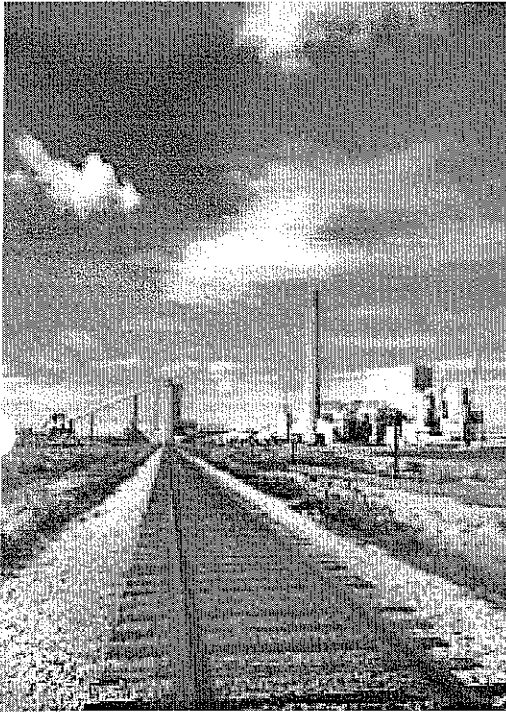


## TAKING IT TO THE WORLD: EXPORTING PPP EXPERTISE



Australia is an attractive partner for infrastructure development in the region because of our experience with private sector input. Doug Jones, AM, of Clayton Utz outlines some of the opportunities.

The growing complexity of privately funded major projects means that increasingly, governments and the private sector are seeking advice as to the best way to structure their projects. In Australia, the private sector has now been in partnership with governments for two decades and Australia continues to lead the world in PPP innovations. This wealth of experience, and the recent focus in East Asia on PPPs as a solution to the problems of public infrastructure means that Australia is well placed both technically and geographically to lend guidance to both investors and governments.

In recent times, governments all over the world have faced the problem of balancing increased budgetary pressures with the demand for more and better public services. Over the past few decades, public spending on infrastructure has been significantly reduced. At the same time, there are clear signs of mounting pressure on national infrastructure.

The problem is particularly acute in Asia. The rapid economic growth experienced by a number of Asian economies in the late 1980s created huge demands on

infrastructure. While spending on infrastructure as a percentage of regional GDP is expected to rise from 4 to 7 per cent in the next few years[1], with the population growing by around 60 million each year, and the rapid urbanisation of the region, further pressure will be placed on existing infrastructure.

The private sector has a large pool of resources from which to seek finance. By allocating projects to private developers, governments can effect large infrastructure improvements without either putting too much pressure on their cash resources or adding to their debt. Increasingly, governments are seeking to transform their role from the exclusive financiers, managers and operators to the facilitators and regulators.

Many Asian nations have recognised the benefits of private finance for public infrastructure. Not only does the Asian Development Bank actively encourage private investment in developing countries in East Asia, but individual countries are now working on making their political, economic and legal environment more attractive to foreign investors.

### AUSTRALIAN 'BEST VALUE' REGIMES

Public private partnership approaches have long been used in this country and Australia probably leads the world in some areas of innovation. The contractual structure of Build, Own, Operate and Transfer first became common in Australia in the late 1980s, but the wider PPP story really kicked off with the adoption in 1995 of a National Competition Policy and the consequent development of the 'best value' regimes. Australian governments have now accepted the fundamental premise that the private sector has a legitimate place in providing infrastructure and related services.

While the Build, Own, Operate and Transfer framework remains the backbone of Australian PPP developments, Australian governments have also experimented with:

- operating franchises where operating risk, control and entitlement to revenue are transferred to the private sector for a finite concession period
- provision of tailored accommodation services where the project is undertaken by private sector providers in exchange for the government's guarantee to take out a long-term lease of the infrastructure that was provided

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- project and strategic alliances where parties contract to align their commercial interests and cede almost all of their ordinary rights to bring claims
- contracts for a long-term service provision where the government retains control of the infrastructure but the private operator assumes an owner-like position in respect of the infrastructure and contributes its expertise to the government's management strategy.

Every major project is unique and the Australian experience reveals that this is particularly true when dealing with partnerships between government and the private sector. In considering the optimal mode of delivery, every aspect of the project is up for grabs, including ownership structure, sources of remuneration, risk allocation and the delineation between core and non-core services. Not only does the PPP framework need to be adapted to suit the particular national law, but inherent in the nature of each project will be a distinctive combination of construction, cultural, legal and political risks.

#### TRANSIT NEW ZEALAND

Australian expertise is being called upon by New Zealand's state highway authority, Transit NZ, to assist in the development of the policy framework and pro forma contractual and tender documentation for the use of private sector financing and expertise to develop state highway projects.

There are significant decisions to be made by Transit NZ in determining appropriate project structures for private sector participation in road infrastructure projects. The New Zealand Parliament enacted the Land Transport Management Act 2003 to regulate the involvement of the private sector in public road infrastructure and facilitate the involvement of private companies. The government's position is that transport policy must serve economic, public health, safety and environmental goals.

The limitations imposed by the legislation and the demographics of the New Zealand population mean it is necessary to consider:

- whether toll roads should be financed solely from the tolls they generate
- whether there should be a mix of tolls and government funding
- the length of the concession period
- whether the roads are economic, and if not, whether shadow tolls may subsidise it.

Furthermore, the legislation will only allow tolls where there is another free alternative route, and prohibits concession agreements from including provisions which provide a disincentive for a person to pursue other sustainable transport options (such as public transport or the implementation of demand management strategies). These requirements may inhibit private sector involvement in NZ toll roads. The challenge is to design project structures that meet the requirements of both the law and government, but continue to be an attractive investment for private players.

#### SIX ECONOMIES, ONE PROJECT - GREATER MEKONG

The World Bank and the Asian Development Bank actively promote the use of PPPs (in particular, BOOT schemes) in developing countries in the Asia-Pacific region. One example is the \$1 trillion Greater Mekong Sub-region Initiative. Australian advice was requested regarding the project framework for a US\$1.5 billion hydro-electric dam in Lao PDR.

This project involved special problems for those designing the PPP agreement. Six different economies were involved: Cambodia, Laos, Myanmar, China's Yunnan province, Thailand and Vietnam. In order to have any success, the project needed to not only be embraced by these various national governments, but the agreement needed to be legally recognised in each of these nations. In November 2002, the governments agreed to a high-level committee to set up rules, protocols and a regulatory framework for regional power trade. Not only was it important to become familiar with the local laws, but it was also important to design a framework appropriate to the business culture and economic environment.

Laos is an underdeveloped nation and investors were understandably wary of involving themselves in such a large project that could carry with it significant legal and political risk. An advantage for the government was that the Electricity Generating Authority of Thailand had already agreed to buy nearly all of the electricity from the Lao plant. Even with this in mind, the reality is generally that the private sector is usually only willing to become involved in an economically questionable development if the government or a development bank is prepared to protect them against risk and compensate them for any losses. Thus, one difficulty in designing the project structure, in addition to the problems already mentioned, was in balancing the allocation of risk. Good risk management practice dictates that risk

## TAXING INFRASTRUCTURE: REFORMING THE TAX ACT

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- The taxpayer party may elect to have the Division apply.

When Div 250 is failed:

- depreciation deductions are denied and
- the relevant financial benefit payments received by the taxpayer from the tax exempt party are subject to notional loan treatment (along the lines of D. 16 D taxation) but
  - the relevant income stream is 'Financial Benefits', not expected 'lease' payments
  - calculation of notional interest is more complex than under D. 16 D.
  - taxation of terminal values under D. 250 can be punitive.

### PREFERRED OUTCOMES

The draft Bill has a number of positive features which the tax exempts endorse. For a start, the removal of s. 51 AD (as recommended by the Ralph RBT) is a major step in the right direction.

The change away from control tests to risk-based assessments of asset ownership is more objective and also welcome. Further, not all projects will be adversely affected by D. 250. On reasonable assumptions, the modelling of D. 250 that was commissioned by the states and territories revealed only minor differential financial impacts for a number of projects that would have cleared s. 51 AD but been caught by D. 16 D.

However, the tax exempts are unable to support the Bill in its current form. There are major negatives for many stakeholders such as a wider casting of the tax net; a bring forward of tax revenues through the taxation of unrealised and unfunded gains, and a

broader definition of the payment stream to be subject to tax assessment under D. 250 compared with D. 16 D. As a result, the states and territories contend that the short term effect of D. 250 would be a transfer of revenue from the tax exempts to the Commonwealth. In addition, the Bill is complex and the maths required of taxpayers will probably necessitate assistance from expert advisors, surely raising compliance costs.

There remain significant policy and/or interpretational differences between most stakeholders and the Commonwealth regarding the scope and direction of infrastructure tax reform. In order not to lose the value embedded in the reform project over the last five years, stakeholders might be willing to continue negotiations on the Bill with a view to further improving its content.

Last year, the states and territories proposed a two-stage process, starting with honouring the commitment to remove s. 51 AD and modify D. 16D, and by this means, gain better stakeholder buy-in and reduce the pressure on the project team to produce a Bill that is acceptable to all parties. The Commonwealth rejected this sequential pathway, labelling it a piecemeal approach, but at the time of writing, the Bill is still being revised and presumably a federal election is close enough to significantly reduce the chances of the Bill becoming law in 2004.

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should be allocated to the parties who can best manage it. At the same time, placing risk in the hands of the private sector will discourage the necessary foreign investment.

Major projects are necessarily complex undertakings and Australia is at the forefront of innovation. As PPPs continue to play an increasingly important role in international projects, Australian expertise in designing sensible and appropriate frameworks will continue to be much sought after.

- [1] Myoung-Ho Shin, Vice President (Region West) Asian Development Bank, "Financing Development Projects: Public-Private Partnerships and a New Perspective on Financing Options" At the OECD/DAC Tidewater Meeting, Penha Longa, Portugal 24-26 June 2001. <<http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan002255.pdf>>

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