

Opinion of the Economic and Social Committee on the 'Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on Public-Private Partnerships in Trans-European Transport Network projects'

(98/C 129/14)

On 16 September 1997 the Commission decided to consult the Economic and Social Committee, under Article 198 of the Treaty establishing the European Community, on the above-mentioned communication.

The Section for Transport and Communications, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 11 February 1998. The rapporteur was Mr Kritz.

At its 352nd plenary session (meeting of 25 February 1998) the Economic and Social Committee adopted the following opinion by 76 votes for and one vote against.

1. Background

1.1. One of the main conclusions of the Commission's White Paper on Growth, competitiveness and employment, published in December 1993, was that efforts should be made to involve the private sector in financing and implementing Trans-European Networks' (TENs) projects. This was seen as a way to accelerating this type of investment and improving its efficiency.

1.2. At the European Council meeting of December 1994 in Essen, it was decided to give top priority to 14 large TEN transport projects. This followed the proposals put forward by a High-Level Group of personal representatives of Heads of State and Government, chaired by the Commission's vice-president, Mr Henning Christophersen.

1.3. The total investment costs of the 14 priority TEN transport projects selected by the Christophersen Group in 1994 were, at that time, estimated to amount to ECU 94 billion, of which ECU 40-45 billion had to be invested in the period 1995-1999. New calculations at the end of 1995 estimated the total investment costs to around ECU 99 billion.

1.4. The Commission's 1996 Annual Report on TENs stated that several of the largest priority projects (especially in the railway sector) are running behind schedule, and that it seems doubtful whether the expected investment levels of ECU 40-45 billion for the 14 projects by the year 1999 can now be achieved or even approached.

1.5. There are two main reasons why the implementation of several of the priority projects has been delayed. First, a general decline in public spending for infrastructure investments has occurred over the last few years, due to the need to reduce public budget deficits. Secondly, public-private partnership schemes (PPPs) as a means of accelerating priority projects, have

been more difficult to realize than foreseen. Furthermore, administrative, legal or political obstacles have appeared in some cases, but the main reasons for the delays are of a financial nature.

2. The high-level group report (May 1997)

2.1. The High-Level Group on Public-Private Partnership Financing of Trans-European Transport Network Projects was set up at Commissioner Kinnock's initiative, and with the agreement of the Transport Council, in September 1996. Under the chairmanship of Commissioner Kinnock, the Group was composed of personal representatives of the 15 Transport Ministers of the European Union, together with representatives from the construction industry, the banking sector, the transport equipment industry and transport operators in their personal capacity. The Group's Report was published in May 1997, and included summaries of the reports from five sub-groups which were appointed by the Kinnock Group.

2.2. The aim of the High-Level Group was to see how Public-Private Partnerships (PPPs) can contribute to achieve the objective of accelerating the implementation of the Trans-European Transport network, which is vital for European competitiveness and growth.

2.3. The report emphasizes that the aim of PPPs is not simply to mobilize complementary financing sources in times of constraints on public finances. It is of equal importance to improve a project's financial viability by mixing private- and public-sector skills: the public-sector experience of infrastructure management, and the entrepreneurial spirit and commercial and financial skills of the private sector.

2.4. A PPP is a partnership between various public administrations and public bodies on the one hand and legal persons subject to private law on the other, for the purpose of designing, planning, constructing, financing

and/or operating an infrastructure project. It is, however, inappropriate to impose a rigid definition of what a PPP is or should be, as each project will lead to a specific partnership according to project needs and characteristics, and the way in which public authorities decide to involve the private sector in the different project phases.

2.5. An economically viable project is one which will produce socio-economic benefits for the society. A financially viable project is one which will generate enough revenues to cover all costs and produce an adequate rate of return for investors. The report emphasizes that the key problem that PPPs address is the shortage of public funds for subsidies to economically viable projects which are not financially viable, rather than a shortage of public or private loan finance for financially viable projects. PPPs can bring projects closer to financial viability.

2.6. The conclusions and recommendations of the High-Level Group can be summarized under three headings:

— General conclusions

— An environment that encourages PPPs

— Development of financing instruments.

2.7. The general conclusions include the following:

- a) Public/private collaboration should start as early as possible in the life cycle of each particular project, so that private-sector, commercially-orientated input can be made in the conception and design stages of a project.
- b) The public sector must, at an early stage, clearly define the aims of a project, and should leave sufficient flexibility in project design to allow appropriate private-sector input.
- c) The creation of ad-hoc project companies is often the best approach — especially for large and cross-border projects — to provide a stable framework within which the various partners can establish a confident working relationship. The European Economic Interest Grouping (EEIG) statute is a good instrument in the early phases of a project, but it is not well adapted to the requirements of the construction and operation phases.

2.8. As to an environment that encourages PPPs the High-Level Group's recommendations deal with public procurement regulations and procedures, and with the application of EC competition rules to infrastructure projects in the railway sector. Clarification especially of

the application of the 'Public Works' and 'Utilities' directives could greatly facilitate PPP infrastructure schemes. The Commission should therefore elaborate specific guidelines which would provide greater clarity in the procurement procedures to be followed for the award of transport infrastructure concessions.

2.9. The High-Level Group points out that during the early operational stage of a project, when its debt burden and debt service obligations are at their highest, the revenue generated by the project is at its lowest. The Group therefore recommended the development of structurally subordinated loans and early operational stage loans to alleviate risks caused by uncertainties in early operational stage cash-flow generation.

2.10. As to the development of financing instruments, the Group also recommended, as a new activity at EU-level, equity and, in particular, quasi-equity, where a targeted application of Community funds could help the emergence of a European mezzanine fund. This could play an important role to encourage institutional investors to become involved in the financing of TENS.

3. The Communication from the Commission

3.1. Several of the recommendations in the High-Level Group's Report are addressed to the Commission for consideration and action. The communication from the Commission, published in September 1997, sets out how it will follow up those recommendations in which it is directly involved. It also sets out a number of projects which the Commission has identified as being suitable for a PPP approach.

3.2. *Public procurement*

3.2.1. Private-sector concerns and specific points in EU procurement rules have been examined by the Commission in order to favour a regulatory framework where flexibility, publicity, negotiations and call for tender would be key issues. The Commission intends to present soon a communication on public procurement, forming the framework for guidelines on the application of the public procurement legislation to infrastructure projects.

3.2.2. In this connection the relationship and differences between the Public Works [93/37/EEC⁽¹⁾] and

⁽¹⁾ Council Directive 93/37/EEC of 14 June 1993 concerning the coordination of procedures for the award of public works contracts (OJ L 199, 9.8.1993, p. 54); ESC Opinion on the relevant Commission proposal: OJ C 106, 27.4.1992, p. 11.

Utilities [93/38/EEC⁽¹⁾] directives are of particular interest, as both directives are potentially relevant for larger transport infrastructure projects. The forthcoming guidelines will clarify which of these directives applies.

3.2.3. Another main issue of concern for the private sector was how to reconcile technical dialogue with the protection of intellectual property of the bidders in the conception and planning stages of a project. According to the Commission, innovative technical solutions in the conception phase can be protected by current European law on patents and design, combined with adequate clauses in tender documents. The same is not the case in a technical dialogue, which is by nature informal.

3.3. *Competition policy*

3.3.1. A separate document⁽²⁾ which tries to clarify the existing guidelines to new rail infrastructure projects has been presented in parallel with the communication at hand. The Commission, however, emphasizes that each case has to be considered on its own merits, due to their complex and often very individual nature. Early consultation with the services of the Commission on application of competition rules is therefore advisable.

3.4. *Development of financing instruments*

3.4.1. Structurally subordinated loans are loans of equal priority to usual bank debt, but with extended maturities (20-30 years) and grace periods. This loan instrument would alleviate the burden of debt amortization by spreading it over a longer period of time. Early operational stage loans are non-amortising loans or revolving credits covering the early operational period of a project. The Commission invites the European Investment Bank (EIB) and the European Investment Fund (EIF), in direct cooperation with commercial bank debt providers, to increase the volume of structurally subordinated loans, and to develop early operational stage loans.

3.4.2. Mezzanine finance, i.e. subordinated debt, complements equity and fills the gap between equity and bank debt. It adds a risk cushion to equity, which helps the raising of bank debt for projects. The Commission, in consultation with the EIB and the EIF, intends to examine the setting up of a mezzanine

fund focused on TENs. The fund should encourage institutional investors to participate in the financing of TENs and to contribute the majority of the capital.

3.5. *Ways of providing support at EU level*

3.5.1. The Commission points out that the prime responsibility for infrastructure development lies with the Member States. The Commission could, however, in two ways play a more active role: to catalyse the early involvement of the private sector in project design by bringing together the key participants, particularly in cross-border projects, and to ensure that support from the range of Community financial instruments is provided in a coordinated way.

3.5.2. The Commission will consider methodologies for assessing the network effects associated to TEN projects. Evaluating project benefits at a European level is supposed to help assessing the level of TEN funding. The Commission will also explore possibilities for the establishment of a European-wide PPP database on transport infrastructure projects, in order to provide an analysis of PPP experiences to date.

3.6. *Possible projects for PPPs*

3.6.1. The Commission has tried to identify some known TEN projects that are suitable for the PPP approach. It should be noted that the aim is not to draw up a new list of priority projects; potential PPPs are identified from within the existing priorities.

3.6.2. The possible projects are the following:

- the HST south: the Madrid-Barcelona section, and the Figueras-Perpignan section;
- the PBKAL, Dutch section;
- the Brenner tunnel;
- the new Berlin airport;
- the Semmering tunnel;
- the Piraeus-Athens rail connection.

For these projects the Commission intends, together with the EIB and the EIF, to make special efforts to support Member States on reaching early agreement on PPP structures and financing.

4. **General comments**

4.1. The Economic and Social Committee has on several occasions in earlier opinions stressed the impor-

⁽¹⁾ Council Directive 93/38/EEC of 14 June 1993 coordinating the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors (OJ L 199, 9.8.1993, p. 84); ESC Opinion on the relevant Commission proposal: OJ C 106, 27.4.1992, p. 6.

⁽²⁾ Clarification of the Commission Recommendations on the Application of the Competition Rules to New Infrastructure Projects (OJ C 298, 30.9.1997, p. 5).

tance of implementing TENs as a means to ensure that the internal market functions properly, competitiveness is strengthened, and economic growth and economic and social cohesion will be fostered.

4.2. The progress that has been made so far on the development of TENs has been slower than expected, because of persistent problems of funding, particularly as a result of constraints on public finances, but also of less than expected involvement of PPPs in TEN projects. This is unfortunate, as PPPs since the early 1990s have been considered an important means of accelerating the implementation of TENs.

4.3. This being the background, the Committee welcomes both the report from the High-Level Group and the communication from the Commission. The two documents form a whole, and should not be seen as separate parts. The Committee appreciates in particular that the Commission in such a short time has responded to the recommendations made by the High-Level Group for action by the Commission.

4.4. On 9 October 1997, the Transport Council held a comprehensive debate on the Commission Communication and adopted a number of conclusions on PPPs in the context of TEN projects. The Committee notes with satisfaction the Council's constructive and realistic conclusions supporting PPPs.

4.5. Traditionally, the state has carried out infrastructure projects when it has seen socio-economic benefits, and when it has had budgetary resources (i.e. money) for planning, construction and maintenance of such projects. The private sector has traditionally been involved mainly as a contractor, primarily in the construction phase.

4.6. Increased involvement of the private sector in large transport infrastructure projects would mean that it should act, alongside the public sector, not only as a contractor, but also as a promoter providing finance and management resources, and even operation responsibilities.

4.7. The Committee would like to emphasize that the role of the public sector remains vital, even in projects where large parts of the implementation of PPPs have been transferred to the private sector. Large transport infrastructure projects are not normally financially viable, unless the public sector shoulders some of the risks involved, and provides support in the form of grants and guarantees.

4.8. The key feature for a successful PPP is the allocation of a project's risk between the public and private sector. Risk allocation is important, as risks

mean real costs. In principle, each party should bear the risks it is best able to control at each stage of a project. Commercial risks should normally fall to the private sector, whereas public risks ('political risks') should be borne by the public sector, i.e. the tax payer.

4.9. It is clear that the lack of sufficient national budget resources for TEN projects has caused increasing interest in PPPs. However, the Committee wants to underline that bringing in complementary financing should not be the overriding aim of PPPs. It is of equal importance to utilize the commercial, financial, technical and management skills of the private sector in order to improve cost-effectiveness when carrying out TEN projects.

4.10. In this connection the Committee cannot refrain from adding that there is a certain amount of over-optimism, in both the High-Level Group Report and in the Commission Communication, as to the potential for increased involvement of the private sector in TEN projects. The private sector invests in a project only when it gives an adequate return on investments.

4.11. According to the Committee there are some important prerequisites for successful implementation of PPPs, namely:

- a firm political commitment on the part of the Member States to complete the projects and to provide the necessary financial resources for implementing PPPs;
- private sector involvement as early as possible in projects, i.e. in the conception, design and planning phases;
- creation of dedicated project companies, responsible for carrying through a project, especially cross-border projects.

4.12. PPPs are usually associated with large TEN priority projects. However, the Committee would like to emphasize that PPPs could be used also for smaller and less spectacular projects. In fact, there are many examples of planned or completed PPP projects of a relatively modest nature, but of crucial importance in a local or regional setting (motorway projects, bridges, tunnels, airports).

4.13. The financing of transport infrastructure was one of the subjects dealt with at the Third Pan-European Transport Conference in Helsinki (June 1997). In the Declaration adopted by the Conference it was stated that 'more efforts should be made in order to increase public financing by the States and the European Union,

as well as to increase private financing, e.g. through public-private partnership' (paragraph IV.5). This was fully supported by the delegation of the Economic and Social Committee to the Conference.

5. Specific comments

5.1. *Public procurement*

5.1.1. The Committee strongly supports the High-Level Group's recommendation that the Commission should elaborate specific guidelines which would provide greater clarity with regards to public procurement procedures to be followed for the award of transport infrastructure contracts. Therefore, the Committee is looking forward to the guidelines which the Commission has promised to issue in the near future.

5.1.2. As has sometimes been suggested, an alternative to guidelines could be a specific directive on public procurement for transport infrastructure concessions, providing a legal framework designed especially for PPPs. According to the Committee, this kind of legislative change is not to be recommended. A specific PPP directive would be difficult to formulate and even harder to apply. Furthermore, it would be necessary to change the existing directives on public procurement and their applicability.

5.1.3. In the view of the Committee, the forthcoming guidelines from the Commission have to deal with the following issues:

- the relationship between the 'Public Works' and 'Utilities' directives when it comes to PPPs;
- ways to improve and facilitate procurement procedures, especially the pre-tendering phase, and the use of the negotiated procedure.

5.1.4. In its opinion on the Green Paper on 'Public Procurement in the European Union: exploring the way forward'⁽¹⁾, the Committee underlined that it is necessary to clarify the differences between a concession and a contract. The two concepts differ when it comes to the objective, the length of the contract/concession, terms for financing, and the extent of liability. The Committee now reiterates that a clarification is needed.

5.1.5. A Public-Private Partnership is a long term contract between various public administrations and public bodies on the one hand, and legal persons subject to private law on the other, for the purpose of designing, planning, financing, constructing, and/or operating an infrastructure project. It differs from public procurement by requiring investments of the private partner.

5.1.6. The Works Directive indicates that the concessionaire can award its public works contracts to undertakings within the same group (consortium) (93/37, Article 3 (4)). The Utilities Directive does not include a corresponding provision (cf. 93/38, Article 13). In the view of the Committee, a consortium which has obtained a concession should be able to allocate contracts between its members according to the Public Works rules, even if it is a question of Public Utilities.

5.1.7. The Works Directive is applicable to the construction of roads, bridges, railways, etc. (93/37, Annex II). In motorway projects, PPPs could include private sector responsibility also for the operation phase (using toll roads or shadow tolls). However, the Committee notes that highway network services are outside the scope of the Utilities Directive (93/38, Article 2 (2) c). Therefore, the forthcoming guidelines should solve this problem of inconsistency.

5.1.8. Tendering can occur in each phase of a project, depending on the public authorities' willingness to involve the private sector. It can be used for small service contracts in order to carry out feasibility studies, or for large concession contracts for building and/or operating an infrastructure project. The tender procedure is more flexible in the Utilities Directive than in the Works Directive, when it comes to the so called negotiated procedure. Utilities may use this procedure without restrictions (93/38, Article 20), but public contracting authorities may use the negotiated procedure only on certain exceptional grounds (93/37, Article 7). The Committee recommends that whenever formal bidding processes are considered, the use of negotiated procedure should be enlarged, and that legislative changes to 93/37 should be considered.

5.1.9. The Committee feels that tendering in the conception and design phases of a project might have some disadvantages for firms in the private sector. The protection of intellectual property of a bidder could be endangered if innovative technical solutions, presented in the tender document of this phase, are used by the project authority as criteria in the subsequent tendering phase. New ideas originating from one private firm would be of general benefit for all bidders, without benefiting the inventor.

5.1.10. As to the procurement process in its entirety, the Committee would like to use as an example a step by step guide, published by the Treasury in the UK in connection with the Private Finance Initiative, which can be summarized as follows:

- prequalification phase against explicit criteria;

⁽¹⁾ OJ C 287, 22.9.1997, p. 92.

- selection of a limited shortlist of three or four candidates;
- invitation to submit the tender against a detailed set of performance specifications and a suggested table of risk allocations;
- tenders having been received, detailed parallel negotiations with the shortlisted tenderers;
- a preferred tender is chosen.

5.2. Competition policy

5.2.1. The Committee welcomes the recently published (September 1997) clarification on the application of the competition rules to new transport infrastructure projects. It deals mainly with rail projects and, in particular, with access to new rail infrastructure and the possibilities of having infrastructure capacity reserved for some operators.

5.2.2. It could be argued, on the one hand, that an infrastructure manager should have the possibility to reserve at least part of the capacity for operators which contribute to the financing of the project. On the other hand, the reservation of capacity over a long period of time is contrary to the principles of freedom of access to infrastructure and of competition.

5.2.3. In order to clarify this issue, the Commission points out that capacity reservation agreements do not pose any difficulty under the competition rules as long as infrastructure is not congested, since no entry barrier is created. However, if there is congestion, an agreement reserving capacity that is essential for the effective operation of transport services may justify the granting of an exemption pursuant to Article 85 (3), where all the conditions laid down therein are fulfilled. The Committee considers this clarification of an important issue to be a constructive one.

5.2.4. The Committee recognizes that each transport infrastructure project has specific features which makes it more or less unique. Therefore, a case-by-case analysis is needed when applying the competition rules, and project promoters should consult the services of the Commission at an early stage of a project. In the view of the Committee, guidelines seeking to clarify the application of the competition rules are a necessary, but not a sufficient, means of eliminating uncertainty amongst PPP partners.

5.3. Development of financing instruments

5.3.1. The Committee agrees with the High-Level Group and the Commission that large transport infrastructure projects need balanced financing packages composed of equity, structurally subordinated loans, early operational stage loans, and bank debt.

5.3.2. Of these financing instruments the structurally subordinated loans play a key role by spreading the burden of debt amortization over a longer period (20-30 years) than for bank debt (up to 15 years). This type of loan has already, on a limited scale, been offered by the EIB in cooperation with the EIF. The Committee is pleased to note that the EIB will be more active within this field, and also for the development of early operational stage loans.

5.3.3. The Commission intends to examine the setting up of a mezzanine fund focused on TENs, with the EIB and institutional investors contributing the majority of the capital. The Committee is of the opinion that the market for this kind of financial instrument has to be developed in Europe, and the Commission should therefore increase its efforts to help creating a mezzanine fund.

6. Summary and conclusions

6.1. The High-Level Group on Public-Private Partnership Financing of Trans-European Transport Network Projects, chaired by Commissioner Kinnock, published its report in May 1997. The aim of the Group was to see how Public Private Partnerships (PPPs) could contribute to accelerating the implementation of the Trans-European Transport networks, which is vital for European competitiveness and growth.

6.2. Several of the recommendations from the High-Level Group were addressed to the Commission for consideration and action. The Commission responded in a communication, published in September 1997, which sets out how it will follow up those recommendations in which it is directly involved.

6.3. The Committee welcomes both the report from the High-Level Group and the communication from the Commission. The two documents form a whole, and should not be seen as separate parts.

6.4. The development of TENs has, so far, been slower than expected, because of persistent problems of funding, particularly as a result of constraints on public finances, but also of less than expected involvement of PPPs in TEN projects.

6.5. When the state has carried out large infrastructure projects, the private sector has traditionally been involved mainly as a contractor, primarily in the construction stage. Increased involvement of the private sector would mean that it should act, alongside the public sector, not only as a contractor, but also as a promoter providing finance and management resources, and even operation responsibilities.

6.6. The key feature for a successful PPP is the allocation of a project's risk between the public and the

private sector. In principle, each party should bear the risks it is best able to control at each stage of a project. Commercial risks should normally fall to the private sector, whereas public risks ('political risks') should be borne by the public sector.

6.7. It is clear that the lack of sufficient national budget resources for TEN projects has caused increasing interest in PPPs. The Committee emphasizes that bringing in complementary financing should not be the overriding aim of PPPs. It is of equal importance to utilize the commercial, financial, technical and management skills of the private sector in order to improve cost-effectiveness when carrying out TEN projects.

6.8. As to the possibility of increased involvement of the private sector in TEN projects, there seems to be a certain amount of overoptimism in both the High-Level Group report and in the Commission communication. The private sector invests in a project only when it gives an adequate return on investments.

6.9. According to the Committee there are some important prerequisites for successful implementation of PPPs, namely:

- a firm political commitment on the part of the Member States to use a PPP;
- private sector involvement as early as possible in projects, i.e. in the conception, design and planning phases;

- creation of dedicated project companies, responsible for carrying through a project, especially cross-border projects.

6.10. The Commission intends to issue, in the near future, specific guidelines providing greater clarity with regard to public procurement procedures to be followed for the award of transport infrastructure contracts. The Committee finds it essential that these guidelines deal with the following issues:

- the relationship between the 'Public Works' and 'Utilities' directives when it comes to PPPs;
- ways to improve and facilitate procurement procedures, especially the pre-tendering phase, and the use of the negotiated procedure.

6.11. The Committee welcomes the recently published (September 1997) clarification from the Commission on the application of the competition rules to new transport infrastructure projects, which deals mainly with access rights to rail infrastructure and the possibilities of having rail infrastructure capacity reserved for some operators. As each project is more or less unique, the Committee underlines that a case-by-case analysis is often needed.

6.12. Large transport infrastructure projects need balanced financing packages composed of equity, structurally subordinated loans, and bank debt. The Committee is pleased to note that the EIB will be more active in developing structurally subordinated loans and early operational stage loans. It also finds it essential that the Commission increases its efforts to help creating a mezzanine fund.

Brussels, 25 February 1998.

The President
of the Economic and Social Committee
Tom JENKINS