

# UNECE PPP Standards – Sixth Session of the Team of Specialists on PPPs

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## The Effect of Corruption on PPP Projects

Thomas Frankl, PhD

Airport Development Partners SA

Brixton Capital LLC



Airport  
Development  
Partners

There are many PPP success stories and best practices. Little is known about the bad practices.



# THE DOUALA TRICK



- This is the story of an airport PPP project, told in five chapters
- The story is based on a real PPP project

# THE DOUALA TRICK



- The Cast:
  - The Government of Freedonia
  - The President of Azurria
  - Numerous consultants (PPP, traffic forecast, ...)
  - Ten consortia, among which:
    - The Firefly consortium, made up of a major public airport operator, a global construction firm and a private equity fund
    - The Flyover consortium, made up of a major private airport operator, a global construction firm (in which the government of Azurria holds 11%) and a major bank

# Chapter 1 – Early Days



- It's early 2008, shortly before the outbreak of the global financial crisis
- Low interest rate / high liquidity environment: money is chasing infrastructure assets
- Infrastructure PPP's are drawing record interest, and achieving record-high offers
- PPP has come to be accepted as the 'friendlier face' of privatization
- Government of Freedonia: Our capital airport is a disgrace – it should be the pride of our nation; alas, lack the funds: *'Let's do a PPP !'*

# Chapter 1 – Early Days



- Traffic forecasters tell the Government what it wants to hear: *‘Your airport has the potential to become the region’s hub before your archrival Sylvania will be able to respond – build the infrastructure, and traffic will come’*
- Government of Freedonia commissions a breathtaking design for a landmark airport terminal, based on a highly aggressive traffic forecast
- Airport PPP consultants are hired (on a success basis), 30-year BOT tender documentation is drafted



## Chapter 2: The PPP Plot Thickens...

- Meanwhile, the ‘great recession’ has arrived – now it’s ‘assets chasing money’; even worst case traffic forecasts turn out to be too optimistic...
- ...and PPP projects that used to be bankable, aren’t so any longer...
- ...while budget-constrained governments are more in need than ever to implement PPP pipelines
- Options for Freedonia’s airport PPP: a) cancel project b) adapt terms & conditions - or c) pull it through, pretending nothing has changed
- Government decides: *‘We stick with it – we have survived worse crises than this !’*

# Chapter 2: The PPP Plot thickens..



- Consultants panic: *‘we can’t get the required minimum number of interested parties for the PQ’ (i.e. we won’t be able to collect our fees)*
- Consultants advise interested parties: *‘don’t worry, Freedonia will ease up on the conditions – just pre-qualify and you will be fine’*
- They also adapt some of the PQ criteria to fit to some candidates who otherwise wouldn’t be able to bid



# Chapter 2: The PPP Plot thickens..



- Government of Freedonia consults with interested parties - their feedback: *'We like your project in principle: however, in it's current design and size it is financially not viable'*
- Future bidders start lobbying – Flyover consortium mobilizes Azurria's President (a close friend of Flyover consortium member CEO)
- In the meantime, the global crisis has led to a credit crunch, many banks are busy fighting bankruptcy...

# Chapter 3: Going live



- Pre-qualification: IM and supporting documents are issued: errors, contradictions, ambiguities...
- Endless rounds of Q&A's, requiring multiple deadline extensions
- Consortia wake up to a harsh reality: financial conditions remain in fact unchanged, so they attempt to change them via the Q&A process – in vain



# Chapter 3: Going live



- A number of consortia prequalify, regardless (hope springs eternal)
- The short-listed consortia analyze the PPP tender: still no change. *‘We can’t make this work – it’s unbankable’. We’ve had enough - we are out!’*
- ...except for one party: the Flyover consortium...



# Chapter 3: Going live



- ...which issues the only valid bid
- The other consortia are in disbelief:



# Chapter 4: The Douala Trick



- *They pulled the Douala trick **again** !*
- *How can they get away with it... yet again ?!*



# Chapter 5: Catch-22



- Freedomia Government declares success – we have a final bidder !
- PPP Agreement is signed with great fanfare
- Ground-breaking before April 11, 2013 *at the latest*
- However, nothing happens...no cranes, no workers, no trucks in sight
- Instead, the concessionaire signals problems – *'we can't get financing at acceptable terms – we are very sorry, but it's entirely outside our control'...*(could it be because the PPP was not not bankable in the first place ??)

# Chapter 5: Catch-22



- Freedonia is a proud country – but it is also a small country and depends, inter alia, on Azurria’s political support
- Cancelling the PPP would carry incalculable risks for the Government of Freedonia, both from an domestic political, and a foreign policy perspective
- The PPP agreement quietly gets revised to take account of the ‘new realities’, letting the concessionaire contractually off the hook

# The Douala-Trick in Five Steps



1. Target PPP projects launched by inexperienced governments, preferably in emerging economies
2. Make an unmatched (if implemented, financially suicidal) offer, removing all competing bidders
3. Once appointed preferred bidder, start re-negotiating contractual details (e.g. start of works) to draw out conclusion of final contract
4. Re-negotiate contract to make it low-risk and lucrative
5. Target the next PPP project launched by an inexperienced government,.....



EPILOGUE



- Contractual PPP agreements are only as good as the parties' capacity to enforce them
- Corrupt business practices – particularly if unethical, albeit not illegal – cause long-term costs for fair-playing public and private parties
- High-value, high-profile PPPs are often subject to heavy-handed lobbying, aiming to exploit political vulnerabilities of host countries

# Reducing Vulnerabilities

- Governments are well-advised to manage public expectations effectively by:
  - Establishing a communications strategy
  - Basing PPP projects on a conservative scenario:
    - Healthy skepticism about demand forecasts
    - Initiate an early dialogue with potential bidders to establish level of interest
    - Avoid raising unrealistic public expectations (even if a future government will have to deliver)
    - Define, and communicate, which outcome will constitute success
    - Establish a plan B, and communicate it

# Final Conclusion

- Law-violating corrupt practices (bribery, cartels/collusion, etc.) carry a high financial, reputational and personal risk
- Sophisticated ethically challenged companies prefer low-risk ('legal') alternatives in order to achieve commercial objectives
- ***'Sunlight is the best disinfectant'*** – corrupt and unethical practices should be discouraged by communicating PPP 'bad practices' and establishing black lists

**THANK YOU !**

**tfrankl@adp.aero**

**+41 797 161 161**



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# Annex

# Corruption & The Law



- Are there any corrupt practices by private parties which are actually *not in conflict with the law* ?
- World Bank: “We (view) corruption as a broader phenomenon where private agents share responsibility, and where many acts which are *not ethical* (...) may not necessarily be *illegal*.” (World Bank, *Myth & Realities of Governance and Corruption*, 2005, pg. 82)

# Corruption & The Law



- In other words: there are corrupt practices which are *perfectly legal*: the floodgates are open...

