

A Legal Perspective on the Case for Procuring Capital-Intensive Infrastructure Services Via P3s in Canada

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PUBLIC-PRIVATE PARTNERSHIPS (PPPS OR P3S)¹ HAVE COMPLETELY revolutionized the way capital-intensive infrastructure² services are

¹ Darrin Grimsey & Mervyn K Lewis, *Public Private Partnerships: The Worldwide Revolution in Infrastructure Provision and Project Finance* (Cheltenham, UK: Edward Elgar, 2004) [Grimsey & Lewis, *Worldwide Revolution*] (“risk-sharing relationship[s] based on a shared aspiration between the public sector and one or more partners from the private and/or voluntary sectors to deliver a publicly agreed outcome and/or public service,” at xiv; “arrangements whereby private parties participate in, or provide support for, the provision of infrastructure,” at 2; “a PPP project results in a contract for a private entity to deliver public infrastructure-based services,” *ibid*). For other definitions of P3s or PPPs, see Canadian Council for Public-Private Partnerships, “Definitions”, online: Canadian Council for Public-Private Partnerships <<http://www.pppcouncil.ca/resources/about-ppp/definitions.html>>; Jeffrey Delmon & Victoria Rigby Delmon, eds, *International Project Finance and PPPs: A Legal Guide to Key Growth Markets* (The Netherlands: Kluwer Law International, 2010) ch 1 at 3-4 [Delmon & Rigby Delmon]; Geza R Banfai et al, “Construction Risk in Public-Private Partnerships in Canada” [2007] *Journal of Canadian College of Construction Lawyers* 63 at 67; Apurva Sanghi, *Public Private Partnership Units: Lessons for their Design and Use in Infrastructure* (Washington DC: World Bank & Public-Private Infrastructure Advisory Facility, 2007) at 13 [Sanghi]; William D Eggers & Tom Startup, *Closing the Infrastructure Gap: The Role of Public-Private Partnerships* (New York: Deloitte Research, 2006) at 5 [Eggers & Startup]; Erik-Hans Klijn & Geert R Teisman, “Governing Public-Private Partnerships: Analyzing and Managing the Processes and Institutional Characteristics of Public-Private Partnerships” in Stephen P Osborne, ed, *Public-Private Partnerships: Theory and Practice in International Perspective* (London: Routledge, 2000) 84 at 85; Stephen H Linder & Pauline Vaillancourt Rosenau, “Mapping the Terrain of the Public-Private Policy Partnership” in Pauline Vaillancourt Rosenau, ed, *Public Private Policy Partnerships* (Cambridge, MA: MIT Press, 2000) 1 at 9; Jim Armstrong & Donald G Lenihan, “From Controlling to Collaborating: When Governments Want to Be Partners” (1999) *Institute of Public Administration of Canada: New Directions-Number 3* 1 at 13, online: IAPC <<http://www.iapc.ca/documents/ND3-RevFeb20091.pdf>>; Consulting and Audit Canada, *Impediments to Partnering and the Role of Treasury Board* (Prepared for the Alternative Service Delivery Group, Treasury Board Secretariat) (13 May 1998) at 8; British Columbia, Task Force on Public-Private Partnerships, *Building Partnerships: Report of the Task Force on Public-Private Partnerships* (British Columbia, 1996) at 8; Kenneth Kernaghan, “Partnership and Public Administration: Conceptual and Practical Considerations” (1993) 36:1 *Canadian Public Administration* 57 at 61; Alti Rodal & Nick Mulder, “Partnerships, Devolution and Power-Sharing: Issues and Implications for Management” (1993) 24:3 *Optimum* 27 at 28.

For definitions of Private Finance Initiatives (PFIs), the UK equivalent programme introduced in November 1992, see the following: Alan Smithers, “Education” in Anthony Seldon & Dennis Kavanagh, eds, *The Blair Effect, 2001-5* (Cambridge: Cambridge University Press, 2005) 256 (“PFIs, or...PPPs, involve the public sector purchasing a service, often the provision of property, from the private sector over a long period and paying an annual charge” at 273); G Owen & A Merna, “The Private Finance Initiative” in Darrin Grimsey & Mervyn K Lewis, eds, *The Economics of Public Private Partnerships* (Cheltenham, UK: Edward Elgar, 2005) 317 at 318 [Grimsey & Lewis, *Economics of Public Private Partnerships*]; Paul A Grout, “The Economics of the Private Finance Initiative” in Darrin Grimsey & Mervyn K Lewis, *ibid*, 332 at 333.

² See Darrin Grimsey & Mervyn K Lewis, “Evaluating the Risks of Public Private Partnerships for Infrastructure Projects” in Darrin Grimsey & Mervyn K Lewis, *Economics of Public Private Partnership*, *ibid*, 567 at 568. The authors define “infrastructure investment” to include:

Energy (power generation and supply); Transport (toll roads, light rail systems, bridges and

procured by governments the world over. This global trend has been informed by a number of significant advantages that result from opting for this procurement approach rather than the conventional public procurement approach. These advantages are chiefly: 1) *cost and time certainty and savings*, and 2) *innovation and high levels of efficiency*.

However, the evolution of the practice of procuring capital-intensive infrastructure services via P3s has not been without some resistance and opposition. The central proposition of this paper is that, taking Canada as a reference point, P3-related law, policy and practice, facilitate and accentuate the aforesaid advantages of PPPs, and also effectively allay the legal concerns which give rise to such resistance and opposition. In addition, the peculiar thrust of the development of Canadian P3 law, policy and practice show the said concerns to be overstated and lacking in merit.

Much of the published research and literature on the subject of P3s directs itself to the meaning, distinctive features and classification of P3s. A significant portion of the literature also presents comparative and statistical studies of the performance of P3 projects relative to projects procured by alternative procurement approaches, especially conventional public procurement. There have also been several efforts to build a case for the use of P3s by sole reference to the results of such comparative and statistical studies and the actual documented performance of the projects examined. However, there has been a dearth of literature explaining the aforestated results and the findings they support in legal terms. Such legal analysis would have the important effect of bringing the concept of P3s out of the almost exclusive preserve of economists, financial analysts, public policy experts and even construction engineers, and into the domain of legal scholars.

tunnels); Water (sewerage, waste water treatment and water supply); Telecommunications (telephones); Social infrastructure (hospitals, prisons, courts, museums, schools and Government accommodation)...[which in common with] other types of fixed investment (such as property development, [and] office construction...[share the following] characteristics: *Duration* (infrastructure is long-lived, and has a long gestation process); *Illiquid* (the lumpiness and indivisibility of infrastructure projects makes for a limited secondary market); *Capital intensive* (projects are large scale and highly geared); *Valuation* (projects are difficult to value because of taxation and pricing rules and embedded options and guarantees [footnotes omitted] [emphasis added].

The foregoing is the sense in which either of the terms, *infrastructure* or *infrastructure investment* is used throughout this paper.

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The research reported in this paper is unique in this regard. It takes the results of notable published studies that have been presented in the literature and explains them in terms of the underlying legal provisions and principles that account for the findings and eventual conclusions such results support.

This paper argues in favour of the use of P3s and addresses arguments against their use. The paper draws upon extensive legal analysis and sets a research agenda for legal theorists by an examination of the legal principles and provisions which provide the foundation for the economic and financial benefits possible under P3s. What follows immediately is a section highlighting the advantages of procuring capital-intensive infrastructure services via P3s and accounting for these advantages by reference to the underlying legal provisions and principles that facilitate them. Thereafter the paper addresses the key arguments against P3s, by reference to aspects of Canadian law, policy and P3 practice.

I. THE IMPACT OF CANADIAN LAW, POLICY AND P3 PRACTICE ON THE ARGUMENTS FOR PROCURING CAPITAL INTENSIVE INFRA-STRUCTURE SERVICES VIA P3S

The key arguments in favour of procuring capital-intensive infrastructure services via P3s relate to the *cost and time certainty and savings*, and *innovation* that result from opting for P3s, as compared to conventional public procurement. The rest of this section is a discussion of these advantages, as well as the aspects of Canadian law, policy and P3 practice that facilitate and accentuate these identified advantages.

A. Cost and Time Certainty and Savings

A number of studies have yielded empirical evidence, which strongly suggests that, the world over, significant cost overruns, and time delays characteristically attend conventional public procurement of capital-intensive infrastructure projects, but not the procurement of such projects via PPPs.³ This global phenomenon, characteristic of conventional public

³ See Mario Iacobacci, *Dispelling the Myths: A Pan-Canadian Assessment of Public-Private Partnerships for Infrastructure Investments* (Ottawa, ON: Conference Board of Canada, 2010) at 11-24 [Iacobacci]; Colin Duffield, National PPP Forum - Benchmarking Study, *Phase II: Report on the Performance of PPP Projects in Australia When Compared With a Representative Sample of Traditionally*

procurements, is known either as “appraisal optimism”⁴ or “optimism bias”⁵. In addition, such studies indicate that the procurement of such projects via PPPs yields considerable cost and time savings.⁶

Procured Infrastructure Projects (Melbourne: Melbourne Engineering Research Institute, 2008) at 4-6, 15-28, 43-44; Allen Consulting, Colin Duffield & Peter Raisbeck, *Performance of PPPs and Traditional Procurement in Australia* (Melbourne: Infrastructure Partnerships Australia, 2007) at 1-2, 25-33; Partnerships UK, *Report on Operational PFI Projects* (London: Partnerships UK, 2006) at 12-14; UK, National Audit Office, *PFI: Construction Performance: A Report by the Comptroller and Auditor General* (HC 371 Session 2002-2003) (London, UK: National Audit Office, 2003) at 1-9, 11-17; Bent Flyvbjerg, Mette Skamris Holm & Soren Buhl, “Underestimating Costs in Public Works Projects: Error or Lie?” (2002) 68:3 *Journal of the American Planning Association* 279 at 280-291 [Flyvbjerg, Holm & Buhl]; Mott MacDonald, *Review of Large Public Procurement in the UK* (London: HM Treasury, 2002) at 14-20, 60-64, online: Mott MacDonald [http://www.hm-treasury.gov.uk/d/7\(3\).pdf](http://www.hm-treasury.gov.uk/d/7(3).pdf) [Mott MacDonald]; Philip Gray, *Private Participation in Infrastructure: A Review of the Evidence* (Washington DC: World Bank, 2001) at 1, 14-15; Don H Pickrell, *Urban Rail Transit Projects: Forecast versus Actual Ridership and Cost* (Washington DC: US Department of Transportation, 1990) at 61-65; RM Fraser, “Compensation for Extra Preliminary and General (P & G) Costs Arising from Delays, Variations and Disruptions: The Palmiet Pumped Storage Scheme” (1990) 5:3 *Tunneling and Underground Space Technology* 205 [Fraser]; MM Dlakwa & MF Culpin, “Reasons for Overrun in Public Sector Construction Projects in Nigeria” (1990) 8:4 *International Journal of Project Management* 237 at 237-240 [Dlakwa & Culpin]; Peter WG Morris & George H Hough, *The Anatomy of Major Projects: A Study of the Reality of Project Management* (Chichester: John Wiley & Sons, 1987) at 7-13, 199-205, 220-226 [Morris & Hough]; David Ardit, Guzin Tarim Akan & San Gurdamar, “Cost Overruns in Public Projects” (1985) 3:4 *International Journal of Project Management* 218 at 218, 220-223 [Ardit, Akan & Gurdamar]; Henry T Canaday, *Construction Cost Overruns in Electric Utilities: Some Trends and Implications* (Occasional Paper No 3) (Columbus, Ohio: National Regulatory Research Institute, Ohio State University, 1980) at i, 9-36 [Canaday]; Peter Hall, *Great Planning Disasters* (London, UK: George Weidenfeld and Nicolson, 1980) at 87-108, 138-151 [Hall]; PD Henderson, “Two British Errors: Their Probable Size and Some Possible Lessons” (1977) 29:2 *Oxford Economic Papers* 159 at 159-185 [Henderson]; Leonard Merewitz, “Cost Overruns in Public Works” in William A Niskanen et al, eds, *Benefit Cost and Policy Analysis: 1972* (Chicago: Aldine, 1973) 277 at 277-293 [Merewitz]; Maynard M Hufschmidt & Jacques Gerin, “Systematic Errors in Cost Estimates for Public Investment Projects” in Julius Margolis, ed, *The Analysis of Public Output* (New York: Columbia University Press, 1970) 267 at 271-281, 291-294 [Hufschmidt & Gerin]; Robert Summers, “Cost Estimates as Predictors of Actual Costs: A Statistical Study of Military Developments” in Thomas Marschak, Thomas K Glennan, Jr & Robert Summers, eds, *Strategy for R & D: Studies in the Microeconomics of Development* (New York: Springer-Verlag, 1967) 140 at 140, 142, 148-149; JM Healey, “Errors in Project Cost Estimates” (1964) 12:1 *Indian Economic Journal* 44 at 44-52 [Healey].

⁴ Grimsey & Lewis, *Worldwide Revolution*, *supra* note 1 at 72.

⁵ HM Treasury, *The Green Book – Appraisal and Evaluation in Central Government* (London: TSO, 2003) at 29-30, 85-87; See Mott MacDonald, *supra* note 3 (“[o]ptimism bias is the tendency for a project’s costs and duration to be underestimated and/or benefits to be overestimated...a measure of the extent to which actual project costs (capital and operating), and duration (time from business case to benefit delivery (project duration) and time from contract award to benefit delivery (works duration) exceed those estimated” at 4).

⁶ See especially Iacobucci, *supra* note 3 at 11-24. See also Peter Fitzgerald, *Review of Partnerships Victoria Provided Infrastructure* (Melbourne: Growth Solutions Group, 2004) at 17.

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In such studies, cost overruns refer to the difference between actual construction costs (i.e. “real, accounted construction costs determined at the time of project completion”⁷) and estimated construction costs “budgeted, or forecasted” at the planning stage.⁸ Time delays refer to delays associated with the failure or inability to deliver infrastructure facilities “fit and available for use” by the public, on schedule.⁹

1. *The Flyvbjerg Study*

One example of the studies just referred to, is that in which Flyvbjerg, Holm & Buhl examined 258 transportation infrastructure projects carried out over a 70-year period across 20 countries and 5 continents, including Europe and North America.¹⁰ Of this number, there were 58 rail projects, 33 fixed-link (i.e. tunnels and bridges) projects, and 167 road projects.¹¹ With the notable exception of the Channel Tunnel, “the overwhelming majority” of these projects had been “developed using conventional approaches to public procurement”.¹² In 90 per cent of these projects, however, there were cost overruns averaging 28 per cent.¹³ The authors of the study found that for rail projects, the average cost overrun was as high as 44.7 per cent.¹⁴ For fixed-link projects, the average was 33.8 per cent;¹⁵ and for road projects the average was 20.4 per cent.¹⁶ “For a randomly selected project, the likelihood of actual costs being larger than estimated costs [was] 86 per cent”.¹⁷ They also found that this global trend of optimism bias or cost underestimation, has not changed over time, leading them to conclude that “[u]nderestimation today is in the same order of magnitude as it was 10, 30 and 70 years” prior to their study.¹⁸

Significantly, Flyvbjerg, Holm & Buhl observed that cost underestimation is not limited to transportation infrastructure projects and occurs in other types of infrastructure projects as well.¹⁹ They

⁷ Flyvbjerg, Holm & Buhl, *supra* note 3 at 281.

⁸ *Ibid.*

⁹ Iacobacci, *supra* note 3 at 9, 12.

¹⁰ Flyvbjerg, Holm & Buhl, *supra* note 3 at 282-283, 286-287, 289, 290.

¹¹ *Ibid* at 283-285 (figures 1 and 2, and tables 1 and 2).

¹² Grimsey & Lewis, *Worldwide Revolution*, *supra* note 1 at 72, 91, n 1.

¹³ Flyvbjerg, Holm & Buhl, *supra* note 3 at 282, 287, 290.

¹⁴ *Ibid* at 282.

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ *Ibid.*

¹⁸ *Ibid* at 286.

¹⁹ *Ibid.*

“reviewed cost data for several hundred other projects including power plants, dams, water distribution, oil and gas extraction, information technology systems, aerospace systems and weapons systems”.²⁰ Notable among these other types of infrastructure projects were the “Sydney Opera House, with actual costs approximately 15 times higher than those projected, and the Concorde supersonic airplane, with a cost 12 times higher than predicted”.²¹ Their analysis of the data led to the conclusion that “other types of projects are at least as, if not more, prone to cost underestimation as are transportation infrastructure projects”.²²

2. *The Mott MacDonald Study*

Similarly, in 2002, the UK Treasury commissioned the Mott MacDonald study to review the outcome of 50 capital-intensive infrastructure projects carried out in the UK over a 20-year period.²³ 39 of the projects examined were conventionally procured, while 11 were procured via PFIs/PPPs.²⁴ Broadly, the project categories included buildings, rail and road links, maintenance projects and the development of equipment and software systems.²⁵

The Mott MacDonald study observed that in the case of the 39 conventionally procured projects, actual capital expenditure exceeded estimates by an average of 47 per cent. For those same projects, the duration between contract award and benefit delivery (works duration) exceeded estimated time by 17 per cent.²⁶ By contrast, optimism bias levels

²⁰ *Ibid.* See also: Arditi, Akan & Gurdamar, *supra* note 3; Coleman Blake, David Cox & Willard Fraize, *Analysis of Projected vs. Actual Costs for Nuclear and Coal-Fired Power Plants* (Report prepared for the United States Energy Research and Development Administration (McLean, VA: Mitre Corporation, 1976) at 3-31; Canaday, *supra* note 3; Department of Energy Study Group, Peat Marwick Mitchell & Co & Atkins Planning, *North Sea Costs Escalation Study* (Energy Paper No 7) (London: Her Majesty’s Stationery Office, 1976) at 6-7, 44-50; Dlakwa & Culpin, *supra* note 3; Fraser, *supra* note 3; Hall, *supra* note 3; Healey, *supra* note 3; Henderson, *supra* note 3; Hufschmidt & Gerin, *supra* note 3; Merewitz, *supra* note 3; Edward W Mellow, Lorraine McDonnell & R Yilmaz Argüden, *Understanding the Outcomes of Megaprojects: A Quantitative Analysis of Very Large Civilian Projects* (Santa Monica, CA: RAND Corporation, 1988) at v-vi, 30-55, 63-64; Morris & Hough, *supra* note 3.

²¹ Flyvbjerg, Holm & Buhl, *supra* note 3 at 286.

²² *Ibid.*

²³ Mott MacDonald, *supra* note 3 at 4, 6-7.

²⁴ *Ibid* at 45-48.

²⁵ *Ibid* at 7-8.

²⁶ *Ibid* at 14 (Table 3).

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were significantly less for the 11 PFI/PPP projects—1 per cent for capital expenditure and minus 1 per cent for works duration.²⁷

What emerges from a brief consideration of these two studies is that with conventional public procurement of capital-intensive infrastructure, cost overruns and time delays attributable to optimism bias are the order of the day rather than the exception. The situation differs radically with P3 procurements, as the result of a recent Canadian study shows.

3. *The Conference Board Report*

In January 2010, as part of a report, which assessed the “benefits and drawbacks of using P3s”, the Conference Board of Canada (Conference Board) published the results of its review of 55 P3 projects initiated between June 2004 and November 2009.²⁸ The P3 projects examined in this study were from “the four Canadian jurisdictions that have been most active in using a P3 procurement model for the delivery of infrastructure facilities and subsequent maintenance services—Alberta, British Columbia, Ontario and Québec”.²⁹ The projects examined cut across a wide range of social infrastructure.³⁰ At the time of the Conference Board report, only 19 of the 55 projects had “reached their respective substantial completion date, that is, the date by which the new facility should be built and soon available to be put in service as stipulated” in the P3 agreement.³¹

The Conference Board report highlighted value-for-money (VfM) estimates, “which compare the total costs of P3 versus conventional procurement methods, *before the start of each P3 project*”.³² The VfM estimates are “based on high-level comparisons with projects delivered through similar procurement methods as well as detailed cost analysis undertaken by the procurement authority and its advisors”,³³ and provide “a gauge of the cost savings expected at the outset of a project”.³⁴

The VfM estimates highlighted in the report showed projected cost savings ranging from “just a few million dollars per project, as in the case of Edmonton’s Anthony Henday Drive Southeast Leg Ring Road or

²⁷ *Ibid.*

²⁸ Iacobacci, *supra* note 3 at i-ii, 13, 20.

²⁹ *Ibid* at 1 (the distribution was as follows: Alberta – 4, British Columbia – 16, Ontario – 30, and Québec – 5).

³⁰ *Ibid.*

³¹ *Ibid.*

³² *Ibid* [emphasis added].

³³ *Ibid.*

³⁴ *Ibid.*

Vancouver's Golden Ears Bridge, through to \$751 million in the case of the Autoroute 30 project just south of the Montréal area".³⁵ These savings, when "expressed as a proportion of the potential costs for procuring the projects through conventional contracting methods... [identified in the report as the "public sector comparator (PSC)"³⁶] range from 0.8 per cent through to 61.2 per cent of the PSC for each project".³⁷ Thus, even at the budgeting stage, opting for a PPP approach held promise of significant cost savings compared to conventional procurement.

Next, the report examined the documented "cost and time performance"³⁸ of the projects "against their own milestones",³⁹ to ascertain "the time and cost certainty with which projects are delivered"⁴⁰ and to determine whether the expected savings would crystallize at the end of the P3 project.⁴¹ This examination was necessary because "[w]hether the actual savings match the expected savings by the end of the P3 project depends on the degree of cost and time certainty of P3 projects".⁴²

All of the projects examined proceeded according to budget, even where there were contract variations and time delays, resulting in cost certainty and ultimately guaranteeing the realization of the cost savings indicated for P3s in the first instance through the forward-looking VfM estimates. Furthermore, out of the nineteen projects that had reached their substantial completion dates by November 2009, and which could thus be assessed for time certainty in the Conference Board report, only three experienced delays. In one, the delay was attributable to a province-wide labour dispute and a schedule adjustment by the public sector owner provided for by the P3 contract; and in each case, the delay was merely two months long. On the other hand, eight of the completed projects were completed ahead of schedule. The report provides strong evidence for the time certainty and savings of PPPs.

The cost and time savings and certainty in P3 procurements are attributable to at least two reasons including: 1) the optimal risk allocation

³⁵ *Ibid.*

³⁶ *Ibid* at 11.

³⁷ *Ibid* at 13.

³⁸ *Ibid* at 12.

³⁹ *Ibid.*

⁴⁰ *Ibid* at 13.

⁴¹ *Ibid* at 12-13, 20-22.

⁴² *Ibid* at 13 [emphasis added].

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characteristic of P3s; and 2) the presence of private project financing. These two reasons are discussed in detail below.

i. Optimal Risk Allocation in P3s

One of the distinguishing features of P3s is the systematic identification, evaluation and allocation of particular project risks between the public and private-sector partners, *depending on which is better qualified to assume each allocated risk*.⁴³ An additional factor that influences the allocation of risk is cost-effectiveness. These considerations give rise to three broad categories of risks: risks retained by the public sector partner; risks shared by both the public and private sector partners, and risks transferred to the private sector partner.

Risks retained by the public sector partner are those in which “the private partner has no control over the outcome”.⁴⁴ One example of such risks is that arising from “soil contamination that is undocumented and unknown prior to the start of the P3 project”.⁴⁵

Risks shared by both the public and private sector partners are “those that are best shared between the two parties to the extent that they both have significant influence over the outcomes”.⁴⁶ For example, both the public sector owner and the private sector operator can wield a measure of influence over traffic outcomes arising from a toll road operated under a P3 contract. While public sector policy will determine the concentration of “economic activity” in the area serviced by the road, and by extension, the volume of road use, the private sector operator may limit the volume of traffic through the quality of its “maintenance work” and resulting “lane availability”.⁴⁷ For these reasons, traffic risk is usually shared.

In determining which risks to transfer to the private sector partner, a key consideration is whether “the risks in question can be managed at a lower cost by the private partner.”⁴⁸ Where they can be so managed, a portion of the resulting “cost saving is transferred to the public sector

⁴³ See John R Allan, *Public-Private Partnerships: A Review of Literature and Practice* (Regina, Sask: Saskatchewan Institute of Public Policy, 2001) at 13. See also Grimsey & Lewis, *Worldwide Revolution*, *supra* note 1 at 14.

⁴⁴ Iacobacci, *supra* note 3 at 33.

⁴⁵ *Ibid.*

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ *Ibid.*

owner in a competitive bid environment”.⁴⁹ And this is one explanation for the cost savings inherent in P3 procurements.

To illustrate how, cost-effective risk transfer translates into real cost savings for the public sector, we will take as an example the Durham Consolidated Courthouse project, procured by Infrastructure Ontario in 2007. “[T]he total risk exposure [that would have been] retained by the public sector (i.e., taxpayers) under the conventional procurement approach was estimated at \$157 million in 2007 dollars. The partnership agreement transferred 84 per cent of that risk exposure in value terms (i.e., \$132 million) to the P3 partner.”⁵⁰ Transferring these risks to the private sector partner “cost the public sector \$74 million” and resulted in a gross cost saving of \$58 million.⁵¹ “[T]he *net* savings to the public purse (or the VfM savings) are obtained by subtracting the incremental transaction costs incurred by the public sector as a result of the P3 procurement method”.⁵² The incremental transaction costs in this project amounted to \$9 million, resulting in net savings of \$49 million.⁵³ This represents a real cost saving for the public sector, as a result of transferring to the private sector partner risks which the latter were “in a better position than the public sector to manage”.⁵⁴

Risks that are “worth transferring” to the private sector partner “are those where the private partner has some control over how to achieve the desired outcomes, which puts it in a better position to manage the outcomes than the public sector partner”.⁵⁵ For this reason, some of the

⁴⁹ *Ibid.*

⁵⁰ *Ibid* at 27 (figures are drawn from VfM studies that compared the total estimated costs of procuring the project via P3/PPP and conventional public procurement respectively).

⁵¹ *Ibid* (“[t]his is the gross estimate of the cost to the public sector of the transferred risks (or risk premium), including the incremental cost of private financing, any incremental transaction costs borne by the private consortium, less the value of any other efficiencies resulting from the AFP procurement approach” at 27).

⁵² *Ibid* at n 31 [emphasis added].

⁵³ *Ibid.*

⁵⁴ *Ibid* at 27. The transferred risks included: “Construction price certainty”, “Scheduling, project completion and delays”, “Building design”, “Benchmarking and market testing”, “Leadership in Energy and Environmental Design (LEED) design and construction obligations”, “Facilities maintenance risks”, and “the cost overruns associated with these risks”. See Infrastructure Ontario, *Value for Money Assessment: Durham Consolidated Courthouse*, online: Infrastructure Ontario <<http://www.infrastructureontario.ca/What-We-Do/Projects/Project-Profiles/Durham-Region-Courthouse/>> at 11-12, 14-15.

⁵⁵ Iacobacci, *supra* note 3 at 33.

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risks typically transferred to the private sector partner include risks associated with financing, cost overruns and scheduling.⁵⁶

The transfer of cost overruns and scheduling risks account for the low incidence of cost and time overruns in P3 projects. Transferring the risk that the project will not be delivered on time and within budget to the private sector partner ensures effective performance on its part.⁵⁷ This is because it makes the private sector partner responsible for cost overruns and introduces the possibility of reduced payments for delays. It is thus in the private partner's interest to perform optimally in order to eliminate the possibility of any such overruns or delays. In this connection, it has been opined respecting P3s that "payments [are] better aligned to the delivery of project objectives", and for this reason, P3s possess "a solid track record of completing construction on time or even ahead of schedule".⁵⁸

However, a conventional public procurement does not benefit from the risk-transfer incentive just discussed.⁵⁹ "[T]he public sector owner (or procurement authority)" does not put forth the same rigorous effort expended in a P3 "to [identify] the wide range of possible risks and to [assess] the value of such risks retained by the public sector under a conventional contract and under one or more potential P3-type contracts".⁶⁰ It is for this reason that the Mott MacDonald study attributed the differing levels of optimism bias between conventional public procurements and P3 procurements to, "the negotiated transfer of project risks from the public sector to the private sector, where project risks are passed to the party best placed to manage them consistent with achieving value for money and quality".⁶¹

Optimal risk allocation represents one of the key areas impacted by Canadian P3 law, policy and practice. Optimal risk allocation has in turn lent support to the arguments in favour of the use of PPPs to procure capital-intensive infrastructure services. For example, in recognition of the efficiency gains which result from optimal risk allocation in the procurement of infrastructure services, section 1 of Québec's *An Act*

⁵⁶ *Ibid.*

⁵⁷ Timothy J Murphy, "The Case for Public-Private Partnerships in Infrastructure" (2008) 51:1 *Canadian Public Administration* 99 at 101 [Murphy].

⁵⁸ Eggers & Startup, *supra* note 1 at 7.

⁵⁹ Murphy, *supra* note 57 at 102.

⁶⁰ Iacobacci, *supra* note 3 at 34.

⁶¹ Mott MacDonald, *supra* note 3 at 14-15.

Respecting Transport Infrastructure Partnerships,⁶² specifically provides that a P3 agreement for the “construction, repair or operation” of transport infrastructure in Québec “*must involve the sharing of risks* between the Government and the private sector”.⁶³ Provisions of this nature enshrine in P3 procurements the salutary practice of identifying, evaluating and cost-effectively apportioning project risks between public and private sector partners.

Moreover, a number of Canadian legal institutions, known as PPP units⁶⁴, “have developed formal, quantitative risk assessment processes, which draw on past infrastructure procurement experience and on commercial cost evaluators to prepare risk templates for assessing which risks to transfer to the private partner”.⁶⁵ This rigorous process potentially allows public and private partners to completely avoid some risks.⁶⁶ One example of a Canadian PPP unit that has developed such a process is Infrastructure Ontario, which “has had construction cost valuation experts develop a detailed set of risk templates identifying up to 80 categories of material risks for large infrastructure projects”.⁶⁷

ii. *The Presence of Private Project Financing in P3s*

The capital expenditure in most P3 projects often consists of both public and private financing. “The publicly financed portion of P3 infrastructure projects takes the form of government contributions paid to

⁶² RSQ c P-9.001.

⁶³ *Ibid*, s 1 [emphasis added].

⁶⁴ See Sanghi, *supra* note 1 (Broadly defined, PPP units are organizations designed to “[p]romote or improve PPPs”. They “may manage the number and quality of PPPs by trying to attract more PPPs, or trying to ensure that the PPPs meet specific quality criteria such as affordability, value for money, and appropriate risk transfer” and have “a lasting mandate to manage multiple PPP transactions, often in multiple sectors”. The specific functions of these legal institutions vary across jurisdictions and include providing government departments with information on P3-related activity in foreign jurisdictions, as well as specialized guidance on P3 procurements through the provision of standardized contractual templates, and streamlined “procedures for identifying, evaluating, and procuring PPPs” at 20-21); see also Mark Dutz et al, “Public-Private Partnership Units” (2006) 311 *Viewpoint: Public Policy for the Private Sector* 1 at 1-2. Examples of Canadian federal PPP units include: Public-Private Partnerships Canada Inc. and Infrastructure Canada; while The Alternative Capital Financing Office of the Alberta Treasury Board, Partnerships British Columbia (Partnerships BC), Infrastructure Ontario and Infrastructure Québec are all examples of provincial PPP units.

⁶⁵ Iacobacci, *supra* note 3 at 33.

⁶⁶ *Ibid*.

⁶⁷ *Ibid* at 34.

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the private partner at key milestones in the delivery of the project”.⁶⁸ However, “[a] significant portion of the capital spending on a P3 infrastructure project is privately financed and at risk”.⁶⁹

Also, as seen above, the risks most likely to escalate costs in a P3 project are typically transferred to the private sector partner(s). Risk sharing agreements combined with private financing incentivize private sector partners to “[consider] upfront all the costs and risks associated with delivering on each stage of the project”.⁷⁰ This prevents optimism bias, as a private sector partner responsible for cost overruns would hardly “bid on, let alone commit to, a P3 project to deliver a facility at a grossly underestimated budget”.⁷¹ On the other hand, it is not “uncommon [in conventional public procurements] for private firms to undertake projects where budgets have been underestimated by the public sector”.⁷² Clearly, “it is the presence of substantial private financing, and the risk that entails, that forces both parties in a P3 procurement to take full account upfront of all the requirements and risks entailed by the project”.⁷³ The incentive in P3 procurements to ascertain, all costs and risks of a project, makes for a “disciplined procurement process”⁷⁴ that eliminates the incidence of optimism bias, and in part accounts for the cost certainty of P3 projects.

The establishment of Canadian PPP units at both the federal and provincial levels of government have contributed to this ‘disciplined procurement process’ that is principally brought about by the presence of private project financing in P3s. These legal institutions “advise the public sector owner...as it prepares for a potential P3 procurement, and... ensure [the existence of] a clear, predictable procurement process” in their respective jurisdictions.⁷⁵ This function of Canadian PPP units, which in conjunction with private financing ultimately contributes to the cost certainty of P3 procurements of capital-intensive infrastructure services, represents another salutary effect of Canadian P3 law, policy and practice.

⁶⁸ *Ibid* at 35-36.

⁶⁹ *Ibid* at 35 (this portion of the capital spending is “at risk” because “service payments begin only after construction”).

⁷⁰ *Ibid* at 36.

⁷¹ *Ibid*.

⁷² *Ibid* (this “was the case with the extension of the Montréal metro to the City of Laval”).

⁷³ *Ibid*.

⁷⁴ *Ibid*.

⁷⁵ *Ibid*.

B. Innovation

PPPs are intrinsically conducive to innovation as they focus on “output specifications”.⁷⁶ In sharp contrast to the widespread use of “prescriptive contracts”⁷⁷ in conventional public procurement of infrastructure services whereby “the public sector owner specifies the exact inputs required for the facility”,⁷⁸ P3s typically employ the instrumentality of “[p]erformance-based contracts”.⁷⁹ These are detailed contracts in which the public sector partner stipulates “deliverables in terms of the outputs...desired by end users rather than prescribing specific inputs or materials to be used in delivering the outputs”.⁸⁰ In addition, such contracts include provisions that prescribe minimum service standards and quality levels expected of the private sector service provider, and a pragmatic system of enforcement consisting of a combination of periodic inspections to ascertain compliance levels as well as “penalties (i.e. deductions from their monthly service payments) or bonuses depending on the outcomes”.⁸¹ By reason of their emphasis on output and outcomes rather than inputs and methods,⁸² as well as built-in payment mechanisms to guarantee performance, the private sector partner has both the freedom “to put forward the best solution for meeting the output specifications”⁸³ and the motivation to innovate efficiently and qualitatively.⁸⁴

The P3’s intrinsic impetus for innovation, discussed above, represents one of the major arguments for its use in the procurement of complex, capital-intensive infrastructure services. One positive contribution of Canadian P3 law, policy and practice in this area has been the entrenchment and legitimization of the unique payment mechanisms that sustain the use of output/performance-based contracts in P3s, and ultimately guarantee a level of innovation in P3 procurements that is virtually nonexistent in conventional public procurements. For example, British Columbia’s *Transportation Investment Act*, in spelling out the mandatory provisions that must be incorporated in P3 agreements that

⁷⁶ Grimsey & Lewis, *Worldwide Revolution*, *supra* note 1 at 14.

⁷⁷ Iacobacci, *supra* note 3 at 32.

⁷⁸ *Ibid* at 3 (table 1).

⁷⁹ *Ibid* at 32.

⁸⁰ *Ibid*.

⁸¹ *Ibid*.

⁸² Murphy, *supra* note 57 at 104.

⁸³ Iacobacci, *supra* note 3 at 3 (table 1).

⁸⁴ Grimsey & Lewis, *Worldwide Revolution*, *supra* note 1 at 14.

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regulate concession highways in British Columbia, provides that such agreements must set out such payment arrangements as:

(i) “payment by the government or any other contracting party of an amount or amounts based on the performance by the concessionaire of any or all of its obligations under the concession agreement”;⁸⁵ and

(ii) “payment by the government or any other contracting party of an amount or amounts based on one or both of use and availability of the concession highway”.⁸⁶

As to performance standards, the same Act stipulates that such P3 agreements must require the concessionaire, in the performance of its obligations or exercise of its rights in relation to the concession highway,

*to meet or exceed the standards applicable to a comparable public highway, or, if higher standards are referred to in the concession agreement, meet or exceed those specified standards, including without limiting this, design, construction, safety, maintenance and signage standards.*⁸⁷

Also mandatory in such agreements are provisions that

require that the concessionaire not close the concession highway except for so long as, and to the extent that, closure is necessary to permit maintenance or construction,...is necessary for public safety, or...is required by the minister under the *Transportation Act*.⁸⁸

Lastly, as an added layer of security, the *Transportation Investment Act* provides that P3 agreements that regulate concession highways must stipulate:

requirements for insurance, bonds, including performance bonds and labour and material payment bonds, securities, indemnities and guarantees that the concessionaire must provide in connection with the concession highway.⁸⁹

The Act facilitates monitoring and periodic inspection of compliance by the private sector partner with prescribed minimum standards, by

⁸⁵ *Transportation Investment Act*, SBC 2002, c 65, s 3(c.1)(i) [emphasis added] [*Transportation Investment Act*].

⁸⁶ *Ibid*, s 3(c.1)(ii) [emphasis added].

⁸⁷ *Ibid*, s 3(f) [emphasis added].

⁸⁸ *Ibid*, s 3(g).

⁸⁹ *Ibid*, s 3(m).

requiring P3 agreements to “set out any reporting and public information requirements and any record retention requirements that the concessionaire must meet, and specify the records or classes of records, if any, respecting the maintenance or safety of the concession highway that the concessionaire must, on request, make available”.⁹⁰

Recognizing on the one hand, that the use of penalties and drawbacks is pivotal to the enforcement of the performance standards prescribed in P3 output/performance-based contracts, and on the other that the judicial interpretation and treatment of penalties usually raises a particularly thorny legal issue across jurisdictions;⁹¹ the *Transportation Investment Act* expressly provides that-

A provision in a concession agreement that stipulates a drawback or penalty for failure to perform a condition of the concession agreement or to fulfil a covenant or promise in the concession agreement *must not be construed as punitive, but as importing an assessment by mutual consent of the damages caused by the failure.*⁹²

⁹⁰ *Ibid*, s 3(k).

⁹¹ See Delmon & Rigby Delmon, *supra* note 1, (“[s]ome jurisdictions allow them [penalties] so long as they are reasonable, others require them to be a genuine [pre-estimate] of the damage likely to be suffered, for example, in England. Still others allow the court to modify such penalties in order to achieve reasonableness, in particular where one of the counterparties is a public entity”). A sampling of the legal issues that frequently arise in connection with “penalties”, “sanctions” and “bonuses” include the following:

(i) “What limitations apply to the government’s ability to pay bonuses to the project company for good performance?

- Do the courts have a right to revise the level of bonuses agreed in a contract?”

(ii) “Do penalties charged need to have some specific relationship with the level of actual damages to be incurred?”

(iii) Do the courts have a right to revise the level of penalties or sanctions agreed in a contract?” at 15).

For a detailed discussion of the treatment of penalties across jurisdictions, see Thomas Benes Felsberg et al, “Brazil” in Delmon & Rigby Delmon, *ibid*, 34-35; F Patricia Núñez, F Sebastián Quijada & Carolina Benito Kelley, “Chile” (*ibid* at 16-17); Matthew McKee & Aldo Settimo Boni de Nobili, “China” (*ibid* at 33-34); Ahmed El Sharkawy & Salma Shams El-Din, “Egypt” (*ibid* at 12); Cyril Shroff & Alice George, “India” (*ibid* at 31-32); Adedolapo Akinrele, Zeld Odidison & Jumoke Onigbogi, “Nigeria” (*ibid* at 26-27); Luminița Popa, Iuliana Craiciu & Marius Bărlădeanu, “Romania” (*ibid* at 31-32); Andrei Baev et al, “Russia” (*ibid* at 42-43); Young Kyun Cho & Seong Soo Kim, “South Korea” (*ibid* at 16); Wilbert Basilius Kapinga, Joy Hadji Alliy & Nasra Hassan, “Tanzania” (*ibid* at 24-25); Tolga Danişman et al, “Turkey” (*ibid* at 42-45); Joseph B Luswata et al, “Uganda” (*ibid* at 22); David Wadham & Mhairi Main Garcia, “United Arab Emirates” (*ibid* at 29-30); Allan T Marks et al, “United States” (*ibid* at 48-49).

⁹² *Transportation Investment Act*, *supra* note 85, s 5 [emphasis added].

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This provision effectively insulates penalty clauses in P3 agreements from judicial interpretative interference and preserves this veritable enforcement device from being whittled down.

By thus prescribing minimum service and quality standards, implementing strict compliance regimes and ensuring that penalties cannot be labelled as ‘punitive’ and then contested in court on that basis, Canadian P3 law, policy and practice enhances the advantages of PPP’s and helps ensure that their benefits accrue to the public sector.

II. RESPONDING TO KEY ARGUMENTS AGAINST P3S

Murphy has succinctly articulated the major arguments proffered against the use of P3s as a procurement approach. They may be summarized as follows:

1. P3 procurements are costlier than conventional public procurements;
2. Over time the private sector will lower its quality of service and design in favour of maximizing profit;
3. Transparency and accountability are not hallmarks of P3 procurements;
4. P3s pose a threat to workers’ interests, and
5. P3s erode public sector flexibility.⁹³

The crux of the first of the arguments enumerated above is that P3s cost more than conventional public procurements.⁹⁴ The relatively higher costs, it is argued, are attributable to “the higher cost of private borrowing; the need to make a profit and associated other potential operational inefficiencies; and higher procurements costs”⁹⁵ As to the higher cost of private borrowing, Iacobacci observes that “[t]he private financing used for P3 projects is more expensive than the public financing (i.e., government bonds) used for conventional procurements”.⁹⁶ And elsewhere that-

⁹³ Murphy, *supra* note 57 at 104. See also CUPE Research Branch, *A CUPE Backgrounder on Urban Infrastructure* (2004) online: CUPE <http://cupe.ca/updir/Cities_Paper.pdf> at 17-22 [CUPE Research Branch]; CUPE Research – Alberta Region, *The Case against Public-Private Partnership (P3) Financing for Public Infrastructure: Recent Research* (np: Canadian Union of Public Employees, 2008) at 2-5; Toby Sanger & Corina Crawley, “The Problem with Public-Private Partnerships: Economic Crisis Exposes the High Costs and Risks of P3s”, *The CCPA Monitor* (1 April 2009), online: CCPA <<http://www.policyalternatives.ca/publications/monitor/problem-public-private-partnerships>>.

⁹⁴ Murphy, *supra* note 57 at 104.

⁹⁵ Lewis Auerbach, *Issues Raised by Public Private Partnerships in Ontario’s Hospital Sector* (2002) at 19, online: CUPE <<http://cupe.ca/updir/P3s-in%20Ont%20Hospitals.pdf>> [Auerbach].

⁹⁶ Iacobacci, *supra* note 3 at ii.

[T]he cost of bank debt is usually at least 100 basic points higher than equivalent-term Canadian Treasury bills...When the public sector relies on financing obtained by the P3 partner, it pays for the higher cost of private financing through service payments to the P3 partner.⁹⁷

The relatively higher procurement costs, on the other hand, result from the “additional due diligence” which arranging private financing and “risk assessment and allocation” entail,⁹⁸ as well as from the bidding process itself.⁹⁹

Clearly, this initial argument does not fall squarely within the ambit of the present paper because strictly speaking, this particular concern does not raise any issue of a clear-cut legal nature; neither can it be addressed by direct reference to Canadian P3 law or policy. Be that as it may the supposed ‘higher costs’ of P3s are “more than offset” by such tangible gains as access to private capital; cost and time certainty and savings; innovation, and efficiency-related benefits associated with risk-transfer and such contractual devices as performance standards, penalties and bonuses.¹⁰⁰

Any comparison between P3s and conventional public procurements that focuses solely on “the cost of money” is of necessity inaccurate.¹⁰¹ An accurate comparative assessment of the two procurement approaches must necessarily consider, as the foremost criterion, “the net benefit, taking into account all factors”.¹⁰²

The ‘higher cost’ refrain also erroneously leaves out the issue of risk.¹⁰³ “Lower interest rates for public sector borrowing exist because they are assumed to be risk free, which, of course they are not. Risks exist as long as there are potential problems with cost overruns, scheduling delays, and so on—problems that are common with public sector projects and lead to higher taxes in the future”.¹⁰⁴ The risk-free illusion of conventional public procurement “is only achieved because of the public sectors’ ability to increase taxes if problems arise with the project. As such, the potentially

⁹⁷ *Ibid* at 27.

⁹⁸ *Ibid* at 28.

⁹⁹ Auerbach, *supra* note 95 at 25; see also John Loxley, “The Hidden Expenses of Public-Private Partnerships”, *The Globe and Mail* (27 June 2000) B16.

¹⁰⁰ Murphy, *supra* note 57 at 104.

¹⁰¹ *Ibid* at 104-105.

¹⁰² *Ibid* at 105.

¹⁰³ *Ibid* at 104.

¹⁰⁴ Harry Kitchen, *A State of Disrepair: How to Fix the Financing of Municipal Infrastructure in Canada* (Toronto: CD Howe Institute, 2006) at 11 [Kitchen].

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sizeable costs associated with unforeseen events are effectively underwritten by the taxpayer”.¹⁰⁵ The added costs held out by P3 critics to be embodied in service payments to the P3 partner may properly be viewed as “an insurance premium to protect against the risk of higher costs”¹⁰⁶ that would otherwise have resulted from missed deadlines, cost overruns and other inefficiencies earlier demonstrated to be typical of conventional public procurements, where the practice is to “[self-insure] at a zero premium cost but at a potentially high failure cost”.¹⁰⁷ In a P3, such risk—“and potential costs—can be transferred to the private sector, but only when compensated by an appropriate return”.¹⁰⁸ The situation is comparable to spending extra cash to purchase “an extended warranty on a car or any other insurance premium”.¹⁰⁹

Add to the foregoing, the fact that, “it is not at all clear that governments can borrow more cheaply...or at a lower cost than the private sector”.¹¹⁰ In fact, given the ongoing European sovereign debt crisis, in some cases the exact opposite is true.

¹⁰⁵ Derek Burleton, *Creating the Winning Conditions for Public-Private Partnerships (P3s) in Canada* (TD Bank Financial Group, 2006) at 13 [Burleton].

¹⁰⁶ Kitchen, *supra* note 104 cited in Murphy, *supra* note 57 at 105.

¹⁰⁷ *Ibid.*

¹⁰⁸ Burleton, *supra* note 105 at 13.

¹⁰⁹ *Ibid.*

¹¹⁰ Jean-Etienne de Bettignies & Thomas W Ross, “The Economics of Public-Private Partnerships” (2004) 30:2 *Can Pub Pol’y* 135 at 146

(“[a] comparison between the borrowing rates charged to governments and to private partners is not necessarily comparing apples with apples, as the private borrower is acquiring a put option with its loan and this must cost it something. To see this, assume that because of its very low probability of bankruptcy, the government can borrow at the risk-free rate of interest, say this is 5 percent over 20 years. If a private borrower had an equally low probability of bankruptcy it would also be able to borrow at 5 percent, but in fact over the course of 20 years there is a not-insignificant chance it will be unable to meet its debt obligations. Thus, a loan contract with this private borrower, say at 7 percent, is actually a combination of a loan plus an option to “put” the remaining portion of the debt back to the original lender.

The important observation here is that the government does not get this put option when it pays 5 percent, it must repay the loan in full, no matter what. This is not to say that the cost of borrowing has to be identical when we take the put option into account, it is just to point out that the listed rate exaggerates the difference...

[Secondly] with a solid, long-term contract from a government buyer a private borrower can most likely secure a very good rate from private lenders. Here the government’s reliability as a buyer substitutes for its reliability as a borrower, with the result that the rate at which the private party can borrow is very low...

....

Presently, the other arguments proffered against the use of P3s will be addressed, in the light of Canadian law, policy and P3 practice.

A. Diminished Quality of Design and Service over Time

The second major argument raised against the use of P3s is that the private sector's profit motive will eventually lead to diminished quality of service and/or design.¹¹¹ In this connection, it has been argued that by their very structure, P3s incentivize the private sector to "reduce costs" and "optimize revenues", "*even if this impacts negatively on levels of service; and ... causes the project ultimately to cost more than it would have with public ownership and normal procurement processes [i.e. conventional public procurement]*".¹¹²

Quite to the contrary, rather than lower service or design quality, the profit maximizing motive of the private sector is in fact a powerful driver of efficiency, which is often reflected in *higher service and design quality and lower costs*. The reality is that the "goals" of profit maximization on the one hand and service/design quality on the other hand "are not mutually exclusive".¹¹³ If anything, the former induces the latter.

[Lastly] when we recognize that governments, particularly subnational (e.g., provincial) ones, can get themselves into serious financial trouble and even possibly face bankruptcy, we know that they will often not be able to borrow at the risk-free rate. Importantly, they may face an upward-sloping supply of capital curve such that the more they borrow the higher the interest they must pay. For example, as a provincial government increases borrowing it runs the risk of having its debt-rating downgraded and having to pay higher rates on all of its borrowing. The implication is a familiar one from monopsony theory - the cost of borrowing for the next project is higher than just the interest rate you pay for that project if it also increases the rate you pay for all your other borrowing. For a government borrowing considerable sums of money regularly, the chance of a downgrade leading to the need to pay even a quarter percentage point more is a very serious matter. Thus, we can have a situation in which even if the interest rate charged to the government borrowing for the next project is lower than that which a private sector partner would have to pay, the ['full'] marginal cost to the government could be much higher" at 146-7).

¹¹¹ Murphy, *supra* note 57 at 107, citing "The Ontario Federation of Labour, "Private-Public-Partnerships (P3s) and the Transformation of Government" *OFL Policy Papers* (November 2005), online: The Ontario Federation of Labour <http://www.ofl.ca/uploads/library/policy_papers/P3s.pdf>; CUPE Research Branch, *supra* note 93 at 19; Canadian Union of Public Employees - Ontario Division, *Re-Building Strong Communities with Public Infrastructure: A Submission to the Ontario Ministry of Public Infrastructure Renewal in Response to the Discussion Paper on Infrastructure Financing and Procurement - "Building a Better Tomorrow: Investing in Ontario's Infrastructure to Deliver Real, Positive Change"* (Ontario: CUPE SCFP, 2004) at 7.

¹¹² Auerbach, *supra* note 95 at 29 [emphasis added].

¹¹³ Burleton, *supra* note 105 at 16.

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Furthermore, in addition to the foregoing inherent private sector incentive to efficiency, additional incentives and safeguards can be – and in practice usually have been – created contractually or statutorily. Contractually, such incentives and safeguards are introduced by provisions in the P3 contract that stipulate minimum “service and quality standards”,¹¹⁴ bonus clauses, “[p]enalty clauses and, in the extreme case, the right to [unilaterally and without liability] terminate the contract”.¹¹⁵ In this regard, as highlighted earlier, the *Transportation Investment Act* mandates the inclusion of provisions that stipulate minimum service and quality standards in P3 agreements concerning concession highways.¹¹⁶ Additionally, performance-related penalty and bonus clauses are mandatory provisions in such agreements;¹¹⁷ and the validity and enforceability of penalty clauses is guaranteed by statutory provisions that preclude their interpretation as “punitive”.¹¹⁸ The aforesaid contractual devices, equip the public sector to stipulate and enforce the quality of performance expected from its private-sector partners,¹¹⁹ and constitute a veritable check to the lowering of service and design quality.¹²⁰ In those circumstances, the profits of the private-sector partner materialize “not through service quality reductions”,¹²¹ as contended, but because of onerous contractual provisions that necessitate the introduction of “sound business techniques and practices, ranging from improvements in

¹¹⁴ Murphy, *supra* note 57 at 107.

¹¹⁵ *Ibid.* For example on April 27, 2006, the Ontario government announced its decision not to renew its five-year contract with Management and Training Corporation Canada (MTCC) under which MTCC was to operate the Central North Correctional Centre in Penetanguishene. The reason cited was that “[a]fter five years, there [was] no appreciable benefit from the private operation of the Central North Correctional Centre...[when] compared with the [identically designed] publicly operated Central East Correctional Centre in Kawartha Lakes”. See Ontario, Ministry of Community Safety and Correctional Services, Press Release, “Central North Correctional Centre Transferring to Public Sector Operation: Private Jail Operation Contract Not Renewed” (27 April 2006) online: Ontario, <<http://news.ontario.ca/archive/en/2006/04/27/Central-North-Correctional-Centre-Transferring-To-Public-Sector-Operation.html>>. See also: *Penological Information Bulletin*, online: Irish Penal Reform Trust <<http://www.iprt.ie/contents/496>>; Murphy, *supra* note 57 (the prison was returned “to the public sector *penalty-free*” at 108 [emphasis added]).

¹¹⁶ See *Transportation Investment Act*, *supra* note 85, s 3(d), (f)-(g).

¹¹⁷ *Ibid.*, s 3(c.1).

¹¹⁸ *Ibid.*, s 5.

¹¹⁹ Murphy, *supra* note 57 at 107.

¹²⁰ *Ibid.*

¹²¹ *Ibid.*

management efficiency, application of new technologies, cash flow management, personnel development and shared resources”.¹²²

Statutorily, these same incentives and safeguards can be introduced by provisions that prescribe optimal levels of service from the private-sector P3 participants,¹²³ provisions that legitimize the use of penalty clauses, and provisions that preserve the government’s power to unilaterally terminate the P3 agreement without liability, in the event of the private sector partner’s failure to comply with prescribed standards. British Columbia’s *Transportation Investment Act* once again provides an excellent example of the use of these types of statutory devices. As highlighted above, the Act outlines rules that regulate transportation P3s, and in particular provides that a concession agreement must obligate the private-sector operator of a concession highway “to meet or exceed the standards applicable to a comparable public highway...including...design, construction, safety, maintenance and signage standards”.¹²⁴ The *Transportation Investment Act* also preserves the government’s power to engage another private-sector partner in relation to the same concession highway, following termination of the P3 agreement with a private-sector partner that was underperforming.¹²⁵

It remains to be said, that in the final analysis, “there is [also] no consistently compelling evidence of lower-quality design or service as a [direct] result of using the P3 model”.¹²⁶

¹²² Burleton, *supra* note 105 at 16.

¹²³ Murphy, *supra* note 57 at 107-108.

¹²⁴ See *Transportation Investment Act*, *supra* note 85, s 3(f).

¹²⁵ *Ibid*, s 10.

¹²⁶ Murphy, *supra* note 57 (in support of this conclusion, Murphy cites, among other things the UK National Audit Office “review of nine PFI prisons” which showed that “PFI prisons tended to be more cost-efficient and better than public prisons in areas relating to decency and purposeful activities for prisoners”, and attributes this success to “a combination of clear contractual service standards and effective monitoring of compliance, including, where appropriate, the use of penalties” at 108).”). See UK, National Audit Office, *The Operational Performance of PFI Prisons: Report by the Comptroller and Auditor General* (HC 700 Session 2002-2003) (London, UK: National Audit Office, 2003) at 7-16, 21-24, 31, 33. See also Iacobacci, *supra* note 3 (“[o]ne of the benefits of a P3 project that incorporates a service or operating phase is that the P3 partner is required to provide a specified level of service and to [maintain] the facility in a satisfactory condition...[at the pain of] penalties” at 24; [A]necdotal evidence...suggests that there is little basis to the criticism that service standards suffer under a P3 relative to conventional maintenance contract[s]...” at iii).

B. Decreased Transparency and Accountability

The present argument against P3s stems from the “secrecy”¹²⁷ – or privacy that surrounds P3s, given their contractual nature. It is argued that for this reason, “[t]here is insufficient transparency, accountability and public consultation”.¹²⁸ Proponents of this argument would like to see disclosure of at least the following:

- Comparisons of the cost and non-cost advantages and disadvantages of relevant alternatives with the use of appropriate comparators
- The RFP [request for proposals]
- The terms of the contract, if one is awarded

And if the project proceeds...

- An adequate and appropriate monitoring and audit regime
- Assurance of audit and public access to relevant performance and financial information of the private sector partners.¹²⁹

The reality is that Canadian P3 law, policy and practice actually fulfil these basic expectations. This is seen in the fact that the specialized P3 agencies or PPP units established for the major P3 utilizing provinces have adopted tools and practices that incorporate these minimum requirements in their procurement processes. Three such significant tools are “the public-sector comparator [PSC], value-for-money audits and...“best practice” standards for disclosure of information”.¹³⁰ All three have been heralded as “key standards”¹³¹ that “allow an adequate sharing of information in a form useful for citizens to hold governments to account on “best value for money” for P3 projects”.¹³²

The PSC is straightforward and works as follows:

[G]ather a realistic and detailed assessment of all of the costs of the proposed project, including delay and budgetary risks, inflation effects, life-cycle costs, finance charges, operating costs, etc., and, based on a net present value, derive a

¹²⁷ Murphy, *supra* note 57 at 108.

¹²⁸ Auerbach, *supra* note 95 at 16.

¹²⁹ *Ibid* at 16-17. See also Tim Gosling, *Openness Survey Paper* (London: Institute for Public Policy Research, 2004) 4-13, 27-28; Duncan Cartlidge, *Public Private Partnerships in Construction* (London: Taylor & Francis, 2006) at 79-88 [Cartlidge]; Joan Price Boase, “Beyond Government? The Appeal of Public-Private Partnerships” (2000) 43:1 *Canadian Public Administration* 75 at 88-90.

¹³⁰ Murphy, *supra* note 57 at 109 [quotes in original].

¹³¹ *Ibid* [emphasis added].

¹³² *Ibid* [quotes in original].

public-sector cost of the project against which the price of a P3 model of delivering the same project can be compared.¹³³

Partnerships BC “has adopted the PSC model and obligates its use through the three-step procurement process outlined in its Capital Asset Management Framework”.¹³⁴ Infrastructure Ontario has equally embraced the use of the PSC model,¹³⁵ and Alberta’s Treasury Board which houses the province’s PPP unit, the Alternative Capital Financing Office, similarly relies heavily on the use of the PSC model for the success of its entire P3 procurement process.¹³⁶

With regard to “value-for-money audits”¹³⁷—the second ‘key standard’ referred to above¹³⁸—Partnerships BC and Infrastructure Ontario have taken up the salutary approach of subjecting P3 projects executed under their auspices “to publicly available value-for-money assessments at three critical stages: 1) at the point of selecting an appropriate procurement methodology; 2) at the point of assessing P3 bids; and 3) at appropriate junctures during the concessionary contract”.¹³⁹ For example, British Columbia’s Sea-to Sky Highway Improvement project was repeatedly subjected to value-for-money assessments first by Partnerships BC and later by the provincial auditor general.¹⁴⁰ Similarly, consistent with its

¹³³ *Ibid.* For a more detailed exposition of the definition, usefulness and possible formats of a PSC, see generally Cartlidge, *supra* note 129 (“[t]he PSC may be defined as a hypothetical risk-adjusted cost model, assuming that the public sector is the supplier. It is based on the output specification...that is prepared as part of the PFI [/PPP] procurement process. . . [and] is a benchmark against which value for money is assessed” at 136, 139-140).

¹³⁴ Murphy, *supra* note 57 at 109. See also Government of British Columbia, *Capital Asset Management Framework: Guidelines*, online: Government of British Columbia (2002) <http://www.fin.gov.bc.ca/tbs/camf_guidelines.pdf> at 39-40.

¹³⁵ See Infrastructure Ontario, *Assessing Value for Money* (Toronto: Queen’s Printer, 2007) at 5-14; Infrastructure Ontario, *Value for Money Assessment: Hôpital Montfort Expansion and Redevelopment Project* (Toronto: Queen’s Printer, 2007) at 5, 10-11, online: Infrastructure Ontario <<http://www.infrastructureontario.ca/en/projects/health/montfort/files/Montfort%20Value%20for%20Money%20-%20Final.pdf>>.

¹³⁶ See Government of Alberta, *Infrastructure and Transportation, Management Framework: Assessment Process* (Alberta: Government of Alberta, 2006) at 14-18; Government of Alberta, *Infrastructure and Transportation, Management Framework: Procurement Process* (Alberta: Government of Alberta, 2006) at 5.

¹³⁷ Murphy, *supra* note 57 at 109.

¹³⁸ See text accompanying notes 130-132.

¹³⁹ Murphy, *supra* note 57 at 109 citing Arthur Andersen and Enterprise LSE, *Value for Money Drivers in the Private Finance Initiative*.

¹⁴⁰ *Ibid.* at 110. See also Partnerships British Columbia, *Project Report: Achieving Value for Money Sea-to-Sky Highway Improvement Project* (Vancouver: Partnerships BC, 2005) at 17-24, online: Partnerships British Columbia <<http://www.partnershipsbc.ca/pdf/SeatoSkyFinal.pdf>>.

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disclosure practice of publicizing value-for-money reports for each P3 project within six months of financial close,¹⁴¹ Infrastructure Ontario saw to it that the “Hôpital Montfort P3 project...was reviewed on a value-for-money basis, and the results were posted on [its] web site”.¹⁴²

Lastly, the specialized provincial P3 agencies have embraced the aforementioned “best practice” disclosure standards.¹⁴³ For example, Partnerships BC has articulated a balanced policy of “[disclosing] as much as possible in the public interest without jeopardizing the ability of the government to generate the best value agreement for taxpayers...while protecting commercially sensitive information, so that private companies will continue to participate in [its] market”.¹⁴⁴ In a similar vein, in a document outlining its Alternative Financing and Procurement (AFP) disclosure practices,¹⁴⁵ Infrastructure Ontario announced its commitment to “striking a balance between acting in the public interest, maintaining accountability and ensuring that all processes are fair, transparent and efficient”.¹⁴⁶ It “will disclose key project documents on its web site,...[for example] RFPs, final project agreements and value for money reports...[but not commercially sensitive information as] determined with reference to the principles under FIPPA [*Freedom of Information and Protection of Privacy Act, 1990*]”.¹⁴⁷

A combination of each of the three measures just highlighted – the PSC, value-for-money assessments and best-practice disclosure standards – effectively addresses “most of the transparency and accountability concerns related to the project award phase”.¹⁴⁸ In practice, “the continued monitoring of the project *during the concessionary period* and the performance of the private-sector partner in meeting existing and evolving service standards”,¹⁴⁹ is achieved through the combined instrumentality of

¹⁴¹ Infrastructure Ontario, “Overview of Infrastructure Ontario’s Disclosure Practices”, online: Infrastructure Ontario <<http://www.infrastructureontario.ca/About-Us/Disclosure/>> [Infrastructure Ontario, “Disclosure Practices”].

¹⁴² Murphy, *supra* note 57 at 110.

¹⁴³ See text accompanying note 199.

¹⁴⁴ Partnerships British Columbia, *Procurement Related Disclosure for Public Private Partnerships* (Vancouver: Partnerships BC, 2007) at 2, online: British Columbia <http://www.partnershipsbcc.ca/pdf/pbc-disclosure_guidance-25-apr-07.pdf>.

¹⁴⁵ Infrastructure Ontario, “Disclosure Practices,” *supra* note 141 (AFP is the term used by the Ontario government for P3s).

¹⁴⁶ *Ibid.*

¹⁴⁷ *Ibid.*

¹⁴⁸ Murphy, *supra* note 57 at 110.

¹⁴⁹ *Ibid* [emphasis added].

carefully worded contractual clauses and the previously discussed devices for securing compliance—*penalties* and *bonuses*. “In a well-drafted P3 concessionary contract, the private sector is [affixed with responsibility] for recording and disclosing performance failures and actively monitoring performance across all services. Significant penalties attach to the failure to carry out such *monitoring* or *disclosure*”¹⁵⁰—the same penalties that, as previously highlighted, effectively ensure compliance with the contract. An added layer of concession-phase monitoring is introduced by the presence of private project financing in most P3 procurements. The lenders usually have considerable funding at stake, and as such, each hire a full complement of “commercial, technical, and legal due diligence advisors on each project...[and] continue to monitor the progress of the project *after financial close*”.¹⁵¹

A further transparency/accountability-related concern “that is often raised against P3s”¹⁵² relates to the problem of “[p]otential bidders lobbying public officials during the bidding process”,¹⁵³ as this is perceived—and rightly so—as capable of impugning “the fairness of the bidding process”.¹⁵⁴ This, as with each of the other concerns raised, is easily dealt with, in this case, “through anti-lobbying policies that disqualify bidders who attempt to lobby public officials”.¹⁵⁵ For example, “Infrastructure Ontario’s standard form request for proposals includes a prohibition against lobbying public officials and Infrastructure Ontario to

¹⁵⁰ *Ibid* [emphasis added]. This responsibility has also been statutorily introduced. For example, the *Transportation Investment Act*, *supra* note 58, s 9. The Act provides that:

At any time, the minister may, after giving reasonable notice to a concessionaire or the billing organization [employed to invoice and or collect tolls], require that the *accounts* and *other records* of the concessionaire or billing organization, as the case may be, that relate to any of the following be audited by an auditor satisfactory to the minister:

- (a) the charging or collection of tolls;
- (b) the collection, use and disclosure by the concessionaire or billing organization of personal information collected under section 25 (2) (a), (b), (c) or (d);
- (b.1) *the basis on which any amount is or may become payable to the concessionaire under a payment arrangement contemplated by section 3(c.1)* [i.e. performance-related bonuses or penalties];
- (c) any other rights or obligations of the concessionaire under the concession agreement or this Act [emphasis added]...

In order to be in a position to furnish such “accounts” and “other records” to the chosen auditor upon demand, the private-sector partner and or its agents or contractors are duty-bound to keep accounts and other records in the first place.

¹⁵¹ Iacobacci, *supra*, note 3 at 37 [emphasis added].

¹⁵² Murphy, *supra* note 57 at 111.

¹⁵³ *Ibid.*

¹⁵⁴ *Ibid.*

¹⁵⁵ *Ibid.*

influence the bid process. A breach of this... [prohibition] can lead to disqualification of a bidder's proposal".¹⁵⁶

In a related development, some Canadian P3 legislation addresses the issue of unsolicited bids. Specifically, section 6 of Québec's *Regulation respecting government concession contracts*,¹⁵⁷ which was made pursuant to section 23 of its *An Act Respecting Contracting By Public Bodies*¹⁵⁸ expressly provides that "[n]o concession contract may be entered into unless tenders have been called for, except where only one agent [i.e. prospective private-sector party] is available in which case the authorization of the Conseil du trésor is required".¹⁵⁹ The Regulation then states a detailed procedure for the making of calls for, and the receipt and treatment of tenders.¹⁶⁰ The *Public Contracting Act* also makes equally detailed provisions which imbue Québec's P3 tendering and procurement processes with fairness and transparency.¹⁶¹ All of these provisions put together ensure for Québec P3s the required level of disclosure, transparency, fairness and accountability that P3 critics argue for.¹⁶²

In the final analysis, contrary to the contentions of some P3 opponents, existing and available contractual, legal and policy measures guarantee the accountability and transparency of P3 procurements, subject to generally acceptable standards of confidentiality in the case of commercially sensitive information.

C. Threat to Workers' Rights

From the most vociferous of critics of P3s, the Canadian Union of Public Employees (CUPE), comes the criticism that P3s are characterized by "high [employee] turnover" and "reduced wages".¹⁶³ These weaknesses, they argue "invariably result in reduced service as a result of reduced staff complements".¹⁶⁴

¹⁵⁶ *Ibid.*

¹⁵⁷ RRQ 1981, c A-6, r 6 [*Public Contracting Regulation*].

¹⁵⁸ RSQ c C-65.1 [*Public Contracting Act*].

¹⁵⁹ *Public Contracting Regulation*, supra note 157, s 6; *ibid.*, s 6.

¹⁶⁰ *Ibid.*, ss 7-17.

¹⁶¹ See *Public Contracting Act*, supra note 158, ss 2, 10-12, 18-20, 22.

¹⁶² See *ibid.* (regarding disclosure, for example, the *Public Contracting Act* requires a public body to "publish information on the contracts it has entered into which involve an expenditure over \$25,000" at s 22 [emphasis added]).

¹⁶³ CUPE Research Branch, supra note 93 at 18-20.

¹⁶⁴ Murphy, supra note 57 at 111.

The merit of this contention becomes dubious in the face of “the general practice in most jurisdictions [whereby] the private sector is obligated to offer employment to all displaced public-sector employees on the same terms and conditions” as their previous employment.¹⁶⁵ As a specific example, “Ontario P3 deals include provisions obligating the private sector to hire public-sector employees on the same terms and conditions as outlined by any existing collective agreement or employment contract”.¹⁶⁶ Furthermore, “even in the absence of a successor employer obligation, there is no compelling evidence of large job losses as a [direct] result of moving to a P3”.¹⁶⁷

Furthermore and significantly, Burleton cites a 2001 United States Department of Labour study “which examined partnerships in 34 cities and countries, [and] found that virtually all affected public employees were either hired by private contractors in order to benefit from their institutional knowledge and experience or transferred to other government positions”.¹⁶⁸ He adds that “[i]n the cases where there have been layoffs, these job cuts have usually occurred through attrition”.¹⁶⁹ Hence, while it is common, “[w]hen a private sector partner takes on the responsibility of delivering a public service, [for] concerns...[to] be raised about the potential for the company to lay-off government employees, cut wages and reduce pension entitlements and other benefits”;¹⁷⁰ for the patent lack of supporting evidence, empirical or otherwise, of such concerns actually crystallizing on a significantly widespread scale¹⁷¹—even in the CUPE’s foremost articulation of its resistance to P3s¹⁷²—the argument that P3s threaten workers’ rights is merely rhetoric.

¹⁶⁵ *Ibid.*

¹⁶⁶ *Ibid.*

¹⁶⁷ *Ibid.*

¹⁶⁸ Burleton, *supra* note 105 at 16.

¹⁶⁹ *Ibid.*

¹⁷⁰ *Ibid.*

¹⁷¹ See CUPE Research Branch, *supra* note 93 (e.g. actual instances of such job, wage or benefit cuts in such statistically significant amounts as would lend overwhelming support to the contention presently under review; as opposed to unsubstantiated, vague and specious assertions that are not verifiable and accordingly smack of speculation, such as: “[h]igh turnover is common with P3s. Because private sector support services pay lower wages than public sector support services, private sector employees are more likely to leave their jobs...Reduced wages are the norm in P3 operations. Private contractors usually pay their workers much less than public employers” at 19 [emphasis added]).

¹⁷² See *ibid.*

D. Erosion of Public Policy Flexibility

From a legal perspective, the most significant prong of the present argument against P3s is the perceived “threat of trade repercussions as a result of private-sector involvement in previously publicly delivered services”.¹⁷³ Proponents of this argument theorize that the participation of the private sector in “the delivery of public services”,¹⁷⁴ coupled with “international trade disciplines concerning foreign investment and services”,¹⁷⁵ could potentially open the floodgates to an avalanche of “foreign investor claims” under agreements such as the North American Free Trade Agreement (NAFTA).¹⁷⁶ This situation, they contend, would “limit the range of public choices available to government and *force* private-sector delivery of public goods and services”,¹⁷⁷ ultimately thereby “[reducing] the flexibility of the public sector to respond to public demands”.¹⁷⁸ Notably, Shrybman conceives of a situation where “a decision by government to terminate...[a] P3 contract, will be characterized as expropriation for the purposes of founding an investor-state claim”, and asserts that, given the “binding international obligations” created under “international trade, investment and services agreements”, P3s open up “*environmental and public-health measures*—from safe drinking-water standards and water pollution controls to the remedial orders of local health officials—to *trade challenges and foreign investor claims*”.¹⁷⁹ Elsewhere, he has contended that-

¹⁷³ Murphy, *supra* note 57 at 112 ([t]he other prong of this argument is that “reduced expenditure choices” and “reduced service and policy choice options” result from the “long-term contractual commitments” involved in P3 arrangements; and these results, in turn, erode public policy flexibility. However, these supposed hindrances to public policy flexibility are easily eliminated “through careful drafting of the P3 contract” to include “a cancellation clause” or other “break options...that would allow the public sector to terminate a P3 contract at specific points and pay predetermined levels of compensation to the private sector” at 112, 114).

¹⁷⁴ *Ibid* at 115.

¹⁷⁵ Steven Shrybman, *Public-Private Partnerships: Assessing the Risks Associated with International Investment, and Services Treaties* (2002) online: CUPE <cupe.ca/updir/Response_to_C2P3_Guidance.DOC11> at 1 [Shrybman, *Assessing the Risks*].

¹⁷⁶ North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States, 17 December 1992, Can TS 1994 No 2, 32 ILM 289 (entered into force 1 January 1994) [NAFTA].

¹⁷⁷ Steven Shrybman [Sack Goldblatt Mitchell], *Public-Private Partnerships: Assessing the Risks Associated with International Investment, and Services Treaties* (Ottawa: CUPE, 2002), online: CUPE <http://cupe.ca/updir/P3s & Trade Agreements .doc> at 2, cited in Murphy, *supra* note 57 at 115 [emphasis added].

¹⁷⁸ *Ibid* at 104.

¹⁷⁹ Shrybman, *Assessing the Risks*, *supra* note 175 at 2 [emphasis added].

[T]he private dispute processes established by international investment treaties have now been invoked to challenge environmental and public health regulation, land-use planning by municipal governments, judgments and jury awards, procurement contracts, and in the broader international context, P3 agreements concerning water and sewer services which have gone sour.¹⁸⁰

The foregoing concerns however are in reality misgivings about international trade agreements and are misplaced as arguments *against the use of P3s*. They only tangentially involve P3s in so far as P3 opponents contend that “[b]y entering into P3 arrangements, governments and other public agencies expose Public services and indeed public authority to tremendous risk from corporate rights enshrined in international trade agreements”.¹⁸¹ Be that as it may, on a closer analysis, these concerns are exaggerated. For example, as to the view that the remedies in trade agreements could be exploited to erode the flexibility of the public sector to respond to public demands, the decision of the NAFTA Chapter 11 Tribunal in *Marvin Feldman v Mexico*¹⁸² is instructive. This case involved, among other things, a claim that the refusal by the Mexican authorities to grant to the Claimant’s company excise tax rebates on exported cigarettes amounted to expropriation of the Claimant’s investment under article 1110 of the NAFTA. In dismissing this head of the claim, the Tribunal held that:

*[G]overnments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this.*¹⁸³

Article 1114 of NAFTA provides that nothing in Chapter 11 “shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter...to ensure that investment activity in its territory is undertaken in a manner sensitive to

¹⁸⁰ *Ibid* at 1.

¹⁸¹ CUPE, “CUPE Talking Trade”, Introduction to Shrybman, *Assessing the Risks*, *ibid*, online: CUPE <cupe.ca/updir/P3s%20&%20Trade%20Agreements%20.doc>.

¹⁸² (2002), 18 ICSID Rev 488 (International Centre for Settlement of Investment Disputes), (Arbitrators: Prof Konstantinos D Kerameus, Mr Jorge Covarrubias Bravo, Prof David A Gantz).

¹⁸³ *Ibid* at 103 [emphasis added].

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environmental concerns.”¹⁸⁴ In the same juncture, *NAFTA* entitles the state parties to make unbounded reservations to the application of its provisions.¹⁸⁵ Consistent with that right, Canada has reserved the right to take measures with respect to “the following services to the extent that they are social services established or maintained for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care.”¹⁸⁶ These provisions of the *NAFTA* preserve public policy flexibility in each of the enumerated sectors.

The contention that the termination of a P3 contract could be characterized as expropriation ‘for the purposes of founding an investor-state claim’,¹⁸⁷ *has been rejected by NAFTA tribunals*. In *Azinian*,¹⁸⁸ a case in which the claimants had unsuccessfully sought damages as a result of the annulment of their concession contract by a Mexican municipality, the Tribunal stated:

The problem is that the Claimants’ fundamental complaint is that they are the victims of a breach of the Concession Contract. *NAFTA* does not, however, allow investors to seek international arbitration for mere contractual breaches. Indeed, *NAFTA* cannot possibly be read to create such a regime, which would have elevated a multitude of ordinary transactions with public authorities into potential international disputes. *The Claimants simply could not prevail merely by persuading the Arbitral Tribunal that the Ayuntamiento of Naucalpan breached the Concession Contract.*¹⁸⁹

Curiously, despite its outcome, Shrybman had referred to this case in support of his view that “an act that might represent a breach of contract may also represent a violation of the *NAFTA* and *found* a complaint under Chapter Eleven [i.e. for Expropriation under Article 1110 of *NAFTA*]”¹⁹⁰ The more correct view of the case is expressed by Kirby and Doubilet: “the Tribunal made it quite clear that *NAFTA does not extend* to protect investors from mere claims of breach of contract...Termination of a

¹⁸⁴ *NAFTA*, *supra* note 176, art 1114(1).

¹⁸⁵ *Ibid*, art 1206.

¹⁸⁶ *Ibid*, Annex II.

¹⁸⁷ See text accompanying note 179.

¹⁸⁸ *Robert Azinian, Kenneth Davitian, & Ellen Baca v United Mexican States* (1999), 14 ICSID Rev 538 (International Centre for Settlement of Investment Disputes), (Arbitrators: Mr Benjamin R Civiletti, Mr Claus von Wobeser, Mr Jan Paulsson) [*Azinian*].

¹⁸⁹ *Ibid* at 83 and 87 [emphasis in original].

¹⁹⁰ Shrybman, *Assessing the Risks*, *supra* note 175 at 19-20 [emphasis added].

properly drafted contract which provides for termination cannot be considered expropriation”.¹⁹¹

Finally, as to the contention that trade agreements such as the *NAFTA* would have the effect of forcing private-sector delivery of public goods and services, it is noteworthy that “*NAFTA* does not obligate all services to be delivered in the same way and, therefore, does not obligate governments to deliver...service[s] using a P3 methodology”.¹⁹²

The result is that, rhetoric aside; there is little merit to the contention that P3s, in conjunction with international trade agreements, erode public policy flexibility in a North American context.

III. CONCLUSION

This paper has demonstrated that significant, well-documented advantages result from procuring capital-intensive infrastructure services via P3s rather than by conventional public procurement. Procurement of such infrastructure services via P3s typically leads to cost and time savings. Furthermore with PPPs the cost overruns and time delays that are almost synonymous with conventional public procurement are the exception rather than the rule.

The cost and time savings, as well as the low incidence of time and cost overruns inherent in P3 procurements of large infrastructure are attributable to at least two major reasons: 1) the optimal risk allocation characteristic of P3s; and 2) the presence of private project financing. The paper has further demonstrated that each of the foregoing factors, which are ultimately responsible for the cost and time certainty and savings of P3s, have been positively impacted by developments in Canadian P3-related law, policy and practice.

Secondly, P3s are intrinsically conducive to innovation and high levels of efficiency, owing to their exclusive use of output/performance-based contracts which prescribe minimum service standards and quality levels expected of the private sector service provider, as well as a pragmatic system of enforcement and incentives, consisting of a combination of periodic inspections, penalties and bonuses. As with cost and time savings

¹⁹¹ Peter Kirby & David Doubilet, *The Canadian Council for Public-Private Partnerships Submission to the Walkerton Inquiry Part 2: Comments of Fasken Martineau DuMoulin LLP on the Shrybman Opinion* (np: no publisher, 2001) at 11 [emphasis added], online: Canadian Council for Public-Private Partnerships <<http://www.pppcouncil.ca/pdf/fretrade.pdf>>.

¹⁹² Murphy, *supra* note 57 at 116.

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and certainty; Canadian P3 law, policy and practice – notably the entrenchment and legitimization of the unique payment mechanisms that sustain the use of output/performance-based contracts in P3s—has given considerable impetus to the innovation that typically characterizes P3 procurements.

This paper has also addressed the key arguments proffered against the use of P3s, in the light of Canadian law, policy and P3 practice. On a careful analysis, and in the face of the present state of the law and applicable policy and practice, each of these arguments has been shown to be lacking in merit.