to manage USPs.
- Issues such as PPP policy; regulatory and procurement framework; political buy-in; stakeholder consensus; private-sector market, etc. should be analyzed before a country-specific USP framework can be recommended.

## GLOBAL TRENDS

There is a global tendency to improve the governance of and increase the transparency in the procurement of large public infrastructure projects. This includes a tendency to mainstream a clear and fair USP framework within or outside the solicited PPP proposal framework. Other trends include the following:

- More than 85 percent of the countries reviewed in this study formally have chosen to allow USPs.
- There has been a clear global trend of adopting new legal frameworks for PPP projects, with provisions for dealing with USPs in a more transparent and competitive manner.
- Some countries facilitate USPs using the generally applicable procurement and PPP regulations.
- More than 70 percent of the countries reviewed in the study have developed formal legal frameworks for USPs, many of them recently. The most recently developed frameworks define features such as:
  - » The need for USPs to be consistent with the country's national infrastructure plans and not appear in the current priority list of projects;
  - » Minimum requirements for submission of USPs, such as pre-feasibility study, financial models, etc.;
  - » Step-by-step procedures for managing USPs, including an approval process; and
  - » Reimbursement mechanisms for payment of project development costs and protection of intellectual property rights of private-sector sponsors.

The analysis of global trends provides the following insights on the role of USPs in the development of infrastructure in developing countries:

- USPs are relied on more for energy, water and sewerage projects than for transportation projects (the latter represent only 14 percent of projects in the Private Participation in Infrastructure (PPI) Database<sup>3</sup>).
- In Asia (including China), USPs appear to be a more significant part of the policy mix than in the rest of the world.
- Low-income countries<sup>4</sup> have more number of their PPPs that reached financial close initiated through USPs, whereas upper-middle-income countries had a greater number of projects with larger absolute contract value originate from USPs.
- In some cases, infrastructure finance is combined with natural resource development, whereby financing of infrastructure is financed using value obtained from natural resources.

## LESSONS LEARNED

USP frameworks are seen as beneficial to achieving the overall objective of governments to identify and prepare economically valuable projects when they lack the human capital and/or financial resources to pursue projects through the solicited approach.

The responses received from survey respondents and interviews with experts confirms the following motivations for using USPs:

- Overcoming the government's lack of (financial and human) capacity to identify, prioritize, prepare and procure projects;
- Avoiding a lengthy competitive process in order to implement projects more quickly;
- Addressing the government's inability to plan and fund necessary infrastructure development; and
- Tapping into the Private-sector's innovation and knowledge to identify value-for-money project solutions.

As a general matter, developing and communicating a clear framework for USPs, building capacity to implement projects procured through USPs, and building stakeholders' consensus on USP processes and enforcement are considered preconditions for the successful implementation of such projects. The specific frameworks to deal with USPs vary widely in their effectiveness, raising a range of framework-specific issues.

The discussion and analysis of lessons learned identified a list of ten key factors on both the macro-level (context) and micro-level (project implementation). The countries studied are facing several challenges (to varying degrees) with respect to achieving these key factors. This compilation provides a guideline for governments to drive the best value outcomes from USPs. The application of the key factors is intended to create opportunities for a two-way engagement between the public and the private-sector in the development and delivery of new infrastructure and services.

<sup>3</sup> The PPI Database is maintained by the World Bank and has data on more than 5,000 infrastructure projects in 139 low- and middle-income countries.

<sup>4</sup> Income status based on OECD-DAC categorization (2013).

Table 1: Key Factors Arising Out of Challenges in Managing USPs

	Key Factor	Challenge
Macro level	Private-sector interest	Market appetite is directly dependent on the ability to make sufficient return on project investment.
	Private-sector capacity	Many USPs are opportunistic and of poor quality.
	Public-sector capacity	The lack of human and/or financial capacity of the responsible agency to identify, prioritize, prepare and procure projects is a common challenge and also a motivation for USPs.
	Public-sector coordination	Both inter- and intra-public-sector coordination and communication issues often hinder implementation of USPs.
	Clarity on procedures	USP frameworks should increase the clarity of procedures, yet in some instances, USP procedures and their enforcement remain unclear.
Micro level	Competitive pricing	It proves challenging to provide a level playing field between the original proponent and potential competitors.
	Private-sector innovations	Despite their importance, USPs in less mature PPP/infrastructure environments are not very innovative.
	Transaction costs	Less formalized procedures can lead to high transactions costs.
	Efficient risk allocation	Lack of capacity to successfully implement PPP projects and focus on short-term results often lead to disregard of future liabilities.
	Transparency	Implementation of USPs often is not very transparent.

## KEY IMPLICATIONS AND RECOMMENDATIONS

Based on an analysis of global trends and the key factors arising out of lessons learned, this study provides some key implications and recommendations for developing countries that allow USPs as part of their procurement policies for public infrastructure development.

While the study clearly recognizes that the frameworks for successful management of USPs could differ across countries, it does enumerate a common set of principles that can be suggested to governments to improve their PPP frameworks and capacity to manage USPs, treating them as an exceptional mode for private delivery of public infrastructure and services:

- Develop USP policy framework—policies for steps and timelines for management of USPs, covering minimum submission requirements; reimbursement and protection of intellectual property; procedures for introducing competition and reward systems (Swiss challenge, bonus system, direct compensation, automatic short-listing, etc.); and eligibility and types of government support, if any.
- Build Institutional capacity—build capacity and empower PPP or similar units to have responsibility for managing USPs; conduct feasibility studies independently or in-house; design and implement clear regulations for the assessment of fiscal risks and liabilities; incorporate blind review of USPs; seek assistance from multilateral development banks (MDBs); and use transaction advisors for due diligence and selection of proposals.
- Follow competitive procurement process and procedures—establish communication with initial USP proponents and competitors; develop stakeholder coordination; ensure commitment for contract enforcement; and follow typical PPP process and procedures.

The studied countries vary widely in terms of their level of capacity to identify, prioritize, prepare and procure public infrastructure projects, their competence in PPP project implementation specifically, and the maturity of their PPP frameworks and markets. In this context, the study provides key findings and recommendations by categorizing countries using three levels of capacity with regard to PPPs—low capacity, mid-level capacity and high capacity, based on the World Economic Forum’s Global Competitiveness Index factor scores. These findings and recommendations are as follows:

- *Countries with low capacity and little experience in implementing PPPs*—For low capacity and less experienced (with PPPs) countries, the priority would be to develop a USP framework, and build capacity to implement projects that were initiated as USPs with support from MDBs and external consultants. For example, such countries should focus on a small number of infrastructure projects that are not too complex yet suitable for PPPs, in a priority sector or area. The rigorous application of a competitive procedure after acceptance of the project is expected to optimally contribute to creating value-for-money and will also reduce the number of opportunistic USPs.
- *Countries with mid-level capacity and experience in implementing PPPs*—For countries that have a PPP framework in place, the focus should be on the adoption and consistent enforcement of a USP framework with a strict set of minimum requirements and a clear (and competitive) process for implementing projects that were initiated as USPs. It is recommended to have an empowered PPP unit with internal and potentially external lead transaction specialists for the management of USPs, which can develop procedures to create a level competitive playing field and also develop a communication strategy to improve awareness of the USP framework among relevant stakeholders.
- *Countries with high capacity and experience in implementing PPPs*—For countries with experience in both PPPs and USPs, the focus of recommendations is on enabling innovation and increasing the role of private-sector participation. This is typically reflected in the USP framework, limiting the USP procedure to “unique and innovative concepts, concepts or services not otherwise available to the government, and not resembling the substance of a recent, current or pending competitive tender.” For highly innovative concepts, the recommendation extends to protection of intellectual property rights of private sponsors.

The USP strategy for a specific country should be tailored to its characteristics and should be continuously refined by seeking improvements in addressing the challenges. This study suggests that there should be continuous improvement for countries to evolve from their current situation (low, mid-level and high capacity), which should be closely coordinated with the development of their PPP market.

## Introduction

### 1.1 PRIVATE INVESTMENT AND PUBLIC INFRASTRUCTURE—WHAT IS THE ROLE OF USPs?

Private Investment significantly contributes to the implementation of public infrastructure projects, and USPs have become part of the policy mix. Globally, private-sector participation in infrastructure has proven to be a significant instrument for the delivery of infrastructure investments in both emerging and mature markets.

Private-sector participation in infrastructure is most often structured in the form of regulated and competitive solicited procurement and contracting processes. Private-sector participation projects typically are in line with a national infrastructure plan and identified in government budgets. Also, the procurement of these projects typically follows the assessment of the project's purpose and need by the government.

An alternative to this typical approach is a privately initiated process often referred to as an Unsolicited Proposal (USP). In the case of a USP, a private-sector entity ("USP proponent") reaches out to the government with a proposal to develop an infrastructure project.<sup>5</sup> Typically, such a project may not have been identified within the government budget or policies, and the project's purpose and need may not have been defined. The nature of a USP is that the private sector initiates the project concept and develops the project, and takes it to the government. In some instances, a USP may be nothing more than a mere idea or concept when it is presented to the government. In such instances, it is possible that the private sector develops the project in consultation with the government before it is taken up for implementation by the government.

After the government accepts a proposal, it may implement the project either through a competitive procedure or direct negotiation with the USP proponent. In both solicited and unsolicited approaches to project development and implementation, the interest of the government is to develop good projects that achieve value for money for the taxpayers. In other words, the projects that are implemented should make sense from an economic and social perspective, and the transaction should be the best deal in terms of quality, price and timeliness.

**Achieving value for money is a challenge even in a solicited approach where the government has the capacity to identify, prioritize, prepare and procure an infrastructure project.** Governments that lack the capacity to develop and implement projects through the solicited approach are tempted to use USPs because of the perception that they are a way to overcome this capacity constraint. Additionally, these governments also believe that USPs are more expeditious and an easier form of project development and implementation of critical infrastructure facilities. However, it must be noted that the implementation of projects that were initiated as USPs face even more challenges than project implementation through a solicited process. These range from inadequate expertise to creating a level playing field and structuring a transparent and competitive process. Moreover, in the case of USPs, there is often widespread allegation of corruption, fraud and poor quality of the infrastructure or services involved.

Little has been documented to date regarding how governments are managing USPs in practice. Have governments explicitly formulated policies regarding USPs? Do governments manage USPs on a responsive and ad-hoc basis in a legal space that does not explicitly regulate USPs, but does not rule them out either? Or do governments define specific policies, set up tailored legal and regulatory frameworks, and consistently handle proposals submitted to them at the initiative of the private sector in accordance with those policies and frameworks? Additionally, even less analysis exists in terms of the outcomes of USPs.

<sup>5</sup> Projects directly resulting from sovereign agreements and resource-backed financing agreements are not included in the scope of this study.

## 1.2 WHAT ARE THE GLOBAL TRENDS AND LESSONS LEARNED FROM USPs?

According to a PPIAF-funded study published in 2007<sup>6</sup>, only a few countries at the time had official USP policies in place.<sup>7</sup> The study noted the importance of policy decisions regarding the treatment of USPs. Since 2007, however, an increasing number of countries have implemented USP frameworks. This has led to an increase in the number of USPs, and most likely, also an increase in the implementation of projects that were initiated as USPs.

**The first section of the present study focuses on *global trends in infrastructure policies related to USPs and the actual use of USPs*.** The purpose of this section is to create an understanding of the global trends in using USP frameworks and the factors that determine whether they should form part of a country's procurement policy. If the policy decision is made to allow USPs, the types of procurement systems in place to introduce competition and transparency in the process are explored.

**The second section of this study identifies *lessons learned from the use of USP frameworks (policy, legal/regulatory and institutional measures defining the government's attitude and response to USPs) and the implementation of projects that were initiated as USPs*.** From publicly available sources, it is known that hidden costs and contingent liabilities are major issues for the public sector in dealing with projects initiated by USPs on a negotiated basis. Public discourse also addresses concerns with respect to transparency and fair competition. This part of the study focuses on these and other challenges governments face when implementing projects initiated by USPs and also explores the effectiveness of USP frameworks and other solutions to these challenges.

**The third section of this study defines *key implications for future USPs*.** Based on the findings of the first two sections, key policy options and potential strategies are recommended, according to countries' capacity and maturity level, to inform and facilitate their decisions in using USPs.

The following table summarizes the methodology and key research questions.

Table 2: Methodology and Key Questions		
Section	Methodology	Key Questions
Global trends	<ul style="list-style-type: none"> <li>Desk research               <ul style="list-style-type: none"> <li>» Public sources</li> <li>» PPI Database</li> </ul> </li> <li>Verification by questionnaires and interviews</li> </ul>	<ul style="list-style-type: none"> <li>What are the most relevant developments and trends with respect to USP legal and regulatory regimes and policies?</li> <li>What are the most relevant developments and trends with respect to the use of USPs?</li> </ul>
Lessons learned	<ul style="list-style-type: none"> <li>Questionnaires</li> <li>Hypotheses</li> <li>Expert meeting</li> <li>Interviews</li> </ul>	<ul style="list-style-type: none"> <li>What is the rationale behind USP frameworks, and how effective are they?</li> <li>What are international practices and experiences with implementing projects initiated by USPs?</li> <li>What are the most important challenges in dealing with USPs and how are governments dealing with these?</li> </ul>
Key implications	<ul style="list-style-type: none"> <li>Expert meeting</li> <li>Expert interviews</li> </ul>	<ul style="list-style-type: none"> <li>How could developing countries effectively manage USPs?</li> <li>What country classification should be used to differentiate USP strategies?</li> <li>How can development banks support governments in managing USPs?</li> </ul>

<sup>6</sup> John Hodges and Georgina Dellacha, 2007, Working Paper No.1, Unsolicited Infrastructure Proposals, How Some Countries Introduce Competition And Transparency.

<sup>7</sup> The subject of the global trends analysis is "policies on USPs," which is broadly defined and includes: (1) provisions on USPs in PPP laws, concession laws or procurement laws; (2) specific laws and regulations covering USPs; and (3) formally documented policies. In this study, policies and processes on USPs are also referred to as USP frameworks.

### 1.3 COUNTRY SELECTION

At the start of this study, a list of 28 countries across Africa, Asia, and Latin America and the Caribbean was developed, with a strong focus on Africa. The list of countries was selected based on the assessment of experts from PPIAF and the World Bank Group (WBG), the Asian Development Bank (ADB), the African Development Bank/ALSF, and the Inter-American Development Bank (IDB/MIF), on the basis of the following criteria:

- Diversity in the degree of private-sector involvement in public infrastructure;
- Diversity in regulatory, policy and institutional capacity to manage USPs;
- Diversity in the maturity level of PPP frameworks and PPP implementation;
- Mix of Francophone and Anglophone countries in Africa;
- Diversity of frameworks used for the management of USPs and related aspects; and
- Diversity of experience in implementing USPs.

The final selection of 17 countries was made based on the questionnaires received, the availability of respondents for follow-up interviews, and the advice of experts from the regional development banks. Documentation on four additional countries has further reinforced the conclusions of this study. With respect to most of the covered countries, this study focused on national-government-level trends and experiences (USP framework, projects, etc.). In the case of India and Brazil, where several regional/provincial governments have separate USP frameworks, the study looked at such regional/provincial-government-level trends and experiences. The following table reflects both the long and short lists.

**Table 3: Country Selection**

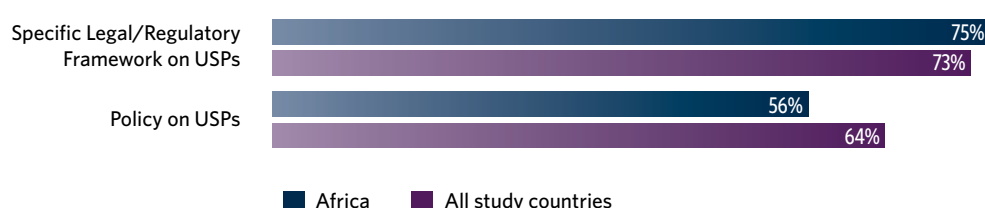
	Africa		Asia	Latin America and the Caribbean	
<b>Long List of Countries</b>	Benin Côte d'Ivoire Ghana Guinea Kenya Niger	Nigeria Senegal South Africa Tanzania Uganda Zambia	India Indonesia Laos Malaysia Philippines Thailand Vietnam	Brazil Chile Colombia Guatemala Jamaica	Mexico Peru Trinidad & Tobago Uruguay
<b>Short List of Countries</b>	Ghana Kenya Niger Nigeria Senegal	South Africa Tanzania Uganda Zambia	India* Philippines Vietnam* Malaysia*	Brazil Chile* Colombia Guatemala Jamaica	Peru Trinidad & Tobago Uruguay

*\* The conclusions of this report have been informed by desk research and data from India, Vietnam, Malaysia and Chile. However, the questionnaires for these countries were not received.*

Even though this study looks at countries across Africa, Asia, and Latin America and the Caribbean, the greatest effort has been invested in the African countries, because the challenges related to USPs appear to be particularly significant on that continent. Therefore the findings and conclusions for Africa are presented separately, wherever possible and meaningful.

The fact that five countries in the list of top 10 countries with private investment in infrastructure in the developing world are represented in this study supports the conclusion that the country list provides a fair representation of experiences with USPs throughout the developing world. This is even further strengthened by the fact that about 75 percent of the selected countries have official frameworks to accept USPs, and between 55 and 65 percent have formulated some type of USP policy, as indicated in the following chart.

**Figure 2: Percentage of Study Countries with USP Frameworks and Policies**



Source: Study questionnaires

## 1.4 LIMITATIONS ON SCOPE OF STUDY

The high-level scope of the study and the amount of data limits in-depth quantitative analysis, but it nevertheless represents global trends and lessons learned with respect to USPs and USP frameworks. The study's limitations include the following:

- There is no single common source of information related to USPs in many countries. Where information is available, there is also a lack of accuracy and consistency.
- Although the study refers to data collected through surveys and questionnaires from government officials in various countries, it is restricted to information provided by a limited number of individuals ("survey respondents") with knowledge of USPs in a given country and should not be construed as an official government response.
- This study is primarily intended to understand the public sector's perspective, not the private sector's motivations and experiences with USPs. In a developing country context, the "private sector" encompasses not only domestic but also international entities, which creates difficulty in arriving at a consensus on the issues.
- Verification of data collected has been very limited, not only because of the limited scope of this study, but also because public sources have proven to be insufficiently reliable.<sup>8</sup>
- Although the PPI Database contains a unique wealth of information on PPPs, the specific information on USPs appears to be incomplete.<sup>9</sup> Unfortunately, there are no other public sources listing structural data on USPs across countries.
- Following the nature and amount of PPP involvement, this study has not covered the Middle East and Europe and Central Asia regions.

<sup>8</sup> Where this study uses questionnaires as a source, it should be noted that this is based upon the limited responses and limited verification.

<sup>9</sup> Where this study uses the PPI Database as a source, it should be noted that this is based on the 32 USPs that reached financial close and 182 projects that reached financial close after direct negotiation between 2000 and 2012 that are registered in the database, which may not cover the complete universe of USPs.

## Global Trends

### 2.1 EMERGING GLOBAL TRENDS

An increasing number of countries are developing formal mechanisms to regulate USPs and overcome the challenges associated with them. Overall there has been a clear global trend of adopting new legal frameworks for PPP projects in general since the 2007 study on USPs conducted by PPIAF<sup>10</sup>, especially in the past five years. Nearly all of these frameworks incorporate provisions for dealing with USPs in a more transparent and competitive manner. The development of clear and fair USP frameworks fits well within a global tendency to improve governance and transparency in dealing with the procurement of large infrastructure projects.

The vast majority (more than 85 percent) of the countries<sup>11</sup> reviewed in this study have chosen to allow USPs in a number of ways, including:

- Policy documents outlining general principles for the treatment of USPs;
- Guidelines, directives or circulars laying down specific details that are either binding or merely recommended;
- Legislative changes to existing, generic, public procurement laws and/or PPP laws; and
- New PPP laws, including regulations regarding the treatment of USPs.

More than 70 percent of the study countries have developed formal legal frameworks (see figure 2 in chapter 1), and many of these have been developed recently. For example, until several years ago, Tanzania did not have in place any USP regulation. In 2010, it adopted general PPP regulations, including a section on USPs, stating that procurement on the basis of USPs should: (1) be done in a competitive manner, and (2) not involve any government contributions.

Most countries with pre-existing PPP laws have added specific provisions relating to USPs. USP and PPP frameworks seem to be inextricably related. Countries are seeking to: improve the PPP enabling environment; strengthen the regulatory, procedural and institutional framework for managing PPP transactions; and improve governance across key infrastructure sectors. USP frameworks have been boosted by this trend.

As indicated in figure 3, about one-third of the countries apply regulatory frameworks that are not specific to USPs. There also exist a number of countries with PPP laws that do not include specific provisions regarding USPs but do not ban them either. Despite the absence of specific USP regulations, some countries—such as Ghana and Nigeria—facilitate USPs using the generally applicable procurement and PPP regulations. In some countries, direct bidding procedures (directly solicited, sole source, negotiated, etc.) are allowed under general procurement regulations. Such procedures often require<sup>12</sup> that the procuring authority demonstrate the technological novelty, national emergency or otherwise strategic importance of a project. Despite such stringent conditions on paper, survey respondents indicated that USPs are often channeled through direct bidding procedures with relative ease. In countries with low transparency and low sophistication in managing PPPs, this raises concerns of abuse and poor value for taxpayers.

<sup>10</sup> John Hodges and Georgina Dellacha, 2007, Working Paper No.1, Unsolicited Infrastructure Proposals, How Some Countries Introduce Competition And Transparency.

<sup>11</sup> Some countries, such as Guatemala and Trinidad & Tobago, do not formally allow USPs.

<sup>12</sup> Many countries have adopted the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects

Figure 3: Percentage of Countries Using Non-Specific Regulatory Frameworks for USPs



Source: Study questionnaires

## 2.2 USP FRAMEWORKS

Most USP frameworks contain at least a definition of USPs, minimum requirements for submission, and step-by-step procedures.

### 2.2.1 DEFINITION OF USPS

The countries that most recently developed USP frameworks start by defining the *essential elements* of a USP. Countries usually require that USPs are: (1) consistent with (long-term) national infrastructure plans, and (2) not part of the existing priorities of the government. As presented in figure 4, about 70 percent of all the study countries and almost 90 percent of the study countries in Africa require USPs to be unique proposals, meaning that the projects that are the subject of these proposals cannot be part of existing government plans or priority lists.

Figure 4: Countries Requiring Unique USPs



Source: Study questionnaires

As such, many countries bar projects that are already part of the country's formal infrastructure program or project priority list. If a project is part of such a list or program, it is by definition considered not to be complementary and therefore not eligible for consideration as a USP. For instance, the South African USP framework requires the public sector to reject a USP if it "relates to known institutional requirements that can, within reasonable and practicable limits, be acquired by conventional competitive bidding methods." The requirements for USPs in the Philippines are described in box 1.

**Box 1: The Philippine BOT Law**

USPs in the Philippines may be accepted in line with the Philippine BOT law<sup>13</sup>, provided that all the following conditions are met:

- Such projects involve a new concept or technology and/or are not part of the list of priority projects (the Public Investment Program and the Comprehensive and Integrated Infrastructure Program);
- No direct government guarantee, subsidy or equity is required;
- The government agency or local government unit has invited by publication, for three consecutive weeks, in a newspaper of general circulation, comparative or competitive proposals, and no other proposal is received for a period of 60 working days; and
- Provided further that in the event another proponent submits a lower price proposal, the original proponent shall have the right to match that price within thirty working days.

The law states that the “grant of usufruct of government assets, including among others, right-of-way, to Project Proponents shall be considered as direct subsidy or equity unless government receives appropriate compensation pursuant to existing laws, rules and regulations, and guidelines.” However the general rule is that “the Government may grant Investment Incentives to Unsolicited Proposals (...)”.

On the other hand, some governments (for example in Tanzania, Brazil and Peru) do not have such a limitation and allow for USPs with respect to projects already on their priority list. In some countries, such as Jamaica, unsolicited initiatives can lead to expediting projects on the long-term infrastructure plan. However, almost all countries are clear that USPs should be consistent with and meet the country’s overall infrastructure policy and strategy.

Some countries define and allow USPs that do not require a direct financial contribution by the government. An example from Colombia is provided in box 2. These projects typically enjoy an expedited procedure, which seems a reasonable approach. However, the policies do not always explain different types of government contributions. From an economic perspective, direct financial contributions are not the only relevant government contributions. Instead, guarantees, loans, rights and land can be equally or more relevant and lead to significant liabilities.

**Box 2: Different Treatments of USPs, Based on Government Contribution, in Colombia's USP Framework**

The national development plan for 2010-2014 ushered in an overhaul of Colombia’s PPP/concession scheme and was accompanied by legal reforms that introduced the 2012 Law No. 1508 regarding PPPs, as well as its implementing regulations. In these regulations, the government makes a clear distinction between USPs requiring government contributions and USPs not requiring government contributions. USPs requiring state guarantees/contributions are—following an approval on the basis of a feasibility study—opened to competitive tender, in which the original proponent is given a three to ten percent bonus on the bid score. If the original proponent does not win the project, they receive compensation for the project preparation efforts. For projects not requiring public funds or resources, the government will invite other bidders to submit competing proposals. If there is a proposal that is superior to the original proponent’s proposal, the original proponent has the right to match it. If not selected, the original proponent is entitled to receive reimbursements.

<sup>13</sup> R.A. NO. 6957, an act authorizing the financing, construction, operation and maintenance of infrastructure projects by the private sector and for other purposes, as amended by R.A. NO. 7718.

## 2.2.2 REQUIREMENTS FOR SUBMISSIONS OF UNSOLICITED PROPOSALS

Most USP frameworks contain requirements for submissions of USPs. These include, for example, pre-feasibility study results, financial models, risk allocations, and brief business plans. These requirements are used as an initial filter to separate the wheat from the chaff. In several countries, USPs submitted by the private sector were often of poor quality and did not further public interest as identified by the governmental agencies. Additionally, in some countries, it was found that government agencies were receiving a large number of USPs, which overwhelmed and distracted the public sector from its priority infrastructure projects. Consequently, many countries have introduced minimum requirements for USPs as a way to ensure proposal quality and deter proposals that are not serious. For example box 3 highlights requirements used for USPs in South Africa. Some first movers in USP regulation are even reconsidering their requirements, because they are now seeing that the filter does not work well enough, and the responsible agencies are still flooded with poorly developed proposals.

Establishing a set of minimum requirements in the definition of USPs or submission documents acts as a check against abuse of the USP framework. For example, Nigeria's requirement of an "outline business case" for each USP was intended to help public officials reject poor and abusive USPs that do not demonstrate a clear public interest. But the practice of strict enforcement can be difficult. Officials and politicians appear to exercise flexibility in judging the completeness of USPs, in case very few proposals have technically met the legal requirement of a "complete proposal."

### Box 3: Requirements for USPs in South Africa

A USP in South Africa<sup>14</sup> must contain the following information in terms of the proponent:

- The proponent's name, address, identification or registration number (if a corporation), VAT registration number, and the contact details of its authorized representative;
- Identification of any confidential or proprietary data not to be made public;
- The names of other South African institutions that have received a similar USP;
- The proponent's current South African Revenue Service (SARS) tax clearance certificate and, in cases where the proponent is a consortium or joint venture, a current SARS tax clearance certificate for each member thereof;
- A declaration of interest containing the particulars set out in Standard Bid Document (SBD) 4, issued by the National Treasury;
- A declaration of the proponent's past supply-chain practices, containing the particulars set out in SBD 8, issued by the National Treasury; and
- A declaration of the proponent to the effect that the offering of the USP was not the result of any non-public information obtained from officials of the relevant institution or any other institution.

The USP must set out the following information in terms of the product or service offered:

- A concise title and abstract (approximately 200 words) of the proposed product or service;
- A statement of the objectives, approach and scope of the proposed product or service;
- A statement describing how the proposal is demonstrably innovative and supported by evidence that the proponent is the sole provider of the innovation;
- A statement of the anticipated benefits or cost advantages to the institution, including the proposed price or total estimated cost for providing the product or service, in sufficient detail to allow a meaningful evaluation by the institution;
- A statement showing how the proposed project supports the institution's strategic growth and development plan and its other objectives; and
- The period of time for which the proposal is valid for consideration, which may not be less than six months.

<sup>14</sup> National Treasury Practice Note No 11 of 2008/2009, Unsolicited Proposals, National Treasury, Republic of South Africa.

Often a technical and financial feasibility study is required, typically carried out by the parties submitting the USP. Some governments, such as Nigeria's, have found that the bankability suggested by proponents in their proposals can be biased and therefore serve little purpose. In one example, a proposed toll-road build-operate-transfer project could not secure requisite financing, leaving the concession contract in limbo.

Governments increasingly require their own due diligence in evaluating USPs. They decide to use feasibility analyses developed either by themselves or by outside experts they have hired. In either case, the government should be able to get comfortable with a technical and economic feasibility analysis, particularly if the government is expected to be the ultimate counterparty or risk taker. Similarly, ignoring the relevance of the financial feasibility analysis can easily lead to optimism bias and result in hidden liabilities.

### 2.2.3 PROCEDURE FOR MANAGING UNSOLICITED PROPOSALS

Most USP frameworks define a step-by-step procedure for managing USPs. Often public officials welcome an objective USP framework that allows them to deal with USPs within a pre-determined process and without having to make exceptions. Such an objective and binding framework acts as a check against abusive as well as politically motivated proposals, and empowers officials to reject such proposals on the basis of a technocratic and rule-based process. Box 4 highlights the typical steps taken in the management of USPs in South Africa.

#### Box 4: Typical Steps in USP Frameworks for the Management of USPs in South Africa

These are the steps that are typically followed in the management of USPs<sup>15</sup>:

- Submission of a USP.
- The authority evaluates the proposal based on a number of aspects, per the minimum evaluation criteria applicable to proponents and proposals.
- If the authority decides to reject the USP, it notifies the authorized representative of the proponent, ensures that the institution does not make use of any of the intellectual property or proprietary data in the USP, and returns to the proponent all documents received in the USP.
- If the authority decides to consider the USP, it confirms such a decision with the proponent in writing.
- The authority conducts a comprehensive evaluation of the USP, in line with the requirements for the assessment of PPPs or non-PPPs in the appropriate regulations, including an independent feasibility study.
- If the authority decides to proceed with the USP, it must negotiate a USP agreement with the proponent to guide the process and to establish 1) the methodology for determining any costs to be reimbursed to the proponent, should the procurement processes result in an award for a party other than the proponent, 2) the procedure for further developing the project, 3) the allocation of responsibility for developing bid documents, and 4) the purchase of intellectual property rights, if any. The agreement will also establish that the information in the USP must be treated as confidential.
- If the USP agreement is closed, then the authority must prepare and issue bid documents.
- The authority issues a request for qualification (RFQ) to test the market for the existence of other private entities capable of providing the product or service.
- If there is no adequate response to the RFQ, the authority prepares a draft contract for the provision of the product or service.
- If there are one or more adequate responses to the RFQ, the authority prepares a request for proposals (RFP), with a draft contract.
- The authority conducts a competitive bidding process.
- The authority reimburses the proponent should the proponent not be awarded the contract for the provision of the product or service at the conclusion of the competitive bidding process.

<sup>15</sup> Based on South Africa's USP framework.

The step-by-step procedure typically includes a competitive follow-up mechanism after acceptance of the proposal by the government. The most common mechanisms<sup>16</sup> are:

- **Swiss challenge:** An open tender process is conducted, in which the USP proponent has the right to match the winning bid in order to win the contract.
- **Bonus system:** An open tender process is conducted. In the evaluation of the bids, the USP proponent receives bonus points (generally five to 10 percent of the points), giving him an advantage over other bidders.
- **Automatic short-listing:** This option applies to a multi-stage tender procedure. The USP proponent does not have to pass the preliminary stages of the procedure, but is automatically invited to the last stage, in which the remaining bidders submit their best and final offer.
- **Regular procurement:** An open tender process is conducted in which the USP proponent competes on equal terms with the other bidders.

In the Philippines, USP submissions must include a full draft contract. This entails a significant amount of work for the USP proponent, even before the granting of original proponent status. It also appears questionable to assume that accepting a full draft contract as the starting point of a negotiation process will lead to a balanced agreement regarding roles and risk allocation. It is probably more advisable to require the submission of a draft term sheet that highlights the proposed principles of the main payment streams, risks allocated, securities and other similar clauses—to be first agreed on in terms of principles, and later to be elaborated into a full contract document.

## 2.2.4 REIMBURSEMENT AND INTELLECTUAL PROPERTY RIGHTS

USP frameworks often deal with the issues of *reimbursement for project development costs and protection of intellectual property rights* for the USP proponent. In the questionnaires received, only about 50 percent of respondents indicated that intellectual property rights were well protected under their USP framework.

For example, South Africa's USP framework requires the proponent to be reimbursed for certain audited costs and for the purchase of intellectual property rights, if any, by the public authority before the procurement of the project. It must be noted that the scope of the intellectual property rights the USP frameworks aim to protect can be broader than typical technological innovations, and can for example extend to project concepts and project delivery and management processes. In some countries, project development costs, including an acknowledgement of the project idea, are to be paid by the ultimate contractor to the initial proponent. But in other countries, USP proponents are not reimbursed for project development costs.

## 2.3 VARYING MOTIVATIONS OF GOVERNMENTS

Governments' motivations to pursue infrastructure projects through USPs are varied. Governments deciding to allow USPs typically have the following motivations:

- Overcome the government's lack of capacity (financial and human) to identify, prioritize, prepare and procure projects;
- Avoid a lengthy competitive process in order to implement projects more quickly;
- Address the government's inability to fully fund necessary infrastructure development; and
- Tap into the private sector's creativity and knowledge.

<sup>16</sup> More extensive discussion of the various mechanisms is provided in Appendix 1.

All the countries covered in this study faced significant gaps in the availability of public infrastructure needed to accommodate vital economic growth. In the face of the resulting demand for additional infrastructure, governments struggle with constraints related to human resources and financial wherewithal. As figure 5 shows, survey respondents indicated that about 60 percent of the study countries formally accept USPs that require government support. The extent of government support allowable for projects initiated as USPs is often restricted and can be found in the formal requirements in the USP frameworks.

**Figure 5: Countries Formally Accepting USPs That Require Government Support**



*Source: Study questionnaires*

The fact that many countries have chosen to formally allow USPs seems to indicate that policy makers believe that USPs can help overcome the constraints discussed above. They take a pragmatic position, in the expectation that leaving room for private initiative ensures they do not miss any opportunity to develop infrastructure.

Additionally, country-specific circumstances such as the immediate need for the exploitation of new-found natural resources or upcoming domestic or global events require governments to make difficult choices. For instance, in advance of Brazil's hosting of major sporting events, the country's enormous infrastructure requirement has enhanced the relative importance of USPs. Naturally, public-sector officials facing such resource and time constraints may believe that USPs are a shortcut for implementing PPPs and a "quick win" of sorts, and have subsequently encouraged their governments to formalize processes for dealing with USPs. However, the long-term sustainability of such frameworks could be susceptible to changes and may affect investor confidence.

## 2.4 IMPLEMENTATION CHALLENGES

USPs are a reality in many countries, and governments are facing serious challenges in the implementation of projects initiated by USPs. Qualitative analysis on the few countries<sup>17</sup> that transparently communicate about USPs provide sufficient evidence for the conclusion that USPs are a significant factor in the realization of public investment projects. This is further supported by survey responses and expert interviews. as the charts in the next page indicate, the use of USPs seems to be applied more in energy, water and sewerage than in transportation infrastructure. Only 14 percent of all USPs that reached financial close in this PPI Database are related to transportation infrastructure.

<sup>17</sup> With the exception of some countries such as Chile and Peru, there is little documented information available on the number of projects that started as USPs. The PPI Database has limited quantitative information on USPs. For the selected countries, the PPI Database registers 32 projects that reached financial close that were initiated as USPs between 2000 and 2012. The database shows 182 projects that reached financial close after direct negotiation. The assumption is that these projects also qualify as USPs. For the purpose of identifying global trends in the use of USPs, the combination of the category "USPs" and the category "direct negotiation" was analyzed. Although this captures only a portion of the total number of USPs that actually occurred, it gives an impression of the sectoral distribution and regional distribution of USPs.

Figure 6: Percent of PPPs Initiated as USPs by Sector

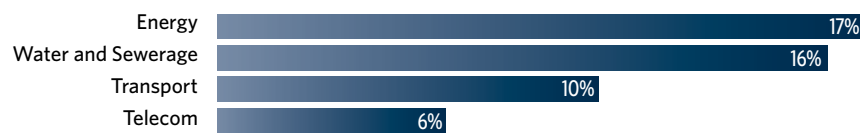
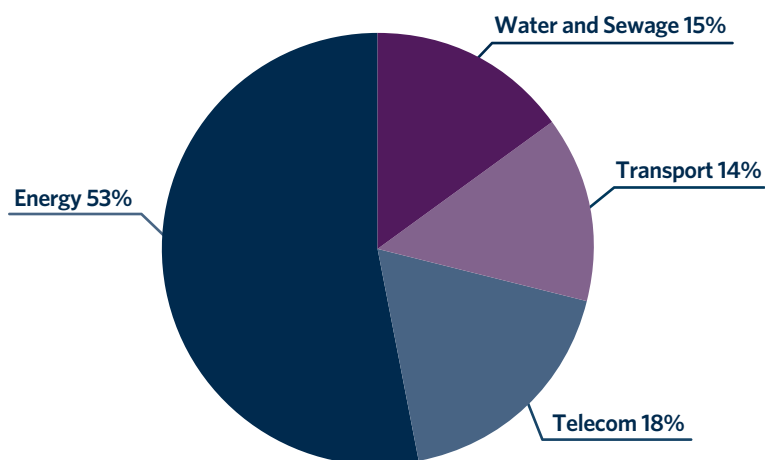


Figure 7: Sectoral Split of USPs



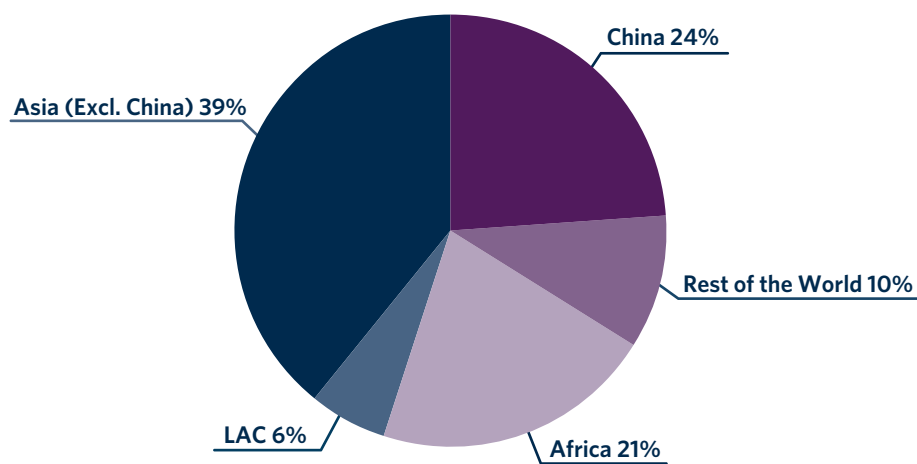
Source: PPI Database

In Asia (including China), USPs appear to be a more significant part of the policy mix. More than 60 percent of all USPs in this PPI Database were located in Asia, as illustrated in the following charts. This can be partly explained by the fact that India and China were the biggest PPP markets in the world, but can also be a result of differences in the accuracy of registration of USPs across the world.

Figure 8: Percentage of PPPs Initiated as USPs by Region



Figure 9: Regional Distribution of USPs



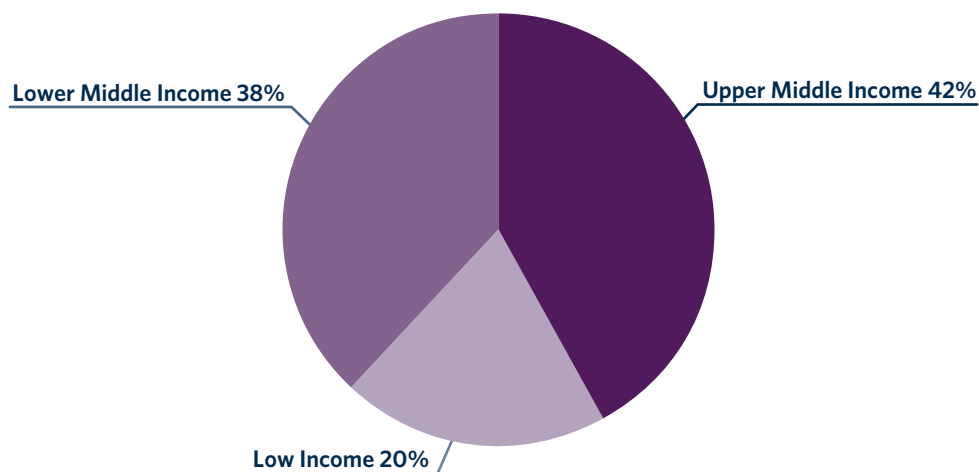
Source: PPI Database

Based on the information available in the PPI Database, low-income countries see more of their PPPs that reached financial close initiated through USPs. However, upper-middle-income countries witnessed a greater number of projects with larger absolute contract value of USPs than low-income countries.

Figure 10: Percentage of USPs by National Income Category



Figure 11: Income Group Distribution of USPs



Source: PPI Database

Projects directly resulting from sovereign agreements are not included in the scope of this study, because they are often subject to specific regulations and governance mechanisms, whereas USPs from foreign companies do qualify as USPs in this study. Respondents indicate that quite a number of proposals submitted by foreign developers seem to be backed by their own governments. These proposals are submitted at a high political level (sector ministers and above), and hence are given high priority status. The basic parameters of the transaction are negotiated by the sector ministers, and handed down to government officials to complete the paperwork.<sup>18</sup>

<sup>18</sup> A number of emerging economies—including China, India and the Gulf States—have a growing role in the financing of infrastructure, mainly in Sub-Saharan Africa. At least 35 African countries were engaged with China on infrastructure finance deals, mainly in hydropower generation and railways. Financing of these projects is channeled primarily through the China Export-Import Bank under very attractive conditions. In some cases, infrastructure finance is combined with natural resource development, whereby repayment of the loan for infrastructure development is made in terms of natural resources. In addition, China has a globally competitive construction industry with particular expertise in the civil works critical for infrastructure development, which is often involved in constructing the projects that were financed by the China Export-Import Bank. An example of a project resulting from bilateral agreements with China is the Standard Gauge Railway Project in Kenya, encompassing the construction of a modern railway line running from Mombasa to Nairobi to Malaba, for which the Kenyan government has accepted an offer from the Chinese government to construct and finance this project. Respondents and other sources indicate that this and other projects that are based on bilateral agreements are not subject to competition and typically do not follow any formal procedures.

Survey respondents indicate that relationship brokers often play an important role in the initial stages of an USP, particularly to the extent that these take place at high political levels. An example of this is the USP for the privatization of Djibouti's main port, as described in box 5.<sup>19</sup>

#### Box 5: Port Privatization in Djibouti Using a USP

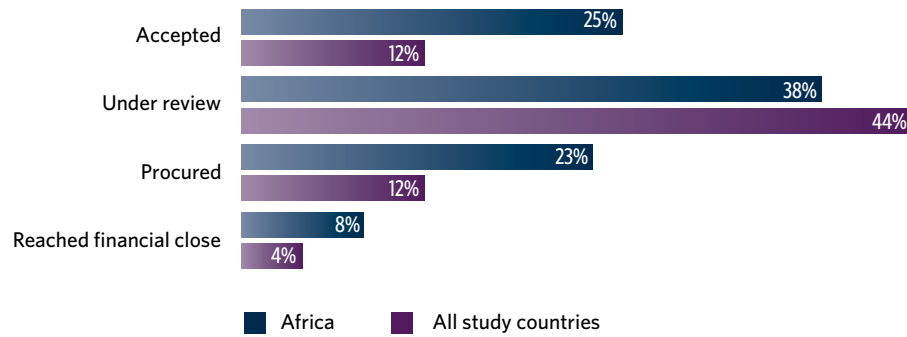
The privatization of Djibouti's main port, Port Autonome International de Djibouti (PAID), resulted from a direct negotiation with Dubai Ports International (DPI). With a quest to become a key player in the international arena, DPI approached Djibouti's government with the opportunity to take advantage of Dubai's economic power through a partnership. While many international aid providers and financial sponsors recommended issuing an open tender process, Djibouti's government instead opted to negotiate a 20-year management contract with DPI.

An important figure in bringing the proposal to Djibouti was Abdourahman Boreh, the right-hand man of President Ismaïl Omar Guelleh and the relationship broker between DPI and the Djiboutian government. A key impetus for the project was its structure, wherein the interests of the Djiboutian government and DPI were aligned by tying the management contract of PAID with the three-phase development of a new port in Doraleh. Under this structure, PAID was expected to become a specialized freight terminal (due to capacity constraints for additional growth) and the income generated by it would partially finance the container terminal in Doraleh. DPI's primary goal was the development of the Doraleh port since it would include a tax-exempt zone, a container port and an oil port, but it simultaneously led to the transformation of PAID. Initially, when the Doraleh project was presented to different international financiers including the World Bank, AfDB, and the French Development Agency (AFD), it was not considered to be viable, but DPI's unique USP, backed by a politically connected relationship broker, brought the project to fruition. Later, when the details of the project were developed, the International Financial Society (SFI), the AFD (through Proparco) and the AfDB agreed to participate in the financing of the project once at least three-quarters of the container terminal was built.

There is little ex-post evaluation documentation on how governments actually managed USPs in practice, and even less analysis exists on the outcome of projects developed and delivered through USPs. It is clear that only a small portion—well under 10 percent, as illustrated in figure 12—of the submitted USPs ultimately achieved financial close. Many survey respondents indicate that governments often do not succeed in the effective and timely management of USPs in a structured procedure, as often described in USP frameworks. The quantity and quality of submitted USPs in combination with limited public-sector capacity is mentioned as the main reason for this. Figure 12 explains the current status of USPs in the sample countries.

<sup>19</sup> This case study is based on a section of the following paper: Arthur Foch, *Déterminants et perspectives de la privatisation des infrastructures à Djibouti: Leçons tirées de trois études de cas*. Documents de Travail du Centre d'Économie de la Sorbonne, May 22, 2013. Available online: <http://ces.univ-paris1.fr/cesdp/2013/13036.html>.

Figure 12: Status of USPs Submitted in the Covered Countries Over the Past Five Years



Source: Study questionnaires

In the interviews conducted, most survey respondents clearly stated that governments across the world struggle with reputational issues related to past and ongoing USP processes, such as perceptions of a lack of transparency, avoidance of competition, corruption and political patronage. Some respondents also noted that USPs have a reputation of leading to poor quality infrastructure that hardly meets minimum requirements of any sort.

All of these issues enforce the perception that USPs often do not serve the taxpayers' interests. It underlines that there is a clear need for the introduction of a formal USP framework that explicitly imposes minimum requirements for USPs. Such a framework acts as a check against inappropriate proposals submitted by vested interests, and empowers officials to reject such proposals on the basis of a technocratic and rule-based approach. Preferably, the framework defines a centralized entry point for USPs, because decentralized models complicate the consistent enforcement of the framework, and make the system less transparent and more prone to corruption.

## Lessons Learned

### 3.1 USP FRAMEWORKS AND PROJECT IMPLEMENTATION

USP frameworks are generally seen as beneficial for the successful implementation of projects initiated through USPs. Such frameworks are developed to promote transparency and introduce competition, and thereby increase the chances of getting good value for money from projects initiated through USPs. In theory, these frameworks should also enhance the predictability of the process, which also enhances market interest and mitigates perception issues. As depicted in figure 13, two-thirds of the study countries did not witness any change in the number of USPs after introduction of USP frameworks. Thus introducing USP frameworks alone does not seem to provide sufficient incentive for the private sector to come forward with proposals.

Additionally, survey respondents and experts in the countries that experienced an increase in USPs after the adoption of a formal framework indicated in follow-up interviews that governments in some countries were overwhelmed by the sheer quantity of proposals received once USPs were formally permitted (which can be before a formal and specific USP framework has been adopted). This likely indicates that the government's capacity to implement the framework was not increased along with the adoption of a framework.

**Figure 13: Percent of Countries Experiencing an Increase in USPs After the Adoption of a Formal USP Framework**



Source: Study questionnaires

USP frameworks are also expected to ensure that the projects resulting from USPs are sound and in line with the public interest and prevent governments from engaging in poorly developed or overly opportunistic proposals. About 43 percent of the survey respondents indicated that they actually experienced an improvement in the quality of USPs after adopting a framework, as shown in figure 14. At the same time, that means more than 50 percent of the respondents continued to receive similar-quality USPs as before or did not experience a specific improvement in the quality of USPs, which can be attributed to a range of issues, as further discussed in this chapter.

**Figure 14: Countries Receiving Higher-Quality USPs After the Adoption of a Formal Framework**

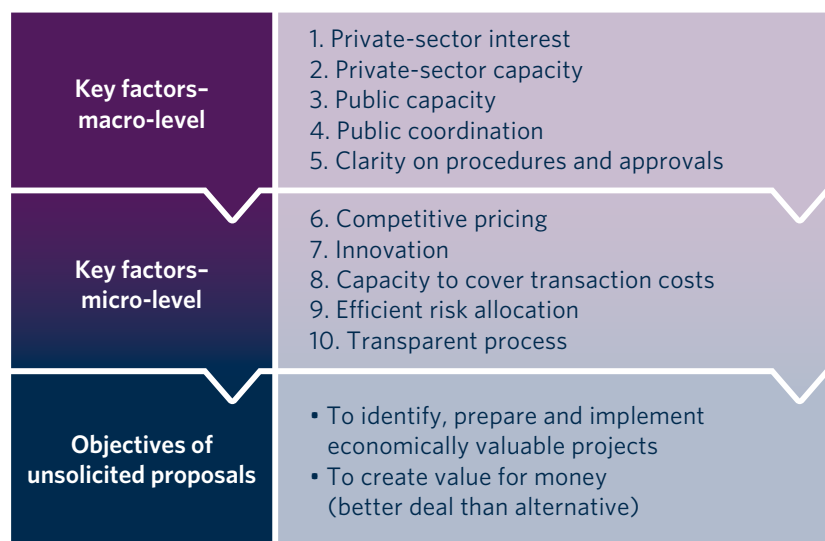
Source: Study questionnaires

Generally speaking, USP frameworks can create more transparency in project initiation and development and help to create the right conditions for the successful implementation of USPs. At the same time, developing a framework alone is not sufficient, because the successful implementation of USPs is dependent on a range of other factors, such as the consistency with which the framework is enforced (discussed later in this chapter).

### 3.2 ROLE OF MACRO- AND MICRO-LEVEL KEY FACTORS

The overall objective of allowing USPs is often to successfully identify and prepare economically valuable projects in situations where governments lack the human capital or financial resources to pursue a solicited approach. As with any other PPP, the objective is also to create value for money or a good deal from the perspective of taxpayers and users. The extent to which these objectives will be met is determined by a set of key factors illustrated in figure 15. The ten factors are based on the analysis and consolidation of the most important challenges countries are facing in the implementation of projects that were initiated as USPs. Five factors concentrate on the macro level or context of a USP; the other five focus on the micro level or individual program/project. Even from a high-level perspective, it is clear that the 10 key factors are strongly correlated. For example, a highly skilled and experienced government will be able to attract market interest and will most likely succeed in achieving an efficient risk allocation and competitive pricing.

Figure 15: Analytical Framework for Factors That Determine the Success of USPs



If the performance on all key factors in figure 15 are high, the chances of realizing the objectives of the USP are similarly high. In practice, governments are experiencing many problems with respect to almost all of the key factors, partly depending on the country's maturity and capacity in dealing with PPPs. In the following section, all of the key factors will be discussed, along with the most important problems and concerns countries are experiencing in these areas, accompanied by examples of strategies to overcome these problems.

### 3.3 MACRO-LEVEL KEY FACTORS—CONTEXT OF UNSOLICITED PROPOSALS

#### 3.3.1 PRIVATE-SECTOR INTEREST

Market appetite is directly dependent on the ability to make a sufficient return on project investment. The clarity, level of development and legal robustness of the USP framework has an impact on private-sector interest. Box 6 illustrates how a legally robust framework encouraged private sector interest in the Philippines. The impact is not so much related to the level of private-sector interest, but rather the type of interest generated. The absence of a well-developed USP framework is extremely likely to elicit opportunistic behavior from private firms. In other words, it may attract private-sector interest that is not conducive to creating value for money and building a long-term partnership (key attributes for PPPs). At the same time, it is observed that a well-developed and well-operated USP framework discourages opportunistic private-sector interest, i.e., the drive to cheaply generate business options, the assumption that governments will be easily lured into one-sided contracts, etc.

It is observed that a well-developed and well-operated USP framework encourages private-sector interest for the right reasons because:

- It attracts private-sector initiators with a genuine long-term interest in the project, because it solidifies the legal robustness of the contract once granted. If granted through a clearly articulated USP framework, the contract is safe(r) from litigation by unsuccessful competitors; and
- It encourages the private sector to submit good proposals by making the government's response to the USP more likely to be predictable, transparent and fair.

#### Box 6: A Legally Robust USP Framework Encourages Private-Sector Interest in the Philippines

The notion that a well-regulated USP framework encourages private-sector interest and confidence is demonstrated by the example of the NLEX-SLEX connector road in the Philippines. In this case, the USP proponent had several options to pursue a concession of the connector road, including a contractual option to extend the existing alignment. However, the USP proponent preferred a well-regulated unsolicited approach to the contractual option, because it provided a sound legal basis for awarding a concession, even though it would involve eventual exposure to competition in the form of a Swiss challenge.

At the same time, if USPs are allowed and a framework is put in place, but the government is not processing and implementing USP projects due to capacity issues, that will eventually affect market appetite for the submission of USPs. The transaction costs for putting together a compliant and compelling USP can be significant. If the expectation is that there will be considerable delay in government follow up and even a notion there will never be a project, the attractiveness of submitting a USP in the first place will be duly affected.

Another element in attracting market interest is providing for some form of reward or reimbursement of project development costs and payment for intellectual property rights, as depicted in the example from Brazil in box 7. One-third of all countries and one-quarter of the African countries surveyed reimburse proponents for compliant USPs, as presented in the chart below.

**Figure 16: Reimbursement of Project-Development Costs**



Source: Study questionnaires

In the absence of a clear competitive advantage or direct contracting, reasonable compensation seems necessary to convince potential proponents to come up with USPs. This has been observed by respondents in countries with neither reimbursement of development costs nor any meaningful protection of intellectual property rights related to USPs. If the government cannot afford to provide such compensation, the bidder to which the project is awarded can include the compensation as part of their costs and increase the revenue requirement.

### Box 7: Reimbursement of Project Preparation Costs in Brazil

There is great variation in Brazil regarding reimbursement of USP proponents' project preparation costs. The guiding principle in Brazil is that if there is reimbursement, it will be done by the winning bidder. There is no obligation on the public sector to reimburse the USP proponent for project preparation costs. The states of Bahia, Goiás, Minas Gerais and Espírito Santo only allow for reimbursement of project development costs if there is an explicit provision in the tender documents providing for reimbursement, and such reimbursement is subject to a statutory ceiling. Otherwise, no compensation or reimbursement whatsoever is due. In some states, such as the states of Rio de Janeiro and São Paulo, the local PMI [Processo de Manifestação de Interesse, or manifestation of interest process] decrees expressly provide that the final winner of the PPP bidding procedure will pay compensation for the USP proponent's project preparation costs, and the statutory ceiling on the amount of reimbursement applies even in this case.

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The compensation approach brings with it the issue of determining the level of compensation. In principle the fee should reflect the value of the proposal to the government, which in practice is very hard to assess. Often, the costs of the initial project development are used as a starting point for compensation. These costs are difficult to assess in an objective manner too. In particular, a proponent's internal costs (the costs of staff and equipment) cannot be easily verified. It was therefore suggested by experts that the amount of compensation be determined upfront according to a prescribed formula, which can be easily implemented and does not require extensive verification on the basis of inputs provided by the original proponent. The amount of compensation is also important while setting up the minimum requirements for the submission of USPs.

Reimbursement without prescribed standards or professional evaluation may offer perverse incentives for opportunistic and frivolous proposals from proponents who do not have a genuine interest in developing and implementing a project, although this can be mitigated by setting quality standards for minimum requirements.

### 3.3.2 PRIVATE-SECTOR CAPACITY

Many USPs are opportunistic and of poor quality. For the same reasons that private-sector behavior can be overly opportunistic in the absence of a well-developed framework, the quality of USPs is often poor. USPs are often limited to brochures, letters of intent, high-level plans, memoranda of understanding, etc. Too often and too easily, governments go along with the salesmanship of private firms proposing an idea rather than a fully developed project on which the government can do its due diligence.

A sophisticated set of minimum requirements and the enforcement of these requirements prevent the government from having to deal with underdeveloped proposals and private-sector parties who do not have the capacity to successfully identify, prioritize, prepare and procure projects. Another approach can be to apply a fee to be paid by the USP proponent upon submission, which can be recovered as part of the contract costs should the USP proponent win the eventual contract. This not only incentivizes USP proponents to submit only serious, well-developed and compliant proposals, but also helps the government to shoulder significant transaction costs that come with assessment of the USPs or, more specifically, cover the cost to the government to conduct an independent feasibility study. Although the imposition of such a submission fee was not reported by survey respondents, it seems like a realistic approach.

In case the capacity of the domestic private sector to develop and implement projects is limited, countries can also benefit from having international (experienced) bidders involved, who can be obliged to work with a local private-sector entity in order to build domestic private-sector capacity.

### 3.3.3 PUBLIC-SECTOR CAPACITY

One of the motivations for governments to facilitate USPs is the lack of financial and human resources capacity to identify, prioritize, prepare and procure public infrastructure projects themselves. The paradox is that the same lack of capacity that motivates the interest in USPs often also afflicts the selection and implementation of these USPs. After all, the successful implementation of USPs requires a high level of expertise in project development (conducting and evaluating the economic and financial viability and feasibility of a project, as well technical feasibility, and preparing design and engineering plans) and contract procurement. A common issue is the lack of capacity of the implementing sectoral agency or ministry, which is often new to PPPs. In many developing countries, government officials have little experience in implementing PPP projects, which require specific skills and knowledge. Even in countries where government officials do have experience, lessons from one project do not necessarily transfer to another.

The majority of experts and survey respondents mentioned lack of capacity as the most important challenge in the successful implementation of USPs, because it affects the enforceability of the framework, no matter how good it is. The respondents do not seem to be too pessimistic (nor optimistic) about the extent to which the USP framework is enforced in a fair and predictable way, when providing a (subjective) scoring of USP framework enforcement. Figure 17 depicts the responses, which mostly rate the enforcement of frameworks as mediocre (i.e., average satisfactory, but with more scores closer to “poor” than “good”).

**Figure 17: Fair and Predictable Enforcement of USP Framework (1 = poor, 3 = satisfactory, 5 = excellent)**



Source: Study questionnaires

Quite often, the initial introduction of regulations allowing USPs has a destabilizing effect, as the responsible officials and departments are quite simply overwhelmed by the sheer quantity of proposals from the moment USPs are formally permitted, as was the case in Colombia. Survey respondents also indicate that the complexity of the proposals causes serious capacity issues, and in some instances, the fact that government officials are personally held liable prevents them from making decisions. Quite often, these circumstances lead to serious delays, which in turn cause a decrease in private-sector interest. Hiring qualified and experienced transaction advisors is crucial to overcome the lack of capacity.

However, hiring advisors is unpopular within some governments due to the additional costs and procurement procedures. Procuring an advisor can easily add a significant number of months to the time needed for developing the actual project. In addition, hiring external experts in some countries is complex and cumbersome. This has led officials to allow and encourage USPs as an external source of project-development capacity and expertise. The Brazilian PMI process is a specific example of this, as further described in box 8.

#### Box 8: Alternative Use of USPs in Brazil to Overcome Public-Sector Capacity Constraints

Due to limited resources and expertise as well as regulatory constraints related to the hiring of private-sector consultants, Brazilian public-sector authorities often use the Manifestation of Interest Process (Processo de Manifestação de Interesse or “PMI”) PMI, wherein the public sector is allowed to receive and validate project development studies prepared by the private sector. The public sector has also used the PMI to deal with the growing number of USPs relating to infrastructure projects in recent years. In practice, when a private-sector entity demonstrates interest in a particular infrastructure idea, the public authorities have channeled such private-sector interest into a PMI to complete initial pre-feasibility studies and develop project-tendering documentation.

Post-PMI, the project is subjected to a competitive tendering process to select the eventual project developer. Thus, even in the absence of a specific framework on USPs, public-sector entities in Brazil have innovated to institutionalize the use of USPs through the PMI, not only to address the public sector’s capacity issues, but also to overcome constraints on hiring private-sector advisors.

According to respondents, some of the lessons learned through this process are:

- It proves challenging to organize a level playing field leading to an effective competitive procedure, resulting in the initial proponent very often winning the competition; and
- The effective implementation of this process requires well-developed legal, financial and technical skills and experience with PPPs, which sub-national governments do not always have. This can easily lead to dependency on the private sector and poorly structured procurements and PPP contracts.

Concerns about attracting external expertise notwithstanding, deploying such expertise for undertaking due diligence and introducing competitive proceedings for USPs are generally accepted as best practice. In fact, competition can play an important role in reducing the level of capacity required to review and procure projects on the basis of USPs. It is easier for procuring agencies to assess proposals received in a competition than to assess the merits of individual proposals without any point of reference. Nevertheless, it is important to emphasize that the capacity level of government officials is still important even for validating and evaluating the merits and demerits of submitted proposals.

Faced with limited resources and capacity, some officials have started to consider USPs a distraction from their core public interests. This is why some survey respondents prefer to focus first and foremost on their predetermined public investment plans. They realize they first need to develop more capacity and expertise for dealing with proposals solicited by them on the basis of that list. Most governments agree that building capacity and expertise is most effective “on the job” and with the support of MDBs and (international) experienced advisors. At the moment, expertise is increasingly being transferred from more experienced environments to emerging PPP markets (e.g., experience developed in the Philippines and India is being used to assist the PPP units of East Africa with individual experts moving in as resident advisors).

### 3.3.4 PUBLIC-SECTOR COORDINATION

Implementation of USPs is often hindered by both inter- and intra-public-sector coordination and communication issues. In counties with a decentralized model of realizing (development and implementation) infrastructure PPPs, management of USPs is often hindered by coordination and communication issues due to the involvement of several ministries and agencies. Additionally, if the point of entry for USPs is dispersed among various government agencies, it is harder to track USPs received by the government, and that makes the management of the USPs less transparent and more prone to abuse.

The most effective way to deal with challenges in public-sector coordination seems to be to let an empowered centralized unit experienced in PPP transaction management take the lead in the management of USPs. Only 50 percent of the respondents indicated that a specific entity within their country's government was formally designated to handle USPs. For example, in Tanzania, the main point of receipt and responsibility for the handling of USPs is at the contracting authority (line ministries, implementing agencies, etc.). The central Tanzanian PPP unit plays a minimal role in the aforementioned process, while it is felt that contracting authorities do not have enough capacity to manage and develop USPs into mature and well-negotiated projects. The earlier involvement of and assistance by PPP units would contribute to better project development.

If a leading role for the central PPP cell/unit is not feasible or not formally provided by the PPP and/or USP framework, the cell/unit can still fulfill three important roles in the early phases of a USP process in order to support line ministries and contracting agencies:

- In the case of an absence of any requirement to apply competition, advise on the best possible way to improve the USP;
- If feasible, promote and advise regarding the best way to introduce competition into the USP process; and
- If the project is suited for it, promote and advise in favor of regular competitive development and tendering.

### 3.3.5 CLARITY ON PROCEDURES

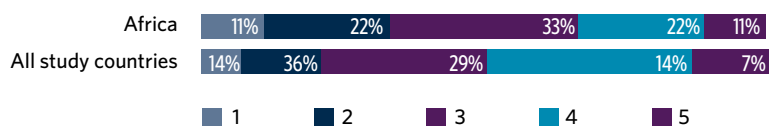
Although USP frameworks should increase the clarity of procedures, in some instances, USP procedures and their enforcement remain unclear. In some countries, procedures for managing USPs from initial submission to acceptance and ultimately to contractual close are unclear, as are the responsibilities for handling PPPs. This can lead to high transaction costs, loss of market interest, and perception issues with the general public. Regardless of the clarity of the procedures as described in USP frameworks, the awareness of USP procedures is very low, according to most survey respondents, as depicted in figure 18. In other words, the respondents indicate that not all government officials who are involved in managing PPPs and USPs are familiar with the existence and content of USP procedures. The notable difference between Africa and the other countries in this study is that significantly fewer survey respondents in Africa indicate that there is awareness of the USP framework across all relevant government bodies. These strikingly low percentages imply that—next to the implementation of an effective USP framework—more attention to the socializing and communicating of such frameworks is required.

Figure 18: Awareness of USP Framework Across all Relevant Government Bodies



The responses reflect a normal distribution with respect to their (subjective) appreciation of the clarity, comprehensiveness and enforceability of the USP frameworks in their country, meaning that the number of respondents assessing the framework as poor is about equal to the number of respondents assessing the framework as good, as shown in the chart below. In Africa, respondents score the clarity, comprehensiveness and enforceability of USP frameworks slightly higher than in Asia and Latin America and the Caribbean.<sup>20</sup>

Figure 19: Clarity, Comprehensiveness and Enforceability of USP Framework (1 = poor, 5= excellent)



Source: Study questionnaires

<sup>20</sup> Please note that the scoring in figure 19 pertains to clarity and enforceability of the USP framework (which is a qualitative assessment of the USP framework as such), whereas the scoring in figure 17 pertains to the actual enforcement of the USP framework (which is a qualitative assessment of the enforcement of the USP framework in practice).

Even with formal frameworks and mechanisms in place, it often remains unclear whether these are being applied in practice. If they are applied, it is also unclear whether they are being applied effectively, and if the outcome of these models adds public value, as indicated by the respondents.

Experts and survey respondents identified some additional challenges with respect to USP frameworks:

- Lack of clarity on the status of the USP framework—often, countries create USP frameworks in an expeditious manner, for instance, in the form of guidelines or government circulars. In some instances, USP frameworks result from studies commissioned by governments from external consultants or with the assistance of international institutions, without clearly explaining their legal status, leading to much confusion over their binding nature. An example is described in the following text box 9.

#### Box 9: Ghana's PPP Toolkit for USPs

In 2012, Ghana's Public Investment Division of the Ministry of Finance prepared the Public Private Partnership Toolkit for Unsolicited Proposals (Processing and Assessing Unsolicited Proposals for Public Private Partnerships Projects) ("PPP toolkit for USPs"). This toolkit outlines a five-step process whereby—if a relevant ministry determines a USP to be viable as per the national policy on PPPs—it is required to undertake a competitive procurement process that would include the original proponent of the USP. Lack of clarity over the legal status of the PPP toolkit on USPs has resulted in various government agencies questioning its binding nature. A pending draft of a new PPP law is expected to resolve this matter.

- Lack of applicability of the USP framework—In some jurisdictions, certain government agencies or types of projects are carved out as exceptions and do not fall under the general USP framework. A related issue is the existence of multiple USP regulations for different agencies. The example of such circumstances in South Africa is delineated in the following text box 10.

#### Box 10: South Africa's USP Framework

National Treasury Practice Note No 11 of 2008/2009 is a subsidiary regulation under the Public Finance Management Act, 1999 that specifically provides the government with a framework within which "USPs/concepts" relating to both PPP and non-PPP projects may be considered. Per the stated note, government institutions are not obligated to consider USPs, but may do so only if the USP meets certain criteria. Once the government institution decides to procure the project that was initiated as a USP, it must do so through a "competitive bidding process in terms of the institution's supply chain management system," among all qualified firms selected through a request for qualifications process.

South Africa's central PPP unit, placed within the National Treasury, supports various government institutions in dealing with projects within this framework. However, several public entities, including state-owned enterprises and government departments, have their own procurement laws. For instance, the South African National Roads Agency Limited (SANRAL) is governed by its own set of procurement laws and issued its own USP policy in 1999, with the support of the Minister of Transport. This is why the general USP framework is not applicable for road infrastructure projects. SANRAL secured this special exemption from the National Treasury framework because it was undertaking PPPs long before the central PPP unit was created within the National Treasury.

- Lack of understanding of the USP framework by government officials—Particularly if the framework was developed by outside consultants, government officials sometimes experience difficulties understanding and interpreting the regulations and policies.
- Lack of consistent implementation of the USP framework due to a decentralized PPP model—If a country has a decentralized PPP model and multiple government agencies can develop projects and accept USPs, this leads to fragmentation in the entry point for USPs, thus making them harder to track, less transparent, more prone to corruption, and less likely to provide consistency in national infrastructure planning.
- Lack of clarity regarding legal hierarchy between the USP framework and bilateral agreements—Even if there is a PPP law, including USP regulations, some government officials believe bilateral agreements are not subject to these laws, particularly when it comes to competitive procedures.<sup>21</sup>
- Lack of appreciation of the value of the USP frameworks by political decision makers—USP frameworks are often developed and applied by bureaucrats. Often, the meaning and implications of the frameworks do not reach the political level. The survey respondents mentioned a number of cases in which USPs were agreed upon at a high political level and therefore given high priority. Obviously this can easily lead to conflicts around the procedures the USP framework demands and therefore the full value of the assessment the framework prescribes in managing the USPs may not be realized.

### 3.4 MICRO-LEVEL KEY FACTORS—IMPLEMENTATION OF USPS

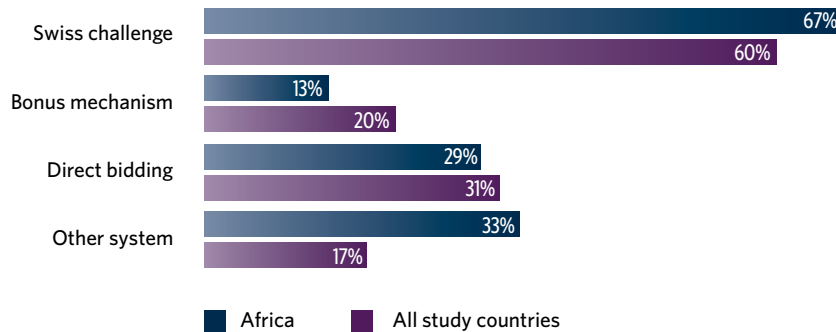
#### 3.4.1 COMPETITIVE PRICING

It proves challenging to provide a level playing field between the original proponent and potential competitors. Survey respondents and PPP experts commented that in a significant number of cases, USPs are desired for the wrong reasons, namely for an assumed speedy process, and in the absence of competitive procurement processes. Sometimes this stems from the desire to implement a project faster than using conventional procurement routes, but in other cases, the USPs act as a cover for nepotism and corruption. Often projects are granted to private proponents without any semblance of transparent and competitive bidding. This leads to little or no incentive for the private proponent to lower costs or profit margins, which in turn leads to the government failing to receive a fair and competitive price.

A government that aims to have a competitive procedure following the acceptance of a USP expects to arrive at a fair market price and value for money. Governments have developed a range of mechanisms to implement projects that are initiated through USPs, including Swiss challenge, bonus system, automatic short-listing (admission to the best and final offer or BAFO phase) and full competition (see further analysis of these mechanisms in Appendix 1 ). Such mechanisms are often described in the PPP or USP legislation, regulation or policy. Figure 20 describes the application of these systems according to the survey respondents.

<sup>21</sup> An example of this seems to be the Standard Gauge Railway Project in Kenya, for which the Kenyan government entered into a bilateral engagement with the Chinese government, which had not been through any competitive procedure.

Figure 20: Follow-up Mechanisms After Acceptance of USPs



Source: Study questionnaires

Some practitioners question the effectiveness of a Swiss challenge and a bonus system. Survey respondents in some countries, such as Tanzania, claim that these and similar mechanisms ultimately are artificial and distort competition. Specifically, with regards to the bonus system, governments in some countries, such as Chile, are finding that the difference between the winning bidder and the runners up is almost always bigger than the bonus points, leading to the conclusion that a bonus system does not influence competition. Although in Chile, the original proponents have won less than half of those bids which were competitively procured where more than one bidder has participated. Another issue is whether the awarding of bonus points to the USP proponent discourages other bidders from seriously bidding, or from bidding at all. In addition, a major problem with the structuring of the procurement process is that other competitors are given only a fraction of the time available to the USP proponent for the preparation of a proposal. This results in a very slim chance of serious high-quality proposals competing on an equal footing with the original USP.

For these reasons, some take the position that the procedure following a USP should be entirely competitive, either through full competition or by admitting the original proponent into the bidding phase directly. The reward for the initial proponent's effort could then be dealt with in a different way, most likely by direct compensation.

In some instances, there may not be a sufficient number of private parties interested in participating in the procurement of a project, in which case organizing a full-fledged competitive process increases the transaction costs for the government and causes delays in procurement (and in the process weakens the government's negotiating position). In such instances, prior to entering into a full-fledged competitive process, a government could conduct a "market sounding" exercise to gauge the level of private-sector interest and make a judgment on the scope and nature of the competitive process to be followed in the procurement of that project. While this may initially add more time and cost to the process, it increases the chance of making an informed decision and avoiding delays and costs at a later stage. The generally agreed-upon position is that eschewing competition can never be a long-term sustainable solution.

### 3.4.2 PRIVATE-SECTOR INNOVATIONS

Despite the importance of innovation, USPs in less mature PPP/infrastructure environments are not very innovative. The role of innovation, with respect to infrastructure development, is tenuous in countries that have less mature PPP/USP frameworks and a poor track record of modern public investment projects. At times, USPs brought to them could be considered relative and innovative in the context of the technology available in the country. For example, printing technology for personal identification documents as well as fare collection technology could be unavailable in certain countries, and could be considered innovative in those countries. In fact, these technologies have been known to be offered to governments as USPs in some developing countries. However, in developed countries, these technologies do not amount to real innovation and could be sourced by governments through regular procurement from international suppliers.

### 3.4.3 TRANSACTION COSTS

Less formalized procedures can lead to high transactions costs. Experts and survey respondents indicate that many USPs can be qualified as poorly prepared and structured, opportunistic (in the sense that they cater primarily to a private party's interest) and not very detailed and committed. This requires detailed preparation at a later stage, which leads to slower implementation and larger transaction costs. A sophisticated set of minimum requirements (and the enforcement of them) can significantly reduce the unnecessary transaction costs.

In case there is no competitive setting, the transaction costs may seem low, compared to a full-fledged competitive procedure. At the same time, global experience shows that in many cases, direct negotiations have been carried on for several years without any agreement. Often an eventual resolution takes longer than a competitively tendered project.

A competitive procedure following a USP seems to increase transaction costs, but it can also significantly improve diligent risk pricing from competition. One could argue that these are necessary transaction costs, in order to acquire competitive pricing. Although the initial proponent may debate it, the introduction of competition is almost never a waste of time and does create a better deal.

### 3.4.4 EFFICIENT RISK ALLOCATION

Lack of capacity to successfully implement PPP projects and a focus on short-term results often lead to a disregard of future liabilities. Due to political motivations, governments are typically under pressure to show results. Their focus tends to be on getting an investment memorandum or letter of intent signed—this reflects the level of detail and the way in which USPs are normally submitted to governments. Therefore concluding an agreement on the basis of an USP and promoting this agreement is: (1) a very expedient way of building political capital for governments, and (2) an effective way to create the option of a business opportunity for private companies. However when short-termism becomes a principal driver of USP processes, the long-term economic, technical and financial rationale of the resulting project cannot be ensured. It also means that many agreements resulting from USPs receive significant attention in the media, only to see their momentum wither as governments and private proponents subsequently struggle to implement the poorly thought-through terms related to works, services and other conditions of those agreements.

There is a concern identified by some experts that some private proponents are using the mechanism of USPs without any intention of constructing, operating and maintaining a project over a period of many years. Sometimes the proponent's motivation for submitting a USP simply is to get reimbursed for project development costs. There are also examples of projects in which a contract with (intentionally) one-sided and onerous termination clauses is negotiated and closed, which the contractor then uses to terminate the contract not long after it was closed. The compensation for early termination leads to a significant return on investment for the contractor, leaving the government without a project and with a significant fiscal liability.

As with regularly developed and implemented PPPs, a USP contract for infrastructure implies long-term liabilities. Without any competition and formal procurement, these liabilities are likely to become less explicit. This is especially true for contingent liabilities, which are liabilities to the government that are not fixed, but contingent on certain future uncertainties. They come in two forms: implicit and explicit contingent liabilities. Explicit contingent liabilities are often agreed upon by governments as part of a USP (traffic level, tariff, loan, and other forms of guarantees) and tend to be subject to less scrutiny than direct financial contributions via grants or subsidies. Governments tend to make biased estimations of future uncertainties driving contingent liabilities. Implicit liabilities are not covered by the contract but nevertheless put the government at risk; evidently these are even more difficult to anticipate, as the example from Tanzania shows in box 11.

The study has found that USPs are especially vulnerable to poor contracting of such future liabilities for a number of reasons, including:

- Lack of negotiation capacity—whereby private firms supported by robust legal and financial advisory firms outsmart poorly resourced government officials.
- Lack of sector expertise—whereby governments negotiate projects without availing themselves of officials or external advisors experienced in the specifics of the sector and the contract type being negotiated (e.g., the particularities of power purchase agreements, or PPAs).
- Pressure to show results quickly—whereby officials' ability to take enough time for due diligence and negotiations is obstructed by their superiors' political drive to expedite a signed agreement and initiate project services or works immediately. This has been observed in Tanzania, among other countries.
- Planning and coordination failings—whereby officials make misguided assumptions concerning the government's ability to fulfill certain of its obligations under the contract, or concerning its ability to realize certain adjacent projects required for the contract to function properly (e.g., a take-or-pay arrangement or capacity charges in the case of an independent power producer (IPP)/PPA, while grid connection is made a responsibility of the government).
- Corrupted decision-making process—whereby individual financial interests of public officials distort decision making with long-term implications to the government's budget.

#### Box 11: Government Liabilities in USPs: Energy Generation in Tanzania

The issue of public-sector capacity and miscalculation can be illustrated by the Tanzanian experience with setting up and negotiating a Power Purchase Agreement. The arrangement was made under the General Procurement Act as an emergency procurement on the basis of pressing power shortage issues. The project was initiated by a private U.S. investor. During negotiations, the government accepted certain guaranteed payments to remunerate the proponent for capacity charges, which were guaranteed by the Ministry of Finance. However, the power production facility's capacity was not fully used, because the national energy company was unable to adequately deliver power to the grid. This left the Tanzanian government making payments for capacity it did not use.

Some countries choose to conduct feasibility studies for USP projects themselves or to do an independent review of the feasibility study provided by the proponent, both of which reduce the risk of overlooking liabilities. Having appropriate procedures and clear regulations regarding fiscal risk management also reduce the chances of hidden liabilities.

### 3.4.5 TRANSPARENCY

The implementation of USPs often is not very transparent. Without a legislative or policy framework, USPs are often implemented through a sole-source procedure. The processes involved with this leave many degrees of freedom to officials and others with involvement and interests in the project to determine the way in which it is procured. Even with USP frameworks in place, there can be significant pressure from external parties, individual officials or institutional interests within government to deviate from the rules prescribed by the framework. Where rules are bent, transparency and accountability can be diminished. It is therefore not surprising that in some countries, USPs are inseparable from corruption or the perception of abuse. Some USPs are developed simply to serve as vehicles for the embezzlement of public funds, without any regard to financial or technical sustainability. This has led to projects being commissioned but never actually constructed, or constructed at a very low level of quality.

A well-developed USP framework can certainly contribute to transparency. Other ways to increase the objective and transparent assessment of proposals are: (1) a blind review of proposals, or (2) having two independent teams conduct the assessment. The lessons learned include suggestions to:

- Involve the centralized PPP cell/unit in the review;
- Involve teams from different departments in the review;
- Involve government officials who were not involved in earlier stages of the project;
- Ensure that there is sufficient PPP experience in the review team(s); and
- Involve a probity officer to ensure compliance with established procedures.

Whereas these measures enhance the transparency and independence of the assessment, they do not resolve information asymmetry between the authority and the bidders. In this study, these approaches were not reported by respondents, but they are common in normal procurements.

## Key Implication and Recommendation

### 4.1 ACCEPTING USPs AS AN EXCEPTION

In light of all the issues and concerns outlined in this study with respect to USPs, one might draw the simple conclusion that it is extremely difficult to manage USPs, and therefore, it is preferable not to allow USPs at all. However, USPs are a reality in many countries, and there are no indications that their use will completely fall out of favor anytime soon. The nature of the private sector is to be proactive in the face of challenges and opportunities, which is demonstrated by the multitude of USPs submitted to governments worldwide. One way or another, governments with poor capacity to develop and implement a public investment agenda pose an opportunity to proactive private-sector entities. Some of these private initiatives actually lead to the realization of public value.

When determining a position on the merits of USPs, it does not seem realistic to completely ignore or prohibit USPs, but rather accept the reality of their presence and explore ways to improve the management of USPs by governments in developing countries. Engaging with key stakeholders in the process is better than deserting them. This study has led to developing Key Factors (KFs) that offer direction in this respect.

### 4.2 SPECIFIC PRACTICAL SUGGESTIONS TO ACHIEVE THE KEY FACTORS

This study indicates that it is important to develop a framework for USPs and build capacity to successfully use that framework and implement PPP projects. It also shows that frameworks to deal with USPs vary widely in their effectiveness, raising a range of issues that are specific to such frameworks. On the basis of the lessons learned as described in the previous chapter, some practical measures can be suggested to governments in order to improve both their USP frameworks and the implementation of projects that were initiated as USPs. In the following table, these practical suggestions are organized around the identified key factors.

**Table 4: Suggestions on the Basis of Lessons Learned**

Key Factor	Potential Practical Measures to Improve USP Frameworks and Project Implementation
<b>Private-sector interest</b>	Arrange for a predetermined policy on reimbursement and an agreement on reimbursement early in the project.
	Arrange for a predetermined policy on property rights and protection of intellectual property.
	Ensure removal of legal ambiguity concerning the status and interpretation of the USP framework, in order to enhance robustness of the PPP once granted and to withstand legal challenges by competitors.
	Define and promote clear timelines, procedures and requirements to ensure clarity of the USP framework and predictability of the USP process.
	Consider deliberate processing/removal of existing backlog of stranded USPs to demonstrate political commitment to consistent and transparent treatment of USPs.
<b>Private-sector capacity</b>	Ensure that international companies are involved, and/or obliged to build local capacity.
	Define clear qualification criteria, as part of setting minimum submission requirements, regarding which private-sector entities can submit USPs. Such qualification criteria could include a proven track record and technical/ personnel capacity and proof of financial capacity (balance sheet, letter of intent regarding equity financing, letter(s) of intent regarding bank financing, etc.). These qualification criteria could be borrowed (with suitable modifications) from the legal and regulatory requirements governing the solicited approach.

Key Factor	Potential Practical Measures to Improve USP Frameworks and Project Implementation
Public-sector capacity	Focus first and foremost on predetermined public investment plans and on the solicited approach of developing and implementing infrastructure projects.
	Be aware that when a USP is presented by a private-sector entity, subjecting it to competitive proceedings is a way to compensate for a lack of public capacity. Even with a low capacity to assess USPs, a government can filter out highly opportunistic proposals if USP proponents know that their proposals will be subjected to competition. Additionally, competition helps a government to easily compare multiple proposals (as compared to having to assess individual proposals) to determine the value offered by a USP.
	Consider that PPP units can build capacity “on the job” with the help of multilateral organizations, and by sourcing internationally experienced support, i.e., with the provision of transaction advisors.
Public-sector coordination	Ensure that USPs are coordinated by an empowered cell/unit (e.g., central PPP unit) that has experience in PPP transaction management.
	Ensure that the fiscal impacts of USPs are appraised and approved by the government authority before they are accepted by the implementing agency for further consideration and processing.
Clarity on procedures	Maximize the degree to which USPs are treated as any other project would be (e.g., for qualification criteria, procedures, etc., USP-specific procedures may borrow from provisions concerning regular solicited procedures, if not by law and regulation, then at least by practice).
	Introduce and consistently enforce a competitive process for USPs.
	Set up procedures and avail of the services of probity advisors to ensure ex-ante quality enhancement and accuracy in the application of procedures.
Competitive pricing	Always implement a competitive procedure following a USP proposition, in order to arrive at a fair market price.
	Allow sufficient time and access to all relevant information for competitors to develop concurrent bids.
	If feasible, reward proponents of USPs by reimbursing project development costs, ideally avoiding reward mechanisms as part of the competitive process (such as Swiss challenge and bonus) to prevent distortion in competition.
	Allow proponents of USPs direct access to bidding phase or simply to a full competition under the same conditions as the competitors.
	As part of the due diligence on the USP and on challenging proposals (if any), pre-determine realistic deal terms, financing terms and a reasonable rate of return or comparable pricing parameters as a “benchmark” to ensure that a competitively priced bid follows from the USP process.
Sustainable quality and innovation	Carry out an independent feasibility study or an audit of the feasibility study submitted by the proponent of the USP.
	Hire external expert advisors, with or without support from multilaterals.
	Use international PPP best practices and model contracts.
Cover transaction costs	Require proponents to pay a fee upon submission, both to cover (at least some of) the costs of evaluation and to incentivize proponents to submit compliant proposals.
	Have the winning bidder reimburse the initial proponent for the value they provide to the winning bidder and the government (and potentially for intellectual property).
Efficient risk allocation	Conduct the feasibility studies in-house or obtain an independent review. In any case, an extensive due diligence on proposed contracts, terms and risk allocations is strongly recommended.
	Implement strong procedures and clear regulation for fiscal risks and liabilities.
	Make sure the USP framework specifies very clearly whether government contributions are allowed. No government financial support or guarantees may be considered as the default option. Always follow a competitive procedure if government support in any form (grant, subsidy, loan, rights, land, traffic, tariff, and other forms of guarantees) is involved.
	Source external expertise (external advisors, resident experts, etc.) to support governments managing a USP process, organizing a competitive procedure and negotiating contracts for projects initiated through USPs, while building capacity “on the job.”

Key Factor	Potential Practical Measures to Improve USP Frameworks and Project Implementation
Transparent process	Implement a well-developed USP framework with a clear description of the procedures to manage USPs.
	Develop a sophisticated set of minimum requirements (and make sure they are strictly enforced).
	Pay attention to socializing and communicating the USP framework, and commit all stakeholders to the enforcement of the framework.
	Incorporate a blind review of proposals, or have two independent teams conduct the assessment of USPs.
	Have a probity officer involved to ensure process compliance and fair treatment of all proposals during the competitive stage.

### 4.3 NEED FOR COUNTRY-SPECIFIC STRATEGY

Differences in country-specific contexts and motivations for allowing USPs give rise to different strategies with respect to managing USPs.

#### 4.3.1 CAPACITY AND MATURITY OF PPP MARKET AND FRAMEWORK

The studied countries vary widely in terms of their level of capacity to prepare and procure projects, their competence in PPP project implementation specifically, and the maturity of their PPP market and framework. Even though the generic recommendation to implement effective frameworks and to build capacity in all infrastructure development areas is very valid, the USP strategy for a specific country could be tailored to its specific characteristics.

Countries vary in terms of capacity levels, i.e., the extent to which a government has the capacity, skills and level of experience to: 1) develop a national infrastructure program and project priority list, 2) prepare and procure projects, and 3) manage a PPP project throughout the project cycle (planning, preparation, contracting and monitoring) and handle USPs. With this, the motivation of different countries for facilitating USPs also varies.

- Countries with low public capacity in all areas of PPP project cycle processes are typically interested in market/private initiatives to get projects done in the first place. Apart from MDB/donor funding available for public projects, the need for private initiative is driven by lack of other realistic public alternatives.
- Countries with a basic national infrastructure program and limited capacity to prepare and implement projects show interest in USPs to optimize their own project prioritization and to identify projects that are not on the government's priority list.
- Countries with considerably well-developed capacity in all areas of PPP project cycle processes are interested in true private-sector innovations and proprietary technology.

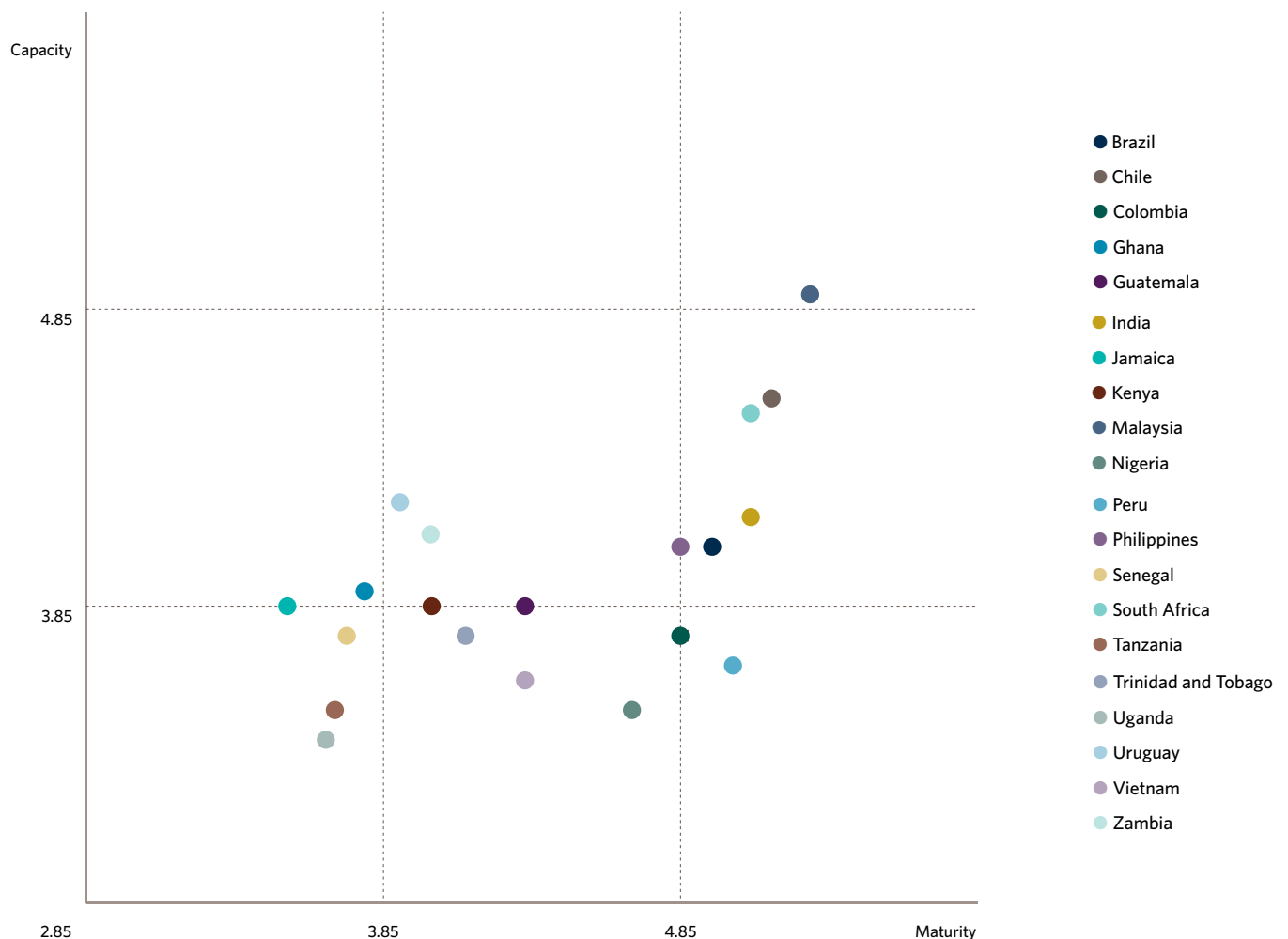
Countries also vary in terms of the maturity of their PPP and USP frameworks and PPP and USP markets, including the level of development and enforcement of the government's laws, regulations and policies with respect to project development, negotiations and project implementation through USPs.

#### 4.3.2 COUNTRY CLASSIFICATIONS—CAPACITY AND MATURITY

Whereas the country classification on the basis of the capacity to implement infrastructure projects and PPPs and the maturity of the PPP market and framework seems valid, the objective measurement is challenging, because there are no objective scoring mechanisms

capturing these aspects. The Global Competitiveness Index<sup>22</sup> includes a number of criteria that can be considered to be fair indicators of capacity and maturity, although these criteria are not specifically applied to infrastructure, PPPs and USPs. For this study to reflect Capacity, the indicators under criteria 1 (Institutions) and 11 (Business Sophistication)<sup>23</sup> seem most appropriate. Similarly to reflect Maturity, the indicators under criteria 3 (Macroeconomic Environment), 8 (Financial Market Development) and 10 (Market Size) seem most relevant. For the countries under this study, a country's average score on variables 1 and 11 is used to plot the capacity (Y axis) and a country's average score on variables 3, 8 and 10 is used to plot the maturity axis (X axis) in the following graph.

Figure 21: Country Scoring on Capacity and Maturity



<sup>22</sup> The Global Competitiveness Report is a yearly report published by the World Economic Forum. Since 2004, the Global Competitiveness Report ranks countries based on the Global Competitiveness Index, developed by Xavier Sala-i-Martin and Elsa V. Artadi. The Global Competitiveness Index measures the set of institutions, policies, and factors that set the sustainable current and medium-term levels of economic prosperity.

<sup>23</sup> Since the overall minimum score in the Global Competitiveness Index is 2.85 and the overall maximum score is 5.67, these values were accepted as minimum and maximum scores for the country classification and chart tailored to reflect the same.

### 4.3.3 CAPACITY AND MATURITY—CORRESPONDENCE TO KEY FACTORS

Whereas all countries have the same objective to continuously strengthen capacity and grow in PPP maturity and thereby reach higher levels of sophistication, a further differentiation of strategies with respect to implementation of projects initiated through USPs can be developed on the basis of the lessons learned, as discussed in the previous chapter. The following correlations between capacity, maturity and the 10 key factors can be deduced from this study and should be taken into account when developing country-specific strategies:

- Country capacity levels and maturity levels are strongly correlated with the key factors. In other words, low capacity and very little experience in implementing PPPs and USPs lead to low scores on all key factors.
- The scores on the macro-level key factors (KFs 1-5) strongly impact the scores on the micro-level key factors (KFs 6-10).
- The scores on public-sector capacity, public-sector coordination and transparency of procedures and approvals (KFs 3-5) strongly impact the score on the private-sector interest key factor (KFs 1).

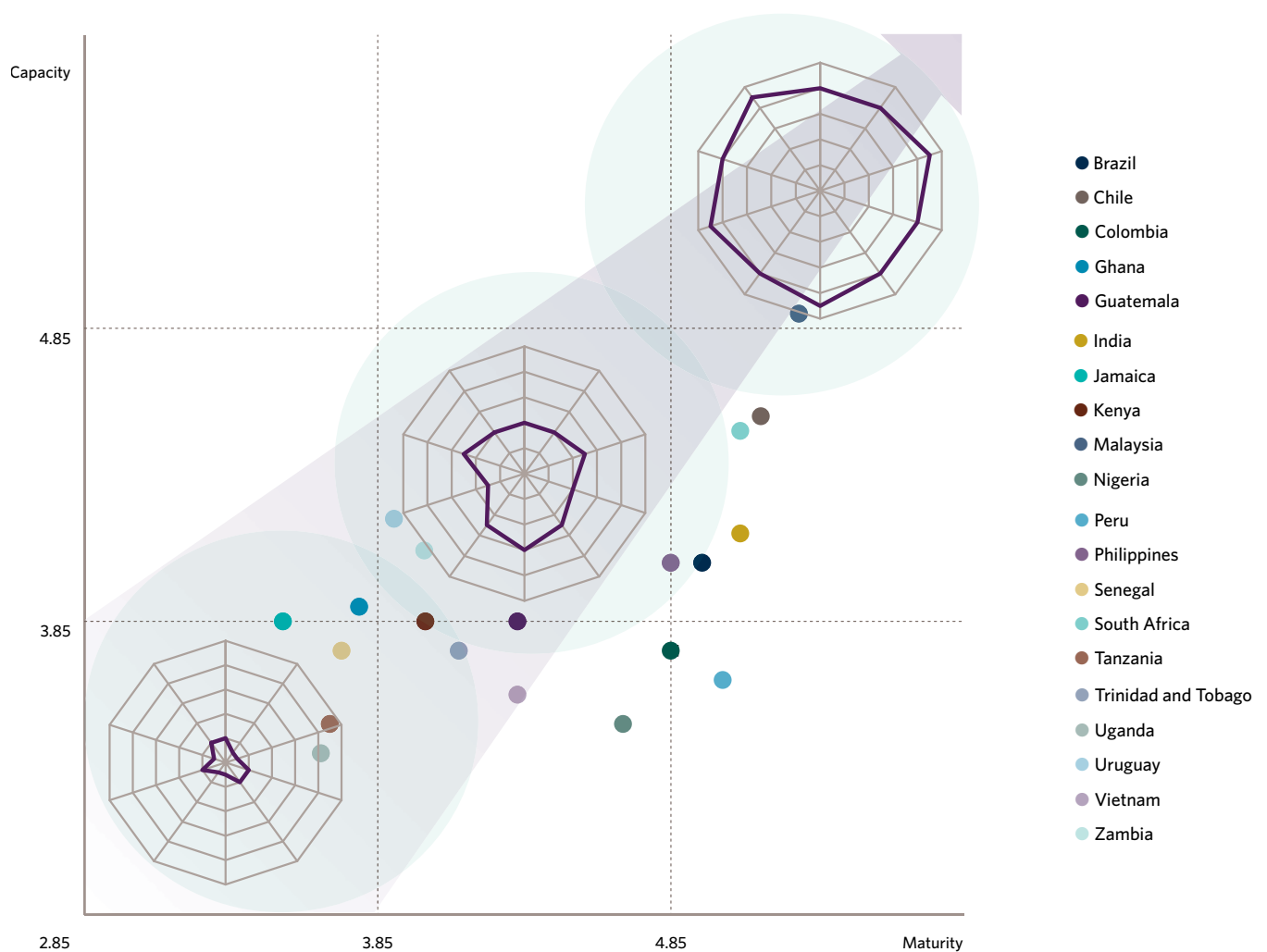
Figure 22: Schematic Illustration of the Correlation of Key Factors



This underscores that developing and communicating a clear framework for USPs (KFs 5) and building capacity to implement projects that were initiated as USPs (KFs 3 and 4) are preconditions for the other key factors. Therefore, these elements will be considered to be the starting point for strategies of countries of all capacity and maturity levels.

The strategies are schematically illustrated in figure 23. In the following subchapters, these strategies are further elaborated on.

**Figure 23: Schematic Approach Toward Sophistication in Implementing PPPs and USPs**



#### 4.4 STRATEGY FOR COUNTRIES WITH LOW MATURITY AND CAPACITY

Countries with low capacity and very little experience in implementing PPPs and USPs will most likely score low on all key factors. Developing and consistently enforcing a framework and building the capacity to implement projects that were initiated as USPs with support from external consultants and international development partners can offer a (temporary) solution and increase the scores on all key factors:

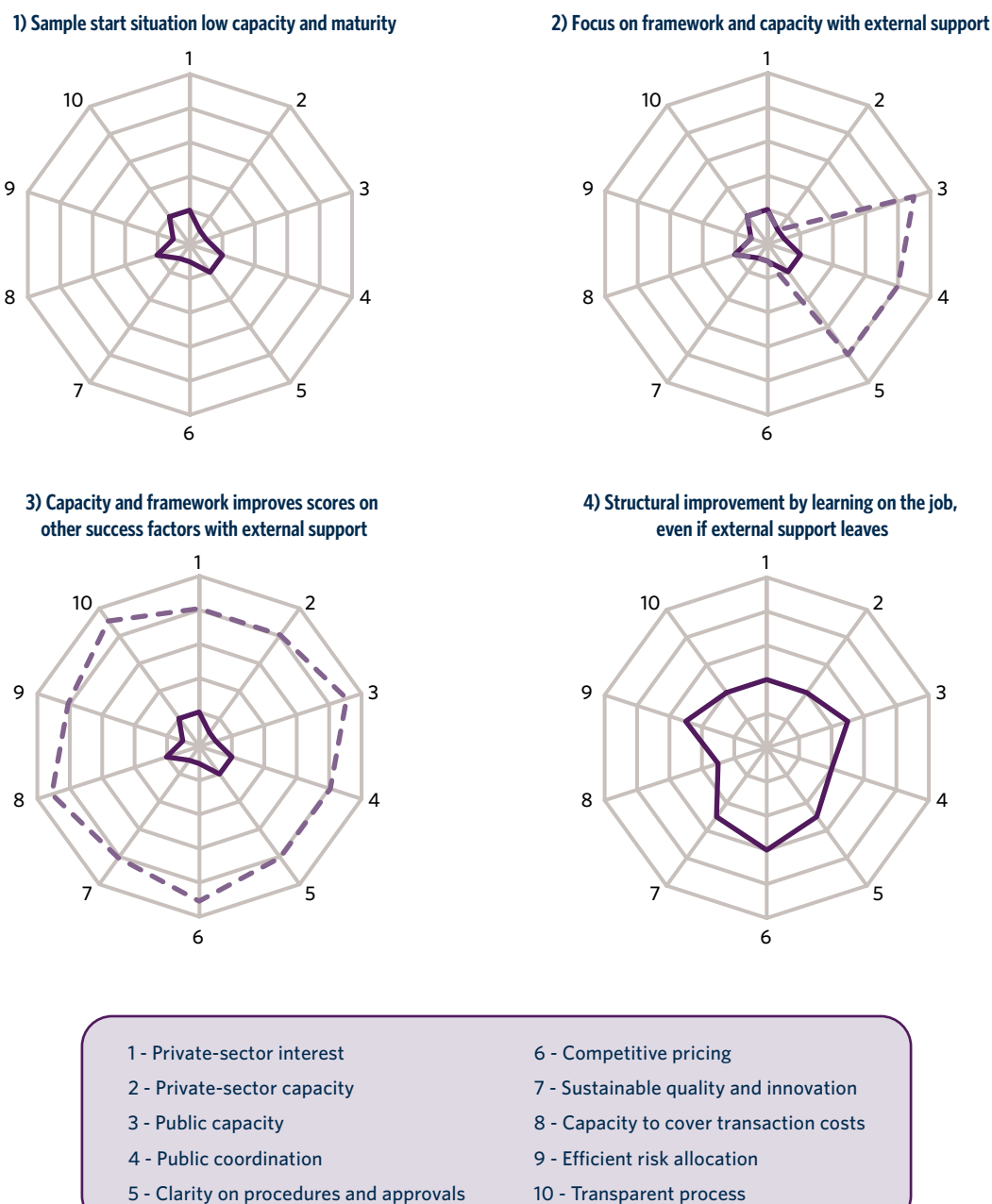
- Introducing and enforcing a simple and clear set of rules and procedures for the USP process—The key objective of the USP framework is to achieve fairness, transparency and competitiveness, in order to ensure that investors can earn a reasonable return on their investments and users and the government maximize value for money through the private provision of infrastructure services. The policy can seek to meet this objective by clearly defining the responsibilities of various government entities involved in procuring PPP projects, so that they can be held publicly accountable, thereby building confidence that private participation in infrastructure provision is undertaken in a manner consistent with the public interest. In addition, the policy provides a framework for enhancing predictability through each stage in the process of procuring and implementing a project, thereby reducing uncertainty in the outcome of each step. This will reduce investors' perceptions of the risks they face, with the beneficial effect of lowering costs.
- Obtaining (external) capacity to manage USPs—Public agencies are encouraged to centralize the management of USPs in one PPP unit, hire (experienced) transaction advisors and make use of international development partners' support, again with the aim of not only implementing successful projects, but of building capacity "on the job."

##### Box 12: IDB's Support Assessment of a USP in Jamaica

The Jamaican government has received an unsolicited PPP proposal for a school solar project. The government is undertaking a full review, as if it were a government-proposed project. The IDB's Multilateral Investment Fund is assisting the government to complete project screening and analysis.

The fact that the USP framework and the capacity to manage USPs, implement projects and structure PPPs are preconditions and dominant key factors also means that countries would be advised not to facilitate USPs if they cannot meet these preconditions. As indicated before, transaction advisors and international development partners can temporarily help with meeting these preconditions and facilitate a country's improvement on all key factors, on both the macro and micro level. At the same time, the country will build capacity and maturity "on the job" to be able to "take over," allowing the external experts to depart.

Figure 24: Improving Scores with the Help of External Consultants and International Development Partners



Depending on the private-sector market capacity and interest, countries in this category can be overwhelmed by a large number of USPs, or else face a total lack of market interest. The challenge in both cases is to build experience and capacity in a controlled way. Instead of a general approach facilitating USPs in all sectors and all geographies, a more targeted approach is more suitable. Typically the way to organize this is not through law and regulation, but through specific policies and requests for proposals.

When experience with USPs is limited, it makes sense for those countries to focus on a small number of infrastructure projects that are not too complex, yet suitable for PPPs, in a priority area for the government and supported by MDBs. If the door is already wide open—i.e., legislation explicitly or implicitly allows USPs and provides for admission and processing—the enforcement of requirements as per the relevant legal provisions is crucial.

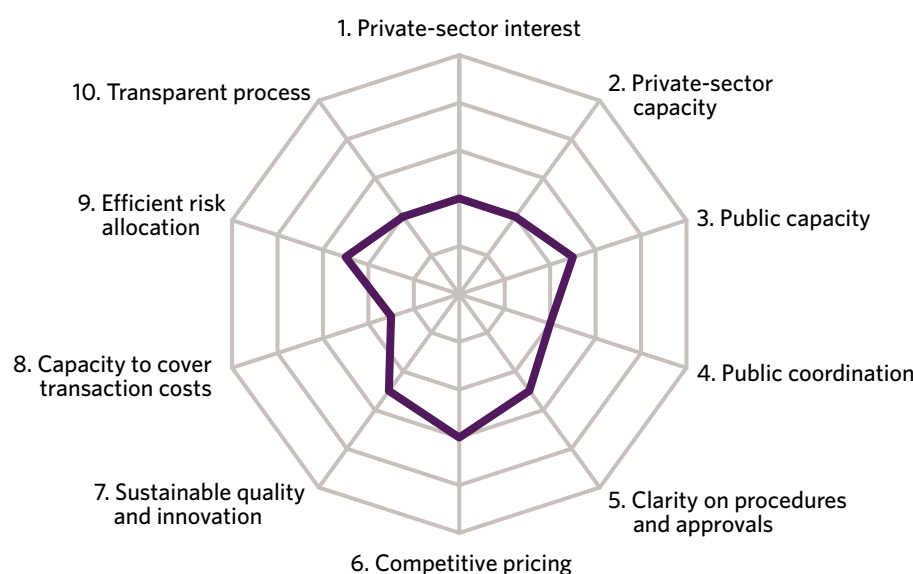
The rigorous application of a competitive procedure (direct short-listing or full competition) after acceptance of the project is expected to optimally contribute to creating value for money (KF 6) and will also reduce the number of opportunistic USPs. The prospect of a fully competitive process will also discourage private and public actors from abusing the USP process. A rigorous fiscal risk and liabilities framework should contribute to realistic feasibility analyses underpinning the project decision-making and efficient risk allocations in the resulting PPP contracts.

In case the private capacity to develop and implement projects is limited (KF 2), countries will benefit from having international (experienced) bidders involved, who can be obliged to work with local industry, to also build private capacity.

#### 4.5 STRATEGY FOR MID-LEVEL CAPACITY AND MATURITY COUNTRIES

Countries with some public institutional capacity with respect to infrastructure project development and some experience in implementing PPPs and USPs score better on the key factors as indicated in the following figure, but typically still deal with transparency and competition issues and experience low quality submissions. The focus during the adoption and implementation of a USP framework should therefore be on a strict set of minimum requirements and a clear (and competitive) procedure and consistent enforcement of both. The existence of the USP framework as such is not enough to effectively enforce it. This also requires acceptance by and awareness on the part of all relevant actors in the implementation of infrastructure projects that were initiated as USPs, which in turn requires active socialization and communication of the USP framework.

Figure 25: Sample Key-Factor Scoring for a Mid-Level Capacity and Mid-Level Maturity Country



Often the sectoral agencies in these countries have little experience in implementing PPPs and USPs. Therefore it is best to have an empowered PPP unit with internal and possibly also external transaction specialists in the lead for the USP procedure. This PPP unit can contribute to the creation of a level playing field and a balanced deal, even in the case of a PPP that started as a USP. The PPP unit will be capable of dealing with the complexities of long-term PPP contracts, including long-term quality issues, efficient transfer of risk to the private sector, and thorough assessment and management of public liabilities. The goal of the PPP unit should also be to build capacity in other parts of the government, which could ultimately lead to a less central role for the PPP unit.

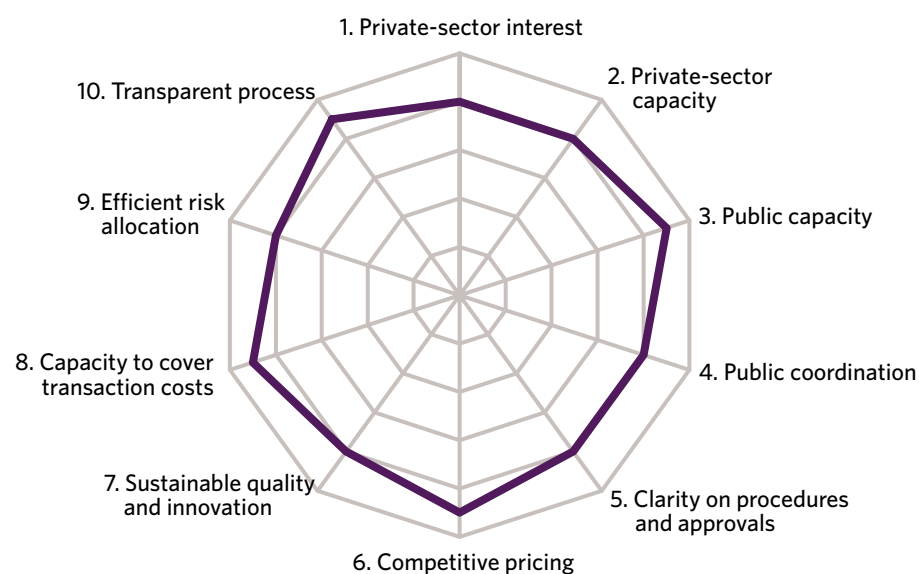
Whether or not projects on a country's priority list are allowed as USPs, a full competitive procurement seems to be the optimal way to the successful implementation of projects. This also requires allowing sufficient time for competitors to prepare bids and provide full access to relevant project information. It seems reasonable to reward the original proponent with financial compensation for its efforts and potentially also for property rights, if not directly by the public agency, then by the winning bidder.

#### 4.6 STRATEGY FOR HIGH-LEVEL CAPACITY AND MATURITY COUNTRIES

Countries with considerable capacity for implementing infrastructure projects, PPPs and USPs are expected to focus on highly innovative USP projects.

If a government has the capacity to prepare and realize infrastructure projects and has considerable experience with implementing PPPs and USPs, the market is competitive and the private sector is capable of preparing and implementing a project, the country will score better on most or all key factors, as illustrated in the figure below. The USP procedure in these countries is expected to focus on enabling innovation, for example with respect to technology, concepts or management approaches. This is typically reflected in the USP framework, limiting the USP procedure to "unique and innovative concepts, concepts or services not otherwise available to the government, and not resembling the substance of a recent, current or pending competitive tender."

**Figure 26: Sample Key-Factor Scoring for a High-Level Capacity and High-Level Maturity Country**



To the extent that the motivation for allowing USPs is to make use of the private sector's creativity, governments may also consider using specific solutions, such as the following:

- USPs could focus on the private initiation of projects, not necessarily private development of projects. For example, the U.S. state of Florida has accepted some conceptual USPs, which it then further developed within the Department of Transportation and procured through a solicited procedure.
- The private-sector knowledge that the USP procedure is trying to capture in order to achieve an optimal project solution can, to a certain extent, also be achieved through solicited procedures. Oftentimes PPP procurements explicitly leave room for optimization by the private bidders, by defining specifications and designs in less detail. For example, the competitive dialogue procurement process that has been extensively used in Europe to procure PPP projects does that. On the basis of output (not input) specifications, short-listed bidders are asked to develop their proposals and do part of the project development during the procurement.

For highly innovative concepts, the protection of intellectual property is an important point of attention. This is not the same as avoiding a competitive process, given that the service being delivered can often be specified in functional terms without disclosing the intellectual products. For all projects submitted as USPs, the goal should be to treat them as any other project would be treated after acceptance of the proposal, and conduct a full competitive procurement, including giving sufficient time for competitors to prepare bids and granting them full access to relevant information. Nevertheless, there should be continuous refinement to the existing USP framework to enhance its effectiveness and improve the competitive environment.

## Appendix 1: Analysis of Follow-Up Mechanisms

Option	Description	Pros	Cons
<b>Swiss Challenge</b>	An open tender process is conducted, in which the USP proponent has the right to match the winning bid in order to win the contract.	In tender procedures where price is the single award criterion, the Swiss challenge approach is very simple and straightforward. Application of this mechanism does not require additional analysis or (possibly subjective) decisions on the part of the procuring authority.	<p>A Swiss challenge mechanism is often difficult to conduct. It is observed that due to their complexity and the effort required on the part of other bidders, challenges to original proponents were rarely raised.</p> <p>If proposals are assessed by both quality and price, the level of complexity increases. The USP proponent can match the best offer of the other bidders by offering a lower price or a higher service quality (or both). In case the USP proponent decides to match the winning bidder by raising the quality of his or her proposal, the procuring authority must decide whether the quality difference between the new and the original proposals is sufficient to match the proposal of the winning bidder. An additional quality evaluation (which by its nature is at least partly subjective) will therefore be required.</p>
<b>Bonus System</b>	An open tender process is conducted. In the evaluation of the bids, the USP proponent receives bonus points, giving the USP proponent an advantage over other bidders.	Many countries using the bonus system have set fixed bonus points, generally between 5 and 10 percent of the total points that can be earned in the evaluation. This simplifies the choice of bonus points and avoids subjectivity and manipulation.	<p>This mechanism does not guarantee a correct compensation for the USP proponent. Bonus points in the range of 5 to 10 percent are largely based on intuition rather than having any scientific or analytical basis.</p> <p>The problem of this approach is the determination of the appropriate size of the bonus. To provide a correct compensation to the party submitting the USP, the bonus should be related to the sunk cost of preparing the proposal, equivalent to the costs of the initial project development. These costs vary by project as well as by evaluation criteria.</p> <p>In multi-criteria evaluation, the bonus points are linked to more than just pricing, which makes the system more complicated.</p>
<b>Automatic Short-Listing</b>	This option applies to a multi-stage tender procedure. The USP proponent does not have to pass the preliminary stages of the procedure, but is automatically invited to the last stage in which the short-listed bidders submit their best and final offer. This option can be combined with an evaluation bonus for the USP proponent.	<p>This is a very simple and transparent approach, requiring no additional analysis or decisions by the procuring authority.</p> <p>Nevertheless, there are still important incentives for private firms to submit USPs. First, the terms of reference of the open tender are based on the USP proponent, which by itself gives the submitter an advantage (especially if the project is indeed innovative and offers substantial benefits compared to the usual approaches). Second, the USP proponent can steer the priorities of the procuring authority toward projects within its own area of activities.</p> <p>To further incentivize and reward private firms to submit a quality and credible proposal that 1) the authority assesses as economically attractive from the public perspective, and 2) is expected to create value for money if carried out in a PPP, a reimbursement for preparation costs can be considered.</p>	It gives little reward to the party that submitted the USP in the procedure itself.
<b>Full Competition</b>	<p>An open tender process is conducted, in which the USP proponent competes on equal terms with the other bidders.</p> <p>The procuring authority pays a fee to the USP proponent to acquire the development rights of the project and compensate the initial proponent for project development costs.</p>	This is a simple and transparent approach, and allows all bidders to compete equally.	<p>Creating a true level playing field is not always easy. USPs taken into competitive procedures often involved years of prior interaction between the government and the USP proponent, whereas subsequent competitive proceedings are given limited periods of time for the submission of bids. This means that other bidders will very likely struggle to develop fully matured bids. Although there is a tension with the expectation that the implementation of USPs should be quick and easy, most governments acknowledge there is value in allowing for enough time to create a more level playing field.</p> <p>The determination of the appropriate size of the development fee can be challenging. In principle the fee should reflect the costs of the initial project development (or better still, the value of the proposal), but the costs or the value are difficult to assess in an objective manner. Internal costs (the costs of staff and equipment) in particular cannot be easily verified.</p> <p>If the development fee is too high, the approach provides a perverse incentive for frivolous proposals and over-priced feasibility studies.</p>





## ENABLING INFRASTRUCTURE INVESTMENT

PPIAF is a multi-donor trust fund that provides technical assistance to governments in developing countries to develop enabling environments and to facilitate private investment in infrastructure. Our aim is to build transformational partnerships to enable us to create a greater impact in achieving our goal.