

THE UNIVERSITY OF HULL

(A RISK BASED APPROACH TO ENHANCING PUBLIC-PRIVATE PARTNERSHIP  
(PPP) PROJECTS IN NIGERIA)

being a Thesis Submitted for the Degree of PhD in the University of Hull

by

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## **ABSTRACT**

This thesis investigated the sources of the problems with Public Private Partnership (PPP) projects in Nigeria. The reason for this enquiry is as a result of the multitude of problems threatening the collapse of most of the concluded projects. Therefore, against the backdrop that proper risk management is the most critical success factor for PPPs, the thesis evaluated how risks have been allocated and mitigated in the projects concluded thus far in Nigeria. This is premised on the basic assumption that if risks are better managed, that it would result in enhanced projects.

Having determined that political risk, demand risk and stakeholder opposition risk were the most prominent risk factors affecting PPPs in Nigeria, three case studies were used to evaluate how these risks have been handled. The projects are the 26 ports concessions, the Murtala Muhammed Airport terminal 2 (MMA2) BOT project and the Lekki toll road concession. It is believed that the lessons learnt from these studies will provide a tool for policy reforms leading to more successful projects. Also, by adopting an interdisciplinary approach, the thesis ensures that its findings and recommendations may easily be generalised across other projects, economic sectors, and disciplines and even to other countries in Sub-Saharan Africa, since these countries share the same socio-economic conditions with Nigeria.

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## **DEDICATION**

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The Law (Miscellaneous Provisions) Law, Laws of Lagos State Cap 65 1973

The Procurement Act, No.14 of 2007

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The Supplementary Notes to the National Policy on Public Private  
Partnership (PPP).

## LIST OF ABBREVIATIONS

Abuja (ABJ)

African Development Bank (ADB)

Air Transport Services Senior Staff Association of Nigeria (ATSSAN)

Asset Resource Managers (ARM)

Bi-Courtney Limited (BCL)

Build Lease Operate Transfer (BLOT)

Build Lease Transfer (BLT)

Build Lease Transfer Maintain (BLTM)

Build Operate and Transfer (BOT)

Build Own Operate (BOO)

Build Own Operate and Transfer (BOOT)

Build Own Operate Remove (BOOR)

Build Transfer Operate (BTO)

Bureau of Public Enterprises (BPE)

Concession Agreement (CA)

Infrastructure Concession Regulatory Commission Act (ICRCA)

Corporate Social Responsibility (CSR)

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Federal Airports Authority of Nigeria (FAAN)

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Public Private Infrastructure Advisory Facility (PPIAF)  
Public Sector Comparator (PSC)  
Special Purpose Vehicle (SPV)  
The Infrastructure Concession Regulatory Commission (ICRC)  
United Nations (UN)  
United Nations Industrial Development Organization (UNIDO)  
United States (US)  
United States Dollar (USD)  
Value for Money (VFM)  
Whole Life Cycle Costing (WLCC)  
World Bank (WB)



# CHAPTER 1

## INTRODUCTION

### 1.1 Background

It is widely acknowledged that Nigeria's infrastructure is in a state of decay.<sup>1</sup> The abysmal state of affairs is a consequence of years of inefficient maintenance of existing infrastructure and the State's declining financial capacity to fund new projects. Virtually all aspects of the country's infrastructure are poor; about 70% of the country's 193,000km of roads is in very bad shape, 60% of the population lack any electric power supply, and the railway system is moribund.<sup>2</sup> While several Government agencies acknowledge the depth of the infrastructure problems facing the country, they have come up with differing statistics of the level of investment required to resolve the country's infrastructure deficit. For instance, while the Governor of the Central Bank of Nigeria, Sanusi Lamido, claims that the country requires at least USD 10billion

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<sup>1</sup> For instance see the following reports: Fund for Peace (2012) 'Failed States Index 2012' (online) Available at: <http://www.fundforpeace.org/global/?q=node/242> (Last accessed October 1, 2012); another report claims that Nigeria's infrastructure is poor even by African regional standards. See World Economic Forum 'Report of the Global competitiveness index for 2012/2013' (online) Available at: [http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport\\_2012-13.pdf](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2012-13.pdf) (Last accessed October 1, 2012). See also Akinwale A.A. (2010) 'The Menace of Inadequate Infrastructure in Nigeria', (2010) Vol. 2 No.3 *African Journal of Science, Technology, Innovation and Development*, pg. 207

<sup>2</sup> Sanusi, L. 'Nigeria Needs \$100b for infrastructure, says Sanusi' *The Guardian Newspaper*, Thursday July 19, 2012 pg. 1. See also Infrastructure Concession Regulatory Commission (2012) Available at: <http://www.icrc.gov.ng/wp-content/uploads/2012/04/ICRC-Presentation-to-CP3N.pdf> (Last accessed on October 1, 2012)

yearly for the next 10 years to check the deteriorating state of the country's infrastructure,<sup>3</sup> the Minister of Finance, Dr. Ngozi Okonjo- Iweala opines that the country requires about USD 67billion to fix its infrastructure in the next 4 years.<sup>4</sup>

Amidst the conflicting statistics on the volume of finance required to save the country's infrastructure from complete collapse, it is apparent that Nigeria requires a lot more money than it can afford to remedy its infrastructure deficit. The National Policy on Public Private Partnership (PPP) clearly attests to this in its introduction thus:

Global demand for basic infrastructure services has grown over the years, quickly outstripping the supply capacity of existing assets. Many years of underinvestment and poor maintenance have left Nigeria with a significant infrastructure deficit, which is holding the country's development and economic growth. Nigeria needs to make massive investments, beyond the means available to government, in order to close its yawning infrastructure gap. The Federal Government ('the Government') believes that the private sector can play an important role in providing some of this new investment through public-private partnerships (PPPs).<sup>5</sup>

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<sup>3</sup> Sanusi, L. Guardian Newspaper, Thursday July 19, 2012 ibid

<sup>4</sup> The Nation Newspaper, November 15, 2011 pg. 5

<sup>5</sup> ICRC, (2008) National Policy on Public Private Partnership, ICRC Abuja, pg. 1

Therefore, due to the paucity of funds and the failure of public authorities and institutions to provide even the basic public services, Nigeria, like most countries in the world has turned to Public Private Partnerships (PPPs) to finance, develop and improve its infrastructure. This shift in government policy, from the erstwhile policy of exclusive public finance of infrastructure projects, coincided with the unveiling of the country's Vision 2020 policy.<sup>6</sup> In order to facilitate the PPP process, the Infrastructure Concession Regulatory Commission Act (ICRCA)<sup>7</sup> that created the Infrastructure Concession Regulatory Commission (ICRC)<sup>8</sup> to manage PPP transactions at the federal level<sup>9</sup> was enacted in 2005. Since then, a few transactions have been consummated using the PPP model in different sectors of the Nigerian economy. Most of the large transactions done so far are in the transport sector including the ports, aviation and road sectors.<sup>10</sup>

It is important to point out also that prior to the enactment of the ICRCA and consequential creation of the ICRC, Nigeria had pursued an ambitious privatisation programme under which a number of transactions including concessions were completed through the Bureau of Public Enterprises (BPE) under the Public Enterprises (Privatisation and

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<sup>6</sup> Nigeria's Vision 2020 Policy is predicated on the fact that Nigeria intends to be the ranked amongst the 20<sup>th</sup> biggest economy in the world by the 2020

<sup>7</sup> Infrastructure Concession Regulatory Commission Act 2005

<sup>8</sup> S. 14 (1) of the ICRCA 2005

<sup>9</sup> Some of the 36 states of the federation have also enacted enabling legislations. For example, Lagos, Rivers, Cross Rivers, Ekiti and Niger states are some of the examples.

<sup>10</sup> Some other projects in the electric power and real estate sectors are ongoing but none of them have reached operational phase.

Commercialisation) Act (Privatisation Act).<sup>11</sup> That notwithstanding, the government's decision to formally pursue PPP as a policy was initially greeted with a lot of optimism from the citizens who started to anticipate the availability of basic infrastructure including electricity, portable water and good roads. Multilateral financial institutions and other development agencies showed support for the nascent PPP programme as they provided technical capacity and financial support.<sup>12</sup>

However, the few transactions that have been concluded to date have been fraught with a number of serious issues threatening to scupper the projects and the country's PPP aspirations. While public sector authorities have unilaterally breached contractual obligations, there is a plethora of court cases between concessionaires and the public authorities on one hand and between the sector workers' unions and the private sector concessionaires on the other.<sup>13</sup> Consequently, doubts are beginning to emerge regarding Nigeria's adoption of the PPP model to provide infrastructure development that has eluded the country, particularly as

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<sup>11</sup> Public Enterprises (Privatisation and Commercialisation) Act No.28 of 1999.

<sup>12</sup> For instance the World Bank recently provided a USD 200 million loan to the country as a seed fund to set up a financial intermediary loan scheme for PPPs.

<sup>13</sup> Some of the major cases which are all reported in This Day Newspaper, Wednesday, October 31, 2012 are Bi-Courtney Limited v. Attorney General of the Federation (unreported) Suit No. FHC/ABJ/CS/50/2009; Ojemaie Investments Limited (claiming as Landlords to Arik Air) v. Bi-Courtney Limited (unreported) Suit No. CA/A/141/M/2009; Safiyanu Dauda Mohammed and National Union of Air Transport Services, Air Transport Services Senior Staff Association of Nigeria (ATSSAN) v. Bi-Courtney Limited (This was an action filed by the workers union) (unreported) Suit No. CA/A/141/M/09; Arik Air v Bi-Courtney Limited; The Federal Airport Authority of Nigeria v. Bi-Courtney Limited & Anor. (2011) LPELR 19742 (CA) pg.1-57; Suit No: CA/A/239/M/2010 and Attorney General of the Federation v. Bi-Courtney Limited reported in This Day Newspaper, Wednesday, October 31, 2012.

the risk of collapse of some of these projects is high.<sup>14</sup> Confidence in PPP among its stakeholders including the citizenry, private sector and even some segments of the public sector is declining.<sup>15</sup> The thesis aims to determine why the delivery and operation of PPP projects are beset with problems that may scuttle the socio-economic development benefits that they bear for the country and its citizens.

The central proposition of the thesis is that the flawed risk allocation and management process in Nigeria's PPP transactions is the major contributory factor to the stress in the developing PPP system leading to delay in project completion and operations. Nonetheless, there are several other factors that have contributed to the growing inefficiency in the delivery of infrastructure development via PPP including deficiency in the legal framework regulating PPPs and the lack of proper project governance. These factors, as the thesis will discuss in subsequent chapters, arguably arise from the lack of proper risk allocation. The thesis argues that if majority of these project risks are properly managed i.e. identified, allocated and mitigated, most of the problems facing PPP projects in Nigeria will be ameliorated and result in more successful projects.

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<sup>14</sup> See the Editorial of This Day Newspaper, November 20, 2012, Pg. 15

<sup>15</sup> See for example the report in Tell Magazine, June 26, 2012 pg. 4

It is evident from the history of PPPs in Nigeria and even its precursor privatisation programme that the issues of risk transfer, balancing and mitigation have never been properly handled. There has always been a tendency to dump all the project risks on the private sector partner without properly evaluating whether it is capable of managing them adequately. Where the comparative advantage of parties to handle risks is not properly analysed, the allocation of risk is unbalanced and the tendency for the project to run into difficulties and/or fail increases. Yet, the practice of dumping risks on the private sector appears to be favoured by the Nigerian government, as its primary concern is to raise money off government balance sheet.<sup>16</sup> Considering the other benefits that arise from implementing PPPs over traditional public procurement seem to be secondary.<sup>17</sup>

The thesis posits that the predisposition to shift all the risks to the private sector has led to the increase in the use of secondary risk mitigating techniques by the private sector. These techniques including “non-compete clauses”, “guarantee clauses”, “equilibrium clauses” and “stabilization clauses” amongst others are not sustainable in the long

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<sup>16</sup> See for instance. Egboh, E.A. and Chukwuemeka, E. ‘Public-Private Partnership in Nigeria: The Challenges of Human Resource Management’ (2012) Vol.1 No. 5 *Kuwait Chapter of Arabian Journal of Business and Management Review*, pg. 19. Note, that using PPPs solely to raise money off government balance sheet is now very difficult as it is subject to very stringent accounting regulations in several jurisdictions especially the EU as it can obscure the level of government contingent liabilities. See for example Hemming, R. (2006) ‘Public Private Partnerships, Government Guarantees and Fiscal Risk’, *International Monetary Fund* pp. 24-25

<sup>17</sup> PPPs have other benefits, including providing better value for money and reduction of government debts. It also contributes to more efficiently run infrastructure services and is a better option than nationalization or privatization, particularly from a political perspective.

term. The use of these clauses contributes to deny citizens access to the infrastructure services and stifle economic and infrastructure development in the long run. For instance, non-compete clauses could bar the government from building additional competing infrastructure close to the one built by the private sector partner irrespective of inadequacies that may arise. The likely consequence of this is that government ultimately breaches its contractual obligations following its likely inability to absorb the socio-economic consequences of contracts that include such secondary risk mitigating techniques.

Another theory that this thesis explores is that a major setback for PPPs in Nigeria is the problem of political risk. This problem is exacerbated by the inadequacy of the regulatory framework for PPPs. It is inevitable that Nigeria, being a developing country without a well-established capital market to draw funds from, will have to rely on foreign direct investments (FDI) to realise its aspirations to develop its infrastructure.<sup>18</sup> Consequently, foreign investors (and even local entrepreneurs) will be wary of tying down their capital for 25-30 years without sufficient guarantees that they would derive profitable economic benefits on their investments in the long run. Also, it does not help that the risks of doing business in an environment like Nigeria, where there are various uncertainties mainly stemming from political instability, are higher than developed economies.

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<sup>18</sup> One of the critical success factors for PPPs is a viable capital market

Simply, prospective investors in Nigeria's PPP industry will like to be assured of a predictable, enabling and well-defined legislative and regulatory environment to convince them that their investment is safe. Currently, Nigeria lacks this sort of legislative and regulatory framework and this has increased the perception of the likelihood of a number of political risk factors eventuating.<sup>19</sup> For this reason, the country has not been able to attract the calibre of investors needed to develop the much required public infrastructure in the country. Where it has been able to attract any form of investment whether locally or internationally, the ensuing transactions have suffered enormous setbacks as a result of the occurrence of some of these political risk issues that will be critically examined in subsequent chapters.

Another theme that this thesis explores is the governance regime for PPPs in Nigeria. It is evident from some of the PPP issues that have been concluded so far, that governance issues that arise during the negotiation process adversely affect PPPs in Nigeria. The thesis will engage specifically with public participation deficit; that is the lack of genuine processes to actively integrate stakeholders' participation in the PPP process beginning with project preparation and ending with project execution. It argues that inadequate public participation in PPP projects in Nigeria is a major setback that has contributed to the project delays and failure. The Lekki Toll Road Concession is an example where the

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<sup>19</sup> There is a correlation between the availability of appropriate regulatory framework and the abatement of political risk



project was delayed and could be considered a “failure” as a result of inadequate public participation. Notably, the Lagos State government initially had to suspend the implementation of the project and pay shadow tolls, thereby hurting its credibility and incurring unbudgeted expenses.<sup>20</sup>

On the whole, this thesis provides an opportunity to critically analyse these various problems that bedevil the effective implementation of PPP projects in Nigeria through the prism of risk analysis. Better risk management is therefore the common solution that resolves all these different issues that are dealt with in this thesis. As noted previously, the thesis' central hypothesis is that if project risks are properly identified, evaluated, allocated and mitigated, PPP projects (especially in Nigeria) will be better delivered and less problematic. The thesis relies on the framework of risks that affect projects in conducting this analysis because it provides the opportunity to analyse issues like project governance and the legal framework for PPPs in Nigeria.

This thesis will be valuable in creating more successful projects for the benefit of both the private sector partners and most importantly the citizens and ultimate end users of the PPP services. Also, it is expected that this thesis will lay the foundation for the enactment of a robust legal and institutional framework and by extension, the enthronelement of an effective regulatory environment. This will create certainty, encourage

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<sup>20</sup> This is discussed in detail in Chapter 7 of this thesis.

and incentivise the inflow of private sector led finance into the country and balance the need to create opportunity for private sector investment with the protection of public interests.

## **1.2 Research Aim and Objectives**

Extant literature has covered issues regarding the merits and demerits of private sector involvement in the provision of infrastructure and public services in Nigeria. These literature have centred mostly on the possibility of the private sector bridging the financing gap arising from the inability of government to provide all of the required funds<sup>21</sup> and risk perception amongst different stakeholders in participating in PPPs.<sup>22</sup> However, there has not been a single analysis of the issues or problems that have arisen from the decision of the government to embrace the PPP model in the provision of these public services. This thesis aims to fill this gap in literature by highlighting the issues of risk allocation, which it argues is a fundamental impediment to the smooth completion of PPP projects in Nigeria. It engages in empirical analyses of three major projects that have been implemented thus far to highlight and provide deeper understanding regarding issues that impeded them and how they could be efficiently resolved and avoided in subsequent transactions.

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<sup>21</sup> See for example Sanusi, L. (2012) 'The Role of Development Financial Institutions in Infrastructure Development: What Nigeria can Learn from BNDES and the Indian Infrastructure Finance Company' *Keynote Address at the 3<sup>rd</sup> ICRC Stakeholders Forum, 18<sup>th</sup> July 2012*

<sup>22</sup> See for example Ibrahim, A.D. *et Al.*, 'The Analysis and Allocation of Risks in Public-Private Partnerships in Infrastructure Projects in Nigeria' (2006) Vol. 11 No. 3 *Journal of Financial Management of Property and Construction*, pg. 149.

This research therefore seeks first to distil the critical success factors for PPPs by examining the reasons why some projects have succeeded in different countries around the world. This part of the thesis also provides evidence that one of the principal benefits to be derived from PPPs is the transfer of risk associated with the operation of the project to the private sectors<sup>23</sup> and that lack of proper risk allocation can lead to the failure of PPP projects and contractual disputes.<sup>24</sup> It should be noted that risk transfer in PPPs is not simply the transfer of risk to the private sector; such transfer of risk must be done in a way to ensure that value for money is attained.<sup>25</sup> Secondly, the thesis aims to assess how risks have been managed in PPP transactions around the world to determine international best practices for risk management with the objective of replicating them in Nigeria where peculiar local conditions permit. The third broad objective of the thesis is to determine how risks have been managed so far in PPP projects in Nigeria. Finally, the thesis aims to determine how best to ensure the success of PPP projects in Nigeria by comparing the results of the case studies with the distilled international best practices to identify the gaps in practice and proffer better ways of handling risks in future PPPs projects.

In summary therefore, the objectives of this thesis are therefore to:

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<sup>23</sup> See for example Tahir, M.N. 'Risk Management in Public Private Partnership Contracts', (2007) 7 *Public Organization Review* 1.

<sup>24</sup> Andersen, A. (2000) 'Value for Money Drivers in Private Finance Initiative', London: Arthur Andersen and Enterprise LSE; Ibrahim, A.D. et al., (2006) *Supra* Note 22; Megens, P. 'Construction Risk and Project Finance- risk allocation as viewed by contractors and financiers' 1997) Vol. 14, No. 1 *The International Construction Law Review*, pg. 5

<sup>25</sup> Tahir M. N. *Supra* Note 23

1. Determine the most critical requirement for successful PPP projects.
2. Discover the perception and the actual practice of risk allocation around the world.
3. Investigate and analyse risk allocation schemes in Nigeria and how they affect PPP projects in the country.
4. Suggest better ways, based on international best practices and local conditions, on how to manage risks in PPP in Nigeria.

### **1.3 Research Methodology**

This subparagraph discusses the methodology that the research employs to test the hypothesis and answer the research questions.

#### **1.3.1 Introduction**

The hypothesis or central argument of this thesis as stated earlier is that: the lack of proper management of risks is the fundamental reason behind failures of PPP projects in Nigeria. In other words, the quality and sustainability of PPP projects in Nigeria will be enhanced if risks are better identified, evaluated, allocated and mitigated. To test this hypothesis, three research questions were designed:

1. Do improved risk identification, evaluation, allocation and mitigation lead to better PPP projects?
2. How have risks been managed so far in PPP projects in Nigeria?
3. How can project risks be better handled to enhance PPP projects in Nigeria?

In order to answer the first research question, a literature review of the theoretical framework for successful PPP projects was initially carried out. The objective of this study, based on an appraisal of extant literature, was to determine the critical success factors for PPPs. The review revealed that proper risk allocation is the most critical factor for successful PPPs all around the world. This finding was further validated by an analysis of how risks have been managed in practice. To achieve this, a review of a number of empirical studies including case studies that were conducted around the world to test risk perception, allocation and mitigation processes was done and this further validated the results obtained from the theoretical analysis. This in effect answered the first research question in the affirmative.

To answer the second research question regarding risk management in PPP projects in Nigeria so far, a qualitative case study approach was adopted. Three case studies involving the ports reform, the MMA2 airport terminal and the Lekki toll road concession projects were used to highlight the risk management practices in Nigeria. The results obtained from the case studies were analysed and compared with the best practices deduced from the literature review carried out in phase one. This enabled the thesis proffer better and more sustainable ways of handling PPP risks in Nigeria in line with international best practices, effectively answering the second and third research questions.

The methodology adopted in this research is a socio-legal studies approach. In essence, an interdisciplinary approach to analysing law, legal phenomena, and relationships between these and wider society. As indicated by the British Library, both theoretical and empirical work is included in this approach, and perspectives and methodologies are drawn from the humanities as well as the social sciences.<sup>26</sup> A socio-legal study of law, also known as the study of law and the social sciences,<sup>27</sup> is the study of law and legal institutions from the perspective of the social sciences (viz all social sciences, not only sociology).<sup>28</sup> It studies the realities of law in action, the social effects of law and the relationship of law to wider questions of social structure<sup>29</sup> and locates legal practices within the context of other social practices that constitutes its immediate environment.<sup>30</sup>

There is a strong tendency to confuse socio-legal studies with the discipline of the sociology of law.<sup>31</sup> It should not be confused with legal sociology of most Western European countries or the law of society scholarship in the United States of America, which encourage much

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<sup>26</sup> British Library (online) at: <http://www.bl.uk/reshelp/findhelpsubject/busmanlaw/legalstudies/soclegal/sociolegal.html> (last accessed October 6, 2012)

<sup>27</sup> Tamanaha, B.Z. (1997) *Realistic Socio-legal Theory: Pragmatism and a Social Theory of Law*, Clarendon Press, Oxford

<sup>28</sup> Harris, D. R. 'The development of socio-legal studies in the United Kingdom' (1983)3(3) *Legal Studies*, pg. 315

<sup>29</sup> Ibid

<sup>30</sup> Lacey, N. 'Normative Reconstruction in Socio-Legal Theory (1996) 5 *Socio Legal Studies*, pg. 131 online at: <http://www.uk.sagepub.com/cross/files/Chapter10-Article2.pdf> (last accessed October 6, 2012)

<sup>31</sup> Lacey, N. *ibid*

stronger disciplinary ties with social sciences. Lawyers and not social scientists are the main actors in the field of socio-legal research.<sup>32</sup> In comparing socio-legal studies with sociology of law, it is imperative to point out that the sociology of law receives the bulk of its intellectual impetus from mainstream sociology and aims to transcend the lawyer's focus on legal rules and legal doctrine by remaining exogenous to the extant legal system in order to construct a theoretical understanding of that legal system in terms of its wider social structures.<sup>33</sup> Socio-legal study on the other hand, often employs sociology (and other social sciences) not much for substantive analysis but as a tool for data collection.<sup>34</sup> In fact, when socio-legal scholars use social theory for the purpose of analysis, they often tend not to address the concerns of sociology or other social sciences but those of law and legal studies.<sup>35</sup>

Socio-legal studies as a methodological approach may be seen to occupy the middle ground between two extremes of a methodological spectrum in the study of law. At one end, we have a strict doctrinal approach, which relies primarily on self-informed analysis of legislation and judicial decisions from the superior courts. At the other end, we have approaches such as critical legal studies and economic analysis of law.<sup>36</sup>

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<sup>32</sup> Banakar, R. and Travers, M. (eds.) (2005) *Theory and Method in Socio-Legal Research*, Hart Publishing, Oxford

<sup>33</sup> *ibid*; See also Campbell, C.M. and Wiles, P. 'The Study of Law in Society in Britain' (1976) 10 *Law and Society Review*, pg. 547

<sup>34</sup> Banakar, R. and Travers, M. *Supra* Note 32

<sup>35</sup> *Ibid*

<sup>36</sup> *Ibid*

Socio-legal studies observe operational and everyday legal situations, and diverse textual sources, disciplinary and cultural perspectives. It is a complete package that looks at law from an interdisciplinary perspective.<sup>37</sup> Wheeler and Thomas see socio-legal studies as an interdisciplinary alternative to the doctrinal study of law. For them the “socio” in socio-legal studies does not refer to sociology or social sciences but represents an interface with a context within which law exists.<sup>38</sup>

This methodological approach is suitable for this work because of the multidisciplinary character of the topic. While admitting that PPP process is basically a long-term infrastructure contract and therefore has a basis in law, it is also a procurement method that is studied widely in the project management discipline, which deals with project risk on a day-to-day basis. Risk itself is evaluated and priced by the economist and the accountant. Different types of risks are also independently managed by different disciplines. For instance the political scientist evaluates political risks while business ethics, engineering, sociology, psychology, marketing etc. deal with stakeholder opposition risks.<sup>39</sup> Clearly, this research is multidisciplinary in both its nature and the scope. Therefore, the sources

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<sup>37</sup> Ibid

<sup>38</sup> See Wheeler, S. and Thomas P.A. ‘Socio Legal Studies’ in Hayton, D.J. (ed) (2002) *Law’s Future(s)*, Hart Publishing, Oxford; Thomas, P.A. ‘Socio Legal Studies: The Case for Disappearing Fleas and Bustards’ in Thomas, P.A. (ed.) (1997) *Socio Legal Studies*, Aldershoot, Dartmouth

<sup>39</sup> Nora, M. *et al.*, ‘Stakeholder Management for Public Private Partnerships’, (2006) 24 *International Journal of Project Management*, pp. 595



of materials consulted was wider than would have been necessary if the research was conducted under a black letter law methodology which focuses narrowly on strict positivist legal analysis of law to the exclusion of all other issues not considered relevant to law-centred research.<sup>40</sup>

It is a fact that theoretically driven research that uses multiple methods can produce stronger validity claims, better illuminate the social mechanisms through which law operates and may lead to research findings that are more readily acceptable to a broader group.<sup>41</sup> Using the socio-legal studies methodology leads to some other advantages, some of which were succinctly analysed by Nicola Lacey thus:

First, socio-legal scholarship locates legal practices within the context of other social practices, which constitute their immediate environment. Thus it comprehends a complex of administrative, commercial, economic, medical, psychiatric and other disciplinary practices wherever they impinge upon or interact with law. Second, socio-legal studies subject legal practices to a (broadly speaking) empirical inquiry which scrutinises not merely the legal articulation of relevant rules and processes but the meaning and effects of those rules and processes as interpreted and enforced and as experienced by their subjects...socio-legal approaches to law are ...diverse, but

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<sup>40</sup> Salter, M. and Mason, J. (2007) *Writing Law Dissertations: An Introduction and Guide to the Conduct of Legal Research* Pearson Longman, Essex, pg. 118, pp. 129-132, pg. 163

<sup>41</sup> Macaulay S. 'Law and the Behavioral Sciences: Is there any There there?' (1984) Vol. 6 Issue 2. *Law and Policy*, pp. 149

related by their espousal of an 'external'- no lawyers perspective on the practices which they address by their concern to understand legal doctrine and legal institutions in terms of their social, economic and political environment; and to design inquiries so as to contribute to the deeper understanding of the legal doctrine and legal institutions in general in the variety of societies and social settings in which the legal phenomena exists.<sup>42</sup>

It is important at this juncture to stress that the law and legal precepts are the primary foundations of this thesis. The broad reference to other disciplines does not derogate from the fact that the research is fundamentally a piece of legal research. The broad theoretical basis is adopted to reflect the interactions between law and society, particularly as PPP projects are not abstract legal manifestations but practical transactions whose success (or otherwise) are determined by the interplay of law and society (politics, economics etc.). Thus, expectedly, socio-legal approach will provide a wider understanding and appreciation of how law is influenced and may aid these disciplines in dealing with PPP projects, specifically project risks. This research is therefore based on a multidisciplinary theoretical research framework and employs multiple methods from the diverse disciplines to produce stronger validity claims amongst the wider audience to which the research is addressed. For law in particular, it seeks a more complete

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<sup>42</sup> Lacey, N. Supra Note 31 at pg.131

picture of risk management within the society, so that it can render valid proposals for changing the way the law in the area is presently formulated.<sup>43</sup>

### **1.3.2 Research Process**

The design of any research study is influenced by both theoretical and pragmatic considerations.<sup>44</sup> Regarding the latter, the fact that there were only three major PPP projects that had reached operational phase during the period of the study, limits the choice of the case study to the three projects. The research process was also designed bearing in mind the basic theoretical framework aimed at finding answers to the research questions. Indeed research generally, including case studies, benefit from prior development of theoretical propositions to guide data collection and analysis.<sup>45</sup> In line with the above, the basic theoretical framework that was developed to answer the research questions in this thesis is that the management of risk is the most critical success factor for PPPs.

It was necessary to conduct a literature review of PPP practices across various countries, especially as the use of PPP is relatively new to Nigeria. The empirical studies from those jurisdictions that examined how project risks were managed provided information useful to conduct a

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<sup>43</sup> See for example Macaulay, S. *Supra* Note 41

<sup>44</sup> McDonnell, A. *et al.*, 'Practical Considerations in Case Study Research: The Relationship between Methodology and Process', (2000) 32(2) *Journal of Advanced Nursing*, pg. 383

<sup>45</sup> Yin, R.K. (1994) *Case Study Research*, 2<sup>nd</sup> Ed., Sage, London

comparative analysis. Literature from Nigeria, although mostly limited to the study of risk perception, was also examined. The most important sources for information on Nigeria were however mostly primary data. Therefore, a textual examination of all the primary sources (legislation, parliamentary reports and case law) relating to PPP in Nigeria was embarked upon. This was followed with an analysis of secondary literature (articles and commentaries) where available.

As stated earlier, this research incorporates a great deal of comparative analysis. This is important to this thesis, since one of its major objectives is to incorporate and introduce international best practices in handling project risks in PPPs within Nigeria. The development of Nigeria's legal and institutional framework can benefit from adapting and incorporating some of the legal and institutional solutions and frameworks that have succeeded in some other jurisdictions, albeit with requisite adjustments to accommodate the countries' peculiar political, socio-cultural and economic differences.

The thesis used three case studies to highlight each of the three risks that were deemed the most concerting that affect PPPs in Nigeria.<sup>46</sup> The three case studies were also carried out through the use of primary data analysis, i.e. through studying some of the contracts between the parties, court proceedings and newspaper reports. Semi-structured interviews

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<sup>46</sup> See S.1.3.3.1 below

were then used to triangulate some of the data that was obtained from this process.



Fig.1. Theoretical relationship of the research

### 1.3.3 Case Study

The principal methodology used in answering the second research question, that is, the determination of how risks have been managed so far in PPP projects in Nigeria, is through the use of the case study methodology. A case study is an empirical methodology that investigates a contemporary phenomenon within its real life context using multiple sources of evidence.<sup>47</sup> It is suitable for answering the questions “how” and “why” things happen, when you can’t manipulate the behaviour of those involved in the study, when the boundaries are not clear between the phenomena and the context and it allows investigations into contextual realities.<sup>48</sup> Case studies also allow investigations into the differences between what was planned and what

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<sup>47</sup> Yin, R.K. (1989) *Case Study Research: Design and Methods*, (rev. edn.): Sage Publications, Newbury Park, CA pg.22

<sup>48</sup> Yin, R.K. (2003) *Case Study Research: Design and Methods*, 3<sup>rd</sup> Ed., Thousand Oaks, Sage Publications, CA

actually occurred.<sup>49</sup> It is said to be appropriate, just like in the present study, where one needs to understand some particular problems or situations in greater depth and where one can identify cases rich in information.<sup>50</sup> It is also useful for testing hypothesis.<sup>51</sup>

All these are pointers to why the case study methodology was apt for answering the second research question. One of the advantages of using case studies is that it enables the researcher gain a holistic view of events.<sup>52</sup> The approach can also provide a broad picture of the issues being explored and different facets of the phenomena are revealed since many sources of evidence are used as issues are explored through a variety of lenses.<sup>53</sup> Adopting the typology suggested by Yin<sup>54</sup>, the type of case study methodology employed in this research could be said to be descriptive and explanatory in nature because the research seeks to describe and explain how risks were handled in the different projects used as cases in the research. The case study is not an end in itself and is

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<sup>49</sup> Anderson, G. (1993) *Fundamentals of Educational research*, Falmer Press, London, pp. 152-160

<sup>50</sup> Patton, M. (1987) *How to Use Qualitative Methods in Evaluation*, Sage Publications, California, pp. 18-20; Feagin, J. et al., (Eds.) (1991) *A case for case study*, University of North Carolina Press, Chapel Hill, NC

<sup>51</sup> Stake, R.E. 'The Case Study Method in Social Inquiry', (1978) Vol. 7 No.2 *Educational Researcher*, pp. 5-8

<sup>52</sup> Gummesson, E. (1991) *Qualitative Methods in Management Research*, Sage Publication, CA, pp. 83-156

<sup>53</sup> Noor Khairu, B.M. 'Case Study: A Strategic Research Methodology', *American Journal of Applied Sciences* (2008) 5 (11) pp. 1602-1604; Baxter, P. and Jack, S. 'Qualitative case study methodology: Study Design and Implementation for Novice Researchers', (2008)13(4) *The Qualitative Report*, pp. 544-559. Also (online) at: <http://www.nova.edu/ssss/QR/QR13-4/baxter.pdf> (last accessed August 29, 2012)

<sup>54</sup> Yin, R.K. (1994) *Supra Note 45* pp. 11-15

not only used to understand the particular case but will be instrumental to understanding how risks are generally dealt with in Nigeria, therefore it may also be said to be instrumental in nature.<sup>55</sup>

It is important to point out that case study methodology has been criticised for lacking scientific rigour and reliability and not addressing the issue of generalisation.<sup>56</sup> However, a number of authors have refuted this claim.<sup>57</sup> For instance, Robert Stake counters the argument of lack of generalisation by claiming that they “are epistemologically in harmony with the readers experience and thus to that person a natural basis for generalisation”.<sup>58</sup> In fact, case studies are said to be an intensive study of a single unit with an aim to generalise across a larger set of units.<sup>59</sup> Therefore, even though only three cases were studied in this thesis, the outcome can be used as a basis for understanding how risks are handled generally in Nigeria.

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<sup>55</sup> Stake, R. (1995) *The Art of Case Research*, Sage Publications, Newbury Park, CA

<sup>56</sup> Johnson, D. (1994) *Research Methods in Educational Management*, Longman Group, Essex; Jensen, J.L. and Rodgers, R. ‘Cumulating the intellectual gold of case study research’, (2001) 61 *Public Administration Review*, pp. 235–46

<sup>57</sup> Ruddin, L.P. ‘You Can Generalise Stupid! Social scientists, Bert Flvberg and Case Study Methodology’ (2006) Vol. 12 No. 4 *Qualitative Inquiry*, pg. 797

<sup>58</sup> Stake, R. (1978) *Supra Note 51*

<sup>59</sup> Gerring, J. ‘What is a Case Study and What is it Good For’, *American Political Science Review* (2004) Vol. 98 No. 2 *Political Science Review*, 341

### 1.3.4 Selection of Cases

Three different case studies were carried out, with each case study dealing with a single case or project.<sup>60</sup> Each of the cases was used to illustrate or discuss how a particular type of risk was handled in PPP projects in Nigeria. The three cases were: the concession of the 26 ports (political risk), the MMA 2 local airport terminal in Lagos (demand risk) and the Lekki toll road concession (stakeholder opposition risk). The three cases were selected basically because they are the three biggest transactions that have been concluded and currently in the operational phase in Nigeria. The different cases were assigned to different risks based on a preliminary desk study review that looked at risk perception in Nigeria.<sup>61</sup>

Also, from a preliminary evaluation of the different issues that had arisen concerning these cases was garnered from court proceedings, newspaper and magazine articles and legislative hearings.<sup>62</sup> These sources pointed to the fact that while all projects might have suffered

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<sup>60</sup> Miles and Huberman define a case a phenomenon of some sort occurring in a bounded context. The case is a unit of analysis. See Miles, M.B and Huberman, A.M. (1994), *Qualitative Data Analysis - An Expanded Sourcebook*, 2<sup>nd</sup> ed., on Sage, Newbury Park, CA., pg. 25

<sup>61</sup> For e.g. Ibrahim, A.D. *et al.*, Supra Note 24 pg. 141; Awodele, O. *et al.*, *Understanding and Managing Risk- Necessary Conditions for Success and sustainability of Privately Financed Market Projects in Nigeria*, (Online) at: <http://www.Arcom.ac.uk/workshops/2010-wolverhampton.pdf> (last accessed on February 29, 2012); Akerele, D. and Didado, K. *The risks and Constraints in the Implementation of PFI/PPP in Nigeria*, (Online) at: [http://www.arcom.ac.uk/publications/procs/ar2003-379-391\\_Akerele\\_and\\_Gidado.pdf](http://www.arcom.ac.uk/publications/procs/ar2003-379-391_Akerele_and_Gidado.pdf) (last accessed on January 1, 2012)

<sup>62</sup> For example: Maduegbuna, N. 'On Lekki Toll Road Concession Project' Business Day Newspaper, January 19, 2012; Abioye, O. 'MMA 2 Concession: FAAN, Bi-Courtney Disagrees on Debts' Punch Newspaper, April 1, 2013



from the poor management of several types of project risks, some of the cases provided richer information on a particular risk than the others. This is in line with the directive from Patton that whichever the case selection method used, the most important principle is to select information rich cases, i.e. cases worthy of in-depth study.<sup>63</sup> Also according to Yin, a single case may be used when the phenomena being studied is unique.<sup>64</sup> In this instance, each particular case (project) is unique and therefore the research is justified in relying on a single case per case study. The cases chosen are also truly representative of the larger class and can be used for generalisations.

### **1.3.5 Sources of Data**

The data that was used for the case study was obtained from several sources. Firstly, documentary evidence was the most used source of information. Some of the documents used were transaction documents including the agreements between the private sector and public sector partners where they were available. Others were parliamentary reports and proceedings. The second source of data was media reports including newspapers, magazines and other commentaries while stakeholder interviews formed the third source of data. The use of this multiple sources of data for triangulation helped validate and enhance the reliability of the findings. This is in consonance with the suggestion by

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<sup>63</sup> Patton, M.Q. (1990), *Qualitative Evaluation and Research Methods*, Sage, Newbury Park, CA, pg. 64

<sup>64</sup> Yin, R.K. (2003) *Supra Note 48*

Yin, who advocates for this on the basis of the ethical need to confirm the validity of the data and process.<sup>65</sup>

Formal letters were written to the regulatory agencies for permission to use some of the transaction documents that were not easily available. The Infrastructure Concession Regulatory Commission (ICRC) and The Bureau of Public Enterprises (BPE) were very useful sources in this regard. However, it was more challenging to get permission to use documents belonging to the Lagos State Government for the Lekki Concession. However, this did not adversely affect the case study materially because the nature of the risk being studied in relation to the Lekki Concession (i.e. stakeholder opposition risk) did not require detailed transaction documents for analysis. Other available public documents like court proceedings, newspaper reports and also interviews with key personnel more or less filled this gap.

Since the projects used as case studies are relatively new projects, involve important infrastructure to the country and are undergoing court and parliamentary hearings, contemporaneous media reports were a veritable source of data for this research. Newspaper reports and magazines were therefore widely used in the case study with reports from different newspapers corroborating the findings of the other. This further strengthened the validity and veracity of the information obtained.

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<sup>65</sup>. Yin, R.K. (1994) *Supra* Note 54

As mentioned previously, stakeholder interviews were used in the form of semi-structured interviews to triangulate the primary and secondary data that were earlier obtained. A semi-structured interview itself is a qualitative method of inquiry that combines a pre-determined set of open questions (questions that prompt discussions) with a flexible and fluid structure that allows for the opportunity for the interviewer to explore particular themes or responses further.<sup>66</sup> This is different from structured interviews, which contain a structured sequence of questions to be asked in the same way to all the respondents.<sup>67</sup> Semi structured interviews allow respondents to discuss issues that may not have been considered initially by the interviewer.<sup>68</sup>

The semi-structured interview was chosen for this research because it offered sufficient flexibility to approach diverse respondents differently whilst still covering the same areas of data collection.<sup>69</sup> This was particularly important in this study because of the differences in projects and types of respondents i.e. public and private sector.

### **1.3.6 Designing the Interview Questions**

In structuring the interview questions, major questions were developed into the form of a general statement, which was then followed by a

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<sup>66</sup> Michael, S. *et al.*, 'Semi-structured Interview, The SAGE Encyclopedia of Social Science Research Methods (Online) at: <http://www.srmo.sagepub.com/view/the-sage-encyclopedia-of-social-science-research-methods/n909.xml> [last accessed November 27, 2012]

<sup>67</sup> Ibid

<sup>68</sup> Ibid

<sup>69</sup> Noor Khairu B.M. *Supra* Note 53

sequence of sub-questions for further probing. The literature review and the documents studied earlier had provided a guideline for formulating the interview questions. The interview questions were designed based on the objective of answering the second research question of how risks were handled in the three PPP projects that were chosen for case studies. In order to craft the questions that would elicit appropriate answers, the model employed by Abednego *et al*<sup>70</sup> to determine appropriate allocation of risk was used. This model is based on designing questions along predetermined prerequisites for proper risk allocation in PPPs. If all the questions are answered in the affirmative, then it proves that PPP risks were properly allocated. However, a negative determination of any of the questions meant otherwise.

According to Ward *et al*,<sup>71</sup> Edwards<sup>72</sup> and Flanagan and Norman<sup>73</sup>, several conditions must be satisfied to ensure the proper allocation of risk:

- a) Risk should be allocated to the party with the best capability to control the events that might trigger its occurrence.
- b) Risk must be properly identified, understood and evaluated.

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<sup>70</sup> Abednego, M.P. and Ogunlana, S. 'Good Project Governance for Proper Risk Allocation in Public Private Partnerships in Indonesia', (2006) *International Journal of Project Management*, 24 (7) pp. 622-634.

<sup>71</sup> Ward, S.C. *et al.*, 'On the allocation of risk in construction projects', (1991) 9 (3) *International Journal of Project Management*, pp. 140-147

<sup>72</sup> Edwards, L. (1995) *Practical risk management in the construction industry*, Engineering management series, Thomas Telford, London, pp. 24-26.

<sup>73</sup> Flanagan, R. and Norman, G. (1993) *Risk management and construction* Oxford-Blackwell Scientific Publications, Oxford UK, pg. 24

- c) A party must have the technical/managerial capability to manage the risks.
- d) A party must have the financial ability to sustain the consequences of the risk or prevent it from occurring.
- e) A party must be willing to accept the risk.

Abednego<sup>74</sup> points out that these criteria only determines who should bear the risk and adds that proper risk allocation should also acknowledge the appropriate time to allocate the risks and provide an alternative solution. They contend that besides determining which party (“who”) has the best capabilities to accept the risk (“what”), the “when” and “how” factors should also be considered to ensure proper risk allocation.

Based on this work by Abednego, questions were crafted for the semi-structured interviews. The questions are classified into 3 main sections. The aim of section 1 is to get an overview and general information about the project. Section 2 explores the risk allocation scheme adopted in the project and finally section 3 establishes whether project risks have been allocated properly to produce better project performance.<sup>75</sup>

### **1.3.7 Choosing Respondents**

In choosing respondents, purposive sampling was employed. Purposive sampling is a selection method where the purpose of the researcher’s

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<sup>74</sup> Abednego, M.P. and Ogunlana, S. (2006) *Supra* Note 70

<sup>75</sup> Sample questions are annexed as Appendix 1 of this chapter

knowledge of the population guides the process.<sup>76</sup> The advantage of this method is that it makes it easier for the interviewer to select samples that suit the needs of the study.<sup>77</sup> For each case therefore, four respondents were chosen, two each from the public and private sectors. Senior transaction officers, who had participated actively in the transaction phases of the projects, or regulators conversant with the cases in the course of their official work schedule, were selected as respondents. Generally, the decisions on the respondents that would represent individual organisations were at the discretion of the organisations. However, respondents were also selected on the basis of the researcher's judgement where this was permitted by the organisation in situations where, known to the researcher, a particular respondent was better suited the needs of the study.

### **1.3.8 Conducting the Interviews**

The choice of semi-structured rather than structured interviews was employed in this research because of its flexibility. Notes were taken during the interview rather than tape recordings to make the respondents (particularly those from the public sector) more relaxed. While the disadvantage of taking notes is the inability to record events verbatim, the less-formal atmosphere made the respondents more forthcoming with information. Importantly, other sources of information

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<sup>76</sup> Mahoney, J. and Goertz, G. 'A Tale of Two Cultures: Contrasting Quantitative and Qualitative Research', (2006) 14, *Political Analysis*, pg.246

<sup>77</sup> Tansey, O. 'Process Tracing and Elite Interviewing: A Case for Non-probability Sampling', (2007) Vol. 40, No.4, *Political Science and Politics*, pp.756- 772

like documentary evidence and the print and other electronic media provided initial data for the case studies. Therefore, the interviews were used to basically cross validate and triangulate information discovered from the other sources.

The interviews were conducted on the premises of the participants. This has advantages because of the likelihood that the researcher is treated both as a guest and as a researcher, this it is believed may lead to an increase level of disclosure from the participants as they are more relaxed.<sup>78</sup> The research was mindful that interviews might increase the chances of bias either due to the phrasing of poor questions or the deliberate attempts by the interviewees to mislead or try to defend their positions or stance on a particular issue since interviewees have their own personal subjective worldviews and opinions on particular issues.<sup>79</sup> The possibility of bias was however mitigated by the fact that respondents from both the public and private sector were interviewed with the researcher distilling the information from an objective standpoint.

### **1.3.9 Ethical Considerations**

According to Stake, “qualitative researchers are guests in the private spaces of the world; their manners should be good and their code of

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<sup>78</sup> Larossa, R. *et al.*, 'Ethical Dilemmas in Qualitative Family Research', (1981) 43 *Journal of Marriage and the Family*, pp. 303-313

<sup>79</sup> Diefenbach, T. 'Are Case Studies More than Sophisticated Storytelling?: Methodological problems of Qualitative Empirical Research Mainly Based on Semi Structured Interviews,' (2009) 43 *Qual Quant*, pp. 875

ethics strict".<sup>80</sup> Bearing this in mind and also in compliance with the University of Hull Ethics Policy,<sup>81</sup> the researcher maintained the appropriate standards of ethics necessary for a study of this magnitude. The researcher was very open with interviewees, explaining the reason for the interview and how the data obtained was going to be used. Also, the researcher paid attention to the appropriate treatment of confidential information. For instance, in line with good practice and the instructions from the regulatory authorities, the commercially sensitive information in the contracts between the government and the private sector that was not already in the public domain was not disclosed in this thesis.<sup>82</sup>

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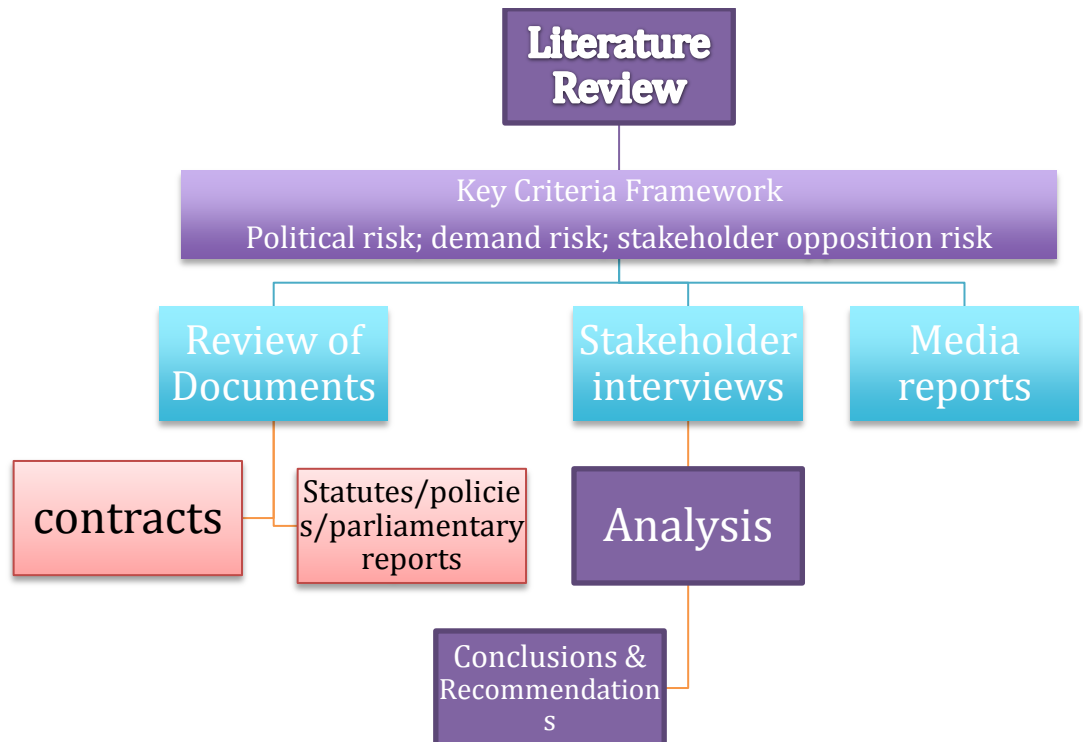
<sup>80</sup> Stake, R.E. (2003) 'Case Studies (134-164)' in Denzin, N.K. and Lincoln, Y. (eds.) (2003) *Strategies of Qualitative Inquiry* (2nd ed.), Sage, London. Pg 134

<sup>81</sup> University of Hull 'Ethics in Research at the University of Hull' (online) at: <http://www2.hull.ac.uk/administration/researchfundingoffice/usefulinformation/ethicspolicy.aspx> (Last accessed August 8, 2013)

<sup>82</sup> This is also in line with The University of Hull Research Ethics Policy Supra



Fig. 2 Case Study structure



#### 1.4 Structure of Thesis

The thesis is divided into 8 chapters including this introductory chapter. The aim of this preliminary chapter is to introduce the work, explain the reasons for embarking on the research and discuss what objectives this thesis aims to achieve. This chapter also seeks to clarify the methodology adopted in testing the hypothesis and answering the research questions in order to make it easier to follow the arguments put forward in the thesis. This chapter also clarifies the ambit and limitations of the thesis.

The second chapter, titled "the conceptual framework", critically engages with the discourse of the key concepts the thesis refers to, particularly with a view to define them for the purpose of the research. The chapter defines PPP, traces its history and examines the different

models that exist. The chapter also provides a brief introduction to the concept of risk, a concept that is equally central to the thesis. The chapter also presents the background for the understanding of the remainder of this thesis. For instance, the nature and extent of infrastructure development in Nigeria is discussed as well as the state and use of PPPs for financing infrastructure projects in Nigeria. This is essential in order to reveal some of the shortcomings for which this thesis aims to recommend solutions.

A comprehensive study of the concept of risk was carried out in Chapters 3 and 4. Chapter 3 critically engaged in the theoretical underpinnings of risk. Relevant literature was analysed to determine the critical success factors for PPPs and the nature of risk in PPPs including other ancillary benefits of proper risk allocation such as the creation of value for money, for example. Chapter 4 assessed the management of risk in practice. This was done through the evaluation of different case studies that had been carried out previously on risk management. This was used to validate some of the findings that were made from the theoretical analysis in chapter 3 and also allowed for certain definite conclusions to be reached regarding desirable methods for managing risk.

Chapters 5, 6, and 7 discussed each of the three case studies that highlight one of the three risks deemed most pertinent to PPPs in Nigeria. Chapter 5 discussed political risk and a case study of the port concession

was used to highlight issues of political risk in Nigeria. Chapter 5 also provided an opportunity to review the current laws regulating PPPs in Nigeria and suggest improvements that can be made to them. Chapter 6 discussed demand risks through the framework of incomplete contract theory. The thesis focused primarily on some of the problems that result from demand risk mitigation strategies. The chapter explored how best to mitigate demand risk by balancing the interests of the public and private sectors without compromising on the long-term interests of the country and the overall benefits of the citizens. The MMA 2 local airport concession case study highlighted the problems with demand risk in Nigerian PPPs. In chapter 7 the thesis, by extending the application of the stakeholder theory, provided a fresh theoretical perspective of the role and legal rights of stakeholders in PPPs. This chapter contributes to the thesis by providing a platform for the codification of stakeholder rights. The Lekki toll road concession project was the case study project in the chapter.

Chapter 8 concludes the research by reiterating the objectives of the thesis and the research questions. It determined whether the objectives had been met and necessary research questions answered. It summarised all the basic determinations and recommendations that were made in the previous chapters of this thesis; including the contributions of this thesis to the body of knowledge and also suggests possible future areas for further research.

## 1.5 Research Significance and Value

This thesis is significant in several respects. Firstly, there has been limited research on PPPs in Nigeria. This limitation is even more pronounced in the area of risk management. The few studies on risk that have been carried out to date were limited to issues of risk perception amongst different stakeholder groups in the country.<sup>83</sup> None of the studies have examined and/or questioned risk management in practice with specific attention to completed PPP projects. There is therefore a gap in literature that needs to be filled. Consequently, there is the need to do an *ex post* analysis of some of the transactions that have been concluded so far to evaluate how those projects were done and to determine how these projects have fared to date. There has been no such diagnostic review conducted on any of the projects. This thesis achieves all of this. Also, conducting an analysis through case studies of some of the transactions already done through PPP in Nigeria will reveal the reasons for transaction failures and contribute to the avoidance of similar pitfalls in future. This will create a transparent, flexible and competitive market for public service delivery in Nigeria. The country can only be the better for it and it will help the country achieve some of its vision 2020 targets.

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<sup>83</sup> See for example Ibrahim, A.D. et al., (2006) *Supra* Note 61; Awodele, A.O. et al., 'Understanding and Managing Risk- Necessary Conditions for Success and sustainability of Privately Financed Market Projects in Nigeria' ARCOM Doctoral Workshop, University of Wolverhampton UK, 25<sup>th</sup> of June 2010 ; Akerele, D. and Gidado, K. (2003) 'The risks and constraints in the implementation of PFI/PPP in Nigeria', in Greenwood, D.J. (Ed.), *19th Annual ARCOM Conference*, 3-5 September 2003, University of Brighton, *Association of Researchers in Construction Management*, Vol. 1 pp. 379-91 .

As stated earlier, the concept of PPP as a means of financing infrastructure in Nigeria is still relatively new. In the haste to provide this much needed infrastructure, the government has not put in place the appropriate enabling legislative framework and the results of the first few attempted transactions have made these shortcomings glaring. This study evaluates the present legal framework and seeks to untangle the confusing and complex web of regulations currently operating in this area. It is believed that this will provide the foundation for the design of an appropriate legal and institutional framework that will govern PPP in Nigeria. It is also assumed that if this issue is resolved, that it will lead to a substantial increase in private sector investment in much needed infrastructure in Nigeria.

The thesis also tackles some of the governance issues that are bedevilling the consummation of PPP projects in Nigeria. For instance all over the world, but more so in developing countries like Nigeria, there has been the wide use of certain risk mitigation clauses and other similar legal devices to protect private sector investments in long-term contracts like PPPs. This has impacted negatively on fairness of these contracts and even the long-term sustainability of the projects. There was therefore a need to examine these clauses and legal devices critically to ensure that they are equitable. The issue of stakeholder involvement in PPPs was also critically evaluated. The stakeholder theory was extended from business ethics into the realm of PPPs to provide a basis for the legal protection of stakeholder rights in PPPs.

In the final analysis, it is expected that the thesis will be valuable in contributing to the development of a robust legal and institutional framework and by extension, an effective and decent governance regime for PPPs in Nigeria and much of sub-Saharan Africa. This will create certainty, encourage and create incentive for the inflow of private sector-led finance into the country and also balance the need to create opportunity for private sector investment with the protection of public interests. This study will not only bridge or close the existing gaps in the legal and regulatory framework for PPPs in Nigeria, but will also be the first major work of any sort in this area in Nigeria. It will definitely be the foundation on which future legal discourse will be advanced in this novel and exciting area.

## **1.6 Limitations of Study**

The concept of PPP is wide and therefore it is important to define the boundaries of the research in order to keep it within manageable limits and avoid undue generalisations.<sup>84</sup> There have been attempts in Nigeria to give PPPs a broader meaning than its conventional definition, particularly when there was a battle for supremacy between two competing public agencies on who should be responsible for the regulation of concessions. It was argued by BPE that PPPs should include privatisation and *vice versa* since both involved some form of partnership

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<sup>84</sup> Hutchinson, T. (2006) 'Research and Writing in Law' (2<sup>nd</sup> ed). Thomson Lawbook Co, Pymont N.S.W. 102-104

between the public sector and the private sector.<sup>85</sup> This argument is flawed because even though both are alternative service delivery arrangements to traditional public sector led procurement and focus on the relationship between the public sector and private sector, they are significantly different. The difference between PPP and privatisation is that in PPP the public sector retains a substantial role despite the private sector involvement, by retaining ultimate responsibility for the services despite it being provided by the private sector. However when a government entity is privatised, the private sector not only takes over the business but also assumes responsibility for service delivery.<sup>86</sup> For the purposes of this research therefore, full-scale privatisation or mere outsourcing is not considered.<sup>87</sup> Looking at PPP from a wider point of view could lead to other conclusions and determinations not intended in this work.

Secondly, it is important to note that this thesis does not declare that proper risk management is the only factor that determines success of PPP projects. Indeed it has been consistently noted throughout the thesis that proper risk allocation is just one of the factors, albeit the most critical of all the success factors. Other factors like a competitive procurement process, political support and availability of a suitable financial market

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<sup>85</sup> This position is consistent with the thinking of academics and the general practice in the United States of America

<sup>86</sup> Grimsey, D. and Lewis, M. (2004) *Public Private Partnerships*, Edward Elgar Publishing, UK

<sup>87</sup> See Section 2.6 of this thesis for the difference between PPPs, privatization and outsourcing.

also need to be taken into consideration to ensure project success.<sup>88</sup> However, it will be unrealistic to study all the critical success factors for PPPs in this work. Therefore, the more manageable task undertaken in this thesis is to first validate the assertion that proper risk allocation is the most critical of all the factors necessary for the successful PPPs. It is this collaboration of the pre-eminence of proper risk management to the success of PPPs that provides the basis for this thesis to explore how PPP risks have been managed in Nigeria.

Thirdly, only three case studies have been conducted in this thesis. The number of cases studies is limited firstly due to the fact that only three major transactions have actually progressed to operational phase so far in Nigeria and secondly, due to the constraint of space in this thesis. The problem with this limited number of case studies is that no one PPP project is the same; therefore the results obtained from the case studies may be specific to particular cases. However, the advantage of using case study methodology is that it allows us to gain in depth knowledge of the different cases studied other than a vague understanding of several related cases. Moreover it is believed that a level of generalisation maybe made across board and that in most cases, conclusions arrived at from the result of one case may be extrapolated across board to several cases.

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<sup>88</sup> Babatunde, S. *et al.*, 'Critical Success Factors in Public-Private Partnership on Infrastructure Delivery in Nigeria,' (2012) *Journal of Facilities Management* Vol. 10 Issue 3 pg.179



Finally, it is important to point out that the criticism of the way projects have been managed so far in Nigeria does not mean that certain things have not been done well or that PPPs have not brought in any benefits at all. Indeed some of the projects like the ports concession have brought in some benefits such as increase in cargo throughput.<sup>89</sup> The point that is made in this thesis is that far more can be achieved if things are done better.

## **1.7 Conclusion**

This chapter provides a detailed introduction to this thesis. It covers the objectives that this thesis seeks to achieve leading to the framing of the hypothesis and research questions flowing from it. It also describes the value or contribution of this thesis to the extant body of knowledge. The chapter also introduces the methodology employed to achieve the research objectives; explaining the reasons why the particular methodology was best suited for engaging the research materials. The chapter then leads the reader through the process used by the research to accomplish the research objectives including a brief description of the content of the thesis.

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<sup>89</sup> Komolafe, E. 'Nigerian Ports Record Increase in Cargo Throughput' P.M News 29<sup>th</sup> June, 2012, (online) at: <http://pmnewsnigeria.com/2012/06/29/nigerian-ports-record-increase-in-cargo-throughput/> (last accessed on August 18, 2013)

## Appendix 1

### Interview Questions

Some of the initial questions asked during the interviews are:

1. Could you explain what this project was about?
2. Do you think the project has been successful?
3. What challenges if any is the project currently facing?
4. Was the risk allocated to the party with the best capability to control the events that might trigger its occurrence?
5. Was the risk properly identified, understood and evaluated?
6. Does the party to whom the risk was allocated have the technical/managerial capability to manage the risk?
7. Does the party to whom the risk was allocated have the financial ability to sustain the consequences of the risk or prevent it from occurring?
8. Is the party willing to accept the risk?
9. Was the risk allocated at the appropriate time?
10. Was the process used in allocating the risk appropriate?

## CHAPTER 2

### THE CONCEPTUAL FRAMEWORK

#### 2.1 Introduction

This chapter discusses the different concepts and foundations on which the thesis is grounded. The discussion of these different concepts helps lead the research in the direction of outcomes, which assist in ultimately posing the research questions which this study seeks to answer. Firstly, owing to the broad complex nature of Public Private Partnerships (PPP), its definition, history and basic structure are discussed to better appreciate the concept. The following subsection, discusses the different PPP models while the third subsection engages with the concept of risk in PPP.

The concept of risk is central to the research question and so its comprehension is essential to the understanding of the thesis. The following subsection examines the nature and extent of infrastructural development in Nigeria to provide an understanding of the setting and the context within which the discussions in this thesis are conducted. Lastly, an examination of the current state and use of PPPs for the financing of infrastructure projects in Nigeria is carried out to reveal some of the shortcomings, which the thesis aims to find solutions to.

## 2.2 What is PPP?

There is no agreement on what exactly constitutes a PPP hence a single definition of the concept does not exist. In fact, the exact nature of PPP is still being contested.<sup>1</sup> The plethora of definitions and the varied characteristics of the concept have raised questions regarding whether there is need to contemplate a definition of the concept in the first place, especially since the concept is very clear and most people understand it.<sup>2</sup> Nonetheless, there is a need to re-examine the different meanings and definitions given to PPP to determine, amongst other reasons, whether the concept is worth keeping and used for empirical studies like this thesis, since a huge number of definitions of PPP exist.<sup>3</sup>

The major determinant factor for the widespread use of the PPP model for the provision of infrastructure across the world appears to be the inadequacy of public funds to meet the increased demand for infrastructure.<sup>4</sup> There are other benefits said to be inherent in the use of PPPs. For instance, the Netherlands has adopted PPP type structures

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<sup>1</sup> Khanom, N.A. 'Conceptual Issues in Defining Public Private Partnerships (PPP).' (2010) Vol. 6 No.2 *International Review of Business Research Papers*, pp.150-163.

<sup>2</sup> William, A.T. (1997) *Regional Governance: Contemporary Public Private Partnerships in the South*, PhD Thesis, Virginia University of Commonwealth. Cited by Khanom, N.A., *ibid* at pg. 151

<sup>3</sup> Hodge, G.A. and Greve, C. 'Public-Private Partnerships: An International Performance Review.' (2007) *67 Public Administrative Review*, pp. 545-558.

<sup>4</sup> Indeed the first PPPs projects were done basically to bring private investments for public services. See Grimsey, D. and Lewis, M.K. (2004), 'Public Private Partnerships: The worldwide Revolution' in *Infrastructure Provision and Project Finance*, Edward Elgar, Cheltenham; Cheung, E. et al 'Reasons for implementing public Private Partnership Projects: Perspectives from Hong Kong, Australian and British practitioners,' (2009) Vol. 27 Issue 1 *Journal of Property Investment and Finance*, pp. 81-95

primarily to promote an efficient procurement regime and reform its public sector.<sup>5</sup>

Other reasons for adopting PPPs include claims that PPPs provide better value for money, reduce governmental debt levels while ensuring better efficiency in providing and running infrastructure services in more politically attractive forms than nationalization or privatization.<sup>6</sup> While noting that not everyone agrees with the notion that PPPs have all these advantages over traditional procurement,<sup>7</sup> PPPs have continued to play an increased role in the provision of infrastructure across different sectors around the world.

Despite a general level of agreement of what constitutes a PPP, there are variations in the way the concept has been defined. The multitude of definitions in existence is influenced primarily by the fact that different professions, countries and institutions employ the concept to achieve their own specific needs.

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<sup>5</sup> Harris, S. 'Public Private Partnerships: Delivering Better Infrastructure Services,' (Working Paper) Inter-American Development Bank, Washington DC pg.3

<sup>6</sup> For instance Savas is of the opinion that 'privatisation' and 'contracting out' are expressions, which generate opposition quickly. See Savas E.S. (2000) *Privatization and Public- Private Partnerships*, New York: Chatham House. Pg. 2

<sup>7</sup> These claims have been vigorously challenged. See for instance Hall, D. (2008) *Public-Private Partnerships (PPPs) Summary Paper*, A Report Commissioned by the European Federation of Public Service Unions (EPSU). Pg 6. Can also be found (online) at <http://www.epsu.org/IMG/pdf/PPPs-summary-011008.pdf> (last accessed February 21, 2012)

### 2.2.1 Why Do We Need A Definition?

Despite the observation to the contrary in the previous subsection, we need to attempt a definition of the concept for the important reason that a working definition at this stage will help delineate the boundaries of this research. This is because we will be able to eliminate other similar or analogous concepts that tend to be interwoven into the concept and grouped as belonging to the PPP family. Invariably, this exercise will help focus the ambit of this thesis on transactions that meet its requirements. Secondly, by having a definition of PPP we will be able to understand the nature or types of transactions that would be regulated by the new legal and institutional framework, which this thesis recommends for Nigeria. Furthermore, it is only projects that fall within the ambit of the agreed definition that will be allowed the benefits which only PPPs enjoy. These include viability gap funding and other incentives on one hand, while also enabling governments to provide for contingent liabilities, which are essential under PPPs.<sup>8</sup>

PPPs have been described and defined variously as a governance or management tool,<sup>9</sup> as a development strategy<sup>10</sup> and as a discursive

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<sup>8</sup> Department of Economic Affairs, Ministry of Finance of India " *Defining Partnerships*" (online) found at [http:// www.pppinindia.com/ pdf/ppp\\_ definition\\_ approach\\_paper.pdf](http://www.pppinindia.com/pdf/ppp_definition_approach_paper.pdf) (last accessed on September 7, 2011)

<sup>9</sup> This notion recognises that PPP provides a novel approach to delivering goods and services to citizens and focuses on the organisational aspects of the relationship especially the cooperation between the private and public sectors. See Hodge, G.A. and Greve, C. (2007), *Supra* Note 3

<sup>10</sup> This notion argues that PPP maximises the benefits of development through collaboration and enhanced development. See for example the definition by the World Bank below.

term or language game.<sup>11</sup> PPPs may also be appreciated from the view point of the different institutions that are involved in PPP transactions around the world which tend to define the concept from the prism of the nature, extent and desired objective of their involvement in the PPP process. These differences in the objectives of these multilateral institutions perhaps best explain the reasons for the differences in the definitions by the different institutions and authors. For the purposes of this work, some institutional definitions will be evaluated for the primary reason, as we will see later, that each of the chosen definitions brings out the different essential elements of a PPP.

### **2.2.2 Institutional Definitions**

This subsection discusses various definitions of PPPs around the globe from an institutional perspective. The aim is to distill an acceptable definition which will be employed throughout this work and which would be used in designing an appropriate legal and institutional framework for PPPs in Nigeria.

According to the International Monetary Fund (IMF), "Public Private Partnerships involve private sector supply of infrastructure assets and

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<sup>11</sup> As a language game it is assumed that PPP is used to cloud other strategies or purposes. For example since privatization is a very contentious term, that a more acceptable term like PPP can be used to cloud the real intentions of the person employing the term. Generally see Khanom, N.A. *Supra* Note 2; Hodge G.A. and Greve C. (2007) *Supra* Note 9.

services that have traditionally been provided by the government".<sup>12</sup> This definition looks at PPP from a historical perspective, stressing the novelty of the concept by contrasting it with traditional procurement. One crucial handicap of this definition is that it does not emphasize the partnership between the public and private sectors that is inherent in PPPs. This limitation in the definition is understandable when viewed against the backdrop that IMF deals mostly with governments and therefore the lesser emphasis on the relationship with the private sector is logical.

Parliament of Australia defines PPPs as "partnerships between the public sector and the private sector for the purposes of designing, planning, financing, constructing and/or operating projects which would be regarded traditionally as falling within the remit of the public sector. Infrastructural projects such as roads and bridges are prime examples".<sup>13</sup> This definition goes a step further than the preceding definition as it not only underscores that PPP is based on partnership but also breaks down the different components of a typical PPP project, from designing, financing, construction and actual operation. This is important because it is believed that it is this bundling of these components into a single

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<sup>12</sup> International Monetary Fund, (online) Found at <http://www.imf.org/external/np/fad/2004/pifp/eng/031204.pdf> (last accessed on June 23, 2010)

<sup>13</sup> Parliament of Australia,(online) at: <http://www.aph.gov.au/library/pubs/rp/2002-03/03rp01.htm#whatareppp> (last accessed on June 23, 2010)



process that makes PPPs very attractive and ensures the attainment of value for money in such projects.<sup>14</sup>

The Canadian Council for Public Private Partnerships defines PPPs as “a cooperative venture between the public and private sectors built on the expertise of each partner, that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards”<sup>15</sup> This definition highlights two important components. The first is that it stresses the cooperative nature of the partnership between the public and private sectors. Secondly, based on the cooperative nature of that partnership it stresses that risk and benefits are shared between the parties. It is noteworthy that the word “appropriate” is used in discussing the allocation of resources, risks and benefits between the parties. This is important because the success of PPP depends on how all these variables are allocated within the partnership so that parties are only burdened with risk, which they can handle, and given rewards that they deserve.

The National Council for Public Private Partnerships (US) defines Public-Private Partnership (PPP) as “a contractual agreement between a public agency (federal, state or local) and a private sector entity. Through this

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<sup>14</sup> Grimsey, D. and Lewis, K. *supra* Note 4; see also Takim, R. et al.,(2011) *A value for Money Assessment Method for Public Private Partnership: A Lesson from Malaysian Approach*, International Conference on Economics and Finance Research Singapore IPEDR Vol4 (online) at <http://www.ipedr.com/vol4/101-F10145.pdf> (last accessed on February 28, 2012).

<sup>15</sup> Canadian Council for Public- Private Partnership, (online) at <http://www.pppcouncil.ca/resources/about-ppp/definitions.html> (last accessed on September 17, 2010)

agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares in the risks and rewards potential in the delivery of the service and/or facility".<sup>16</sup> This definition highlights the legal and contractual nature of PPPs. Indeed, the relationship between the public and private sectors is more or less contractual in nature and evidenced by very detailed contractual documents.

The OECD defines a public-private partnership as:

An agreement between the government and one or more private partners (which may include the operators and the financiers) according to which the private partners deliver the service in such a manner that the service delivery objectives of the government are aligned with the profit objectives of the private partners and where the effectiveness of the alignment depends on a sufficient transfer of risk to the private partners.<sup>17</sup>

This definition while accepting that the objectives and interests of the private and public sectors differ underlines the need for the alignment of the objectives of the parties to the relationship and this meeting of

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<sup>16</sup>Organisation For Economic Co-operation and Development, (online) at: <http://ncppp.org/howpart/index.shtml#define> (last accessed on September 17, 2010)

<sup>17</sup> Jose Luis Navero Espigares and Jose Aureliano Martin Segura, 'Public Private Partnerships and Regional Productivity in the United Kingdom,' (online) at: <http://www.reser.net/file/75439/> (last accessed on November 14, 2010)

interests is dependent on finding the right balance in the apportionment of risks between the parties.

According to Public Private Infrastructure Advisory Facility (PPIAF) of the World Bank, “[A] PPP is an agreement between a government and a private firm under which the private firm delivers an asset, a service, or both, in return for payments. These payments are contingent to some extent on the long-term quality or other characteristics of outputs delivered”.<sup>18</sup> The addition of this definition to the already discussed foregoing definitions is that it makes the crucial point that payments to the private sector under a PPP is customarily benchmarked or tied to the quality of services rendered.

According to HM Treasury of the United Kingdom:

Public private partnerships (PPPs) are arrangements typified by joint working between the public and private sector. In the broadest sense, PPPs can cover all types of collaboration across the interface between the public and private sectors to deliver policies, services and infrastructure where delivery of public services involves private sector investment in infrastructure.<sup>19</sup>

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<sup>18</sup>PPIAF, (online) at: <http://www.ppiaf.org/ppiaf/sites/ppiaf.org/files/publication/WB%20-%20PPP%20Units%202007.pdf> > (last accessed on September 17, 2010)

<sup>19</sup> H.M Treasury, (online) at: [http://www.hm-treasury.gov.uk/ppp\\_index.htm](http://www.hm-treasury.gov.uk/ppp_index.htm) (last accessed on September 17 , 2010)

This wide definition seems to accommodate almost all transactions where there is collaboration between the private and public sector. This means that arrangements like privatization will fall within the purview of this definition.<sup>20</sup> This is not in conformity with the position of this research, as the research does not consider typical privatization or similar arrangements as PPPs.

The Asian Development Bank (ADB) appears to have the most comprehensive definition and seems to sum up all the characteristics that have been pointed out in the previous definitions. According to the ADB:

Public-private partnership describes a range of possible relationships among public and private entities in the context of infrastructure and other services. PPPs present a framework that—while engaging the private sector—acknowledge and structure the role for government in ensuring that social obligations are met and successful sector reforms and public investments achieved. A strong PPP allocates the tasks, obligations, and risks among the public and private partners in an optimal way. The public partners in a PPP are government entities, including ministries, departments, municipalities, or state-owned enterprises. The private partners can be local or international and may include businesses or investors

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<sup>20</sup> This definition is similar to be the position of a number of writers from the United States who seem to give privatisation a wider meaning to encompass PPPs. See for example Dannin, E. 'Crumbling Infrastructure, Crumbling Democracy: Infrastructure Privatisation Contracts and Their Effects on State and Local Governance', (2011) Vol. 6 *North Western Journal of Law and Social Policy*,

with technical or financial expertise relevant to the project. Increasingly, PPPs may also include non-government organizations (NGOs) and/or community-based organizations (CBOs) that represent stakeholders directly affected by the project.

Effective PPPs recognize that the public and the private sectors each have certain advantages, relative to the other, in performing specific tasks. The government's contribution to a PPP may take the form of capital for investment (available through tax revenue), a transfer of assets, or other commitments or in-kind contributions that support the partnership. The government also provides social responsibility, environmental awareness, local knowledge, and an ability to mobilize political support. The private sector's role in the partnership is to make use of its expertise in commerce, management, operations, and innovation to run the business efficiently. The private partner may also contribute investment capital depending on the form of contract".<sup>21</sup>

The point must be made at this juncture that characteristics or boundaries of transactions, which constitute PPPs, are not closed. For instance the European Commission observed that PPP is still evolving and

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<sup>21</sup> Asian Development Bank (online) at: <http://www.apec.org.au/docs/ADB%20Public%20Private%20Partnership%20Handbook.pdf> > (last accessed on September 17, 2010)

has divergent arrangements that may be adapted to suit the requirement of projects and project partners on a pragmatic basis.<sup>22</sup>

Clearly from the discussions above, there are various definitions of what constitutes a PPP arrangement. Since it is constantly evolving in various ways in different countries, there are bound to be so many more in the future. However, there are certain baseline characteristics that tie these different definitions together. Some of these characteristics have been highlighted from the definitions above. The Malaysian PPP Guidelines lists them as:

- i. The relationship between the public and private sectors is based on a partnership, which means that risk is shared between both partners optimally as it is allocated to the party who is best able to manage it.
- ii. The public sector procures specified outputs and outcomes of a service for the contract period whilst the private sector determines the required inputs to achieve the specified output. The private sector is given the freedom to introduce innovation into their design and development to reduce cost; there is thus an integration of design, construction, finance and maintenance and operation.
- iii. Payment for services is based on predetermined standards and performances.

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<sup>22</sup> EC Guidelines for Successful Public Private Partnerships 2003 , (online) at: [http://ec.europa.eu/regional\\_policy/sources/docgener/guides/ppp\\_en.pdf](http://ec.europa.eu/regional_policy/sources/docgener/guides/ppp_en.pdf) (last accessed on September 17, 2010)

- iv. PPP promotes a 'maintenance culture' where the private sector will be responsible for the long term maintenance of the assets throughout the operational period agreed upon by the parties.
- v. In some instances, there is an option for the transfer of the infrastructure asset back to the public sector at the end of the contract period.
- vi. PPP involves a Whole Life Cycle Costing ("WLCC") whereby PPP projects are usually awarded based on lowest total cost over the contract period compared to lowest construction cost under traditional procurement.<sup>23</sup>

Majority of projects that are classified as PPPs will have a number of these characteristics. Importantly however, the partnership structure must allocate risks and rewards optimally amongst the public and private parties in accordance with the strengths and abilities of each of the parties. It is only this optimal allocation of risks and benefits that ensures that each party contributes in an effective manner to the project.

From the above discussions, PPP may be defined as a long term relationship between public sector agencies and private sector entities under which the responsibility for any or all of the combination of designing, financing, construction, management and operation of

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<sup>23</sup> Malaysian Public Private Guidelines (2009) PPP Unit, Prime Ministers Department Putrajaya (online) at: [http://www.ukas.gov.my/html/themes/miu/content/ppp\\_bi\\_131109.pdf](http://www.ukas.gov.my/html/themes/miu/content/ppp_bi_131109.pdf) (last accessed on February 29, 2012)

public infrastructure and utilities that were traditionally undertaken by the public sector are contractually shared and jointly undertaken by both the public and private sector, usually in proportion to the kind of risks each party can best carry.

### **2.3 The History of PPP**

The modern concept of PPPs is commonly said to have originated in the United Kingdom.<sup>24</sup> However, the concept that emerged in the United Kingdom is similar to the model used to facilitate independent power projects in the United States of America in the 1980s. Thus while it can be said that the emergence of modern forms of PPPs may be traced to the Private Finance Initiative (PFI) scheme of the United Kingdom that was launched in 1992, the template for modern PPP contracts may be traced to Power Purchase Agreements (PPAs) signed by the US authorities and independent power producers in the 1980s.<sup>25</sup>

Even though the modern concept of PPP is relatively new, the idea of toll roads and bridges are not. For example, in the United Kingdom and the United States of America as far back as the eighteenth and nineteenth centuries over 2500 companies were chartered and incorporated to develop private turnpikes.<sup>26</sup> These turnpikes basically involved local

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<sup>24</sup> Yescombe, E.R. (2007) *Public –Private Partnerships: Principles of Policy and Finance*, Butterworth-Heinemann Corporation: MA USA, pg. 9

<sup>25</sup> *ibid*

<sup>26</sup> Grimsey, D. and Lewis, M.K. (2004) *Supra* Note 14



business entrepreneurs forming trusts, which borrowed money from private investors to repair roads and repaid them by charging tolls. For instance, in the 19<sup>th</sup> century the Brooklyn Bridge in New York was built with private sector capital.<sup>27</sup> Also as far back as the seventeenth century, French concession models were employed to develop infrastructure, especially in sectors such as water.<sup>28</sup> A further development in the use of the concession model in France was the use of franchises or '*affermage*', which basically is the right given to the private sector to exploit an already existing asset by making lump sum payments to the public sector.<sup>29</sup> The use of these methods faded away after the 19<sup>th</sup> century as the role of the state in the provision of infrastructure expanded.<sup>30</sup>

The PFI scheme itself emerged in the UK as an evolution from the previous government initiatives of privatization, then competitive tendering before finally evolving into PFI.<sup>31</sup> The conservative government in 1992 first laid the foundation for the PFI by abolishing the rules that had previously restricted the use of private capital for funding of public assets. When the Labour government came into power in 1997, it further strengthened the PFI scheme by creating the Treasury Taskforce to

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<sup>27</sup> Ibid

<sup>28</sup> Ibid

<sup>29</sup> *ibid*

<sup>30</sup> Yescombe, E.R (2007) *Supra* Note 24 at pg.5

<sup>31</sup> Harris, S. *Supra* Note 5

develop and promote a common approach to ensure that best practices were available across all departments of government.<sup>32</sup>

More recently, PPPs have become a global phenomenon. Sectors in which PPPs have been completed worldwide, include: Electric power generation and distribution, water and sanitation, refuse disposal, healthcare, education, airports facilities, prisons, transportation (railways, roads) technology systems, and housing to mention a few.

## **2.4 Types of PPP**

PPPs come in different forms with most depicted by different acronyms. A number of these so called different PPP arrangements are merely slight variants of one another. Some of the popular examples are:

### **Build Operate and Transfer (BOT)**

This is the most popular PPP arrangement. In this type of project, the private sector entity finances the building of the infrastructure asset and is allowed to own and operate it for a number of years, usually long term ranging from 25 to 30 years before transferring control and ownership back to the public sector. Normally, the infrastructure is transferred back to the public sector at a zero or at least a cost less than the assets residual value. These types of arrangements are common with greenfield projects.<sup>33</sup> The idea of a BOT is to benefit from the private sector's

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<sup>32</sup> *ibid*

<sup>33</sup> World Bank Found (online) at: < <http://ppp.worldbank.org/public-private-partnership/agreements/concessions-bots-dbos>> (last accessed on February 27, 2012)

detailed knowledge of project design. The materials used in the construction phase can result in the development of a tailored maintenance plan over the project lifespan.<sup>34</sup>

### **Build Own Operate (BOO)**

This PPP arrangement is similar to a BOT in the sense that the private sector finances the construction of the infrastructure and is also allowed to operate the infrastructure; however the distinguishing feature from a BOT arrangement is that the private sector is allowed to own the infrastructure in perpetuity. It is important to note that the fact that there is no government involvement in the beginning does not mean that it is not a PPP. The Government may still be involved in fixing tariffs and guaranteeing revenues. These types of arrangements are common in the power generation sector.

### **Build Own Operate and Transfer (BOOT)**

Under a typical BOOT, the private sector is responsible for financing the construction of the infrastructure asset, it is also allowed to own and render services deriving from that infrastructure asset for a number of years before transferring the asset to the government/public sector. Quiggin has argued that BOOT arrangements are usually bad schemes because it sacrifices long-term public interests and are only popular

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<sup>34</sup> Tvarno, C.D. 'Presentation of the PPP Concept' in Tvarno, C.D ed. *Public private Partnerships: An International Analysis- From a Legal and Economic Perspective*; (2010) Asia Link pg. 35

because they appeal to the elementary human fallacy of wanting something for nothing.<sup>35</sup>

### **Build Lease Transfer (BLT)**

In a BLT arrangement the private sector after building the infrastructure asset with its own funds, leases the asset from the public sector entity, paying a periodic fee before transferring the asset in the long run to the public sector at the end of the lease period.

### **Build Lease Operate Transfer (BLOT)**

This is similar to the BLT but the only difference is that there is an obligation on the private sector to operate the asset for the duration of the lease before transferring the asset to the public sector entity.

### **Build Lease Transfer Maintain (BLTM)**

Under this arrangement, like a classic BLT, the private sector entity uses its finances to build an asset, and then leases the asset from the public sector entity, before finally transferring the asset back to the public sector. However, unlike a BLT there is an obligation on the private sector entity to continue to maintain the asset even after the transfer of the asset is completed to the public sector.

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<sup>35</sup> Quiggin, J. *BOOT: In the Public Interest?* Presentation made at University of Technology, Sydney, March 1998, organized by the Australian Centre for independent Journalism, Australian Mekong Resource Centre, Sydney University and Community Aid Abroad. (online) at <http://www.uq.edu.au/economics/johnquiggin/conference/BOOT.html> (Last accessed on February 28, 2012)

### **Build Transfer Operate (BTO)**

Unlike the more popular BOT transactions, in this case the asset is transferred back to the government, which now allows the private sector to operate the asset for a number of years on behalf of the government.

### **Build Own Operate Remove (BOOR)**

As the name implies, under this arrangement the private sector entity finances the construction of the infrastructure asset and owns and operates it for a number of years after which it must remove it.

### **Design Build Finance Operate (DBFO)**

Under this scheme, the public partner specifies the services it wants the private sector to deliver. The private partner then designs and builds an asset specifically for that purpose, finances its construction and subsequently operates the asset by providing services that derive from it.<sup>36</sup> DBFOs are considered the classic PPP projects and are indeed the most common. The Lekki Road Concession and the MMA 2 Airport terminal both in Lagos, Nigeria are all strictly speaking examples of DBFO schemes.

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<sup>36</sup> International Monetary Fund (2006), *Public-Private Partnerships, Government Guarantees and Fiscal Risk*, prepared by IMF Staff team, Washington D.C. International Monetary Fund.

## **Design, Build, Finance, Operate, Manage (DBFOM)**

In addition to all the responsibilities and obligations of the private sector partner under a DBFO above, the private sector partner also shoulders the responsibility of managing the asset. Another variant of this is Design, Construct, Manage, and Finance (DCMF)

## **Lease**

Leases (*affermage*) as a form of PPP, are usually used where the assets are already in existence and therefore it is no longer necessary to make investments in infrastructure or where the risk premium of transferring the responsibility for building of the asset to the private sector is very high. Thus under this arrangement, investment and financing of the infrastructure is done under the responsibility of the public as opposed to the private sector. However, the commercial risk *a priori* continues to be allocated to the private sector. The length of contract in leases is usually shorter than in typical concessions. Note, even though the arrangements in a lease and *affermage* are similar there is a slight distinction in the sense that in a lease, the private sector operator usually retains revenue collected from the users of the facility and makes specified lease fees to the public authority. While under an *affermage*, the private sector contractor and the public authority share revenues from the customers/users.<sup>37</sup>

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<sup>37</sup> United Nations (Economic and Social Commission for Asia and the Pacific) (2011) *Guidebook on Public- Private Partnership in Infrastructure*, Bangkok, Pg. 4

### **Lease Develop Operate (LDO)**

This begins with the leasing of the infrastructure asset, usually empty land by the private sector and then financing the development of the asset before also operating the asset.

### **Lease Renovate Operate and Transfer (LROT)**

Under this arrangement there is first of all the lease of an existing asset, which is renovated and then operated by the private sector before finally transferring the asset to the public sector after a number of years.

### **Joint Ventures**

Joint ventures are often alternatives to full privatizations in which the infrastructure is co-owned and operated by both the public and private sector. In practice however, the private sector partner usually assumes the operational role. Under a joint venture both parties may decide to incorporate a Special Purpose Vehicle (SPV) which is the joint venture company and which is responsible for the project.

### **Operations and Management Contracts**

Under this arrangement, the public sector basically outsources the provision of services which were hitherto provided by it to the private sector. The payment for services is made directly to the private partner by the public partner, rather than through revenue collected directly from the end users, like in other PPP arrangements.

## **Concessions**

Under a typical concession, the public sector grants (concessions) the private sector (concessionaire) a right to deliver certain services in certain areas for a fee paid by the concessionaire for those rights. The private sector operator is responsible for operation, maintenance and even rehabilitation of the asset including any capital required for upgrade and expansion even though ownership of the asset remains with the government throughout the duration of the concession period. The public sector sets performance standards and ensures that they are met thereby being in effect regulators of the price and the quality of services delivered.

### **2.5 PPP and Conventional Public Procurement**

Conventional Public Procurement refers to the purchase, lease, rental or hire of goods or services by the public sector. This method is desirable if the goods or services needed are not complex and there is a possibility of choosing from numerous providers.<sup>38</sup> Under a classic PPP arrangement (DBFO), the public sector specifies the services it wants the private sector to provide and then the private sector designs and builds a dedicated asset for that purpose, finances its construction and subsequently operates the asset and provides the services deriving from the asset. This is different from traditional procurement, where the public sector is

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<sup>38</sup> United Nations economic Commission for Europe (2008), *Guidebook on Promoting Good Governance in Public-Private Partnerships*, United Nations Publications, Sales No. 08.II.E.1



responsible for the design and financing of the provision of the asset and then its operation once it is built. The role of the private sector is only limited to building the asset on contract for the public sector. Thus the main differentiating characteristic between a PPP and conventional procurement is the fact that finance, ownership (at least initially) and service delivery lie in the hands of the private sector.<sup>39</sup>

## **2.6 Differentiating PPP from other Similar Types of Procurements**

As noted earlier, PPP is a term that is usually employed to capture a range of possible relationships between the private and public sectors. Therefore there is the tendency to erroneously consider different sorts of scenarios or relationships between the private and public sectors such as private sector participation (PSP), contracting out and privatization as PPPs. There are however differences between most of these terms and PPPs at least in the context of this work.

### **Contracting Out**

This scheme arises where a private sector party provides in a commercial manner a service, which was previously provided by the public sector itself. The private contractor is paid a predetermined rate for its services and other anticipated costs. The difference between contracting out and PPPs is that under the former, there is little transfer of control or risk to the private sector and no substantive private sector involvement in the

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<sup>39</sup> Note that this classification differ from jurisdiction to jurisdiction and from institution to institution. There is a tendency by some countries to describe broad private sector involvement with the public sector as PPPs.

decision making process leading up to the transaction as under a PPP arrangement. Under a PPP, there is some form of devolution of control and authority to the private sector as well as private sector participation in the decision making process. The key advantage is that many operational gains that result from private sector management can be made without transferring the asset to the private sector.<sup>40</sup> It may take various forms like franchise, service agreement or licensing.<sup>41</sup>

### **Privatisation**

Privatisation is the complete transfer of previously owned public assets to the private sector. Indeed, critics of PPP have likened it to privatisation, claiming that it is merely privatization “through the back door”.<sup>42</sup> In Nigeria, PPPs have sometimes been viewed as a variant of privatisation.<sup>43</sup> It was argued that PPPs should include privatisation and vice versa since both involved some form of partnership between the public sector and the private sector.<sup>44</sup> This is not correct because even though both are alternative service delivery arrangements to traditional public sector led

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<sup>40</sup> Asian Development Bank, (2008) Public Private Partnerships Handbook supra Note 110

<sup>41</sup> Hrab, R. (2004) *Private Delivery of Public Services: Public Private Partnerships and Contracting-Out* Panel on the Role of Government in Ontario, Research Paper No. 21. Available (online) SSRN: <http://ssrn.com/abstract=694582> or <http://dx.doi.org/10.2139/ssrn.694582> (last accessed on February 28, 2012)

<sup>42</sup> See Harris, S. Supra Note 32

<sup>43</sup> This information was obtained from semi-structured interviews conducted during the course of this thesis.

<sup>44</sup> This position is consistent with the thinking of academics and the general practice in the United States of America. See Savas, E.S *Privatization and Public Private Partnerships* (online) at: [http://www.cesmadrid.es/documentos/Sem200601\\_MD02\\_IN.pdf](http://www.cesmadrid.es/documentos/Sem200601_MD02_IN.pdf) (last accessed on February 28, 2012)

procurement, and focus on the relationship between the public sector and private sector, they are different.

The difference is that in PPP, the public sector retains a substantial role despite the private sector involvement by retaining ultimate responsibility for the services despite it being provided by the private sector. However, when a government entity is privatised, the private sector not only takes over the business but also assumes responsibility for service delivery.<sup>45</sup> Risks are entirely borne by the private sector under privatization but are allocated between the parties under a PPP.<sup>46</sup> For the purposes of this thesis therefore, full-scale privatisation or mere outsourcing is not considered as part of PPP.

## **2.7 Risk**

The success of PPP projects depends on appropriate allocation of risk between the public and private sectors. One of the central themes of this thesis is that proper allocation of risk in infrastructure projects will enhance PPP projects in Nigeria. Therefore, the understanding of the concept of risk is important in the context of this thesis.

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<sup>45</sup> Grimsey, D. and Lewis, M.K (2004) *Supra* Note 29

<sup>46</sup> United Nations (Economic and Social Commission for Asia and the Pacific) *Guidebook on Public- Private Partnership in Infrastructure* *Supra* Note 37

A risk is defined as any factor, event or influence that could threaten the successful completion of a project in terms of time, cost or quality.<sup>47</sup> It is said to be characterised by three components: The risk event: what might happen to the detriment or in favour of the project, the probability of occurrence: the chance of the event occurring and the potential loss or gain: consequence of the event happening.<sup>48</sup>

One of the central arguments for the use of PPPs is that it allows for proper risk transfer from the public sector to the private sector. In a perfect world, the concept of risk transfer in PPPs will involve the transfer of risk from the public sector to the private sector leaving the public sector as merely purchasers of long-term risk free services. However, this is not exactly as simple in practice as government usually agrees to take back some of the risks which if assumed by the private sector will become more expensive than if it assumed it itself.<sup>49</sup> Thus it is commonly agreed in PPPs that risk should be allocated to the party that is most able to bear it.<sup>50</sup> The concept of risk in PPPs is dealt with in greater detail in the succeeding chapters of this thesis.

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<sup>47</sup> Wideman, R. (1992) *Project and Program Risk Management: A Guide to Managing Project Risks and Opportunities* (PMBOK Handbooks)pg.3 ; Akintoye, A.S. and Macleod, M.J 'Risk Analysis and Management in Construction, International'(1997) *Journal of project Management*, Pg.31

<sup>48</sup> Iyer, K.C. and Sagheer, M. 'Risk and Uncertainty Assessment in PPP infrastructure Projects: Need for Systems Dynamic Framework' (online) at: [http://www.indianjournals.com/glogift2k6/glogift2k6-1-1/theme\\_5/Article%2011.htm](http://www.indianjournals.com/glogift2k6/glogift2k6-1-1/theme_5/Article%2011.htm) (last accessed on February 28, 2012)

<sup>49</sup> *ibid*

<sup>50</sup> Partnership Victoria advocates that public interest consideration should also be taken into consideration in deciding whom risk should be allocated to.

Risk transfer in projects in Nigeria is usually handled poorly between parties involved in PPP projects. This has led to some of these projects encountering problems. It would be seen that instead of risk distribution being influenced by established guidelines they are persuaded more by economics, debt financiers' requirements and the bargaining strength of parties. A preliminary profiling of the large PPP projects so far concluded in Nigeria such as the concession of the country's 26 port terminals, the MMA 2 Local airport terminal and the Lekki toll road in Lagos show that indeed most project risks are prominent in PPP projects in Nigeria. Those that were obvious are political risk, demand risk and stakeholder opposition (public acceptance) risk.

The aim of this thesis is to analyze the cause of the disputes and problems that have afflicted the above-mentioned projects. The hypothesis that is central to this thesis is that if these risks are better handled, it will enhance the quality of PPP projects in Nigeria. This research will therefore carry further in-depth case studies of these projects, from the perspective of these three mentioned risks and determine how the legal, institutional and governance framework may be improved to enable better management of these risks in Nigeria.

## **2.8 Infrastructure Development in Nigeria**

The word "infrastructure" was coined out of the words 'infra'(beneath) and "structure" (building) and thus usually encompass services or facilities that are underground such as piped water and sewerage or

those that lie on the surface such as roads and railways.<sup>51</sup> Investment in infrastructure is said to have crucial input in economic development of a country.<sup>52</sup> The stock of public infrastructure in most countries plays an important role in attracting private sector finance from overseas into the country. This is the case in most developing countries and Nigeria is no exception, hence the move by the country to develop its infrastructure base.

Infrastructure is broadly classified into economic and social infrastructure.<sup>53</sup> Economic infrastructure provides key intermediate services to businesses and industry and its principal function is to enhance productivity,<sup>54</sup> development and prosperity.<sup>55</sup> Some examples of economic infrastructure include roads, highways, bridges, railways, airports, telecommunication installations and power stations. Social infrastructure provides basic services to households. Its main role is to improve the quality of life and welfare of citizens.<sup>56</sup> Some of the recognized social infrastructure includes hospitals, schools, water supply and prisons.

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<sup>51</sup> Gomez, I. J. (2003) *Regulating Infrastructure: Monopoly, Contracts and Discretion*, Harvard University Press, USA, pg. 4.

<sup>52</sup> Grimsey, D. and Lewis, M.K., 'Evaluating the Risk of Public Private Partnerships for Infrastructure Projects', (2002) *International Journal of Project Management*, 20 pp. 107-118; Threadgold, A. 'Private Financing of Infrastructure and Other Long Term Capital Projects,' (1996) 1 (1) *Journal of Applied Finance and Investment* pp. 7-12

<sup>53</sup> Infrastructure can be further subdivided into "hard" and "soft" infrastructure and also as "material infrastructure", "personal infrastructure" and "institutional infrastructure"

<sup>54</sup> Grimsey, D. and Lewis, M. K. (2004), *Supra Note 45*

<sup>55</sup> Loosemore, A. M. 'Risk Allocation in Private Provision of Public Infrastructure', (2007) *International Journal of Project Management* 25 pp. 66-67 at pg. 66

<sup>56</sup> Grimesy, D. and Lewis, M. K. (2004) *Supra Note 54*

As noted previously, the state of Nigeria's infrastructure is appalling and requires urgent attention. The power sector is marked by low generating capacity relative to installed capacity. For instance, electricity generation in 2012 ranged from between 2,500 megawatts to about 3,000 megawatts while estimated national consumption is in excess of 10,000 megawatts.<sup>57</sup> It is estimated that the country currently spends US\$13billion in fuelling power generators to cover the deficit in power needs<sup>58</sup> and it is estimated that demand will double in the next few years.<sup>59</sup> The state of the country's roads network is poor with only about 15.3% of its 195,200 kilometers paved and about 28% of these paved roads are bad and not motorable.<sup>60</sup> The situation with the railway infrastructure is even worse; the entire network is virtually moribund and outdated due to lack of upgrade and maintenance for over two decades.

In many urban areas, hospitals, water supply, sewerage and waste disposal infrastructure to mention a few are virtually non-existent.<sup>61</sup> Maintenance of the partially existing ones has been poor. All these are

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<sup>57</sup> Yusuf, M.O (2004). *Private Sector Initiatives and Infrastructural Development in Nigeria* Found at <http://www.cenbank.org/out/Publications/occasionalpapers/rd/2004/Jos-02-4.pdf> (last accessed on February 28, 2012)

<sup>58</sup> Ekanem, N.G. (2010) *Nigeria the Most Dynamic PPP Market in Africa?* Being a paper presented at the SADC PPP Forum and Network Launch in Midrand, South Africa, February 2010

<sup>59</sup> *ibid*

<sup>60</sup> Ohia, U.(2011) *Infrastructure Concessions in Nigeria: Challenges and Opportunities*, a paper presented at the 5<sup>th</sup> Annual Diaspora Conference held in Abuja from the 25<sup>th</sup> to 27<sup>th</sup> of July 2011

<sup>61</sup> *Ibid*

being compounded by the twin problems of rapid population growth and urbanization. The investment required to meet the Government's Vision 2020 target is estimated to be \$35 billion for the Power Sector, \$13 billion for the railways, \$5 billion for the ports and \$3.5 billion for the roads.<sup>62</sup>

Nigeria's Vision 2020 programme is aimed at making Nigeria the 20<sup>th</sup> biggest economy in the world by 2020. To achieve this, it is estimated that the country needs to invest between \$6 billion and \$9 billion every year for the next eight years.<sup>63</sup> This is an enormous amount of money required within a very short time frame. The Government obviously cannot afford to solely fund the provision of such costly infrastructure and has turned to PPPs as its only viable alternative.

## **2.9 PPPs in Nigeria**

The primary motivating factor for the aggressive PPP drive in Nigeria is the lack of Government funds to improve the country's derelict infrastructure. Therefore, the Government is trying to attract much needed private sector funds for infrastructure development. The other factor is the failure and/or inefficiency of public authorities in providing much-needed public services. It is hoped that the private sector would be more efficient in providing these services.

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<sup>62</sup> Ahmed, M. (2011) *Infrastructure Development for Nigeria: The PPP Imperative*, (online) at <http://www.icrc.gov.ng/wp-content/uploads/2011/07/PPP-Forum-ICRC-DG-presentation-v4.pdf> (last accessed on February 28, 2012)

<sup>63</sup> Animashaun, M.A. (2011) *Public Private Partnership as a Strategy of Infrastructure Finance in Nigeria* (online) < <http://njpg.pactu.edu.np/njpgfiles/4-animashaun-mojeed-adekunle-public-private-partnership-as-a-policy-strategy-of-infrastructure-financing-in-nigeria.htm> > (last accessed on February 28, 2012)



The decision to resort to PPP was made easier by the fact that the country had gone through a privatization program that lasted for over 3 decades. This also included a reform program encompassing the liberalization and deregulation of the economy.<sup>64</sup> In essence, there was a partially liberalized economic environment in place; PPP was thus seen as the natural progression from privatization. Also, PPP did not carry “the baggage” which burdened the privatization program simply because it did not lead to the complete transfer of ownership of assets from the Government to the private sector (usually from overseas) and so people were naturally more comfortable with it.

Nigeria being a developing country, with a moderate capital budget, an undeveloped capital market and not very buoyant private sector had to rely on foreign private sector funding to realize its goals of providing infrastructure for its citizens. It is not surprising therefore that most of the early investment in infrastructure via PPP came through collaboration between foreign investors and Nigerian businesses. The multilateral financial agencies also came in with a lot of support and finance.<sup>65</sup>

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<sup>64</sup> This program was pursued through the Bureau of Private Partnership (BPE). Under this program over 200 transactions were concluded.

<sup>65</sup> On March 17, 2011 the World Bank approved a loan of US\$115m for the PPP initiative project aimed at helping increase private sector investment in PPP infrastructure in Nigeria

Some of the transactions that have been consummated so far are mainly in the transport sector including a new airport terminal in Lagos, a new toll road in the Lekki area of Lagos, the seaports located around Lagos and the Niger Delta region of the country. There are a number of other projects currently in the pipeline like the light rail project for the Federal Capital Territory and Lagos and the concession of major road networks around the country.<sup>66</sup> There is also a muted suggestion that the existing railway network will also be concessioned. In other sectors like housing, the Federal Capital Administration has concluded plans to concession the provision of infrastructure in certain areas of the capital city to some investors and there are also ongoing deals being negotiated in the power sector.<sup>67</sup> Joint ventures and BOT arrangements appear to be the most common PPP delivery mechanism used in infrastructure projects in Nigeria.<sup>68</sup> However, apart from BOT and joint ventures, other popular PPP arrangements are BOOT and DBFO. It is also true that there have been a number of concessions.<sup>69</sup>

It is clear therefore from the foregoing that Nigeria has fully embraced the use of PPP to finance infrastructure. However, due to the desperation

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<sup>66</sup> Ekanem, N.G. *Supra* Note 58.

<sup>67</sup> Most of the hitherto Government owned power assets are being completely divested through privatization. The only assets to be concessioned are the hydro power plants.

<sup>68</sup> Ibrahim, A.D. *et al*, 'The Analysis and allocation of Risk in Public Private Partnerships in Infrastructure Projects in Nigeria' (2006) Vol. 11, Issue 3 *Journal of Financial Management of Property and Construction*

<sup>69</sup>The 26 Ports in the country were concessioned through the use of the "landlord tenant" model

and haste by government to provide infrastructure, crucial enablers to ensure for successful PPP transactions were never put in place. This has been a strong hindrance because investors (foreign and local) are wary of tying down their capital for 25-30years without sufficient guarantees that they would be able to recoup their investments and make some profit. It does not also help that the risks of doing business in Nigeria is higher than in more established economies. Therefore, prospective investors would like to see evidence or assurances that their investments will be safe and yield profitable returns. Currently, Nigeria is unable to provide such guarantees and thus faces the difficulty of attracting the calibre of investors that will partner with the government to develop the country's infrastructure.<sup>70</sup> Where it has been able to attract foreign investment to develop PPP projects, such transactions have suffered enormous setbacks. There are numerous on-going cases in the courts between the government and the investors on one hand and between the government and its citizens on the other. A number of the contracts have already been re-negotiated less than 3 years into its operation. There have also been instances where users of the infrastructure or the public have refused to use the asset provided or refused to pay tolls.

Also, Nigeria being a developing country has suffered more than most countries in Europe and America from governance issues that arise from

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<sup>70</sup> With the population of over 160 million, large market and the strategic location of Nigeria in the African continent, the level of foreign direct investment into the country has been appalling.

the negotiation of long-term investment contracts like PPP contracts. These issues occur due to the use of one-sided contractual clauses like stabilization<sup>71</sup> and 'non-compete' clauses<sup>72</sup> which are usually skewed heavily in favour of the local or overseas investors due primarily to a lack of technical capacity. There is also a lack of a genuine process for stakeholder engagement during the PPP contract negotiation process and all through the project execution.

## **2.10. The Legal and Institutional Framework for PPPs in Nigeria**

Nigeria operates a federal system of government where legislative powers are shared between the constituent units of government comprising the federal, the state and the local governments. The Constitution divides legislative power into 2 lists; the exclusive list and the concurrent list. Items on the exclusive list are reserved exclusively for the central government,<sup>73</sup> whilst both the federal and state governments may legislate on items listed in the concurrent list.<sup>74</sup> An inferred third, the residual list, is reserved exclusively for the state governments.<sup>75</sup> The net

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<sup>71</sup> Stabilisation clauses are risk management devices in investment contracts between host states and investors. They address changes in law or other circumstances during the life of the contract. See for example Lorenzo, C. (2008) 'Regulatory takings, stabilization clauses and sustainable development (online) at: <http://www.oecd.org/dataoecd/45/8/40311122.pdf> (last accessed on January 24, 2012)

<sup>72</sup> Non-compete clauses usually prevent the government from providing alternative infrastructure that will compete with that of the private sector investor for revenue. These provisions effectively make the public the guarantor or insurer of the private sectors' expected revenues. See Dannin, *Supra* Note 20 pp. 47-105

<sup>73</sup> S.4(2) of the 1999 Constitution of the Federal Republic of Nigeria

<sup>74</sup> Note that if there is any conflict the federal government will override the state government.

<sup>75</sup> These are not matters that are in the Exclusive nor concurrent legislative lists. See S. 4(7)(a) of the Constitution of the Federal Republic of Nigeria 1999.

effect of this distribution of power is that there are both federal and state legislations regulating PPPs in Nigeria. Depending on the particular infrastructure which a private sector is involved in, it may deal with a particular state or both the state and the federal government and this may invariably determine which set of laws will regulate the transaction. For instance, certain types of infrastructure assets like roads and electric power on the concurrent list are owned and/or regulated either by the federal or state government.

Based on this distribution of legislative powers, the Federal Government and a number of states in the Federation have enacted specific laws regulating PPPs.<sup>76</sup> These laws operate along with other legislations that indirectly affect a potential PPP project within the country. Some of these laws are the different planning laws of the states of the federation, the multiple tax legislations and the general law of contract that is largely based on received English law.<sup>77</sup> Since the Federal Government executes most of the large infrastructure projects, the analysis of the legal framework for PPPs in this thesis will be based primarily on the federal legislations.

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<sup>76</sup> Some of the states with existing PPP legislations are Cross Rivers, Ekiti State, Lagos State and Rivers State.

<sup>77</sup> This consists of the Common law, doctrines of equity, together with statutes, and subsidiary legislations that were in force in England on the 1<sup>st</sup> of January 1900. See for instance the provisions of S.2 of the Law (Miscellaneous Provisions) Law, Laws of Lagos State Cap 65 1973

The legal framework at the federal level for PPPs in Nigeria comprises of a confusing and conflicting web of regulations and policies. Presently, a potential private sector investor needs to decide which of the conflicting legislations or institutions would regulate a particular transaction before initiating a PPP project in Nigeria. These laws and policies are also generally inadequate, contain conflicting provisions and thus contribute to manifest uncertainty which inordinately increase transaction costs. A brief review of some of these laws is done in this chapter as extensive analysis is done in Chapter 5 below.

Some of the laws that constitute the legislative framework for PPP in Nigeria are:

### **The Infrastructure Concession Regulatory Commission Act 2005**

The Infrastructure Concession Regulatory Commission Act (the ICRC Act), which was enacted in 2005, provides the primary legal framework for Private Sector Participation in Infrastructure Development in Nigeria and is the principal legislation for PPP in Nigeria. The ICRC Act is divided into two parts:

The first part vests government ministries and other agencies with power to enter into contracts with, or grant concessions to the private sector for the financing, construction, operation and maintenance of any viable infrastructure.<sup>78</sup> The second part establishes the Infrastructure Concession

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<sup>78</sup> S.1 of the Act

Regulatory Commission (the ICRC), which is managed by a 12-member board that includes a part time chairman, the Attorney General of the Federation, the Governor of the Central Bank and a person from each of the six geopolitical zones of the country. The main function of the Commission is to take custody of every concession agreement or contract entered into by the Government Ministry or Agency, and monitor compliance with the ICRC Act and the efficient execution of any such Concession Agreements.<sup>79</sup>

However, despite the use of the word "regulation" in the title of the ICRC Act, the law does not confer regulatory powers on the ICRC. Under the ICRC Act, the institution is for instance, not allowed to perform any form of economic or technical regulation but the Commission presently assumes this responsibility. The position of this thesis is that legally and technically speaking there is no central regulator for PPP transactions in Nigeria. However, since the ICRC's assumption of this function is yet to be tested before a competent judicial body, the Commission continues to perform this role.

### **The Public Enterprises (Privatisation and Commercialisation) Act 1999 (Privatisation Act)**

The Privatisation Act provides the legal framework for the privatisation and commercialisation of various public assets in Nigeria. It also creates the National Council of Privatisation (NCP) as the apex body charged

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<sup>79</sup> SS. 14, 15, 16 and 17 of the Act

with the responsibility of setting and administering the Federal Government's policies and objectives on privatisation and approving transactions. The Act also established the Bureau of Public Enterprises (BPE) to function as the secretariat of the NCP and carry out the actual day-to-day privatisation activities.

A number of concessions including concessions of the 26 seaports, the trade fair complex, Tafawa Balewa Square, the electric power plants and the National Theatre had been consummated under this law and by BPE. However, this is clearly in conflict with the express and exclusive powers conferred on the ICRC regarding concessions in Nigeria by the ICRC Act. This has led to a lot of confusion and bickering between the two institutions created under the respective laws. There have been suggestions that BPE should do brown field concessions whilst the ICRC should be responsible for green field transactions, however this is not supported by legislation. There are a number of transactions still listed under the schedule to the privatization law including the concessioning of the airports and the railways and this will definitely lead to further conflicts between the two organisations.

### **The Public Procurement Act 2007**

The Procurement Act applies to procurement of goods and services carried out by the Federal Government of Nigeria, any public body engaged in procurement and all entities which derive at least 35% of the funds appropriated or proposed to be appropriated for any type of



procurement from the Federation share of the Consolidated Revenue Fund.<sup>80</sup> The Act does not apply to procurements carried out by the constituent states of the Federation.<sup>81</sup>

The Procurement Act does not expressly mention procurements done under PPPs like concessions and so it is believed that it only applies to traditional procurement and not to procurements done as PPPs.<sup>82</sup> It is based on this that the ICRC has stipulated some guidelines under the National PPP Policy for the PPP procurements.<sup>83</sup> This position is however questionable because the Procurement Act applies to procurement of goods and services for infrastructure projects.<sup>84</sup> It is obvious that the Procurement Act did not take the ICRC Act or Privatisation Act into contemplation, as it ought to have, being later in time. The decision of the ICRC to provide specifically for PPP type procurements under the PPP Policy has led to more confusion, as the overlap between the two laws and institutions created under them is further exacerbated and the existing gaps are yet to be filled.

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<sup>80</sup> S.15 of the Procurement Act, No.14 2007

<sup>81</sup> *ibid*

<sup>82</sup> This assertion has been severely challenged by the Bureau of Public Procurement in relation to the Management Contract granted Manitoba Hydro of Canada to operate the transmission network by BPE.

<sup>83</sup> Part 1 of the Supplementary Notes to the National Policy on Public Private Partnership (PPP).

<sup>84</sup> It is however silent on the non-tender aspects of PPP transactions or handling of unsolicited bids.

### **The Debt Management Office Act 2003**

The Debt Management Act<sup>85</sup> established the Debt Management Office to prepare and implement a plan for the efficient management of Nigeria's external and domestic debt obligations and set guidelines for managing the country's risk and currency exposure with respect to all loans.<sup>86</sup> PPP transactions will obviously require the Government of Nigeria to borrow both externally and internally as well as issue guarantees and therefore the Debt Management Office will necessarily be involved. However, there is nothing in any of the existing laws regulating PPPs that takes this fact into consideration and therefore potential investors are likely to be stranded.

### **The Fiscal Responsibility Act 2007**

The Fiscal Responsibility Act promotes the prudent management of the country's resources by ensuring greater accountability and transparency in fiscal operations and also by imposing limits on the country's spending and borrowing. The Act establishes the Fiscal Responsibility Commission to ensure that the objectives of the Act are met.<sup>87</sup>

From the foregoing, it is apparent that there ought to be coordination between the ICRC, which is the primary body charged with PPP transactions in Nigeria and the Fiscal Responsibility Commission. If there is

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<sup>85</sup> Debt Management Office Establishment, (etc.) Act No. 18 of 2003

<sup>86</sup> *ibid* S.4

<sup>87</sup> *ibid* S.6

any kind of Government borrowing or spending on infrastructure, which is likely in PPP transactions, then the Fiscal Responsibility Commission ought to sanction it. However, neither the Fiscal Responsibility Act nor the ICRC Act mentions any sort of interface between the organisations. It is difficult for ICRC to conclude transactions without any reference or interface with the Fiscal Responsibility Commission. Potential investors run the risk of being stuck in the middle of their projects, suffering cost overruns and project abandonment if the Fiscal Responsibility Commission ever decides to flex its muscle. The proper thing to do is to ensure that the PPP laws and regulations clearly legislate for the extent, period and method of involvement of the Fiscal Responsibility Commission.

### **The National Planning Commission Act 1993<sup>88</sup>**

The National Planning Commission was established by Act No.12 of 1992 and later amended by Act No. 71 of 1993. The major function of the Act as it relates to infrastructure development is in relation to designing, coordinating and monitoring the implementation of the Nation's infrastructure master plan. It is therefore necessary that the ICRC will need to first ensure that any projects earmarked for PPP is included in the nation's master plan designed by the National Planning Commission and also ensure that its activities are in concordance with that of the National Planning Commission. There is therefore a need for the PPP legislations to recognise this synergy.

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<sup>88</sup> National Planning Commission Act CAP N66 LFN 2004

## **Various infrastructure sector Acts and Bills (currently before the National Assembly)**

A number of existing infrastructure sector legislations e.g. the Electric Sector Reform Act, are in conflict with the ICRC Act. This is the same with a number of infrastructure bills like the Railway Bill, Port Reform Bill, Road Sector Bill etc. that are currently before the National Assembly. These Bills seem to have been drafted in complete isolation of one another as they do not inter- reference one another or other economy wide legislations like the ICRC Act, the Procurement Act or Fiscal Responsibility Act.

It is obvious from the foregoing that any investor coming into Nigeria will be wary of the great regulatory risks, which it is likely to face in Nigeria. The main problem will arise from the responsibility given to the ICRC under the ICRC Act to monitor PPP contracts. Virtually all other sector legislations also give regulatory powers to the different bodies that have been created under these laws. This situation has contributed to confusion and unless these different laws are properly synchronized with one another and also with the wider legislations this will continue to impact negatively on PPP transactions in the country.

It is important that Nigeria eliminates or at least mitigates this policy and regulatory risks by designing a PPP law that will resolve these conflicts discussed above and ensure that private sector entities have the confidence to invest in Nigeria. This is one of the important issues, which this thesis aims to resolve and is dealt with in greater detail in Chapter 5.

The issue of proper stakeholder engagement is another problem that is militating against the use of PPP in Nigeria. For instance, the ₦50 billion (\$333M) Lekki toll road in Lagos which was awarded to Lekki Concession Company on a 30-year concession on a Design, Finance, Construct, Operate, Maintain and Transfer basis has stalled. The toll road has long been completed but the concessionaires were not been able to operate the toll road for a long time due mostly to lack of stakeholder support and suspicion of corruption. The lack of proper stakeholder engagement is commonplace in Nigeria, perhaps due to the so-called “military mentality” acquired by the public sector after years of military rule in the country. The issues arising from the Lekki concession is a timely warning about the need to provide a framework for better public participation in the PPP procurement and management process in Nigeria. This issue is considered in detail in this thesis in Chapter 7.

All these issues discussed above portend great risks for potential investors. If Nigeria is serious about attracting investors into its PPP program and enjoy the benefits that are inherent in PPPs, the country must strive to eliminate these risks as much as possible and put in place the appropriate enabling framework to be able to do so.

## **2.10 Conclusion**

So far this chapter has looked at the various definitions of PPP. Also the different types of PPPs are discussed, with a complete examination of the different meanings of the various acronyms that represent the

diverse but similar financing options that characterize the concept. It is noted that there are various definitions of PPP depending on who is defining the concept and the context from which the definition is being made. This chapter has tried to look at the various institutional definitions of the concept and has concluded that the definition by the Asian Development Bank (ADB) is the most detailed and utopian and recommends that Nigeria should adopt and aspire towards the values enumerated in that definition.

One recurrent theme from most of the definitions is the importance of proper risk allocation and its necessity for successful PPPs. This is in line with various commentaries,<sup>89</sup> which emphasize the significance and necessity of good risk management for good project governance and successful PPPs. The question then arises as to whether risks are properly managed in Nigeria? If not, could this be the reason why PPPs in Nigeria have not been entirely successful? This is the hypothesis, which this thesis seeks to find an answer to.

To answer the question posed above, it was necessary to understand the concept of risk in PPPs, with a discussion of the perception, allocation and mitigation of risks in PPP projects. While a review of the literature relating to risks in PPP projects in Nigeria showed that risk perception was discussed, it was found that there was no discussion of how those

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<sup>89</sup> United Nations *Guidebook on Promoting Good Governance in Public-Private Partnerships* Supra Note 38

identified risks were to be managed. This discussion is necessary because as a natural progression to the previous studies, the basic theme of this thesis is to look at how PPP in Nigeria could be enhanced through proper handling of project risks.

The number of PPP projects that have been completed so far in Nigeria are not significant, however what is significant is that majority of these projects have had and continue to experience niggling issues and are therefore not success stories. The prerequisites for successful PPPs are many but one of the reoccurring and most significant seems to be proper risk allocation and mitigation. It is from the understanding of this fact, that this thesis therefore looks at how PPPs in Nigeria can be enhanced through better project risk management.

In summary, this research seeks to look at PPP projects in Nigeria through the prism of risk analysis. The intention is to look at how PPP projects can be enhanced in Nigeria by better allocating and mitigating risks.

## CHAPTER 3

### THE THEORY OF RISK IN PUBLIC PRIVATE PARTNERSHIPS

#### 3.1 Introduction

This chapter focuses on risk in Public Private Partnerships (PPPs), which is the core subject matter of this thesis. It begins with a definition of the concept of risk; first in a general sense, then in relation to project management, and finally, vis-à-vis PPPs. The next section engages the theory of risk and how it impacts the different stages of a PPP project. The third section of the chapter discusses the nature; identification and categorization of risks in PPPs. Subsequent sections of the chapter discuss issues of risk valuation, allocation and mitigation.

#### 3.2 Definition of Risk

The definition of risk is controversial<sup>1</sup> primarily because the choice of a definition can affect the outcome of policy debates, the allocation of resources and even the distribution of political power in the society.<sup>2</sup> A number of writers have looked at risk solely from the perspective of a negative event. For instance, Akintoye and Macleod defined risk as the likelihood of unforeseen factors occurring, which would adversely affect the successful completion of a project in terms of cost, time and quality.<sup>3</sup>

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<sup>1</sup> Fischhoff, B. *et al.*, 'Defining Risk' (1984) 17 *Policy of Sciences* pp. 123-139

<sup>2</sup> *ibid*

<sup>3</sup> Akintoye, A.S. and Macleod, M.J. 'Risk Analysis and Management in Construction', (1987) 15(1) *International Journal of Project Management*, pp. 38-39; see also the following: Wideman, R.M. (1992) *Project and Program Risk Management*, PMI; Niwa, K. (1989) *Knowledge Based Risk Management in Engineering*, John Wiley and Sons, New York; Chicken, J.C. and Posner, T. (1998) *the Philosophy of Risk*, Thomas Thelford Publishing, London



The Royal Society also defined risk as the probability that an adverse event occurs during a stated period.<sup>4</sup> However, risk is not always negative. From a project management point of view, risk also reflects the underlying uncertainty of developing and operating projects. It is when risk is viewed as an uncertain event, that it reflects the possibility of both threats and opportunities.<sup>5</sup> For instance, Al-Bahar took this approach by examining both the negative and positive aspects of risk by combining both risk and uncertainty.<sup>6</sup> According to Al-Bahar, risk is the exposure or chance of occurrence of events adversely or favorably affecting project objectives as a consequence of uncertainty.<sup>7</sup>

Similarly, Conrow and Shishido<sup>8</sup> opine that risk is often used incorrectly to represent the probability term. When used correctly, risk represents the combined effect of the probability and consequence terms. They

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<sup>4</sup> Royal Society (1991) '*Report of the Study Group on Risk; Analysis, Perception and Management*' (Group coordinator Sir F. Warner) Royal Society London pg. 2. Cited in Edwards, P.J. and Bowen, P.A. 'Risk Management in Construction: A review of future directions and research' (1998) Vol. 5. No. 4, *Engineering, Construction and Architectural Management*, pp. 339-349

<sup>5</sup> Froud, J. 'The Private Finance Initiative: Risk Uncertainty and the State', (2003) Vol. 28, No. 6 *Accounting Organizations & Society*, pp. 567-589

<sup>6</sup> Al-Bahar, J.F. (1989) 'Risk Management in Construction Projects: A Systemic Analytical Approach for Contractors'. *PhD. Thesis* University of California Berkeley, 1989; See also the following: Al-Bahar, J.F. and Crandall, K.C. 'Systemic Risk Management for Construction Projects', (1990) 106 (3) *Journal of Construction Engineering and Management* pp. 533-546; Raftery, J. (1994) *Risk Analysis in Project Management*, E & FN Spon London; Chapman, C.B. 'A Risk Engineering Approach to Project Risk Management' (1990) 8(1) *International Journal of Project Management* pp. 5-16; Vaughan, E.J. (1997) *Risk Management*; John Wiley & Sons Inc., US.

<sup>7</sup> Al-bahar, J.F. and Crandall, K.C. *ibid*

<sup>8</sup> Conrow, E.H. and Shishido, P.S. Implementing Risk Management on Software Intensive Projects, (1997) 14(3) *IEEE Software*, pp. 83-89

defined risk as the probability or likelihood of failing to achieve a particular cost, performance and schedule objectives and the consequence of failing to achieve those objectives.<sup>9</sup> Akintoye *et al* agree with this definition and insist that the two attributes of probability and consequence must always be considered when risks are dealt with.<sup>10</sup> From the analysis of the above definitions, it is posited that risk is the probability of a particular event occurring multiplied by its corresponding impact level.<sup>11</sup>

Risk is characterized by three essential components: The risk event i.e. what might happen to the detriment or in favour of the project, the probability of its occurrence and thirdly, the potential loss or gain i.e. impact of the risk.<sup>12</sup> Martin and Heaulme added 'time and occurrence' as a fourth component.<sup>13</sup>

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<sup>9</sup> *ibid*

<sup>10</sup> Akintoye, A. *et al* (1998) 'Risk in Private Finance Initiative Projects' in Montanheiro, L. and Spiering, M. (eds.) *Public and Private Sector Partnerships: the Enterprise Governance*, Sheffield Hallam University Press, Sheffield

<sup>11</sup> Marques, R. and Berg, S. 'Risks, Contracts and Private Sector Participation in Infrastructure', (2010) *Journal of Construction Engineering and Management* (online) at: [http://warrington.ufl.edu/purc/purcdocs/papers/0925\\_marques\\_risks\\_contracts\\_and.pdf](http://warrington.ufl.edu/purc/purcdocs/papers/0925_marques_risks_contracts_and.pdf) (last accessed on April 3, 2012)

<sup>12</sup> Iyer, K.C. and Sagheer, M. (2011) 'Risk and Uncertainty Assessment in PPP Infrastructure Projects: Need for a Systems Dynamic Framework' (online) at: [http://www.indianjournals.com/glogift2k6/glogift2k6-1-1/theme\\_5/Article%2011.htm](http://www.indianjournals.com/glogift2k6/glogift2k6-1-1/theme_5/Article%2011.htm) (last accessed on April 3, 2012); see also Al-Bahar, (1989) *Supra* Note 6.

<sup>13</sup> Martin, J.E. and Heaulme, P (1998) 'Risk Management: Techniques for Managing Project Risks' in Cleland, D.I. (ed) *Field Guide to Project Management*, Van Nostrand Reinhold, New York

Whilst seeking a coherent understanding of the different ways in which the concept of risk has been defined, Vlek and Stallen<sup>14</sup> analysed and distilled the different definitions of risk from relevant professional literature, and came up with the following ways in which risk has been used. These include: a) risk is a probability of a loss b) risk is the size of a possible loss c) risk is a function, mostly the product- of probability and size of loss; d) risk is equal to the variance of the probability distribution of all possible distribution of a risky course of action e) risk is the semi variance of the distribution of all consequences, taken over the negative consequences only, and with respect to some adopted reference value; and f) risk is a weighted linear combination of the variance and expected value of the distribution of all possible consequences. The definition in (f) above is consistent with the view that risk involves both positive and negative consequences. This is the position also adopted in this thesis.

It is important to note that risks arise in all projects whether done through traditional public procurement or through PPPs. In traditional public procurement, while it is sometimes erroneously assumed that risks are solely borne by the public sector, in reality they are merely passed on to the public as customers and taxpayers. Large-scale public works are more risky than other business activities because of the complexity of coordinating a wide range of disparate and inter-related skills and

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<sup>14</sup> Vleck, C. and Stallen, P. 'Judging Risks and Benefits in the Small and in the Large' (1981) *Organizational Behavior and Human Performance* 28, pp. 235-271

activities.<sup>15</sup> This complexity is further compounded by the fact that public sector projects tend to have multiple stakeholders whose objectives and interests differ and due also to the fact that the infrastructure is user specific.<sup>16</sup>

Risk is also fundamental to project management. In fact, it has been suggested that the main purpose of project management is to manage the risks in a project.<sup>17</sup> Nonetheless, while risk has always played an important role in project management, awareness of risk has increased greatly under PPPs due to the inextricable link between risk and PPPs. Indeed, the centrality of risk to PPPs has raised the awareness of project risks to the level which public procurement has not been able to do to date.<sup>18</sup> PPP project risks may nonetheless be distinguished from the risks arising from other types of projects due to its unique peculiarities arising from the partnership between the public and private sectors. However, the central concern in every project, however carried out (traditional procurement, PPP or other means), remains whether the project will be profitable taking into consideration all the risks that are inherent in it.<sup>19</sup>

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<sup>15</sup> Shen, L. *et al* 'Role of Public Private Partnerships to Manage Risks in Public Sector Projects in Hong Kong', (2006) Vol. 24(7), *International Journal of Project Management* pp. 587-594

<sup>16</sup> *ibid*

<sup>17</sup> Grey, S. (2005) *Practical Risk Assessment for Project Management*, John Wiley & Sons, England Pg. ix.

<sup>18</sup> Grimsey, D. and Lewis, M. K. (2004) *Public Private Partnerships: The Worldwide Revolution in infrastructure Provision and Project Finance*, Edward Elgar Publishing, Cheltenham UK. Pg. 136.

<sup>19</sup> *Ibid*

The management of risk is therefore crucial to the success of PPP projects. This involves:

- a) risk identification: the process of identifying all the risks relevant to the project;
- b) risk assessment: the determination of the degree of likelihood of the risk and the possible consequences if the risk occurs;
- c) Risk allocation: assignment of the responsibility of the consequence of the risk to one or more of the contracting parties; and
- d) Risk mitigation: the process of controlling the likelihood of occurrence of the risk and or the consequence of the risk.<sup>20</sup>

These processes are discussed in greater detail in the following subparagraphs of this chapter.

### **3.3 Risk and PPPs**

One of the major advantages of PPP over other procurement models is the transfer of risk from the public sector to the private sector.<sup>21</sup> However, this declaration is quite simplistic as in reality it is not feasible or wise to transfer all the risks that may arise in a project to the private sector. The essence of the “partnership” in PPP is the fact that parties are able to share the risks and rewards so that the party best able to assume a

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<sup>20</sup> Department of economic Affairs (2006) National Public Private Partnership Handbook, Department of Economic Affairs, Ministry of Finance, Government of India pp. 1-246

<sup>21</sup> Grimsey, D and Lewis, M.K. (2004) *Supra* Note 19; Grimsey, D. and Lewis, M.K. ‘Are Public Private Partnerships Value For Money: Evaluating Alternative Approaches and Comparing Academic and Practitioner Views’<sup>29</sup> (2005) *Accounting Forum*

particular risk shoulders it. Transferring all the risks to the private sector would greatly impair the profitability and consequently the feasibility of the project. This will lead to either the abandonment of the project by the private sector, or escalate the cost of the project thereby reducing its economic viability, as the private sector will cost every risk allotted to it and charge a premium for them.

Consequently, one may conclude that there is a correlation between the proper transfer and management of risk and the improvement of value for money in projects. The reason for this is simply because parties now become more conscious of these risks and are able to reduce either the probability of the risk occurring or the financial consequences if it does, or both.<sup>22</sup> Accordingly, it is important as the thesis proposes that every PPP project strives towards the proper allocation of risk between the public and private sectors.

It is customary and good practice for the parties to the PPP project to do a checklist of all the risks likely to affect the project at each phase and properly apportion it to the parties. The most common tool used for this exercise is the risk matrix. A risk matrix is useful at the conception of a project, even before actual tender commences, as it is vital for, amongst other things, the proper costing of the project. It is also helpful during contract negotiations as it can act as a checklist to ensure that all risks

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<sup>22</sup> *ibid*

are accounted for and apportioned. Also, after the signing of the contract it can be a useful summary of all the risk allocated and dealt with in the contract.<sup>23</sup>

The allocation is done first of all on the basis that the party best able to assume a particular risk should bear it. However even after the risks have been apportioned, it may make social, political and sometimes commercial sense for the public sector to mitigate some of the risks that had been allocated to the private sector by taking some elements of these risks back. This is notwithstanding the fact that the private sector may choose to mitigate a number of its contractually assumed risks by for instance buying insurance to cover them or passing them to other parties via subcontracts. The reason is because the latter option is more likely to increase the cost of the project. Therefore it is advised that where socially, politically or commercially desirable, the public sector should mitigate some of the risks allocated to the private sector as the viability of the project might ultimately depend on this.<sup>24</sup>

Also when the construction phase of the project is completed and the private sector begins the operation of the services, the public sector

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<sup>23</sup> United Nations Economic Commission for Europe (2008) 'Guidebook on Promoting Good Governance in Public-Private Partnerships' *United Nations Publication*, Sales No. 08.II.E.1 p.36

<sup>24</sup> It has been argued in some quarters that this effectively makes the public the guarantors of the private sector. See Dannin, E. 'Crumbling Infrastructure, Crumbling Democracy: Infrastructure Privatisation Contracts and Their Effects on State and Local Governance', (2011) Vol. 6 *North Western Journal of Law and Social Policy*,

must also put in place a risk monitoring system to ensure that the services are delivered to the public according to the contracted performance specifications.<sup>25</sup> This will ensure that parties continue to assume allocated risks and therefore guarantee the continued viability of the project.

### **3.4 Nature and Categorisation of Risks in PPPs**

There is no exact agreement on the exact nature and number of risks that a project may face. The reason is simply because risks vary from project to project and even within the lifespan of the same project is likely to change from time to time. More so many of the so-called categories of risks overlap with one another. Risk factors may be categorized from different perspectives, some from more general perspectives and others from more precise formulations. There is also a lack of uniformity in the use of semantics in making the classifications resulting in the use of different labels for the same type of risks by different scholars. Despite these difficulties, it is however agreed that some form of classification or categorization of project risks is needed in order to understand clearly what types of risks are to be shared by the parties in a PPP.

UNIDO divides project risks into two broad categories: general risk and specific risks. While general risk refers to risk which the project sponsors have no control over like political, economic and legal environment of the host country, specific risks are those which the private sector project

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<sup>25</sup> United Nations Guidebook, Supra Note 23



entity has control over like construction risk.<sup>26</sup> For purposes of contractual design, project risks have been classified as either global or elemental. Global risks are those that are normally allocated through the project agreement like political risks, legal and regulatory risks, commercial risks and environmental risks while elemental risks are those associated with construction, operation, finance and revenue generation of the project.<sup>27</sup>

Dias and Loannou are of the opinion that risks are either pure risk or speculative risk. Pure risks occur when there is the possibility of financial loss but no possibility of financial gain and speculative risk involves the possibility of both gains and losses.<sup>28</sup> Ng and Loosemore also classify risk into two main groups: general risks and project risks. Project risks arise from the way a project is managed or from events in its immediate microenvironment, while in contrast general risks are not directly associated with project strategies, yet are capable of having significant impact on the outcome of the project.<sup>29</sup> Marques and Berg's classification is in three categories: production, commercial and

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<sup>26</sup> UNIDO (1996) '*Guidelines for Infrastructure Development Through Build-Operate and Transfer Projects*': United Nations Industrial Development Organisation, Vienna; See also Iyer, K.C and Sagheer, M. *Supra* Note 190

<sup>27</sup> Grimsey, D. and Lewis, M.K. '*Evaluating the Risk of Public Private Partnerships for Infrastructure Projects*', (2002) 20 *International Journal of Project Management* pp. 107-118; Merna, M.A. and Smith, N.J. (1996) *Privately Financed Concession Contract*, Vols. 1 and 2. 2<sup>nd</sup> ed. Hong Kong: Asia Law and Practice

<sup>28</sup> Dias, A. and Ioannou, P. '*Debt Capacity and Optimal Capital Structure for Privately Financed Infrastructure Projects*' (1995) Vol.121 No.4 *ASCE Journal of Construction Engineering and Management* pp. 404-414

<sup>29</sup> Ng, A. and Loosemore M. '*Risk allocation in the private provision of public infrastructure*' *International Journal of Project Management* 25(2007) pp. 66-76.

contextual risks.<sup>30</sup> Whilst production risks are usually borne by the private partner, the allocation of the commercial and contextual ones is mixed.<sup>31</sup>

Extant literature has categorized risks according to type. Miller and Lassard classify risks into three categories including market related risks, completion risks and institutional risks.<sup>32</sup> Risks have also been classified using a meta-classification approach, on the basis of three levels of risk factors. Li *et al.* classified risk into macro level risks, meso level risks and micro levels of risks.<sup>33</sup> The macro level of risks refers to risks that are sourced exogenously i.e. external to the project but which impact on the project e.g. political and legal conditions. The meso level risks occur endogenously i.e. within the project itself, this involves risks such as project demand usage, design and construction. The micro level risks represents risks found in the stakeholder relationships formed in the procurement process. Whilst these risks are also endogenous they differ from meso risks because they are party related, arising because of the different project objectives of the contracting parties. Whilst the public sector is driven by its social responsibility, the private sector is driven by its profit-making motive.<sup>34</sup>

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<sup>30</sup> Marques, R. and Berg, S. *Supra* Note 11

<sup>31</sup> *ibid*

<sup>32</sup> Lassard, D. and Miller, R. 'Understanding and Managing Risk in Large Engineering Projects (2001) MIT Sloan Working Paper No. 4214-01

<sup>33</sup> Li, B. *et al.*, 'The Allocation of Risk in PPP/PFI Construction Projects in the UK' (2005) 23 *International Journal of Project Management*, pp. 25-35

<sup>34</sup> *Ibid*

According to Li *et al*, the advantage of their classification is that it facilitates a strategic approach to risk management and it may also indicate situations in the risk management process where common approaches to risk analysis, treatment and monitoring can be adopted.<sup>35</sup> Slazmann and Mohammed in their analysis of international BOOT arrangements grouped risks into four categories namely host country risk, investor's risk, project risk and project organisation risks.<sup>36</sup> Xenidis and Angelides analysed the manner risk has been classified in several literature and concluded that they are able to decipher two major types of risk classification: the first is based on the life cycle phase that a risk occurs during the PPP contract period, and the second according to the source or origin of each risk.<sup>37</sup>

The advantage of the broad grouping of risks that was discussed in the preceding paragraphs is that it may ease the management of risks. This is because risks within the same category or group may be treated, allocated or managed in the same way since they share the same characteristics. However in practice, these groupings are usually dispensed with. Generally, most academics tend to discuss the different risk factors individually without any recourse to which category or broad

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<sup>35</sup> Ibid

<sup>36</sup> Salzman, A. and Mohammed, S. (1999) Risk Identification Frameworks for International BOOT Projects. In Ogunlana, S. (ed.) Profitable Partnering in Construction Procurement, CIB W92 Proceedings Publication 224, pp. 475-485, ISBN 0-419-24760-2

<sup>37</sup> Xenidis, Y. and Angelides, D. 'The financial Risk in Build Operate and Transfer Project', (2006) 23 *Construction Management and Economics*, pp. 431-441.

groups they fall into. The reason for this is probably because indeed, no two types of risks are truly the same. They may share certain common characteristics but it is doubtful whether all their characteristics always align, so that they can be treated in the same way in different projects every time they occur.

Typically, most commentators divide the risk associated with projects into 5 major categories.<sup>38</sup> For instance, the UK Department of Defence sees risk as covering 5 broad areas: design and development, construction, finance, co-operation and ownership.<sup>39</sup> However, these risks usually overlap and can often be further sub-divided into up to 61 factors.<sup>40</sup> The International Monetary Fund also divides risk into 5 categories:

- a) Construction Risk-which is related to design problems, building cost overruns and project delays,
- b) Financial risk- which is related to variability in interest rates, exchange rates and other factors affecting financing costs,
- c) Availability risk – which is related to the continuity and quality of service provision (which in turn depends on the “availability” of an asset),
- d) Demand risk- which is related to the ongoing need for services, and

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<sup>38</sup> Bakar, R.W. 'Handling Uncertainties', (1986) 4 (3) *International Journal of Project Management*, pp. 205-10

<sup>39</sup> Department of Defence UK (2001) Private Financing Manual, Organisational Effectiveness Branch, Interim version 25 February.

<sup>40</sup> Ibrahim, A.D *et al*, 'The Analysis and allocation of Risk in Public Private Partnerships in Infrastructure Projects in Nigeria' (2006) Vol. 11, Issue 3 *Journal of Financial Management of Property and Construction*, pp. 149-164.

- e) Residual value risk, which is related to the future market price of an asset.<sup>41</sup>

According to Grimsey and Lewis who divided risks into 8 categories, project risks include:

- a) Technical risk- due to engineering and design failures.
- b) Construction risk- because of faulty construction techniques and cost escalation and delays in construction.
- c) Operating risk- as a result of higher operating costs and maintenance cost.
- d) Revenue risk- e.g. because of traffic shortfall or failure to extract resources, the volatility of prices and the demand for products and services leading to revenue deficiency.
- e) Financial risk- arising from inadequate hedging of revenue streams and financing costs.
- f) Force majeure risk- involving war and other calamities and acts of God, changes and unsupportive government policies.
- g) Environmental risks- because of adverse environmental impacts and hazards.
- h) Project default- as a result of failure of the project from a combination of any of the above.<sup>42</sup>

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<sup>41</sup> International Monetary Fund (2005) 'Public Private Partnerships, Government Guarantees, and Fiscal Risk' prepared by staff team of the IMF led by Hemming, R. Washington DC: IMF Multimedia Services Division

<sup>42</sup> Grimsey, D. and Lewis, K. (2007) *Public Private Partnerships: The Worldwide Revolution in infrastructure Provision and Project Finance* Edward Elgar Publishing, Cheltenham UK. Pg. 172

As can be seen from the analysis above, the classifications or the number of risks that affect a project lack precision and sometimes classifications generally depend on the objectives of the individual doing the classification. These different approaches are all important for the purposes of this research because the different studies analyzed and undertaken in the subsequent chapters of this thesis employ either one or a combination of these classifications. Therefore a general recognition and understanding of the various classifications of risk is important for the understanding of the discussions that follow in subsequent chapters.

### **3.5 Risk Assessment**

The technique for risk assessment can be classified into 2 broad techniques: Quantitative and Qualitative Techniques. Quantitative techniques are used to assess the risks and represent the likelihood and impact of the risk in terms of either time or money. Two of the commonly used quantitative techniques are the deterministic and the probabilistic approach.<sup>43</sup> Sensitivity analysis is the most representative approach amongst the deterministic analysis.<sup>44</sup>

Qualitative techniques are predominantly used to list the likely sources of risks and their consequences. Some of the commonly used qualitative

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<sup>43</sup> Hans-Wihelm, A. et al, 'An Introduction to PPP Concept in Public-Private Partnership in Infrastructure Development: Case Studies from Asia and Europe Bauhaus Universitat Weimar, (online) at [http:// e-pub.uni-weimar.de/volltexte/2009/](http://e-pub.uni-weimar.de/volltexte/2009/) (last assessed on March 28, 2012).

<sup>44</sup> *ibid*

techniques are risk registers and probability impact tables. Risk registers have a tabular form to compile all the risks relevant to the projects along with information necessary for management of the risk. In probability impact tables, the probability and impact of the risk are subjectively assessed using qualitative scaling factors. These scaling factors are then converted into values, weights and the scores of all the risks are computed by multiplying the values of probability and impact.<sup>45</sup>

### **3.6 Allocation of Risks**

One of the essential roles of PPP is to achieve optimal risk allocation. Under traditional procurement, the risk assumed by the public sector when it owns and operates an infrastructure asset is often unvalued. What PPP ensures through the involvement of the private sector is that risk is adequately and properly identified, priced and then transferred to the party that is best able to manage it.

In simplistic terms, the concept of risk transfer in PPP would have involved the public sector transferring all the risks to do with the project to the private sector leaving the public sector merely as purchaser of risk free services.<sup>46</sup> As mentioned earlier, this will not work in practice, as the private sector with its profit making mindset, will always price the risk and charge a risk premium for whatever risks it assumes. Therefore, if the transfer of risk is total, the private sector will, if in the unlikely event that it

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<sup>45</sup> Ibid

<sup>46</sup> Grimsey, D. and Lewis, M.K. (2004) Supra Note 21

decides to continue with the project, charge too much thereby making the project too expensive and economically unviable. The notion of value for money, which is central to the viability of PPPs, will be defeated. At all times, it is essential to ensure that the public benefit of risk transfer to the private sector outweighs any increase in financial cost associated with the risk bearing.<sup>47</sup> Therefore, the objective of the public sector must not be to seek to maximize risk transfer at any price but to seek optimal risk transfer.<sup>48</sup>

Max Abrahamson recommends five cases in which a contracting party may bear project risks:

- a) If the risk is a loss due to his or her own willful misconduct or lack of reasonable efficiency or care.
- b) If he can cover a risk by insurance and allow for the premium in settling his charges and it is the most convenient and practicable for the risk to be dealt with in this way.
- c) If the preponderant economic benefit of running the risk accrues to him.
- d) If it is in the interest of efficiency to place the risk on him.
- e) If when the risk eventuates, the loss happens to fall on him in the first instance, and there is no reason under any of the above

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<sup>47</sup> Quiggin, J. 'Risk, PPPs and the public sector comparator' (2004) Vol. 14, No.2 *Australian Accounting Review*, pp.51-61

<sup>48</sup> Nisar, T. 'Risk management in public-private partnership contracts', (2007) Vol.7, No.1 *Public Organisation Review* pp.1-19



headings to transfer the loss to another or it is impracticable to do so.<sup>49</sup>

According to Ward *et al*, even though these guidelines by Max Abrahamson have received wide support and are a useful first step in addressing the problem of risk allocation, they do not provide a complete solution.<sup>50</sup> The reason for this view is that the guidelines fail to recognize the pricing of risk, the differing attitudes to risk by the contracting parties and offer little help in allocating risks that are uncontrollable or controllable to a degree by more than one of the contracting parties. The possibility of risk sharing which is vital for the success of PPPs is therefore not contemplated by the guideline.<sup>51</sup>

Accordingly, for Ward *et al*, parties who bear project risks have 4 basic response options:

- a) Pass the risk to a third party; or
- b) Continue to bear the risk and manage it for profit, but accept liabilities; or
- c) If a downside risk eventuates, try to recover costs from other parties including the public partner; or

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<sup>49</sup> Abrahamson, M. 'Contractual risk in tunneling: how they should be shared', (1973) *Tunnels & Tunneling* pp. 587-598

<sup>50</sup> Ward, S.C. *et al.*, 'On the Allocation of Risk in Construction Projects', (1991) Vol.9 No.3 *International Project Management*, pp. 104-147

<sup>51</sup> Ibid

- d) If a downside risk eventuates, meet liabilities reluctantly, walk away from the contract, or go bankrupt.<sup>52</sup>

It is assumed that the bearers of risk will be motivated to use the first option provided that it is cost effective.<sup>53</sup>

In the spirit of partnership, which is core to PPPs, the public sector usually bears some of the risks that it feels that it is in the best position to assume, otherwise it gambles on the possibility of an unsuccessful project. If a project collapses due to a flawed risk allocation process, the consequences can be quite grave especially in public utility projects as the public sector will have no other option but to step in and rescue the project, inadvertently assuming the entire risk in the project.

There are certain agreed rules that guide risk allocation in PPPs. It is agreed that risk should only be allocated to a party who:

- a) Has been made fully aware of the risks they are taking.
- b) Has the greatest capacity to manage risk effectively and efficiently (and charge the lowest risk premium).
- c) Has the capability and resources to cope with the risk eventuating.
- d) Has the necessary risk appetite to want to take the risk.
- e) Has been given the chance to charge the appropriate premium for taking it.<sup>54</sup>

According to Ng and Loosemore:

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<sup>52</sup> *ibid*

<sup>53</sup> *ibid*

<sup>54</sup> Ng, A. and Loosemore M. *Supra* Note 29

Not following these simple rules will compromise the success and efficiency of the project since it will produce higher risk premiums than necessary, increase the chance of the risk arising and the consequences if they do arise. Further inefficiencies can arise from confused responsibility for monitoring and responding to risks; resentment for being forced to take them and; denial, conflict and dispute to avoid responsibility when they do arise. In effect, by not following the above rules, the public sector is merely gaining the illusion of risk transfer, since it is likely that the risk will be transferred back to them in the form of higher risks, risk premiums and project problems.<sup>55</sup>

While most risks are within the control of either party, there are certain risks that are outside both parties' control. In practice, such risk is priced by the private party and the public party decides whether it is cheaper for it to assume the particular risk, taking into consideration the likelihood of the risk eventuating and how it may be able to mitigate its impacts. The other option will be for the parties to decide to share the risk through various risk sharing mechanisms.<sup>56</sup> It is alright to say that risk should be allocated to the party that is best able to bear it but the dilemma is what to do with risk that neither party can control, such as *force majeure* risk.<sup>57</sup>

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<sup>55</sup> *ibid*

<sup>56</sup> Grimsey and Lewis (2004) *Supra* Note 46 pg. 179.

<sup>57</sup> Nisar, T. M. *Supra* Note 48 pp. 1-19.

It is important that the risk in a project is identified early, because it enables project constraints and appropriate cost estimates to be determined early enough. This also helps focus project management attention on ways of controlling and allocating risk.<sup>58</sup> There are two dimensions to risk allocation. The first is qualitative in nature, concerned with the type of risk that is allocated and to whom? <sup>59</sup> The second is quantitative concerned with determining how much of the risk is allocated.<sup>60</sup> This second aspect involves mathematical solutions.<sup>61</sup>

According to Nisar, allocation of risk in PPP projects can either be done implicitly or explicitly.<sup>62</sup> Risk transfer to the private sector is implicit in a normal PPP arrangement and is usually directly proportional to the level of responsibility assumed by the private sector. For instance, in a normal DBFO, transfer of the risk of the level of occupancy or usage of the asset is implicit in the PPP arrangement. Also, the degree to which demand risk can be transferred varies depending on the extent to which the public sector directly controls the flow of users and revenue, for example the difference between schools at one extreme and roads at the other.<sup>63</sup> Explicit transfer of risk may occur in two ways: The first is through

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<sup>58</sup> Ward, S.C. *et al*, *Supra* Note 50

<sup>59</sup> See for example Li, B. *et al*, 'VFM and Risk Allocation Models in Construction PPP Projects' in Akintoye, A. *et al* (eds.) ARCOM Doctoral Workshop Publication, pg. 16.

<sup>60</sup> See for example Yamaguchi, H. *et al*, (2001) 'Risk Allocation in PFI Projects' 17<sup>th</sup> Annual Conference Salford Vol. 2 pp. 885 - 894.

<sup>61</sup> Li, B. *et al*, *Supra* Note 59

<sup>62</sup> *ibid*

<sup>63</sup> *ibid*; see chapter 6 for a comprehensive discussion of this concept.

the payment mechanism used to pay the private sector for services rendered and secondly through contract terms. For example with respect to the provision of custodial services, the prison operator is paid for 'available' prison cells (the payment mechanism) but is specifically penalized in the event of escape of prisoners (the contract term).<sup>64</sup> An analysis of risk should strongly influence the choice of method of payment and the form of contract.<sup>65</sup> This fact is most vital when allocating demand risk as evident from the analysis in chapter 6 of this thesis.

It is pertinent to note that not everyone agrees that risk transfer to the private sector always leads to positive outcomes. Indeed it is claimed that risk management practices could be highly variable, intuitive, subjective and unsophisticated.<sup>66</sup> A major criticism of the management of risk in practice is that PPP contracts usually involve lengthy and complex contract tendering procedures with a large number of stakeholders participating in the process. Therefore, it is argued that the complex nature of PPP arrangements actually increases public sector risk rather than reducing it, increases service costs for the public and

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<sup>64</sup> *ibid*

<sup>65</sup> Ward, S.C. *etal* *Supra* Note 58

<sup>66</sup> Akintoye, A. (2001) *Framework for Risk Assessment and Management of Private Finance Initiative Projects*, Glasgow Caledonia University, Glasgow, Scotland; Cited also in Ng, A. and Loosemore, M. *Supra* Note 233 pp. 66-76.

represents a barrier to the entry of small companies, which is patently uncompetitive.<sup>67</sup>

It has also been argued that in some situations PPP are not economically viable for the private sector without exorbitant risk related service charges, which are saddled on the public.<sup>68</sup> Also, due to the long-term nature of PPP contracts and the changing nature of risks over the term of the PPP contract, there are doubts that parties will be able to fully conceive all probable risks that will eventuate during the life span of the contract. Therefore, in order to compensate for these unknown risks, the private sector consortium demands high-risk premiums that are eventually transferred to the public in the form of high user fees.<sup>69</sup>

However despite these criticisms, there is superior literature and arguments as discussed above to the effect that it is more desirable and rewarding to properly manage risks in PPPs.<sup>70</sup>

### **3.7 Valuation/Pricing of risk**

The steps involved in the valuation of risk are:

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<sup>67</sup> Ng, A. and Loosemore, M. *ibid*; see also Moore, W.B. and Muller, T. 'Impacts of development and Infrastructure Financing' (1989) 115 (2) *Journal Urban Plan Development ASCE* pp. 95-108.

<sup>68</sup> *Ibid*

<sup>69</sup> *ibid*

<sup>70</sup> See also Grimsey, D. and Lewis, M.K. (2005) *Supra* 21

- a) Identification- all potential risks that can occur in the context of the project are first identified.
- b) Consequence assessment- the consequence and impact of each of the identified risks is then assessed.
- c) Risk probability calculation- the assessment of the probability of each risk occurring.
- d) Contingency factor- this accounts for the unobservable costs that could lead to the undervaluation of identifiable and observable risks
- e) Value calculation- the value of the risk is calculated by multiplying the consequence and probability of occurrence and then adding that product to the contingency factor.<sup>71</sup>

Value of risk= consequence x probability of occurrence + contingency factor.

The mechanics for pricing risks first assumption is that nothing is free. When bidding for a project the private sector partner, being naturally risk averse, evaluates the risks potentially associated with the project and then estimates their potential impacts on the project. It then sets premiums to protect itself from the financial consequences in the event of the occurrence of the risk.<sup>72</sup> The premiums are then averaged across

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<sup>71</sup> Morillos, D. et al, 'Value for Money Analysis in US Transportation Public-Private Partnerships' (2009) *Journal of Transportation Research Board* 2115, National Academy Press, Washington DC.

<sup>72</sup> See Pollock, A. and Price, D. (2004) *Public Risk transfer for private gain? The public audit implications of risk transfer and private finance*, UNISON, London. In a study carried out on behalf of UNISON the authors show that the structure of PPP deals obscures the relationship between risk and the risk premiums for two reasons: firstly the SPV is merely a shell company and transfers risk to other companies through a variety of

the projects the private sector is involved in and are weighted according to the probability and consequences of various kinds of events. The risk premium hereby calculated is seen as a form of self-insurance.<sup>73</sup> For the public sector the basic question is whether the risk premium offered by the private sector is good enough for it i.e. whether it is value for money. Where it is considered not to be good value for money, the public sector would assume the risk itself.

In order to assume this responsibility, the public sector needs to have a risk management plan.<sup>74</sup> According to Grimsey and Lewis, the plan involves the following:

- a) Identifying all the project risks including the general risk (which features in the risk matrix) and project specific risks (for example the risk to public health in a water project).
- b) Determining the core services which are provided by government and which the risk cannot be transferred to the private party.
- c) Examining each risk and identifying those that the government is best placed to manage as a result of the level of control it exercises and those that may otherwise not be optimal to leave with the private party. These should in each instance be taken back by the government.

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complex financial mechanisms which makes it difficult to assess its value. Secondly because the main providers of private finance are heavily protected from risk.

<sup>73</sup> Ibid

<sup>74</sup> Ibid



- d) Ascertaining whether any of the remaining risks should be shared because of market convention or specific factors relating to the project, and
- e) Adjusting the risk allocation inherent in the basic PPP adjustment structure and using the contract to reflect that adjustment and allowing for any power imbalance between parties arising from special government powers.<sup>75</sup>

It is good practice to design a risk matrix as a framework for the allocation of risk in a project. A risk matrix has two objectives: the first is that it aids optimal risk management and provides the impetus to achieve it because it ensures that the party best able to control the risk is allocated the risk. The second is that it ensures value for money,<sup>76</sup> because the party that is best able to assume a particular risk is usually most able to do it at the least cost.<sup>77</sup> It is important to note that these matrixes are merely useful guides and suffer several limitations. This is apparent when viewed against the backdrop of the changing nature of risks throughout the life span of the project and therefore it is advocated that risks should best be considered on a project-by-project basis.<sup>78</sup>

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<sup>75</sup> *ibid*

<sup>76</sup>It is common practice to determine whether the value for money requirement has been met by comparing the benefits of financing a project through the use of PPPs or doing so through direct public procurement. This is usually achieved by using a public sector comparator (PSC) i.e. whether more value for money could have been better achieved if the project was done solely through public sector finance.

<sup>77</sup> *ibid* at pg. 179

<sup>78</sup> Grimsey, D. and Lewis, M.K. ( 2005) *Supra* Note 70 ; Ng, A. and Loosemore, M. *Supra* Note 67

### 3.8 Value for Money Considerations

In deciding whether to finance a project through PPPs rather than through traditional public sector procurement, the major consideration for government is usually whether the PPP alternative presents better value for money (VFM). Usually, proper risk allocation in a project contributes to the attainment of VFM. For instance, Cheung *et al* carried out a comparative study of Hong Kong, Australia and the United Kingdom and discovered that proper risk allocation was the greatest VFM enabler in all three jurisdictions.<sup>79</sup> They discovered that when risks are handled well, fewer pitfalls are experienced and this leads to the achievement of VFM.<sup>80</sup> In a similar vein, Bing Li *et al* whilst conducting research on the factors that enhanced VFM in PPP projects found that the top three factors are efficient risk allocation, output based specification and the long-term nature of contracts.<sup>81</sup> This conclusion was similar to the result reached by Arthur Anderson.<sup>82</sup>

VFM itself is not an easy term to define because of its political underpinnings. Its definition depends on the motives and interests of

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<sup>79</sup> Cheung, E. *et al.*, 'Enhancing value for money in public private partnership projects: findings from a survey conducted in Hong Kong and Australia compared to findings from previous research in the UK'. (2009) 14(1) *Journal of Financial Management of Property and Construction* pp. 7-20.

<sup>80</sup> *ibid.*

<sup>81</sup> Li, B. *et al.*, 'VFM and Risk Allocation Models in Construction PPP Projects', *Preliminary result of on-going PhD research*, School of Built and Natural Environment, Glasgow Caledonia University. (online) at: <http://www.reading.ac.uk/AcaDepts/kc/ARCOM/eorkshop/04-Edinburgh/06-Li.pdf> (last accessed August 12, 2012)

<sup>82</sup> Andersen, A. (2000) 'Value for money drivers in private finance initiative': Arthur Andersen and Enterprise LSE.

government; it may therefore change over time due to political, economic and social developments.<sup>83</sup> The term “VFM” may either be used as an absolute or relative term. As an absolute term, it can be taken to mean that the benefits of purchase to the purchaser exceed the costs. While as a relative term it means that one of the options for meeting the purchaser’s needs provides greater benefits relative to cost than the other.<sup>84</sup>

According to the UK HM Treasury Value for Money Guide, VFM is “the optimum combination of whole-of-life costs and quality (or fitness for purpose) of the goods or service to meet the users requirements. VFM is not the choice of goods and services based on the lowest cost of the bid”.<sup>85</sup> In essence, the UK HM Treasury’s definition underlines that in determining the value of pursuing a project as a PPP, the public sector must account for the cost savings to be made from the project over the lifetime of the project. In addition, it stresses that VFM assessment should ensure that the public agencies focus on the competency of the private sector and not only on securing the lowest bids.<sup>86</sup>

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<sup>83</sup> Ismail, K. *et al*, (2011) ‘The evaluation criteria for Value for Money (VFM) of Public Private Partnership (PPP) bids’ (2011) *International Conference on Intelligent Building and Management Proc of CSIT* Vol. 5; Akintoye, A. ‘Achieving best value in private finance initiative project procurement,’ (2003) 21 *Construction management and Economics* pp. 461-470

<sup>84</sup> Nigerian National Policy on Public Private Partnership (PPP), (2009) Infrastructure Concession Regulatory Commission Nigeria.

<sup>85</sup> HM Treasury, ‘Value for Money Assessment Guide’, HM Treasury London (2006); Takim, R. *et al*, (2011) *Supra* Note 14

<sup>86</sup> *ibid*

According to Grimsey and Lewis, a number of conditions ought to be met in order to achieve VFM in projects. Firstly, projects should be awarded in a competitive environment. Secondly, economic appraisal techniques including proper appreciation of risk should be vigorously applied, and risk allocated between the public and private sectors so that the expected value of money is maximized. Finally, the comparisons between publicly and privately financed options should be fair, realistic and comprehensive.<sup>87</sup>

Under traditional public procurement, decisions on options to follow in procuring a particular project is based on a cost benefit analysis that does not consider alternative ways of procuring the project but assumes a particular commercial approach, which is often procurement by the public sector. Once the procurement approach is decided, the public sector sets in motion a competition between bidders where price and non-price factors are assessed to ensure that VFM is achieved. However in PPPs, the test for VFM is two-pronged: first there is competition between bidders like under traditional procurement. Secondly, the choice of a particular arrangement is also tested to ensure that it is capable of delivering VFM to the government.<sup>88</sup>

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<sup>87</sup> Grimsey, D. and Lewis, M.K. (2005) Supra Note 78 pp. 345-378

<sup>88</sup> Grimsey, D. and Lewis, M.K. (2002) Supra Note 27

VFM itself is a broad term that captures both financial and non-financial elements of evaluations.<sup>89</sup> To ensure that the analysis of the two alternatives available to the government is comparable, there will be a need for a proper accounting for quality of services, price, timeframe, risk apportionment and certainty.<sup>90</sup> VFM is often computed in most jurisdictions by using a benchmark called the Public Sector Comparator (“PSC”). The PSC simply describes the options and assesses what it would cost the public sector to provide the outputs it is requiring from the private sector on its own. Thus the private sector bids are assessed against the PSC to determine which option between the two will guarantee better VFM.<sup>91</sup>

In most countries the method of calculating VFM using the PSC is that the Net Present Value (NPV) of the risk adjusted PSC is compared to the NPV of the proposed future service fees or benefits paid to the private sector bidder over the life of the PPP. It is based on estimates of full costs, revenues and risks set out in cash flow terms, discounted at a public sector rate to the NPV, which is compared with the discounted value of payments under the PSC along with the adjustment for risks and costs retained.<sup>92</sup> Once the NPVs of both PSC and that of the SPV have been prepared and adjusted to an equivalent footing, then a simple

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<sup>89</sup> Takim, R. *et al.*, Supra Note 85

<sup>90</sup> Partnership South Australia Guidelines, found (online) <http://www.treasury.sa.gov.au/public/download.jsp?id=513> (Last accessed on January 22, 2012)

<sup>91</sup> Grimesey, D. and Lewis, M.K (2005) Supra 87.

<sup>92</sup> *ibid*

comparison of both will be undertaken.<sup>93</sup> Note that there are different approaches to this in certain jurisdictions. However, most of them are mere variants of the methodology discussed above.

The use of the PSC has inherent challenges mainly as a result of the difficulties involved in obtaining data to make the comparison. This is the reason why the Nigerian PPP Policy accepts that the Government cannot rely on the PSC in calculating VFM at this early stage of its PPP development. However, the Policy also concedes that it may do so over time when the country collates enough evidence of outturn costs to be able to rely on PSC effectively.<sup>94</sup>

It is noted that it is not wise to jettison the PSC merely because of paucity of data. According to Grimsey and Lewis, the PSC performs the other roles apart from calculating VFM. According to them:

- a) It promotes full costing at an early stage in project development.
- b) It provides a key management tool during the procurement process by focusing attention on the output specification, risk allocation and comprehensive costing.
- c) It provides a means of testing value for money.
- d) It provides a consistent benchmark and evaluation tool.

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<sup>93</sup> Ismail, K. The Malaysian Private Finance Initiative and Value for Money Supra Note 83

<sup>94</sup> Nigerian PPP Policy Supra Note 57

e) It encourages competition by generating confidence in the market that financial rigor and probity principles are applied.<sup>95</sup>

VFM can be measured against a number of proxies, including the business case, the PSC and by benchmarking costs.<sup>96</sup> VFM is usually associated with three “Es” i.e. Economy, Efficiency and Effectiveness.<sup>97</sup> Therefore in seeking VFM, three initial strategies should be deployed: effective evaluation mechanism; viability of PPP contractor and commitment to VFM.<sup>98</sup> The baseline cost of the PSC is usually based on historical cost for services and adjusted based on project future demand, demographical changes and political considerations.<sup>99</sup> Long term forecasting requires assumptions to be made about the future, which limits the accuracy of any PSC valuation.

Grimsey and Lewis<sup>100</sup> and Dorothy Morallos *et al*<sup>101</sup> discuss in detail the assessment of VFM in PPP projects. VFM methodology typically involves

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<sup>95</sup> Grimsey D. and Lewis, M.K. (2004) *Supra* Note 56

<sup>96</sup> National Audit Office, *Managing Resources to Deliver Better Public Services*, HC 61-1, Session 2003-04, London.

<sup>97</sup> English, L. and Guthrie, J. ‘Driving Privately Financed Projects in Australia: What Makes them tick?’ (2003) 16(3) *Accounting, Auditing and Accountability Journal* 493-511; Grimsey, D. and Lewis, M.K (2005) *Supra* Note 91; Shaoul J. ‘A Critical Financial Analysis of Private Finance Initiative: Selecting a Financing Method or Allocating Economic Wealth’ (2005) *Critical Perspectives in Accounting* 16(4) pp. 441-471

<sup>98</sup> Takim, R. *et al.* ‘The Malaysian Private Finance Initiative and Value For Money’ (2009) 5(3) *Asian Social Science* P. 103

<sup>99</sup> The Nigerian National Policy on PPP recognizes that there are probably no robust database of outturn costs for similar projects procured and so concludes that public authorities in Nigeria will not be able to reliably estimate ex ante costs for estimating VFM in PPP projects.

<sup>100</sup> Grimsey, D. and Lewis, M.K. (2005) *Supra* Note 97; Grimsey, D. and Lewis, M.K (2004) *Supra* Note 95

two primary assessments: quantitative and qualitative. While the quantitative component includes all project factors that can be valued in monetary or financial terms, the qualitative assessment of VFM takes into account aspects of the project that are not quantifiable in monetary terms. The quantitative assessment usually involves the comparison of the PPP bid with the PSC. The qualitative assessment on the other hand evaluates factors such as the characteristics of the market and the competitiveness of the bidding environment. It also assesses the resources and capabilities of the private and public sectors and other benefits and costs not included in the quantitative assessment.<sup>102</sup>

### **3.8.1 Quantitative Assessment**

PSC uses the Discounted Cash Flow (DCF) analysis to provide a projection of the NPV of the expected cash flow. Critical to the DCF analysis therefore is the discount rate mechanism employed. The discount rate that a public agency uses should reflect the government's time value of money plus a systematic risk premium for the interest rate involved in the project.<sup>103</sup>

There are several approaches to determining the discount rate to be employed in the project:

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<sup>101</sup> Morillos, D. *et al* Supra Note 71

<sup>102</sup> *Ibid*, pp. 27-36

<sup>103</sup> *Ibid*



- a) A single discount rate could be used for both the PSC and the PPP project without adjusting for the risks a public sector would acquire in the PSC. This is the method favored in South Africa<sup>104</sup> and Ireland.<sup>105</sup>
- b) The values of project risks can be calculated and the costs of such risks then incorporated into the projected cash flows of each procurement option. A risk free discount rate could then be applied to these risk free adjusted cash flow. This is the option that is used in the United Kingdom.<sup>106</sup>
- c) A risk mark up or a risk adjusted discount rate can be added to a risk free discount rate to account for “risky” cash flow while the risk free rate can be used for “non-risky” cash flows. Partnership Victoria of Australia supports the use of the last option.<sup>107</sup>

According to Morillos D. *et al* there are four components of a PSC:

- a) The raw PSC which accounts for the base cost (capital and operation). Note that this does not incorporate the cost of risks involved in the project.
- b) Competitive neutrality value- this removes the inherent competitive advantages and disadvantages that are available to the public sector agency but which are not available to the private sector. This allows both projects to be compared at an equal level. Examples of

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<sup>104</sup> National Treasury PPP Unit (2004) ‘Public Private Partnership Manual’ Pretoria, Republic of South Africa.

<sup>105</sup> Central PPP Unit Ireland ‘Value for Money and the Public Private Partnership Procurement Process’, Ireland National Development Finance Agency Dublin 2007.

<sup>106</sup> Grimsey, D. and Lewis, M.K. (2004) *Supra* Note 100

<sup>107</sup> Partnership Victoria (2003) ‘Use of Discount Rates in the Partnership Victoria Process’ – Technical Note: Melbourne Department of treasury and Finance, Australia.

public sector advantages include exemptions from taxes. Disadvantages could be accountability costs and reporting requirements.

- c) Transferable risks- these are risks that are likely to be transferred from the public sector to the private sector. The value of transferable risk in the PSC measures the cost government could expect to pay for that risk over the term of the project if it was done through public procurement.
- d) Retained Risks- these are those risks or responsibilities retained by the procuring public sector agency. The retained risks are the same for the PSC and the PPP.<sup>108</sup>

Once all risks have been categorized as transferable or retained, the size and timing of the expected cash flows associated with each risk is aggregated to determine the NPV.<sup>109</sup> Once the total NPV of each of the four components costs have been calculated, the values are then summed up to determine the final risk-adjusted PSC cost. For the PPP cost calculation of the VFM analysis, the procuring agency determines the projected cash flows on the basis of the retained risks and service payments (if any) that it would pay the private sector for the provision of the service. The projected PPP costs are then brought to NPV terms. The total PSC cost is then compared with the NPV of the PPP with the difference being the VFM.<sup>110</sup>

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<sup>108</sup> Morillos, D. *et al* Supra Note 102

<sup>109</sup> Ibid

<sup>110</sup> Ibid

### 3.8.2 Qualitative assessment

This assessment typically covers the feasibility and desirability of a project based *inter alia* on the quality of a contract, the skills and resources of both the public and private sector and the market interest for the project. It may also include additional costs and benefits that could not be quantified in the quantitative assessment such as additional innovations and improvements which a private sector SPV may provide the public sector with.<sup>111</sup> All material factors that have not been included in the PSC should be used to evaluate the private sector bid.<sup>112</sup> Some of the examples given by Partnership Victoria, include the reputation and competence of the private bidder, wider benefits or costs that a PPP should bring and the accuracy and comprehensiveness of the information used.<sup>113</sup> According to Partnership Victoria, the consideration of the qualitative factors can make or break the attractiveness of the PPP procurement route, especially when the lowest private bid is very close to the PSC.<sup>114</sup>

In 2006, the HM Treasury of the United Kingdom published a new VFM Guideline that replaces the requirement for a PSC with the Outline Business Case ("OBC").<sup>115</sup> The OBC requirement is much wider than the PSC and requires amongst other things that potential PPP projects are assessed for whether they have potential of reaching successful

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<sup>111</sup> Ibid

<sup>112</sup> Partnership Victoria Supra Note 107

<sup>113</sup> Ibid

<sup>114</sup> Ibid

<sup>115</sup> HM Treasury (2006), Value for Money Assessment Guidance' London

procurement. Also, whether there are any potential identifiable project management obstacles.<sup>116</sup> This guideline introduces three stages in the assessment of VFM for potential projects. First is the Programme Level Assessment, which evaluates whether the use of PPP is appropriate for the potential project and whether VFM can be achieved. The second stage is the Project Level Assessment, which requires an OBC; this is similar to the PSC. Finally, the Procurement Level Assessment, which requires an on-going assessment of the procurement process.<sup>117</sup>

The National Policy on PPP in Nigeria also considers VFM proposition as the most appropriate way of maximizing the overall benefit of a project.<sup>118</sup> The Policy concedes that there is no simple rule that can be used to satisfy a VFM test because of the difficulty in measuring quality and cost of the service as well as the unavailability of relevant data. It however states that the assessment of VFM should consider the whole life cost of the service requirement not just the initial cost and associated risks, which may have financial impact.<sup>119</sup>

A pertinent question is whether developing countries like Nigeria with little or no money to pursue infrastructure projects have any real

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<sup>116</sup> Nisar, T.M. (2011) 'The Design and Implementation of Public Private Partnerships in the UK's Social Sector' Paper presented at Improving the Quality of Public Services: A Multinational Conference on Public Management, Moscow Russia.

<sup>117</sup> Cheung, E. *et al.*, *Supra* Note 79, pp. 7-20.

<sup>118</sup> National Policy on Public-Private Partnership (PPP), a document of the Infrastructure Concession Regulatory Commission

<sup>119</sup> *ibid*

alternatives, to PPPs even when VFM analyses show that it is more cost effective to do a project through public procurement. There seems to be just a single option available to these countries, which is PPP. The comparative testing schemes in these countries involve the governments merely going through the motions before deciding on the premeditated option to procure the projects through PPP.<sup>120</sup> However, it is conceded that some of the other benefits that are accruable through the use of the PSC may warrant its continued use.

There are several arguments against the use of the PSC, which have been aptly summarized by Grimsey and Lewis after reviewing some of the available literature where concerns have been raised about the VFM question. According to them, these are that:

1. The value for money evaluation usually comes down to the choice between two very large net present values, with the difference between them often very small and reliant on the risk transfer calculations included in the PSC. Also, because the PSC is entirely hypothetical, its value can be altered by assumptions made especially about risk transfer to the private sector.
2. The discount rate methodology is faulty and a free risk discount rate is advocated.

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<sup>120</sup> It is however claimed that VFM also helps the public sector understand how the project risks can be allocated between the public and private sectors and also that the VFM tool also helps give the government confidence about the use of PPP and that scarce resources would be well spent. See for example Flores, J.L. (2010) 'The Value of the "Value for Money" Approach When There's No Money' In IFC Advisory Services in Public-Private Partnerships: Smart Lessons from Infrastructure, health and education : International Finance Corporation, pg. 7

3. Irrespective of how much risk is transferred to the to the private sector, the main risks (obsolescence, changing needs and service performance outcomes) are still held by the public sector and costs fall upon the general public. Furthermore, that the real risk is uncertainty not risk and that the significance of this distinction renders risk calculation problematic.<sup>121</sup>
4. With contracts lasting sometimes for more than 60yrs, financial evaluations relating to cost estimates, discount rates and risks allocation are incomplete bases to draw conclusions about the viability of proceeding with the PPP option and more elements need to be given to non-financial elements in the longer term evaluation.<sup>122</sup>

There are other criticisms about whether VFM is achievable in PPP projects. This is usually centred on high transaction costs, for example regarding legal fees and the length of time it takes to negotiate and conclude a PPP transaction.<sup>123</sup> It is argued that this may not encourage the attainment of VFM in PPPs.<sup>124</sup> It has also been contended that PPPs increase public sector risk rather than reduce it, increase service costs for

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<sup>121</sup> Shaoul (2005) Supra Note 97

<sup>122</sup> Broadbent J. and Laughlin R. 'Public Private Partnerships: An Introduction ' (2003) *Accounting, Auditing and Accountability Journal* 16 (3) pp.332-341

<sup>123</sup> Grimsey D. and Lewis M.K (2005) Supra Note 100

<sup>124</sup> *ibid*; Ahadzi, M. and Bowles, G. 'Public- private Partnerships and Contract Negotiations: an Empirical Study Construction Management and Economics' (November 2004) 22, 967-978; Ng, A. and Loosemore, M. Supra Note 78

the public and shut out the entry of small companies thereby reducing competition.<sup>125</sup>

According to Parker and Harley, the early history of PFI in the UK was troubled by private sector complaints of over-protracted and wasteful project bidding and aborted projects.<sup>126</sup> The National Audit Office of the United Kingdom estimated that the average cost of taking part in a PFI bidding process was between £0.5m and £2.5m.<sup>127</sup> Partnership UK tried to mitigate this through the introduction of model contracts and other similar measures.<sup>128</sup> It is generally agreed that if VFM is to be attained in PPPs, that they have to genuinely result in lower costs over the projects life cycle for a given quantity and quality of service.<sup>129</sup>

Also, another point that is readily made is that the concept of VFM is predicated on the assumption that both parties negotiating the PPP contract are acting in good faith and in the protection of their own interests. In the case of the public sector, it is to pursue optimal risk allocation and ensure that only the most economically and efficient project is pursued through PPP. Parker and Harley, basing their argument on 'public choice' theory from economics, are of the opinion that the

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<sup>125</sup> Moore, W.B. and Muller, T. 'Impacts of Development and infrastructure Financing' (1989) 115(2) *Journal of Urban Planning Development ASCE*, pp. 95-108

<sup>126</sup> Parker, D. and Harley, K. 'Transaction Costs, Relational Contracting and Public Private Partnerships: A Case Study of UK Defence,' *Journal of Purchasing and Supply Management* 9 (203) pp. 97-108.

<sup>127</sup> The National Audit Office, 1997. *The PFI Contracts For Bridgend and Fazakerley Prisons*, HC 253, Sessions 1997-98 London; Cited in Parker, D. and Harley, K. *ibid*

<sup>128</sup> Parker, D. and Harley, K. *Supra* Note 126 above.

<sup>129</sup> *ibid*

public sector will most likely act in their own self interests. Consequently, they might not be ready to pursue efficiency in PPPs when they are unable to share in the cost savings of the government. The public sector may therefore only pursue projects that do not adversely affect their position, status or income.<sup>130</sup> In which case, the public sector may employ several measures including very low PSC figures to deter the private sector from pursuing the project.

It is also difficult to obtain evidence of the capital cost of comparable, conventionally financed projects in order to aid proper PSC computation because construction costs are well known to vary widely depending on time, place, circumstance and specifications and even from tender to tender in the same time, place, circumstance and specifications.<sup>131</sup>

There is however considerable literature on the merits of VFM in PPPs. For example, Grimsey and Lewis<sup>132</sup> who have variously defended the position that PPPs actually deliver value for money argue that PPPs appeal to people in charge of allocating public sector resources because they offer one way of resolving the large cost overruns and delays in traditional public procurement methods for infrastructure (optimum bias). This is because of greater incentive to the private sector that acts in more commercially oriented ways than the public sector;

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<sup>130</sup> *ibid*

<sup>131</sup> Nisar, T. M. *Supra* Note 116 Pg. 1-19

<sup>132</sup> Grimsey, D. and Lewis, M.K. (2005) *Supra* Note 123; Grimsey, D. and Lewis, M.K. (2004) *Supra* Note 106



they claim that the transfer of risk to the private sector provides an incentive to the private entities.

The major factor that ensures cost savings and therefore better VFM in PPPs is private sector's innovation and efficiency. Due to the fact that the private sector is responsible for the whole process including design and the actual provision of services, this synergy helps for achieving lowest possible total life cycle costs while maximizing profits. Also, a transparent and efficient procurement process is essential for lowering transaction costs as it shortens the time of negotiations. According to Arthur Anderson, the six main factors that ensure value for money in PPPs are risk transfer, long term nature of contracts, the use of output specifications, competition, performance measurement and incentives and private sector management of skill.<sup>133</sup> The most important factors are said to be competition and risk. In fact risk transfer was said to account for 60 % of the total cost saving for PFI projects in the UK.<sup>134</sup>

### **3.8.3 Mitigation of Risks**

It is important to note that risk transfer does not eliminate the risk; it only reduces their economic cost.<sup>135</sup> After risk has been allocated to the parties in a PPP, there might still be need for the government to reduce the severity of the risks assumed by the private sector by taking back

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<sup>133</sup> Andersen, Supra Note 82; see also Grimsey, D. and Lewis, M.K Supra Note 132 pp. 35-378.

<sup>134</sup> Ibid

<sup>135</sup> Marques, R. and Berg, S. Supra Note 30

some of the risks. This is important in order to stimulate the private sector to invest in projects, which it would otherwise not have considered for investment. Another reason may be to reduce costs to the private sector and consequently reduce tariff and other burdens on its citizens.

In the first instance, the private sector tries to mitigate some of its assumed risks by taking out insurance policies against them. Those risks that cannot be insured against are inevitably provided for through the use of special clauses in the contract to mitigate its impact. For example, the private sector may protect itself against sever demand risk by insisting that non-compete clauses be inserted into the agreement. However, as already pointed out, these types of contractual clauses if used indiscriminately invariably stifle economic and social development. The best solution is for the government to take back some of these risks or share them with the private sector. For example, the government may provide the private sector with assurances of minimum revenue guarantees to limit the private sector's exposure to demand risk. Below are some other risk mitigating techniques, most of them suggested by the United Nation's Guide Book on Promoting Good Governance in Public-Private Partnerships:<sup>136</sup>

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<sup>136</sup> United Nations Economic Commission Guide Book on Promoting Governance in Public Private Partnerships Supra Note 25

### **3.8.4 Public Loans**

The government can offer the private sector loans at very low or no interest rates at all. This will lower the project cost. The loans may come as subordinated loans that supplement senior loans obtained from commercial banks to enhance the financial terms of the project. Also, the loans may be structured in a way that the private sector only becomes entitled to it if certain project risks materialize.

### **3.8.5-Loan guarantees**

The public sector may decide to guarantee the loans of the private sector. This has the effect of lowering interest rates.

### **3.8.6-Equity Participation**

Direct or indirect equity participation of the government in the project company has two advantages. The first is that it strengthens the assurance of the public and other stakeholders about the project and the other that it helps the project achieve better equity/debt ratio.

### **3.8.7 Subsidies**

Where the actual cost of providing the service by the private sector is too high and likely to affect the demand for the service, the government may pay tariff subsidies to the private sector. The payment may be structured in such a way that it becomes payable only where income generated by the private sector falls below a certain minimum level. An

alternative way of doing this is to allow the private sector to cross subsidize a less profitable service, activity or route with profitable ones.

### **3.8.8 Sovereign guarantees**

The government may guarantee the proper behavior and/or respect of the commitments or obligations entered into by the public sector. The failure of the public sector to respect such commitments or obligations will give rise to a requirement to pay monetary compensation to the private sector. The guarantee may come in the form of 'off take guarantee" where the public sector guarantees that it will buy an agreed quantity of the service or product provided by the private sector. This is usual in power purchase agreements where the government or the off taker agrees to pay capacity payments.

### **3.8.9 Tax incentives**

Government may decide to give tax exemptions, tax holidays, rate reductions, tax abatements or tax credits in order to incentivize the private sector to go into certain businesses that it would not ordinarily have gone into. The exemptions may also extend to duty waivers etc. This provides a cash flow cushion for the investor, which makes the project numbers work better. These tax incentives can be directed at specific financial aspects of the project. The problem with tax incentives in a country like Nigeria that operates a federal system of government is that there is likely to be conflicts between the national, states and local

authorities who also have autonomy to tax within their respective jurisdictions.

### **3.8.10 Viability gap funding**

This is a capital subsidy provided by the government to make projects which would otherwise not be viable if left alone to the private sector to finance exclusively, financially viable. For instance, the Government of India has a scheme whereby the viability gap in PPP infrastructure projects is supported up to the tune of 20% of the cost of the project and the state government or its agencies that own the project are also allowed to contribute an additional grant out of its own budget not exceeding a further 20% of the cost of the project.<sup>137</sup>

### **3.8.11 Protection from competition**

This comes in the form of an assurance given by the government to the private sector investor that it would not develop any competing infrastructure within a given period within the perimeter of the private sector's asset. For instance in a toll road project, the government may undertake not to build an alternative road that will compete or undercut the revenues of the private sector. Given the long-term nature of PPP agreements and the likelihood of constant population growth, this may be capable of stifling infrastructure growth and is quite patently anticompetitive. In Nigeria for instance, the use of this mitigating

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<sup>137</sup> Gujarat Infrastructure Development Board 'Public Private Partnership' online at [http://www.gidb.org/cms.aspx?content\\_id=96](http://www.gidb.org/cms.aspx?content_id=96) (last accessed on March 30, 2012)

technique in the financing of the new local airport terminal in Lagos has led to public anger and resentment.

### **3.8.12 Payment Mechanism**

Government grants may be combined with the payment mechanism to cover some of the capital cost. This may allow the required user charge to be kept at a level that is affordable to end-users. It may also be useful if the total project-funding requirement is larger than the market appetite for funding projects of such nature. This process has been used in light rail projects in the United Kingdom, Guatrain projects in South Africa. Such payments may also be performance linked.

### **3.8.13 Annual Operating Subsidies**

The difference between this and capital grants is that the use of subsidies may increase overall project costs since the project SPV has to fund the entire project cost.

Where the government decides to provide any form of guarantee, such guarantee must be provided with absolute care because if it is misused, the public sector may be inadvertently creating a guarantee culture where the private sector seeks guarantees as an alternative to managing the risk itself.<sup>138</sup> The use of guarantees may mean that the risk previously assumed by the private sector reverts back to the public sector.<sup>139</sup> There is also the possibility that the cost and risk of such

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<sup>138</sup> United Nations Economic Commission Guide Book Supra Note 136

<sup>139</sup> Alonso-Conde, A. B, *et al.*, 'Public private partnerships: Incentives, risk transfer and real options', (2007) Vol. 16, Issue 4 *Review of Financial Economics*, pp. 335-349.

guarantees are neither transparent nor well understood by the PPP stakeholders.<sup>140</sup> It is also good practice to ensure that where these guarantees are used, provision should be made for the use of claw-back clauses. These clauses ensure that the private sector gets only the benefits they need to make the project work and ensures that excess benefits are creamed off and given back to the tax payers. The reasoning behind this is simply the notion that if risks are to be shared, then benefits should also be shared.<sup>141</sup>

### **3.9.1 Allocation and Mitigation of Risk in Legal and Policy Documents**

The PPP contract is the principal document that regulates the partnership and ensures risk allocation between the public and private sectors over the term of their relationship. It also provides the foundation on which other project documents like the financing agreement rests. The other contractual documents that are relevant to risk allocation are the shareholders agreement between project sponsors, the credit agreement with the project lenders, EPC Contract, operations and maintenance contract and supply contracts.

Contractual clauses are the basic instruments for the transfer of risk in PPPs. The contract may basically allocate risks through the use of indemnities, conditions, warranties and force majeure clauses. As Ward *et al* pointed out:

Successful and appropriate allocation of risk  
presupposes an atmosphere of trust between

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<sup>140</sup> Ibid

<sup>141</sup> Ibid

contracting parties and a clear mutual appreciation of all relevant project risks and their effects... in the absence of one or both of these guidelines, it is perhaps not surprising that the debate about the appropriate allocation of risk is often diverted to the investigation and clarification of the effectiveness of allocation mechanism such as contract clauses.<sup>142</sup>

Contract design is not a straightforward task and it is even more complicated if it also assigns risk like in PPP contracts. This is because the imperfect allocation of risk in contracts constitutes one of the primary reasons for the failure of PPP arrangements.<sup>143</sup> Failure to allocate risks properly in PPP contracts may lead to other undesirable consequences like contract re-negotiation. Contract renegotiation may invariably lead to bargaining between the private sector operator and the government in a non-competitive and non-transparent environment.<sup>144</sup> Re-negotiation might in that instance become a part of the strategy for the private sector to ask for other concessions from the government by raising other unrelated issues at the risk of damaging the public interest in the project. Marques and Berg contend that this promotes opportunistic behaviour, including opportunistic bidding at the tender stage, so that the winners curse becomes a winners blessing.<sup>145</sup> Where risk is inappropriately or excessively transferred to the private sector it might

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<sup>142</sup> Ward, S.C. *et al* Supra Note 65

<sup>143</sup> Murphy, T. 'The Case for Public- Private Partnerships in Infrastructure', (2008) Vol.51, No.1 *Canadian Public Administration* pp. 99-126.; Berg, M.R. 'Revisiting the strengths and limitations of regulatory contracts in Infrastructure Industries', PURC Working Paper No.14 , University of Florida, Glanville, Cited in Marques, R. and Berg, S. Risk, Contracts and Private Sector Participation in Infrastructure Supra Note 313

<sup>144</sup> Ibid

<sup>145</sup> Ibid



reduce the number of bidders and foster opportunism of the remaining tenderers.<sup>146</sup>

The issue of risk allocation is essential in PPP contracts for three main reasons viz; it improves risk allocation, reduces economic costs, provides incentives for sound management of the PPP and reduces the need to enter a re-negotiation process.<sup>147</sup>

Due to the fact that the PPP contract is used to allocate project risks, it should be drawn up in such a way that it takes into consideration all eventualities that may affect the risk profile of the parties. Contracts that fail to address risk in a comprehensive manner are likely to raise the cost of infrastructure services to the final consumers.<sup>148</sup> On a policy level, it can be useful to provide for risk allocation and mitigation guidelines in policy and legislative instruments. This will guide the parties through the contract negotiation process in the allocation, mitigation and pricing process before reducing them into contractual clauses as either for instance conditions or warranties or other contractual terms.

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<sup>146</sup> Zitron, J. 'Public- Private Partnership Projects: Towards a Model of Contractor Bidding Decision-Making'. (2006) Vol.12 No.2 *Journal of Purchasing and Supply Management*, pp. 53-62.

<sup>147</sup> Asenova, D. (2010) 'Risk Management in Private Finance Initiative Projects: The role of Financial Services Providers', Lambert Academic Publishing, Saarbrücken

<sup>148</sup> Marques R. and Berg S. Risks, Contracts and Private sector Participation in Infrastructure Supra Note 323

There is also sometimes a need for standardization of PPP contracts by creating templates as it may contribute towards greater transparency and reduce the incidence of corruption. However, such standardization may lead to a greater deal of rigidity in the PPP process.

When allocating risks in contractual documents, the following goals should be pursued:

- a) To provide incentives to reduce long term costs of a project.
- b) To provide incentives to complete the project on time and within budget.
- c) To provide incentives to improve the quality of service and revenue yield.
- d) To insure the public and private partners against risk.<sup>149</sup> Risk insurance for the public partner helps to improve its profile of expenditure on the project by converting variable operation and capital cost into predictable unitary payments. Risk insurance for the private partner helps reduce the cost of capital.<sup>150</sup>

These goals can be achieved by contractually providing for the service output specifications of the private sector. This will fully ensure that risk for the quality of the service is transferred to the private sector by ensuring that the private sectors revenue has a correlation with the quality of the

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<sup>149</sup> World Bank (2007) 'Contract Design in Public Private Partnerships' (A report prepared for the World Bank by Iossa E., Spangnolo G., and Vellez M. (online) at: <http://www.gianca.org/PapersHomepage/Contract%20Design.pdf> (last assessed on March 25, 2012)

<sup>150</sup> *ibid*

service and also enables the public sector effectively monitor the output of the private sector.

Below are some of the different ways in which selected risks are handled in PPP contracts.

### **3.9. 2 Insurance Risk**

Insurance is a viable tool for mitigating risks. However at times, insurance for certain risks may become unavailable or available on unfavourable terms. To address this issue, PPP contracts may include insurance benchmarking with an adjustment to PPP payments if market insurance premiums vary beyond a threshold. In some instances un-insurability which typically constitutes an event of default under the project loan is a termination event, unless the public sector agrees to act as insurer of last resort.

### **3.9.3 Design, Construction and Technical Specification Risk**

When this Design Construction and Technical Specification Risk eventuate, it may lead to the project not being concluded at all or concluded on time. The PPP contracts should be designed to be output based, such that the private sector assumes the design and construction risk. Payments also have to begin upon the satisfactory completion of construction i.e. no service, no fee. This was one of the major problems with the Lekki Toll Road Concession in Lagos where the Concessionaire

started collecting tolls on the road after completing only less than 10% of the road project.<sup>151</sup>

The project Special Purpose Vehicle (SPV) usually takes the construction and design risk and passes it down to construction subcontractors with appropriate warranties to the public sector. It is not advisable for the public sector to approve or sign off on design, as this will unwittingly transfer the risk back to it. This seems to be one of the shortcomings of the MMA2 Airport Concession, where the public authority approved all the private sector party's designs. The contract may also employ liquidated damages provisions to ensure that the private sector compensates the public sector for this risk. However care should be taken to ensure that it does not become a penalty provision by ensuring that compensation is only payable upon the public partner suffering economic loss from late delivery.<sup>152</sup>

#### **3.9.4 Planning and Approvals Risk**

Even though planning risks should be allocated to the private sector, the Public sector may commit itself by way of warranty in the contract to provide assistance.

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<sup>151</sup> A case study of the Lekki Concession toll road project is carried out extensively in Chapter 7.

<sup>152</sup> If it becomes a penalty provision the courts will not enforce it. See *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co. Ltd.* [1975] A.C. 79

### **3.9.5 Change in law risk**

This is best treated as a shared risk whereby the general change in law risk is shared and change in law risk specific to the project is retained by the public sector.

### **3.9.6 Operational Performance Risk.**

This risk is better allocated to the private sector through the use of contractual incentives and penalties incorporated within the payment mechanisms and performance/quality requirements to enforce standards during the operating phase. The contract should therefore clearly specify the consequence of not meeting these requirements<sup>153</sup>.

### **3.9.7 Financial/Economic Risk.**

The payment mechanism is also used to allocate economic risk between the public and private sectors. Proper allocation ensures that the users of the facilities only pay for services or outputs delivered. The public sector should have the right to withhold payments if the services are substandard and not remediated on time.

### **3.9.8 Exchange rate risks**

To the extent that equity and debt funding for the project is denominated in local currencies, the public sector need not bear exchange rate risk. However, if funding for the project is denominated in

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<sup>153</sup> The World Bank (2007) Contract Design in Public-Private Partnerships by Iossa E., Spangnolo G., and Vellez M. World Bank Publication Supra Note 149

foreign currencies, the government is likely to bear the exchange rate risk in order to maximize cost efficiency of the project. One of the ways of handling this in the contract is by ensuring that the project payments are adjusted for exchange rate variations. The alternative would be to provide in the contract for compensation to the private sector where the event, which is within the control of the public sector, eventuates. This is necessary in order to restore the economic equilibrium of the contract.

### **3.9.9 Default risk**

This occurs when the SPV is not able to deliver either during construction or operation phase of the project. This can be dealt with and mitigated in the contract by providing step-in rights for the public sector to come in and replace the private sector partner.

### **3.9.10 Demand Risk**

This occurs when the end user demand for project output is lower than the base case original forecast. In many sectors, it is difficult for the private sector to reliably predict end user demand. In such cases the PPP payment mechanism may be designed to eliminate demand risks. This is discussed in detail in Chapter 6 of this thesis.

### **3.9.11 Political or Legal risks**

This includes risks of expropriation, non-convertibility or non-repatriation. This may be dealt with through political risk insurance to cover for

example sovereign default and expropriation. The contract may deal with this risk by specifying for example, that expropriation is an event of default and that war and strife may be termed a force majeure event. Political risk is discussed in detail in Chapter 5 of this thesis.

### **3.9 Conclusion**

This chapter is important because it provides the foundation on which subsequent chapters of this thesis rest. It allows for the understanding of the concept of risk generally and then in relation to PPPs. By identifying the areas of risk that are relevant to this research, the chapter helps delineate the boundaries of this thesis and focuses the research towards answering the research questions.

Firstly, this chapter engaged in a critical discussion of the definition of 'risk'. It also looked at the different classifications of risk available in literature and discovered that they are diverse. It is concluded that these different approaches are all important for the purposes of this work because the different studies analysed in subsequent chapters use either one or a combination of these classifications to discuss their findings and therefore a general recognition and understanding of the various classifications is important for the understanding of the discussions to follow.

Another finding in this chapter is that the essence of PPP is to achieve optimal risk allocation. Under traditional procurement, the risk assumed

by the public sector when it owns and operates an infrastructure asset is often unvalued. What PPP ensures through the involvement of the private sector is that the risk is adequately and properly priced and then transferred to the party that is best able to manage it. This chapter examined the issue of VFM in PPPs. It was concluded that in most cases PPPs led to VFM and that the advantages in the use of the PSC far outweigh the disadvantages.

The idea that risks should be properly mitigated was also discussed. The chapter examined the various risk mitigation measures open to the public and private sector partners. It was noted that risk transfer does not eliminate the risk; it only reduces their economic cost.<sup>154</sup> It was also noted that contractual clauses are the basic instruments for the transfer of risk in PPP. This chapter therefore looked at how some of the basic project risks can be allocated contractually.

Finally, this chapter emphasizes that the few PPP projects concluded so far in Nigeria have not done very well. Indeed one of the major objectives of this thesis is to discover the reasons for this. This chapter distills the critical success factors for the PPP projects as well as international best practices for carrying out PPP projects. Importantly, this chapter provides the benchmark against which the Nigerian PPP program is assessed in subsequent chapters. This assessment will help

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<sup>154</sup> *ibid*



discover the reasons for the shortcomings in PPP projects in Nigeria and propose the improvements that can be made.

## CHAPTER 4

### THE MANAGEMENT OF RISK IN PRACTICE IN PUBLIC-PRIVATE PARTNERSHIPS

#### 4.1 Introduction

As was noted in the preceding chapters, risk is generally difficult to handle in projects, and gets even more complicated with regards to large infrastructure projects and exceptionally difficult in PPPs. It is because of this difficulty in handling risk that it is said to require both a theoretical and practical management framework to manage.<sup>1</sup> Having critically discussed the theoretical underpinnings for the proper management of risk in PPPs in Chapter 3, this chapter evaluates the different methods used in managing risk in practice. The different theoretical assumptions and conclusions reached in Chapter 3 are further validated in this chapter. The validation of these assumptions is crucial to answering the first research question of this thesis, which is whether better handling of project risks translates to more successful projects?

The approach adopted is to appraise how risks have been managed in different countries and in different projects in practice. This is achieved by conducting a review of different empirical studies on different aspects of risk management, especially case studies, available in extant literature. The essence of this exercise is firstly to gauge the level of

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<sup>1</sup> Yongjian, Ke. 'Preferred Risk Allocation in China's Public Private Partnership (PPP) Projects', (2010) 28 *international Journal of Project Management* pp. 482-492.

conformity or variance of the outcomes of the different case studies with the theoretical assumptions made earlier in Chapter 3. Secondly, by looking at the practical management of risk on a country-by-country and project-by-project basis, it is easier to distill international best practices. This will help in enhancing risk management in Nigeria, which is the core objective of this thesis. Finally, the various empirical studies reviewed in this chapter provide the necessary foundation for conducting case studies in the succeeding chapters of this thesis.

## **4.2 Classification of Risk**

As was noted in Chapter 3, there are diverse classifications of risk factors in PPPs. It was also noted that risk classification is mostly predicated on perception of risk and that the perception of risk itself is determined principally by social and economic factors. This chapter tests these assumptions by analyzing the practical aspects of the classification of risk. This is achieved by carrying out an analysis of the different empirical studies that have been carried out by different academics mostly through case study research.

The essence of this exercise is to discover whether there are any discernible patterns in respect of these classifications. For instance in relation to countries, sectors or stakeholders and also to determine the appropriate classification of risk and the most important risk factors discernible from the frequency of occurrence of a particular risk category in literature. The objective of this exercise in relation to this

research is that it will allow the thesis focus on the most important risk factors in subsequent chapters, as it is not possible to study all the different types of risks factors within the limited ambit of this research.

## **Classification According to Countries**

### **China**

Ke, Y., S. Wang, *et al* using desktop literature review, telephone interviews of practitioners and previous work of authors identified 37 potential risks in PPPs in China.<sup>2</sup> They suggested that 12 out of these risks should be allocated to the public sector. This includes: “expropriation and nationalization”, “government’s reliability”, “government’s intervention”, “poor political decision making”, “land acquisition”, “approval and permit”, “corruption”, “supporting facilities risk”, “uncompetitive tender”, “competition (exclusive right)”, “change in law” and “immature juristic system”.<sup>3</sup>

According to them, both the public and private sectors should share 15 of the risks. These include: “third-party reliability”, “public/political opposition”, “interest rate”, “foreign exchange and convertibility”, “inflation”, “improper contracts”, “ground/weather conditions”, “market demand change”, “tariff change”, “payment risk”, “force majeure”, “tax regulation changes”, “environmental protection”, “subjective

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<sup>2</sup> *ibid*

<sup>3</sup> Yongjian Ke. *et al* ‘Equitable Risk Allocation of Projects inside China: Analysis from Delphi Survey Studies’ (2011) , Vol. 5 Issue: 3 Chinese Management Studies 298- 310

evaluation" and "insufficient financial audit".<sup>4</sup> Finally, they suggested that 10 risks out of 37 should be mostly allocated to the private sector. These risks include: "financial risk", "construction completion", "construction/operation changes", "delay in supply", "technology risk", "operation cost overrun", "residual assets risk", "consortium inability", "organization and coordination risk" and "private investor change".<sup>5</sup>

## **Indonesia**

Wibowo and Mohammed identified 39 key risks inherent to water supply projects in Indonesia. These risks were classified into 6 major categories namely: political risk, macroeconomic risk, production related risk, force majeure risk, project related risk, and business risk.<sup>6</sup>

Nur Wulan identified 7 risks that may occur in a toll way project in Indonesia to include:

1. *Political risks*, which include discontinuation of concession, tax increase, inappropriate tariff implementation, inappropriate tariff increase, new government policy, etc.
2. *Construction risks*, which include inappropriate design, land acquisition, project delay, project site condition, contractor's failure, etc.
3. *Operation and Maintenance risks*, which include toll way network

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<sup>4</sup> ibid

<sup>5</sup> Ibid

<sup>6</sup> Wibowo, A. and Mohamed, S. (2008) 'Perceived Risk Allocation in Public –private-Partnered (PPP) Water Supply Projects in Indonesia, First International Conference on Construction in Developing Countries (ICCIDC-I) "Advancing and Integrating Construction Education, Research and Practice" August 4-5 Karachi Pakistan 2008. 349

- condition, operator's incompetence, construction quality, etc.
4. Legal and Contractual risks, which include concession time warranty, flawed inconsistent document etc.
  5. *Income risks*, which include inaccurate traffic volume estimates, inaccurate toll way tariff estimate, construction of a competing alternative road, etc.
  6. Financial risks, which include inflation, devaluation, interest rate, changes in monetary policies, limited capital etc.
  7. *Force major*, such as weather condition, war, natural disasters, etc.<sup>7</sup>

## **Vietnam**

Ninh carried out a case study on the Yen Lenh Bridge BOT project to assess stakeholders' perspective on risk and opportunities in such projects. It was discovered that the top 10 risks that are likely to affect BOT infrastructure projects in Vietnam are "land acquisition delays", "delay in approvals from Government agencies", "risk of transportation networks in the region influencing BOT projects", "cost overrun", "unrealistic forecast on future economic development and demand of the society"; "Increasing inflation rate"; "incorrect analysis of ownership duration"; "interest rate fluctuation", "general corruption and

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<sup>7</sup> Wulan, N. (2005) 'Analisa kelayakan finansial proyek jalan tol: Studi kasus jalan tol Cipularang (Feasibility study of toll road project financing: A case study of the Cipularang tollway)', Tugas Akhir No.007/TS/D-IV JT/111/2005, Politeknik Negeri Jakarta

untrustworthiness of public officers”, “actual traffic revenues are lower than estimated”.<sup>8</sup>

The preceding paragraphs have shown that there are different classifications of risks in different countries. Even where there was a consensus on the nomenclature of a particular risk, there was no agreement on the makeup of that particular risk. This makes a uniform assessment difficult. This conclusion is similar to that reached by Yongjijian *et al* where the authors attributed the diversity to differences in social, economic and legal differences within respective countries.<sup>9</sup> Risk perception is therefore said to be a social construct because it varies according to people's points of view, attitudes and experiences. People tend to perceive events differently because most of the time their perceptions are influenced by their value systems and attitudes, judgments, emotions and our beliefs.<sup>10</sup>

Having come to the conclusion that there are diverse and lengthy classifications of project risks, Nur Alkaf Abd Karim<sup>11</sup>, mapped all the

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<sup>8</sup> Ninh, N.D. (2006) 'Stakeholders Perspectives on Risk and Opportunities of BOT Infrastructure Projects in Vietnam: A Case Study of the Yen Lenh Bridge Project', Masters Thesis, Asian Institute of technology. Cited in Public-Private Partnership in Infrastructure Development: Case Studies from Asia and Europe Bauhaus Universitat Weimar, found at: [http:// e-pub.uni-weimar.de/volltexte/2009/](http://e-pub.uni-weimar.de/volltexte/2009/) (Last assessed on March 28, 2012).

<sup>9</sup> Yongjian, Ke *et al.*, (2011) *Supra* Note 4

<sup>10</sup> Awodele, O. *et al.*, ' Understanding and Managing Risks- Necessary Condition for Success and Sustainability of Privately Financed Market Projects in Nigeria (2010) ARCOM Doctoral Workshop, University of Wolverhampton, UK 25<sup>th</sup> of June, 2010

<sup>11</sup> Karim, N. A. 'Risk Allocation in Public-Private Partnership (PPP) Project: A Review of Risk Factors', (2011) Vol. 2, Issue 2 *International Journal of Sustainable Construction Engineering & Technology*, pg. 8

classifications of risks from around the world by reviewing various literature including the works of Yongjiyan<sup>12</sup>, Abednego<sup>13</sup>, Li<sup>14</sup>, Shen<sup>15</sup>, Ibrahim<sup>16</sup>, Yuan<sup>17</sup>, Yelin<sup>18</sup> Xiao<sup>19</sup>, Zhang<sup>20</sup>, Singh<sup>21</sup> and Wibowo.<sup>22</sup> He came up with 10 major groups of risk factors and their frequency of occurrence in the different literature reviewed.

This thesis also examined the above literature and arrived at similar conclusions as Karim. Consequently, the thesis adopts Karim's broad and sub-classifications of risk. The classifications of the different risk factors

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<sup>12</sup> Yongjian, Ke. (2010) Supra Note 1

<sup>13</sup> Abednego, M.P. Ogunlana, S.O. 'Risk and its Management in the Kuwaiti Construction Industry: A Contractors Perspective', (2001) Vol. 19 *International Journal of Project Management*, pp. 325-335.

<sup>14</sup> Li, B. et al, 'The Allocation of Risk in PPP/PFI Construction Projects in the UK' (2005) 23 *International Journal of Project Management*, pp. 25-35

<sup>15</sup> Shen, L.Y. et al 'Role of Public Private Partnership to Manage Risk in Public Sector Project in Hong Kong', (2006) Vol. 24 *International Journal of project Management* pp. 605-594.

<sup>16</sup> Ibrahim, A.D et al, 'The Analysis and allocation of Risk in Public Private Partnerships in Infrastructure Projects in Nigeria' (2006) Vol. 11, Issue 3 *Journal of Financial Management of Property and Construction* pp.149 – 164.

<sup>17</sup> Yuan, F.J. et al, 'Critical Risk Identification of Public Private Partnership in China and the Analysis of Questionnaire Survey' (2008) Cited in Karim, N. A. Supra Note 11

<sup>18</sup> Yelin, X. et al, (2009) 'Risk Factors in Running Public Private Partnership (PPP)- An Empirical Comparison between Government and Private Sector', Paper delivered in *International Conference on Management and Service Science*, 20-22 September, 2009

<sup>19</sup> Xiao, H.J. and Zhang, G. 'Modeling Optimal Risk Allocation in PPP Projects Using Artificial Neural Networks', (2011) Vol. 29 *International Journal of Project Management*, pp. 591-603.

<sup>20</sup> Zhang, X. 'Paving the Way for Public Private Partnership in Infrastructure Development', [2005] *Journal of Construction and Engineering Management* pp. 956-965.

<sup>21</sup> Singh, L.B. and Kalidindi, S.N. 'Traffic Revenue Risk Management Through Annuity Model of PPP Road Projects in India', (2006) Vol.24 *International Journal of Project Management*, pp. 587-594.

<sup>22</sup> Wibowo, A. and Mohamed, S. 'Risk Criticality and Allocation in Privatised Water Supply Projects in Indonesia', (2010) Vol. 28 *International Journal of Project Management*, pp. 504- 513



and their frequency of occurrence are reproduced in Appendix 1 below. The identified major groups are “political risk”, “construction risk”, “legal risk”, “economic risk”, “operations risk”, “market risk”, “project selection risk”, “project finance risk”, “relationship risk” and “natural factors risk”. The advantage of this classification is that it combines the different risk factors noticed in different countries ranging from China, Kuwait, Hong Kong, Nigeria to the United Kingdom and from different types of projects. The listing of the frequency of occurrence enables us to determine the importance of a particular risk. This is important, as this is the criterion employed by this thesis in selecting the different risks that are studied through the use of case studies in subsequent chapters of this thesis.

### **4.3 Allocation of Risk**

The three common methods used to allocate risk are firstly, enumerating a simple list of risk factors. Secondly, employing a risk matrix and thirdly, using a risk allocation framework.<sup>23</sup> These are however more aptly described as risk prompters because they do not by themselves do the actual allocation and management of risks. Actual risk allocation is done through other techniques like the use of intuition, personal experience including the benefit of hindsight, investigative interviews, surveys, checklists, brainstorming consultations, event and fault trees, HAZOP studies and risk safety reviews.<sup>24</sup> However common sense and

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<sup>23</sup> Li, B. *et al* (2005) *Supra* Note 14; Ibrahim, A .D *et al*, *Supra* Note 14.

<sup>24</sup> McKim, R.A. ‘Risk Management- back to basics’, (2005) Vol. 34, No.12 *Cost Engineering*, pp. 7-12.

experience are probably the prime risk assessment and management techniques employed in practice.<sup>25</sup>

Regarding the risk prompts, the most commonly used of the three methods discussed above is the risk matrix. A prototype that is commonly adopted in several literatures is that by Grimsey and Lewis,<sup>26</sup> which is reproduced in Appendix 2 of this chapter. There are however a number of limitations with regards to what may be achieved with this risk matrix. The first is that the table presents broad categories of risks and every project is unique with a different array of risks, which needs to be thoroughly analyzed and understood on their own merits.<sup>27</sup> Secondly, this risk matrix does not reflect the fact that risk is dependent on the resources and capacities available to the parties to the contract.<sup>28</sup> Also these types of matrixes are static models. It is important that risk distribution mechanisms reflect the fact that risks changes considerably over the life of a project.<sup>29</sup>

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<sup>25</sup> Akintoye, A. and Chinyio, E. 'Private Finance Initiative in the Health Sector: trends and Risk Assessment', (2005) Vol.12 *Engineering, Construction and Architectural Management*, pp. 601-616.

<sup>26</sup> Grimsey D and Lewis M.K. (2004), *Public Private Partnerships: The worldwide Revolution in Infrastructure Provision and Project Finance*, Edward Elgar, Cheltenham

<sup>27</sup> This is one of the major criticisms leveled against the Australian attempts at providing model risk matrixes as guides for the public sector agencies engaging in PPP transactions.

<sup>28</sup> Grimsey D. and Lewis M.K (2004) *Supra note 26*

<sup>29</sup> Ng, A. and Loosemore M. 'Risk allocation in the private provision of public infrastructure' *International Journal of project Management* 25(2007)

Most of the literature reviewed in Chapter 3 reveals that the common approach used to predict how risks are allocated in PPPs is by investigating risk perceptions from different respondents in their sample areas of study. This was either done through the use of surveys or by structured interviews. It was discovered that these perceptions differ from project to project and from country to country. In this study, a country-by-country analysis is preferred in line with our earlier position that perception of risk is influenced by social and economic factors.

## **China**

In the research conducted by Yongjian, Ke *et al* discussed above, they discovered that the public sector would normally take sole responsibility for the risk of "Expropriation and nationalization" and the public sector should also take the majority of the responsibility for 12 other risks related to government or government officials and their actions.<sup>30</sup> They identified 14 risks which neither the government nor the private sector are able to deal with alone, which should be shared equally.<sup>31</sup> Finally they came to the conclusion that the private sector would normally agree to take responsibility for 10 risks that are at the project level.<sup>32</sup> They did not find any risk that should be allocated solely to the private sector.<sup>33</sup>

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<sup>30</sup> YongJian Ke (2010)Supra Note 12

<sup>31</sup> *ibid*

<sup>32</sup> *ibid*

<sup>33</sup> *ibid*

Yongjian *et al* compared these observations with the result reached by Li *et al*<sup>34</sup> in relation to risk allocation in the United Kingdom. In contrast to China, 32 risks out of the identified 46 were allocated to the private sector, representing 70% where allocated to the private sector. This according to the authors proved that there was better risk transfer in the United Kingdom than in China and Hong Kong.<sup>35</sup>

Albert Chan *et al* <sup>36</sup> in their own study found that the three most important risk factors in PPP projects in China are government intervention, corruption as well as poor decision-making processes. They conclude that these obstacles to the success of PPP projects in China are caused by the inefficient legislative and supervisory system for PPP projects in China. They also noted that the major risk, which the public sector preferred to retain were systematic risks, political, legal and social risks. The private sector preferred to retain specific project risks like construction, operation and relationship risks. Environmental risk is preferably shared between the parties.

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<sup>34</sup> Li, B, *et al.* (2005) *Supra* Note 23

<sup>35</sup> *Ibid*

<sup>36</sup> Chan, A.P.C. *et al* 'Empirical Study of Risk Assessment and Allocation of Public-Private Partnership Projects in China', (2011) Volume 27 Issue 3 *Journal of Management in Engineering*, pp. 136-148

## Hong Kong

Shen Y. *et al* conducted a case study on the Disneyland theme park in Hong Kong and catalogued 13 risks affecting PPP projects in Hong Kong.

According to them, the risks and preferred allocation models are:

1. Site acquisition risk, which involves both land acquisition and protecting or demolishing existing buildings. The government is allocated the risk of land acquisition whilst the private sector is responsible for protecting and demolishing existing buildings.
2. Risk of unexpected underground conditions is allocated to the private partner because it is in the better position to undertake site survey on the underground conditions.
3. The risk of the pollution to land and surroundings is shared between the government and the private sector partner.
4. The risk of land reclamation, which concerns time delays, cost overrun and other technical problems, is allocated to the private partner since it is responsible for the construction of infrastructure and facilities.
5. Development risk, which concerns loss in the project development stage, for example the waste of resources, committed by either the government or private partner is shared between the two parties.
6. Design and construction risk, which concerns cost and time overruns, poor quality performance, poor safety measures and

other risk factors relating to design and construction works, is allocated to the private partner.

7. The risk of market changes which involves the provision of facilities, population, inflation, technologies etc., is shared between the government and the private partner.
8. Risk of choosing an inexperienced private partner who is not suitable, incompetent or has financial difficulties is allocated to the government.
9. Financial risk which involves changes in interest rates, exchange rates, ownership and other factors, is shared between the public and private sectors.
10. Operations risk is a risk that arises during the operation of a project and affects the profitability of running the projects such as changes in technologies, variations in materials or components for maintaining and repairing the facilities. Since this risk is better borne by the party responsible for the day to day running of the business, it is allocated to the private partner.
11. Risk of Industrial action, which includes risk of strike among employees who carry out various duties or businesses activities during the building and running of the project. Since this risk is associated with management within the business organization, it is allocated to the private partner;
12. Legal and policy risks, which include changes in business tax, urban planning, environmental protection is best allocated to the government.

13. Force majeure, which are various and include the risk of war, earthquake, flood and other types of natural calamities is shared by parties.<sup>37</sup>

### **United Kingdom**

Using a three level risk factor classification, of “macro” (ecological, political, economic, social, natural environment etc.) risk, “meso” (project engineering) and “micro” level risks, Li *et al* carried out a survey and found that majority of the identified risks were allocated to the private sector.<sup>38</sup> Out of the 42 identified risks, 32 risks representing 70% of total risks were preferably assigned to the private sector. 5 risks (site availability and other political risks) are exclusively assigned to the public sector. This, according to Li *et al.*, was similar to the conclusions reached by Zhang *et al*<sup>39</sup> and Vega *et al.*

Other risks (lack of commitment from partner, change of law and force majeure etc.) were shared between the public and private sectors. They also discovered several risks that are difficult to include into a single category. These risks include “level of public support”, “project approval and permit”, “contract variation” and “lack of experience”. Thus they

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<sup>37</sup> Li-Yen, S. *et al*, ‘Role of Public Private Partnerships to Manage Risk in Public Sector Projects in Hong Kong’, (2006) 24 *International Journal of Project Management* pp. 587-594.

<sup>38</sup> Li, B. *et al*. *Supra* Note 34

<sup>39</sup> Zhang, W.R. *et al*. ‘Risk Management of Shanghai’s Privately Financed Yan’an Donghu’ (1998) Vol. 5 No.4 *Tunnel’s Engineering Construction and Architectural Management* Blackwell, pp. 399-409.

concluded that macro level risks should be retained by the public sector, meso level risks should be transferred to the private sector while micro level risks should be shared between the public and private sectors.

## **Indonesia**

The results from the study conducted via questionnaire survey by Andreas Wibowo to determine risk allocation preferences in PPP water supply projects in Indonesia confirmed the common notion that risk is best given to the party who can control and manage it.<sup>40</sup> The study also reaffirmed that certain risks especially traditionally political and quasi-commercial risks like availability and cost of land, nationalization, force majeure risk etc., were best allocated to the government. Risks like construction cost, cost overrun and most of the business risks are borne by the private sector.

The survey also confirmed that proper risk allocation is nearly elusive. The researchers came to this conclusion due to the high disagreement levels amongst different respondents on the proper allocation of certain risks. The only counter intuitive finding by the research is that most of the respondents opted for the private sector to retain foreign exchange related risks. This is not in conformity with other studies from other parts of the world.<sup>41</sup>

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<sup>40</sup> Wibowo A. and Mohamed, S. (2008) Supra Note 22

<sup>41</sup> *ibid*



## Portugal

Marques R. and Berg S. after analyzing risk in the water sector in Portugal concluded that risk is not correctly transferred to the private sector and that this tendency limits the success of contracts and consequently reduces the benefits from private sector participation in the water sector in particular.<sup>42</sup>

## Ireland

Reeves and Ryan use an Irish school project to describe the complex practical risk allocation process in Ireland's education sector.<sup>43</sup> According to them, some risks such as statutory planning approval and business risks may be shared. Secondly, risk allocation may be renegotiated half-way through the contract. For instance the risk of information technology obsolescence was allocated to the private sector for the first three years only, after which it would be the subject of renegotiations. Thirdly, allocation of finance risks may be dependent on performance. Accordingly, although the private sector is responsible for raising all the required finance, in the event of the private sector default, the public sector becomes liable for the senior debt payments.<sup>44</sup>

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<sup>42</sup> Marques, R.C. and Berg, S. 'Risks, Contracts and Private Sector Participation in Infrastructure', *Journal of Private Sector Participation in Infrastructure*, (2011) Vol. 137 (11) *Journal of Construction Engineering and Management*, pg. 925

<sup>43</sup> Reeves, I. and Ryan, J. 'Piloting Public Private Partnerships, Expensive Lessons from Ireland's Schools' (2007) Vol. 27(5) *Sector, public Money and Management*, pp. 331-338.

<sup>44</sup> Ibid

The analysis of the studies above, reaffirm the assumptions made in Chapter 3. Firstly, it is usually said that risks should be allocated to the party that is best able to manage it. These studies discussed in the preceding paragraphs confirm the theoretical assumption made in chapter 3 that this rule is too simplistic and not easy to accomplish. Risk allocation is not that straightforward and is a rather complex process. Some of the established reasons for the difficulty in risk allocation are due to the technical, legal and political complexities of PPP transactions<sup>45</sup> and the fact that risk is constantly changing over the duration of the project.<sup>46</sup>

Expanding these reasons further, the analysis of some the empirical studies done in this chapter reveal that the perception of the parties and the complex structure of the private sector arrangements leading to the transfer of risk outside the SPVs also contribute to this complexity. Also, the unavailability of certain risk mitigating factors in all the countries is another important factor. For instance in developed economies, well developed financial and insurance markets allow for acceptance of certain risks by the private sector in the knowledge that it would be able to mitigate the risk by buying financial and insurance products. The unavailability of these financial products in developing economies may mean that the private sector is reluctant to take the same set of risks because it will be unable to mitigate them.

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<sup>45</sup> Ng A. and Loosemore M. 2007 Supra Note 29

<sup>46</sup> *ibid*

Some of the areas of congruence in all the studies analyzed are that political risks, (which include the risk of expropriation and nationalization) as well as legal and policy risks should always be assumed by the public sector. It was agreed in majority of the cases that the construction and operations risk should be borne by the private sector whilst financial risk and *force majeure* risk should be shared. Fundamentally, there was also consensus that where there has been a proper allocation of risk in projects that the project is more likely to be successful.<sup>47</sup> This validates the major theoretical foundation of this thesis, which is hinged on the fact that proper risk allocation leads to successful PPPs.

#### **4.5 Value for Money Considerations**

As has been pointed out earlier, optimal risk allocation is the essential basis for achieving VFM in PPP projects. Cheung E *et al*<sup>48</sup> studied the different measures that enhance VFM in PPP projects from three different countries; Hong Kong, Australia and United Kingdom and found that of the 18 identified VFM facilitators, efficient risk allocation was the top VFM enabler. They concluded that when risks are properly handled, fewer pitfalls are experienced and that efficient risk allocation is vital in determining whether VFM can be achieved in PPP projects. This conclusion is in congruence with the theoretical framework of this thesis.

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<sup>47</sup> See for example Cheung, E. *et al* 'Enhancing value for money in public private partnership projects: findings from a survey conducted in Hong Kong and Australia compared to findings from previous research in the UK'. (2009) 14(1) *Journal of Financial Management of Property and Construction*, pp. 7-20

<sup>48</sup> *ibid*

Regarding the method for evaluating the attainment of VFM in projects, Grimsey and Lewis identify four main alternative approaches through which VFM has been tested around the world:

1. A full cost- benefit analysis of the most likely public and private sector alternatives.
2. PSC-PPP comparisons before bids are invited.
3. A PSC-PPP VFM test after bids and
4. A reliance on a competitive bidding process to determine VFM once PPP 'road testing' has been established.<sup>49</sup>

In practice, different countries use several variants of these approaches and some are highlighted below.

### **United Kingdom and Australia**

In both countries a PSC – VFM after bids test is required prior to the final approval of the project. This procedure basically compares the financial differences between two procurement options (traditional procurement and PPP) for the same project. This is done by preparing a hypothetical set of costs for the public procurement of the project delivering the same output, including an evaluation of the project risk borne by the private sector. This hypothetical costing is compared with actual cash flows to be paid by the private sector provider, plus the value of any residual cost and risk transferred and therefore retained by the public sector.<sup>50</sup> The

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<sup>49</sup> Grimsey, D. and Lewis, M.K. 'Are Public Private Partnerships Value for Money? Evaluating Alternative Approaches and Comparing Academic and Practitioner Views' (2005) 29 *Accounting Forum* pp. 345-378

<sup>50</sup> *ibid*

PSC procedure is therefore based on “estimates of full costs, revenues and risks set out in cash flow terms, discounted at a public sector rate to an NPV. It is compared with the discounted value of payments under the PSC along with the adjustment of risks and costs retained.”<sup>51</sup>

This UK and Australian model has been adopted in many countries including Hong Kong, Japan and Canada with slight variations. For example, the main difference between the UK model and the Australian Model is that the latter has an additional assessment tool called the Public Interest Test (PIT). This is to ensure that a broader assessment of the public interest is taken into account before a project can be offered as a private finance project. The PIT requires the completion of a checklist, which includes project effectiveness, impact of stakeholders, public access and equality, consumer rights, security, privacy and other associated non-economic costs and benefits.<sup>52</sup>

## **Malaysia**

In Malaysia, the evaluation of a tender for VFM is done by evaluating the costs and benefits of the project. The bidding proposal is compared against the PSC of each project. The capital expenditure and the

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<sup>51</sup> *ibid*

<sup>52</sup> English, L. and Guthrie, J. ‘Driving Privately Financed Projects in Australia: What makes them tick?’ (2003) 16 (3) *Accounting, Auditing and Accountability Journal* 493-511

maintenance cost of the project must be less than the PSC benchmark before a project could be awarded to the private sector partner.<sup>53</sup>

### **United States**

In the United States most of the contracts for the provision of private prisons require that private firms offer services at 5-10 percent below what it would have cost the state to provide a similar service.<sup>54</sup>

### **Japan and Netherlands**

In both Japan and the Netherlands, an early indication that VFM will be achieved in a project is a prerequisite for a PPP project to proceed.<sup>55</sup> VFM is assessed before bids are requested, by using a hypothetical PSC and a shadow PSC. This involves first a theoretical assessment and then subsequently the original assumption of VFM may be rechecked with a PSC. This second PSC test may be worthwhile because in practice initial estimate of bidders' prices will often diverge widely from outturn.<sup>56</sup>

As pointed out in chapter 3, it is debatable whether the PSC is suitable for developing economies like Nigeria where there is a paucity of

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<sup>53</sup> Takim, R. *et al.* 'The Malaysian Private Finance Initiative and Value For Money' (2009) 5(3) *Asian Social Science*; see also Ismail, K, Takim, R. and Nawawi, A.H. 'The Evaluation Criteria of Value for Money (VFM) of Public Private Partnership Bids' [2011] *International Conference on Intelligent Building and Management*, Pg. 349-355

<sup>54</sup> Schneider, A.L. 'Public Private Partnership in the U.S. Prison System', (1999) 43(1), *Behavioral Scientist*, pp. 192-208

<sup>55</sup> Grimsey, D. and Lewis, K. (2005) *Supra Note 49*

<sup>56</sup> *ibid*

government money to pursue credible public procurement alternatives. The Nigerian PPP Policy postponed the use of the PSC until the government accumulates historical data from actual PPP transactions. This seems to be a sensible approach since the country has only completed a few PPP deals.<sup>57</sup> The other likely problems to be encountered with the use of the PSC and other comparative assessment methods in Nigeria is that since the PSC is a mere hypothetical scenario,<sup>58</sup> relying on estimations made by public agencies and experience of staff, it may be easily manipulated.<sup>59</sup> This is more likely in developing countries like Nigeria where corruption is endemic.

However before the Government accumulates credible data to enable the use of the PSC, it must seek other credible alternatives to the PSC to evaluate the attainment of VFM in PPP projects. This is important since PPP projects should not be done for the sake of it but should be assessed to determine its economic and social value. For this reason, both the American model due to its simplicity combined with the PIT in the Australian model containing additional qualitative factors which pay attention to the social importance of PPPs; seem to be the perfect option for Nigeria. However, PSC assessment should not be the sole basis

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<sup>57</sup> Nigerian National PPP Policy, ICRC Abuja Nigeria

<sup>58</sup> Moralos, D. and Amekudzi, A. 'The State of the Practice of Value for Money Analyses in Comparing Public Private Partnerships to Traditional Procurement', (2008) Vol. 13, No. 2 *Public Works Management and Policy*, pp. 114-125

<sup>59</sup> Heald, D. 'Value for Money Tests and Accounting Treatment in PFI Schemes', (2003) 16(3), *Accounting, Auditing and Accountability Journal*, pp. 342-371.

of measuring VFM since its methodology has obvious limitations as discussed above. In addition, where the PSC is adopted, public agencies especially in developing economies must evaluate their capacity to manage large, complex, long term projects and the overall interest of the public must also be put into consideration despite the outcome of the PSC test.<sup>60</sup>

#### **4.6 Assessment of the Achievement of VFM**

Under this sub section, the thesis evaluates whether PPPs have actually led to VFM. This is an important question since there would be no point pursuing a PPP if the country does not achieve VFM from it. Again like in preceding paragraphs, this analysis is done through a country-by-country evaluation.

##### **United Kingdom**

In the United Kingdom, Anderson and LSE Enterprises studied 29 business cases and estimated a 17% cost savings from PFI projects when compared with projects done through traditional public procurement.<sup>61</sup>

The National Audit Office of the United Kingdom in its 1998<sup>62</sup> and 2000<sup>63</sup>

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<sup>60</sup> Sarmiento, J.M. 'Do Public Private Partnerships Create Value for Money in the Public Sector? The Portuguese Experience' (2010) Vol.1 *OECD Journal on Budgeting*, pp. 93-119.

<sup>61</sup> Anderson, A. and LSE Enterprises (2000) 'Value for money drivers in the private finance initiative', report commissioned by the UK Treasury Task Force on Public-Private Partnerships.

<sup>62</sup> National Audit Office (1998) *The Private Finance Initiative: The first four design, build, finance and operate roads contracts*, HC 476, London

<sup>63</sup> National Audit Report (2000) 'Examining Value for money deals under the private finance initiative' London.



reports identified similar gains from the use of PFI in the UK, reporting an estimated 10-20% cost savings in 7 projects studied in the 2000 report. The reports also attributed these reductions to appropriate risk transfer from the public to the private sectors. In another study carried out in 2001 the National Audit Office found that 81% of the public sectors interviewed were of the opinion that value for money was achieved from PPPs.<sup>64</sup>

Nisar carried out a case study of 5 PFI projects to examine the effects of risk transfer on value for money gains in PFI projects in the United Kingdom. He concluded that PFI contracts were more or less achieving risk transfer and delivering price certainty.<sup>65</sup> However, the Institute of Public Policy Research was of the opinion that while PFIs were successful for prisons and roads they were of limited value in hospitals and schools.<sup>66</sup>

Even though majority of academics are of the opinion that PPPs have led to better VFM in infrastructure projects in the United Kingdom, there are contrary opinions. For example, Parker and Hartley carried out a case study of the use of PPP in the UK defence industry and concluded that the use of PPP will not necessarily lead to improved economic efficiency in defence procurement. It was discovered that PPPs involve

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<sup>64</sup> National Audit Report (2001) 'Managing the relations to secure a successful partnership in PFI projects', *A Report from the Comptroller and Auditor General*, HC 375, London.

<sup>65</sup> Nisar, T. 'Risk management in public-private partnership contracts', (2007) Vol.7, No.1 *Public Organisation Review* pp. 147-156

<sup>66</sup> The Institute of Public Policy Research, 'Building Better Partnerships: 'The Final Report of the Commission on Public Private Partnerships': Emphasis London

significant transaction costs.<sup>67</sup> Edwards *et al* also examined the structure and performance of PPPs in roads and hospitals and concluded that PPPs appear to be an expensive proposition to the public sector.<sup>68</sup> They argued for a more transparent financial regime. According to them, this is essential in order to assess the performance of PPPs.<sup>69</sup>

## **Australia**

Just like the United Kingdom, most of the reports that are in support of the attainment of VFM originate from the government and there have been calls for more independent assessments.<sup>70</sup> Another constraint pointed out by English is that it is difficult to assess whether VFM has been achieved in the PPP transactions done in Australia because most of the audits carried out by the Government in Australia have focused on the procurement stage and not much on the actual operation of the project.<sup>71</sup>

Fitzgerald carried out eight case studies of major projects in Australia and found that the discount rate and risk adjustments were integral to the issue of whether the commercial arrangements proposed in the tender

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<sup>67</sup> Parker, D. and Hartley, K. 'Transaction Costs, Relational Contracting and Public Private Partnerships: A Case Study of UK Defence' (2003) Vol. 9 (3) *Journal of Purchasing and Supply Management*, pp.97-108 (12)

<sup>68</sup> Edwards, P. *et al*, (2004) 'Evaluating Operations of PPP in Roads and Hospitals', ACCA Research Report, Certified Accountants Educational Trust, London.

<sup>69</sup> Ibid

<sup>70</sup> English, L.M. 'Public Private Partnerships in Australia: An Overview of Their Nature, Purpose, Incidence and Oversight' [2006] *University of South Wales Law Journal* pg. 250

<sup>71</sup> Ibid

offered value for money over the public procurement alternative.<sup>72</sup> Keating, whilst analyzing PPPs in Australia concluded that the Australian government is trying to transfer a lot of risks to the private sector, which the banks in turn shift to the contractor. Keating points out that this structure insulates debt investors from holding as much risk as possible.<sup>73</sup> Walker and Walker were of the opinion that accounting management of PPPs eroded accountability to representative public bodies.<sup>74</sup> English and Guthrie concluded that the Australian Governments are not as successful as the private sector at identifying and transferring risk.<sup>75</sup> It is therefore safe to conclude that whilst there is evidence, albeit from the Government, that VFM is achieved through PPPs in Australia, a lot of work is still required to ensure that the process of VFM assessment is more transparent and objective. Independent assessments need to be undertaken by other bodies that are not linked to the Government for a more credible appraisal of the state of affairs.

### **United States, Canada, Denmark, Netherlands**

Relatively few PPPs have been implemented in the United States so therefore it is difficult to come to a credible conclusion on the success of

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<sup>72</sup> Fitzgerald, P. (2004) 'Review of Partnerships Victoria Provided Infrastructure', final report to the Treasurer, Melbourne: Growth Solutions Group.

<sup>73</sup> Keating, S. (2004) 'Public- Private brinkmanship', *Project Finance*, September 2004, pp. 27-29.

<sup>74</sup> Walker, B. and Walker, B.C. (2000) 'Privatization: Sell off or sell out? The Australian experience', ABC Books, Sydney

<sup>75</sup> English, L.M. and Guthrie, J. 'Driving Privately Financed Projects in Australia: what makes them tick?' (2003) Vol. 16(3) *Accounting Auditing and Accountability Journal* PP. 493-511

PPPs in achieving VFM.<sup>76</sup> Nevertheless, there is evidence that PPPs in the United States have been successful.<sup>77</sup> However, Bloomfield *et al* found PPPs' lease purchasing financing arrangements to be wasteful and more expensive than conventional general obligation financing.<sup>78</sup> A study in Canada found an average of 24% cost savings on PPP projects in Canada from 2006-2010.<sup>79</sup> Greve on the other hand painted a very depressing picture of a major PPP project in Denmark opining that the project outcomes were devastating for all parties involved, According to him; it nearly ruined the mayor, the council and the citizenry.<sup>80</sup> However, it is claimed that PPPs are not frequently employed in Denmark because of the country's strong public finances and well-built physical infrastructure.<sup>81</sup> The Netherlands Expertise Centre PPP and Dutch National Audit Office studies were both of the opinion that PPPs in the Netherlands have not been successful.<sup>82</sup>

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<sup>76</sup> Amekudzi, D.M. et al, 'Value for Money Analysis in U.S. Transportation Public Private Partnerships, (online) at : <http://people.ce.gatech.edu/~aa103/valueformoney.pdf> (last accessed on July 7, 2013)

<sup>77</sup> National Council For Pubic Private Partnerships, 'Testing Tradition: Assessing the Added Value of Public-Private Partnerships' (online) at: <http://www.ncppp.org/wp-content/uploads/2013/03/WhitePaper2012-FinalWeb.pdf> (Last accessed on July 7, 2013)

<sup>78</sup> Bloomfield, P. *et al*, 'Innovation and Risks in a public-private partnership financing and construction of a capital project in Massachusetts', (1998) 21 (4) *Public Productivity and Review*, pp. 460-471

<sup>79</sup> Toppston, A. 'Alternative Construction Delivery' (paper presented at Aon DC Construction Forum, Washington, D.C. April 2 2012) cited in National Council For Pubic Private Partnerships, 'Testing Tradition: Assessing the Added Value of Public-Private Partnerships'

<sup>80</sup> Greve, C. (2003) 'When Public –Private Partnership fail. The extreme case of the NPM-inspired local government of the forum in Denmark', Paper for the EGPA conference 3-6 September, Oerias, Portugal. Cited in Nisar, T. M. (2007) *Supra* Note 65, pp. 1-19

<sup>81</sup> Petersen, O. H. 'Public-Private Partnerships as Converging or Diverging Trends in Public Management? A Comparative Analysis of PPP Policy and Regulation in Denmark and Ireland' (2011) Vol. 12, Issue. 2 *International Public Management Review*, pp. 1- 37

<sup>82</sup> Netherland Audit Office, Cited in Nisar, T. M. *Supra* Note 80

In summary, it is clear that there is a lot of skepticism as to whether PPPs actually lead to VFM. Whilst most official reports are of the opinion that VFM is more or less achieved, opposition has come from mainly academics. However, most empirical studies done to date show that there is considerable achievement of VFM when projects are done through PPPs instead of through traditional public procurement.

Grimsey and Lewis cite two reports to buttress the superiority of PPPs over traditional procurement in attaining VFM.<sup>83</sup> The first is the study conducted by Flyvbjerg, Holm and Buhl that examined 258 large transport infrastructure projects spanning 20 countries, the majority of which were developed using conventional procurement.<sup>84</sup> Costs were found to have been underestimated in over 90% of the projects. While in another study commissioned by the UK Treasury, Macdonald reviewed 50 large projects in the United Kingdom, 11 of which were undertaken under PPP.<sup>85</sup> It was found that on the average the PPP projects were concluded within time compared to 17% over time for the others. The cost overrun for PPP projects averaged at 1% compared to 47% cost overrun for traditional procurement. These reports in the absence of

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<sup>83</sup> Grimsey and Lewis (2005) *Supra* Note 83

<sup>84</sup> Flyvbjerg, B. *et al*, 'Underestimating Costs in Public Works Projects: Error or Lie?' (2002) 68(3) *Journal of the American Planning Association* pp. 279-295

<sup>85</sup> MacDonald, M. (2002), *Review of Large Public Procurement in the UK*, HM Treasury, London.

controvertible empirical studies show that VFM is being achieved in majority of PPP projects.

In conclusion, it is perhaps a bit early to make definitive judgments on the attainment of VFM in majority of countries due to the relative early stages of PPPs in these countries. It may perhaps be more useful to wait a bit longer before a more thorough evaluation can be undertaken.<sup>86</sup>

#### **4.7 Mitigation of Risk**

In Chapter 3, this thesis highlighted the different risk mitigation techniques available to both the public and private sectors. Under this subheading, some examples of how some of these risk mitigation tools have been used in practice are examined.

##### **Demand Risk**

Even though demand risk is most times allocated to the private sector, it is not uncommon for the public sector to take some of the risk back. The Columbian Government for instance in the PPP contract for the construction of the runway at Bogota's El Dorado Airport, guaranteed a minimum revenue to the private sector partners.<sup>87</sup> Again, in the El Cortijio- El Vino Toll Road in Columbia, the Columbian government agreed to reimburse the private sector consortium if traffic on the road was less than 90% of the specified level.<sup>88</sup> This was the same for the North South Highway Project in Malaysia where government undertook to

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<sup>86</sup> IPPR (2001), *Building Better Partnerships*, Institute of Public Policy Research: London.

<sup>87</sup> Ng, A. and Loosemore, M. *Supra* Note 46

<sup>88</sup> *ibid*

compensate the project consortium if the traffic flow and resulting toll income fell below a certain level.<sup>89</sup>

It is one of the arguments in this thesis that the manner in which demand risk was mitigated in the examples above are usually better than the use of non-compete clauses. With non-compete clauses, the Government is restricted from developing competing infrastructure to the PPP project in order to secure the revenue streams of the private sector partner. For instance, in the Nigerian MMA 2 Domestic Airport project, the contract expressly restricted the Government from building any new terminals near the vicinity of the newly PPP financed airport. The public roundly criticized this provision, as it had the tendency to stifle further development in the Nigerian aviation sector. A case study of the MMA 2 project is conducted in Chapter 6 of this thesis.

### **Exchange rate risk**

Despite the fact that the obligation to raise finance usually rests with the private sector, it is not uncommon in situations where funds for the financing of the project are coming from abroad, for the government to also guarantee exchange rates. For example in a major road project in Vietnam, assurances were given by the government that the Dong

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<sup>89</sup> Liou, D.D. 'Bridging the Funding Gap' (1997) 148 (8) *Project Trade Finance*; 32-3 Cited in Ng, A. and Loosemore, M. *Supra* Note 87.

(Vietnam's Currency), will always be converted at a specified rate regardless of currency fluctuations.<sup>90</sup>

### **Construction risk**

This risk, which is conventionally allocated to the private sector, occurs from the private sector party's failure to meet performance criteria for the completion of the construction phase of the project. Selecting a single contractor for the construction and operation of the project may mitigate this risk and also the public sector partner may require the private partner to provide insurance backed guarantees to ensure project completion. In the Hong Kong Tate Cairn Road Tunnel project, the project completion risk was mitigated by the good reputation of the private sector partner that was selected through a procurement process and also by a 10 year performance bond extended by the private sector consortium.<sup>91</sup>

### **Political risk**

In the Guangdong-Shenzhen-Zhuhai superhighway project in China, the political risk was mitigated by political risk insurance which was arranged by the financiers and a project guarantee which was offered by the

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<sup>90</sup> *ibid*

<sup>91</sup> Checherita, C. and Gifford, J. 'Risk Sharing in Public Private Partnerships: General Considerations and the Evaluation of the U.S. Practice in Road Transportation', Paper presented at the Transportation Research Board 87th Annual Meeting, Washington, D.C., 2008



government.<sup>92</sup> Political risk is discussed in greater detail in Chapter 5 of this thesis.

### **Cost and Schedule Overrun**

This risk is usually allocated to the private sector and may occur due to inefficient construction practices. Selecting a single contractor for both construction and operation of the project may mitigate this risk. Also, it helps to select an experienced private sector partner with adequate financial backing and a good track record. It is also possible to negotiate a fixed price construction contract, including penalties for delays (penalties should be proportional to the short fall e.g. penalty per day or week of delay). This may be combined with bonuses for early completion.

In conclusion, positive mitigation measures should usually go hand in hand with some clauses that ensure that the private sector does not make excessive profits from Government support. For instance, the government may employ claw back provisions, which basically allow the government to share some of the profits made from such gestures. The contracts may also contain abatement clauses, which may penalize the private sector for falling below certain set standards.

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<sup>92</sup> United Nations economic Commission for Europe (2008), *Guidebook on Promoting Good Governance in Public-Private Partnerships*, United Nations Publications, Sales No. 08.II.E.1

## 4.8 Contractual Documentation of Risk

This thesis has established that risk allocation in PPP contracts significantly affect project outcomes. For instance, project related risks such as construction risks, cost overrun risks and demand risks are all allocated through the contract design. Problems arise when the contract transfers a wrong amount or the wrong types of risk to the private sector party. According to a World Bank study of PPPs in Latin American and Caribbean countries, majority of the reasons for the high level of contract terminations or re-negotiations<sup>93</sup> in these countries was as a result of contracts failing to manage risks.<sup>94</sup>

Specific levels of risk allocation between the private and public sector partners vary according to the method of PPP used for a project because the scope of activities delegated to the private sector varies from method to method. For each type of contractual mode (whether BOT, DBFO, Concession etc.), risk is allocated to the private sector through contractual incentives and penalties incorporated within the payment mechanism and through activities for which the private sector party is responsible.<sup>95</sup>

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<sup>93</sup> Whilst renegotiations are not entirely bad, there are many undesirable outcomes that typically arise when contractual revisions take place. It may give rise to opportunistic behaviour by contracting parties.

<sup>94</sup> World Bank (2007) 'Contract Design in Public Private Partnerships' (A report prepared for the World Bank by Iossa, E. Spagnolo G. and Velez, M.) (online) at: <http://www.gianca.org/PapersHomepage/Contract%20Design.pdf> (last assessed on March 25, 2012)

<sup>95</sup> *ibid*

Having discussed the theoretical recommendations for risk allocation through contractual documents in chapter 3, this chapter reviews several methods that have been used in projects to accomplish the contractual allocation of risks seeking to determine whether they conform to the theoretical recommendations.

Wang and Yongjijian Ke carried out a case study of the Labin B. Power Project in China and came to the conclusion that one of the principal reasons for the success of the project was the way risks were handled in the contractual document.<sup>96</sup> This study provides a good indication of how some PPP risks may be allocated in contractual documents. According to them the risks were handled in the following way:

### **Change in Law**

The contract stipulated that should there be any change in Chinese laws, regulations, decrees or any material conditions associated with any of the approvals applicable to the project, which substantially adversely affect the rights and obligations of the consortium, the consortium may request the adjustment of the terms of the contract so as to place the consortium in substantially the same economic position it was prior to such changes. The Government therefore assumed this risk in line with the theoretical assumptions made in Chapter 3.

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<sup>96</sup> Wang, S. and Yongjijian, Ke (2009) 'Case Study of Labin, B. Power Project- The First State Approved Power Project in China in Public-Private Partnership in Infrastructure Development': *Case Studies from Asia and Europe* Bauhaus Universitat Weimar, (online) Available at [http:// e-pub.uni-weimar.de/volltexte/2009/](http://e-pub.uni-weimar.de/volltexte/2009/) (last assessed on March 28, 2012)

## **Exchange Rate**

The government under the contract assumed the foreign exchange risk by allowing the project company to adjust the floating portion of the tariff (indexed in US dollars but payable in RMB) to reflect any changes in the RMB/US Dollar exchange rate.

## **Political risk**

The contract provided for compensation for the private sector where the Government defaulted with regard to the political risk that it assumed. For instance, where construction work is delayed or the cost of construction or financing is increased due to the fault of the government, the government may either extend the concession period accordingly or adjust tariff in order to compensate the private sector.

## **Force Majeure**

At the occurrence of a *force majeure* event, either party was allowed to terminate the agreement and the project company's obligations under the agreement will cease and Government will pay the private sector consortium compensation. Upon the payment of the compensation, the consortium was obliged to transfer the asset to the government. Lenders will be repaid and sponsors will receive compensation corresponding to their equity investment. However, if termination results from the company, in event of default the private sector is not entitled to any compensation.

This is in consonance with the recommendations in Chapter 3 and typically what happens in Independent Power Projects. It is also important to stipulate clearly in the contract the events that will amount to *force majeure*. It is also good practice to clearly specify thresholds for renegotiation (e.g. toll levels) in case for example if the profitability of the project is affected.<sup>97</sup>

In a separate work, Yongjijian *et al* recommended that change of law risks should be handled as follows:

- If a significant change in law prevents the private sector party from fulfilling its obligations, then the private sector party should be entitled to receive corresponding payments irrespective of its inability to supply contracted services.
- The private sector can be restored to the same economic position if the change in law results in additional cost to the private sector company over and above an agreed threshold.
- The change in law should apply to any change in law after bid submission date and should include any changes in tax regulations etc.<sup>98</sup>

The contract design may also be used to mitigate demand risk. This may be dealt with by directly guaranteeing minimum purchase of project output or indirectly through adjusting tariff with demand or a combination of them. For example, the price would increase in

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<sup>97</sup> *ibid*

<sup>98</sup> Yongjijian, ke. *et al*, *Supra* Note 9

accordance with the reduction of demand below agreed thresholds. The government may also insist that price be reduced if the market volume increases.<sup>99</sup>

The contract may also provide for fixed term plus a given extension period if the level of demand is below an agreed break-even point specified in the contract. Another option is to grant an upfront subsidy or a demand guarantee limited to a strictly enforceable period (e.g. 3 years, to vary according to the project's attractiveness). In toll road projects, the introduction of a dynamic tolling regime is another option. In this case, toll pricing varies according to peak travel periods or time of day or days of the week.<sup>100</sup>

It is also good practice where a non-compete clause is employed, to link the clause with congestion limits and expansion obligations. These will also help strike a good balance with the long-term sustainability of the infrastructure sector. These issues are considered in greater detail in Chapter 6 of this thesis, which deals exclusively with demand risk.

### **Legal and Institutional risk**

This risk can occur due to changes in the general legal framework (taxes, environmental standards). The contract can specify clearly the trigger

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<sup>99</sup> Ye, S. and Tiong 'Effects of Tariff Design in Risk Management of Privately Financed Infrastructure Projects'. (2003) 129 (6), *Journal of Construction Engineering Management* pp. 610-618

<sup>100</sup> *ibid*

clauses for re-negotiation (e.g. toll levels) in cases where the profitability of the project is affected. It is also good to strengthen the institutional framework in advance.

#### **4.8 Management of Risk in Nigeria**

In contrast to most of the developed economies, there is very little research on the assessment of how PPP risks have been managed in the few projects that have been concluded. As rightly pointed out by Adewale *et al*, this is due to the novelty of the PPP in the country and the fact that most of the projects are still at their infancy. Many of the projects are still at the construction or preconstruction phase, with very few at the operation stage.<sup>101</sup> However there are a few of the studies, which have looked at mainly risk perception. These studies are analysed below as they provide a basic foundation for the case studies that are conducted in subsequent chapters of this thesis.

A.D. Ibrahim *et al* investigated the perception of Nigerian construction professionals on the relative importance of identified risks and their preference of allocation between the public and private sectors.<sup>102</sup> The respondents were presented 61 risk factors to assess their perceived level of importance. They discovered that the 10 most important risk factors for PPPs in Nigeria are “unstable government”, “inadequate experience in PPPs”, “availability of finance”, “land acquisition/site availability”, “poor

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<sup>101</sup> Awodele, O.A. *et al* (2010) ‘Understanding and Managing Risks Necessary Condition for success and sustainability of Privately Financed Market Projects in Nigeria’. Proceedings of ARCOM Doctoral Research Workshop on Sustainability Strategies in the UK Construction Industry. University of Wolverhampton, 25th June, 2010

<sup>102</sup> Ibrahim, A. D *et al* *Supra* Note 23

financial market”, “residual value risk”, “availability of appropriate labour/ material”, “financial attraction of the project to investors”, “corruption and lack of respect for law” and “poor workmanship”.

They also found that 7 out of the 10 risk factors related to exogenous (outside of the project) risk factors. They advised that the way to deal with the exogenous risk factors is through effective legislation and a standardized administration framework to regulate the development and implementation of PPPs. This suggestion is in line with the popular notion that an enabling regulatory, legal and political environment is the cornerstone to sustainable private sector participation in urban infrastructure services.<sup>103</sup> It is also the position of this thesis that the best risk allocation and mitigation tool especially with respect to political risk is an adequate legal and regulatory framework.

Of the 61 risk factors listed by A.D. Ibrahim et al., they concluded that 34 (representing 56%) of the risks should be assigned to the private sector partner. According to them, this concurs with a similar survey conducted by Li *et al* on the risk factors in PFI projects in the United Kingdom.<sup>104</sup> The survey also came to the conclusion that 32 out of the 42 risk factors identified should preferably be assigned to the private sector. Since this number is substantial, they conclude that the selection of private sector partners with necessary skills, experience and resources to manage the risks and yet deliver quality and cost reflective services is quite crucial to

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<sup>103</sup> Ibid

<sup>104</sup> Li *et al* (2005) *Supra* Note 57



the success of PPP projects.<sup>105</sup> Out of the seven risk factors that should be preferably shared between the public and private sector partners, four of them are endogenous. The authors conclude that this is in line with the notion that a harmonious and collaborative working relationship is very vital to the success of long-term PPP projects. <sup>106</sup>

The risk allocation preferences in the country according to them therefore, is that while the preference is for most of the endogenous risk factors to be assigned to the private sector partner, the public sector should retain political and site acquisition risks. Also, relationship based risks should be shared between the private and public sectors.<sup>107</sup> Awodele *et al* on their part carried out a case study of the reconstruction of the Erekesan market in Akure, southwest Nigeria, and found that cultural (stakeholder) and political risks are the most prominent risks, while design risks are also important.<sup>108</sup> According to them, the mismanagement of these risks was responsible for the poor performance of the market, which had only 50% occupancy.<sup>109</sup>

Damilolo Akerele and Kassim Gidado were of the opinion that political, inflation and currency risks are the most important risk factors that affect

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<sup>105</sup> *ibid*

<sup>106</sup> *ibid*

<sup>107</sup>. Ibrahim, A.D. et al., (2006)Supra Note 102

<sup>108</sup> Awodele, O. et al., ' Understanding and Managing Risks- Necessary Condition for Success and Sustainability of Privately Financed Market Projects in Nigeria (2010) ARCOM Doctoral Workshop, University of Wolverhampton, UK 25<sup>th</sup> of June, 2010

<sup>109</sup> *ibid*

projects in Nigeria.<sup>110</sup> Regulation risks (comprising of contract risk and tax risk) were also significant. They contend that regulatory risk can be reduced through the adoption of a clear policy and a regulatory framework. They however scored demand and resource risk low on importance. They attributed this to be due to the fact that Nigeria has a large and increasing population with abundance of skill and natural resources. One of their notable finding was that the public sector seemed to underestimate the extent of risk and constraints affecting projects in Nigeria that need to be seriously addressed before considering the implementation of a reliable PPP/PFI project. This is in agreement with the position of this thesis that it is the lack of understanding and therefore underestimation of the different risks that are likely to affect PPP projects by the public sector that is a major reason for the multitude of issues that currently affect most of the concluded PPP transactions in Nigeria.

On their part, Akinyemi *et al* looked at the perception of risk by Nigerian banks and found that Nigerian banks were of the opinion that they should take the lowest amount of risk and that risks should be shared evenly amongst all project actors with project contractors taking the largest share of risks. Curiously, the banks would also want the general

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<sup>110</sup> Akerele, D. and Gidado, K. (2003) 'The risks and constraints in the implementation of PFI/PPP in Nigeria' in Greenwood, D. J. (Ed.), *19th Annual ARCOM Conference*, 3-5 September 2003, University of Brighton Association of Researchers in Construction Management, Vol. 1, pp. 379-91 also (online) at [http://www.arcom.ac.uk/publications/procs/ar2003-379-391\\_Akerele\\_and\\_Gidado.pdf](http://www.arcom.ac.uk/publications/procs/ar2003-379-391_Akerele_and_Gidado.pdf) (last accessed on January 1, 2012)

public and interest groups to share an equally large part of the risks.<sup>111</sup> The authors suspect that the country's taxpayers are taking in an unfair share of the risks because of specific national challenges for example the lack of technical expertise in PPP risk management, regulatory limitations, general unwillingness and inability of the Nigerian government to invest substantially in infrastructure projects.<sup>112</sup>

Aluko and Oyebode opined that the public sector is typically allocated the change of law risk in Nigeria. However, due to the Nigeria's federal system of government, the state governments are reluctant to take on the change of law risk for federal legislative changes and therefore parties are left with the option of agreeing to use their best endeavors to mitigate the impact of change of law. The private sector also has the option of taking out political risk insurance.<sup>113</sup>

Nearly all the major PPP projects that have been completed so far in Nigeria seem to be experiencing one problem or the other. Several of them are already in court and this has led to major apprehension on the part of financiers and the reason for these issues stem mainly from improper management of risk. While the National Policy on PPP

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<sup>111</sup> Akinyemi, B. *et al* 'Nigerian Banks and the Perception of Risks in PPP project Delivery', (2009) Vol. 8 (2) *Journal of Finance and Management in Pubic Services*,

<sup>112</sup> *ibid*

<sup>113</sup> Aluko and Oyebode (2007) *The International Comparative Legal Guide to PFI/PPP Projects 2007: A practical Insight into Cross-border PFI/PPP Projects* Work Published by Global Legal Group, (online) at: [http://www.iclg.co.uk/index.php?area=4&country\\_results=1&kh\\_publications\\_id=28&chapters\\_id=1027](http://www.iclg.co.uk/index.php?area=4&country_results=1&kh_publications_id=28&chapters_id=1027) (last accessed on January 31, 2012).

recognizes the need for proper management of risks, it is clear that this is not usually being followed in practice. The risk management strategy currently adopted in most of the projects in Nigeria is therefore more in response to solving problems when they have occurred rather than taking preventative actions.<sup>114</sup> The reason for this might be due to the lack of capacity in the public sector for valuing and modeling risk and one can argue even in the private sector. This is not a unique Nigerian problem. The same can be said of the public sector in most countries of the world.<sup>115</sup> This ensures that the private sector usually possesses substantial advantage over the public sector in risk negotiations.<sup>116</sup>

From the literature discussed above, it is evident that there is great similarity between the risk factors that exist in PPP projects in Nigeria and the rest of the world. The major difference is that whilst the risk of corruption is pronounced in Nigeria, it is not as prominent in most of the developed countries.<sup>117</sup> Also the literature focused mainly on risk perception and very little on risk management. The research has also been very generalist not doing in-depth studies or looking at any of the major PPP transactions that have taken place. This research intends to fill these lacunae by carrying out in-depth case studies on the

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<sup>114</sup> Abednego, M.P. and Ogunlana, S.O. (2006) *Supra Note* 13 pp. 622-634

<sup>115</sup> Ahadzi, M. and Bowles, W. 'Public Private Partnerships and Contract Negotiations: an empirical study', (2004) Vol. 22(9) *Construction Management and Economics* pp. 967-978.

<sup>116</sup> Hood, j. and McGarvey, N. 'Managing the Risk in Public- Private Partnerships in Scottish Local Government', (2002) Vol. 23 (1) *Policy Studies*, pp. 21-35

<sup>117</sup> Corruption risk is also a major risk factor in China.

management of risks in some of these recent major projects. The thesis will also determine how the legal, institutional and governance framework may be improved to enable better handling of these risks in Nigeria.

#### **4.9 Conclusion**

This role of this chapter in the overall scheme of this thesis is to validate the theoretical assumptions distilled from various literatures in chapter 3 by comparing them with empirical findings from various studies. This helps in answering the first research question of whether risk allocation and mitigation leads to better PPP projects? The answer to this research question provides this thesis with the tool with which to answer the second and third research questions in subsequent chapters.

This chapter has confirmed that even though there are many factors and considerations that enable a successful PPP project, proper allocation and management of risk seems to be the most important factor.<sup>118</sup> For instance, it is believed that contractual misallocation of risk is the leading cause of contractual disputes in the United States.<sup>119</sup> This is suspected to be the same for Nigeria. It is clear therefore that proper allocation and mitigation of risk is a prerequisite for good PPP projects. Research question 1 is therefore answered in the affirmative.

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<sup>118</sup> Anderson, A. (2000) *Supra* Note 61; Grimsey and Lewis (2004) *Supra* Note 28

<sup>119</sup> Megens, P. 'Construction Risk and Project Finance- risk allocation as viewed by contractors and financiers' (1997) Vol. 14, No. 1 *The International Construction Law Review*, pp. 5-32

Finally, this chapter also provides the justification for selecting the three different risks that are discussed in subsequent chapters of this thesis. Due to constraint of space and lack of available cases as a result of the few projects that have taken place in Nigeria, this thesis selected to study the three most important risks affecting PPP projects in Nigeria. The different literatures studied above provide the basis for choosing to study political risk, demand risk and stakeholder opposition risk in the subsequent chapters.

**Appendix I:**

**Classification According to the Frequency or Occurrence of Risks by Nur**

**Alkaf Abd Karim**

<b>Risk attribute from Public Private Partnership project</b>	[27]	[2]	[11]	[17]	[7]	[28]	[26]	[31]	[25]	[30]	[18]	[24]	[13]	[21]	<b>Frequency</b>
<b><u>Political</u></b>															
Change in law	*			*		*	*			*	*	*	*	*	9
Delay in project approvals and permits	*	*	*	*	*				*		*		*	*	9
Expropriation/nationalisation of assets	*		*		*		*					*	*	*	7
Poor public decision making process	*		*	*	*	*	*								6
Inconsistencies in generating policies	*	*			*	*									4
Strong political opposition/hostility	*		*		*				*						4
Unstable government			*		*					*					3
Government intervention	*						*								2
Government reliability	*									*					2

Inability to concessionnaire							*												1
<b><u>Construction</u></b>																			
Land acquisition	*	*	*		*	*	*					*		*	*	*			9
Availability of appropriation labour/material	*		*		*	*	*					*	*	*					8
Availability of finance			*	*		*	*			*	*		*	*					8
Construction costs overruns	*		*	*	*	*					*		*	*					8
Design deficiency			*	*	*	*		*	*								*		8
Construction time delay	*		*	*	*	*				*	*	*							8
Excessive contract variation/contractual risk	*		*	*	*	*		*	*				*	*					8
Geotechnical conditions/ground condition	*		*		*		*							*	*				6
Late design changes			*	*	*									*	*				5
Contractor failure/capacity of SPV		*		*		*				*									5
Project delay		*		*			*		*										4
Completion risk							*							*	*				3
Consortium inability	*					*			*				*						3
Unproven engineering						*										*			2



technique																
Resettlement and rehabilitation											*			*		2
Quality risk													*	*		2
Insolvency/default of subcontracts and suppliers			*		*											2
Poor quality of workmanship			*		*											2
Change of scope											*					1
<b><u>Legal</u></b>																
Change in tax regulation	*	*	*		*		*									5
Corruption and lack of respect of law	*				*	*	*			*						5
Legislation change/inconsistencies			*		*		*		*	*						5
Industrial regulatory change			*		*				*						*	4
Import/export restrictions					*											1
Rate of returns restrictions					*											1
<b><u>Economic</u></b>																
Interest rate volatility	*	*	*		*	*	*				*			*		8
Inflation rate volatility	*	*	*		*	*	*							*		7
Foreign exchange and	*				*	*	*					*	*			6

convertibility															
Poor financial market			*		*					*					3
<b><u>Operation</u></b>															
Operation cost overrun	*		*		*	*	*				*		*		7
Residual value (after concession period)			*		*		*						*	*	5
Maintenance cost higher than expected			*		*	*								*	4
Operation financial risk			*		*	*					*				4
Low operating productivity			*		*	*									3
Risk regarding pricing of product/service				*	*		*								3
Operator default													*	*	2
Quality of operation													*	*	2
Project/operation change							*		*						2
Supporting facilities risk/necessary infrastructure risk	*												*		2
Technology risk						*									1
Waste of material													*		1
<b><u>Market</u></b>															
Tariff change	*	*								*		*	*	*	6

Market demand	*						*	*					*	*	5	
Fluctuation of material cost (by government)													*	*	2	
Fluctuation of material cost (by private)													*	*	2	
<b><u>Project selection</u></b>																
Public opposition to projects			*		*	*	*							*		5
Uncompetitive tender	*						*		*	*						4
Level of demand for the project			*		*	*										3
Competition risk	*				*											2
<b><u>Relationship</u></b>																
Different working methods/know-how between partners	*		*	*	*				*	*						6
Inadequate experience in PPP			*	*	*	*				*						5
Lack of commitment from public/private partner	*		*		*					*						4
Organisation and coordination risk			*	*	*		*									4
Third party tort liability	*		*		*		*									4

Inadequate distribution of responsibility and risk			*		*					*										3
Inadequate negotiation period prior to initiation				*	*															2
Staff crises			*		*															2
Cultural differences between main stakeholders					*															1
Non-involvement of host-community					*															1
<b><u>Project finance</u></b>																				
Financial attraction of project to investors			*	*	*	*				*										5
High finance cost	*		*		*					*										4
Lack of creditworthiness					*		*			*										3
High bidding costs					*					*										2
Delay in financial closure										*	*									2
Inability to service debt					*															1
Lack of government guarantees					*															1
Delay in payment of annuity											*									1
Financiers unwilling to take high risk										*										1

**Natural factors**

Force majeure	*	*	*		*	*	*				*		*		8
Environment	*	*	*		*	*	*								6
Weather	*	*	*		*		*								5

[Appendix 2:

**Standard Risk Allocation Matrix by Grimsey and Lewis**

<b>TYPE OF RISK</b>	<b>SOURCE OF RISK</b>	<b>RISK TAKEN BY</b>
<b>Site risks</b>		
Site conditions	Ground conditions, supporting structures	Construction contractor
Site preparation	Site redemption, tenure, pollution/discharge, obtaining permits, community liaison	Operating company/project company
	Pre-existing liability	Government
Land use	Native title, cultural heritage	Government
<b>Technical risks</b>	Fault in tender specifications	Government
	Contractor design fault	Design contractor
<b>Construction risks</b>		
Cost overrun	Inefficient work practices and wastage of materials	Construction contractor
	Changes in law, delays in approval etc.	Project company/investors
Delay in completion	Lack of coordination of contractors, failure to	Construction contractors

	obtain standard planning approvals	
	Insured <i>force majeure</i> events	Insurer
Failure to meet performance criteria	Quality shortfall/defects in construction/commissioning tests failure	Construction contractor/project company
<b>Operating risks</b>		
Operating cost overrun	Project company request for change in practice	Project company/investors
	Industrial relations, repairs, occupational health and safety, maintenance, other costs	Operator
	Government change to output specifications	Government
Delays of interruption in operation	Operator fault	Operator
	Government delays in granting or renewing approvals, providing contracted inputs	Government
Shortfall in service	Operator fault	Operator

quality		
	Project company fault	Project company/investors
<b>Revenue risks</b>		
Increase in input prices	Contractual violations by government-owned support network	Government
	Contractual violations by private supplier	Private supplier
	Other	Project company/investors
Change in taxes, tariffs	Fall in revenue	Project company/investors
Demand for output	Decreased demand	Project company/investors
<b>Financial risks</b>		
Interest rates	Fluctuations with insufficient hedging	Project company/government
Inflation	Payments eroded by inflation	Project company/government
<i>Force majeure risk</i>	Flood, earthquake, riots, strikes	Shared



<b>Regulatory/political risks</b>		
Changes in law	Construction period	Construction contractor
	Operating period	Project company, with government compensation as per contract
Political interference	Breach/cancellation of licence	Government
	Expropriation	Insurer, project company/investor
	Failure to renew approvals, discriminatory taxes, import restrictions	Government
<b>Project default risks</b>	Combination of risks	Equity investors followed by banks, bondholders and institutional lenders
	Sponsor suitability risk	Government
<b>Asset risks</b>	Technical obsolescence	Project company
	Termination	Project company/operator
	Residual transfer value	Government, with

		compensation for maintenance obligations
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## Chapter 5

### Political Risk

#### 5.1 Introduction

This chapter discusses political risk in PPPs. The chapter starts by analysing the different definitions and classifications of political risk generally and then particularly in relation to PPPs. This is followed by an evaluation of the different aspects of political risk theory. The third section considers the various methods used in assessing political risk, while the fourth analyses the different instruments employed in political risk mitigation. The concession of the 26 federal ports PPP project in Nigeria is used as the case study to evaluate how political risk has been managed in the country. The final sections of this chapter appraise the regulatory and institutional framework for PPPs in Nigeria and proffer recommendations for improving the management of political risk in the country.

#### 5.2 Definition

There is little consensus as to what constitutes political risk,<sup>1</sup> with the occurrence of a new event within the class of political risks possibly

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<sup>1</sup> Simon, J.D. 'Political Risk Assessment: Past Trends and Future Prospects'(1982) *Columbia Journal of World Business*, pp 62- 71; Fitzpatrick, M. 'The Definition and Assessment of Political Risk in International Business: A Review of The Literature' (1983) Vol.8 No.2 *Academy of Management Review*, pp. 249-254

changing the definition materially.<sup>2</sup> The definition of political risk may be broadly categorised into four.<sup>3</sup> The first views political risk from the prism of political events or constraints imposed on a specific industry or firm. In this light, political risks have been defined as “managerial contingencies arising from political events and processes”.<sup>4</sup>

Secondly, political risk has been viewed as arising out of government or sovereign action. In this regard, political risk may be described as “any activity of the state resulting in the reduction of companies’ value and capital”.<sup>5</sup> It may also be defined in this regard as “arbitrary or discriminatory actions taken by home or host governments, political groups or individuals that have an adverse effect on trade or investment transactions”.<sup>6</sup> This category of definitions of political risk have been criticized for looking at political risk only from the purview of negative unwanted consequences of political activity from host governments.

The assumption that political risk is always negative may not be a

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<sup>2</sup> Hill, C.A. ‘How Investors React to Political Risk’, (1998) 8 *Duke Journal of Comparative and International Law* pp. 283-313

<sup>3</sup> Fitzpatrick, M. *Supra* Note 1

<sup>4</sup> Stephen, J. K. ‘Political Assessment by International Firms: Models or Methodologies?’ (1981) 3(2) *Journal of Policy Modeling* pp. 251-270

<sup>5</sup> Ostojić, S. and Unković, Z. ‘Insurance and Management of Political Risk Exposure in Developed Economies and Serbia’ (2011) Vol. 6 No.2 *South East European Journal of Economics and Business* pp. 79-93

<sup>6</sup> Wagner, D. ‘Political Risk Insurance Guide’, (1999) International Risk Management Institute, Dallas TX; see also Root, F. (1972) ‘Analyzing Political Risk in International Business’ in Kapoor, A. and Grub, P.D. ed. *Multinational Enterprise in Transition*, Darwin Press, London; Kobrin S.J. Political Risk: A Review and Recommendation, (1979) 10 (Spring-Summer) *Journal of International Business Studies*, pp. 67-80

universally valid assumption as the occurrence of a political risk event may also lead to positive outcomes.<sup>7</sup> As Robock explained, “yet as in the case of other types of risks, political risk can result in gains as well as losses”.<sup>8</sup> Haendel supports the above position in his definition of political risk as “the probability of the occurrence of some political event that will change the prospects for the probability of a given investment”.<sup>9</sup> This perception of political risk is consistent with the general appreciation of risk in this thesis, as having both a negative and a positive effect. An example of how a positive outcome can result from the existence of political risk is given by Kobrin regarding the increase in business for companies involved in the armoured car industry as a result of the political instability in Argentina.<sup>10</sup>

The third theme from the classification above views political risk in terms of changes in the business environment. According to Robock and Simmonds, political risk in International investment exists when three factors are present: 1) when discontinuities occur in the business environment, 2) when they are difficult to anticipate, and 3) when they

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<sup>7</sup> Kobrin, S.J. *Supra* Note 457; Butler, K.C. and Joaquin, D.C. ‘A Note on Political Risk and the Required Return on Foreign Direct Investment’, (1998) Vol. 29, No. 3 *Journal of International Business Studies* pp. 599-607

<sup>8</sup> Robock, S.H. ‘Political Risk: Identification and Assessment’ (1971) *Columbia Journal of World Business*, pp. 6-20

<sup>9</sup> Haendel, D. *et al* ‘Overseas Investment and Political Risk’ (1976) Vol.18 Issue1 *The International Executive* pp.11-13

<sup>10</sup> Kobrin, S.J. *Supra* Note 458; Also, Bouchet, M.H *et al*, (2003) ‘Country Risk Assessment: A Guide to Global Investment and Strategy’, John Wiley & Sons, West Sussex England pg. 10

result from political change.<sup>11</sup> The fourth viewpoint classifies political risk from an environmental perspective; but differs from the third category because there is no detailed search for a definition of political risk by proponents of this theme. This faction only acknowledges a source of risk to international business that is generated from the business environment within a host country.<sup>12</sup> This group tend to look at political risk more holistically and their work has led to new line of literature, which sees political risk as being encompassed in 'country risks'.

The definition offered by Meldrum is a good exposition of the philosophy of this group.<sup>13</sup> According to the author:

All business transactions involve some degree of risk. When business transactions occur across borders, they carry additional risk that are not present in domestic transactions. These additional risk called country risks typically include risks arising from a variety of National differences in economic structures, policies, socio political institutions, geography and currencies.<sup>14</sup>

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<sup>11</sup> Robock, S.H. and Simmonds K. 'International Business and Multinational Enterprise' (1973) Vol15, Issue 3 *The International Executive* pp. 5-6

<sup>12</sup> Fitzpatrick, M. *Supra* Note 3

<sup>13</sup> Meldrum, D.H. 'Country Risk and Foreign Direct Investment', (Jan 2000, (35) (1) *Business Economics* pp. 33-40; See also Stobaugh, R. Jr. 'How to Analyze Foreign Investment Climates', (Sep/Oct 1969), 47(5), *Harvard Business Review* pp. 100-107

<sup>14</sup> *ibid*

The argument for looking at traditional political risk in this manner is that it is important to take into consideration all the different sources of political risk, or even risk generally. This is because all the sources of political risk interact with one another and possibly affects all sectors of the economy if they finally eventuate.<sup>15</sup>

However, for the purposes of this thesis, this wider country risk assessment classification will not be pursued further. This is because this thesis is concerned specifically with political risk in its traditional sense and the inclusion of other subtle economic and geographic factors will unduly widen the scope of analysis beyond the intention of the work. Besides, this definition is also not suitable for the purposes of this research because even though it acknowledges the existence of political risk, it does not pursue its nature in-depth.<sup>16</sup>

The success of PPPs depends on a stable political environment. The reason is simply that most countries, particularly developing ones, rely on the influx of private capital from overseas to finance infrastructure under PPPs. It makes sense that the private sector will not invest in a country unless it is satisfied that the political environment is conducive for its investments to flourish. If the private sector decides to invest regardless of the existence of political risk, it will usually demand a great premium,

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<sup>15</sup> Bouchet, M.H. *Supra* Note 10

<sup>16</sup> Fitzpatrick, M. *Supra* Note 12

whether in the form of guarantees, discounts or larger profit margins for assuming the risk.<sup>17</sup>

The need to ensure the recovery of capital is even more crucial in PPPs than other investments. This is because PPPs are consummated primarily through non-recourse financing, where a syndicate of banks and other financial institutions typically provide loans and other investments. Such funds are normally recoverable from the project cash flow and not from any other form of collateral or security from the private sector investor, which is more often than not, a mere Special Purpose Vehicle (SPV). Therefore the SPV, which is often led by financial institutions, will try to ensure that these funds are not at risk.

Like a number of authors, Reside concludes after an analysis of events affecting many PPP projects around the world that the single most important and most influential risk driving project outcomes is political risk.<sup>18</sup> He also pointed out that political risk is not always independent of other project risks and is usually positively correlated with other PPP risks.<sup>19</sup> In essence, political risk may be triggered by the occurrence of other project risks and have consequences that include the prompting of

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<sup>17</sup> Hill, C.A. *Supra* Note 2

<sup>18</sup> Reside, R. (2009) 'Global Detriments of Stress and Risk in Public-Private Partnerships (PPP) in Infrastructure' *Asian Development Bank Institute Working Paper Series No.133* (2009) (online) at: <http://www.en.kyushu-u.ac.jp/aslea/apapers/Global%20Determinants%20of%20Stress%20and%20Risk%20in5asleab4.pdf> [last accessed on August 23, 2012]

<sup>19</sup> *ibid*



subsequent discretionary actions by host governments that put private capital at risk.<sup>20</sup>

In summary, the exercise of political power is the root cause of political risk.<sup>21</sup> Political risk is a large amorphous category. It contains virtually all “risks associated with business or investment in a country which would not be present in another country with a more stable and developed business and economic climate and regulatory regime”.<sup>22</sup> Some of the components of political risk are currency inconvertibility and transfer restriction, expropriation, breach of contract, political violence, legal, regulatory and bureaucratic risks and non- governmental action risks. Investors will avoid countries where there are high incidences of these factors. This is why it is said that political risks have an impact on a country's development.<sup>23</sup>

For purposes of this thesis, the constituents of political risk are defined as widely as possible, as referring to any action by government, agencies of government or its employees that adversely affect PPP transactions. It is also acknowledged that political risk is very wide in scope, it can range from a revolution in which all foreign businesses are disrupted and

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<sup>20</sup> *ibid*

<sup>21</sup> Wagner, D. (2000) 'Defining Political Risk' (online) at: <http://www.irmi.com> (last accessed May 1, 2012)

<sup>22</sup> Hill, C.A. *Supra* Note 17

<sup>23</sup> Sachs, T. and Tiong, R.L.K, 'The impact of political risk on public-private partnership (PPP) opportunities in Asia' (2007) No.20 Civil Engineering Research, ISSN: 0219-0370 pp. 20-23 Also Available (online) at: <http://www2.ntu.edu.sg/ResearchPaper/ODR/2006/Impact%20of%20political%20risk%20on%20PPPs%20-%20CEE.pdf>. (last accessed on August 11, 2013).

eventually nationalized (macro political risk) to a revision of tax law that negatively affects an individual company's profit margin (micro political risks).<sup>24</sup>

There is a need to also distinguish political risk from political instability as for example, a political instability occasioned by an unexpected change in government leadership may or may not involve political risk.<sup>25</sup> There is also a need to distinguish political risk from political uncertainty. According to Root, "when the international manager makes a probability judgment on an uncertain political event in a host country, he thereby converts a political uncertainty into a political risk".<sup>26</sup>

Adopting the classification put forward by Tilmann Sachs *et al*, political risks can be roughly classified under six broad headings:

(A) Currency inconvertibility and transfer restriction Risk: any action of the host government restricting the conversion and transfer of currency outside the host country.

(B) Expropriation Risk: any legislative or administrative action from the host government that has the effect of depriving an investor of ownership or control of or substantial benefit from its investment.

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<sup>24</sup> See Robock, S.H. *Supra* Note 11. Also, Simon, J.D. *Supra* Note 1

<sup>25</sup> Robock, S.H. *Supra* Note 24. Also, Simon, J.D. *Supra* Note 1

<sup>26</sup> Root, F. 'US Business Abroad and Political Risks' (Winter 1968 ) *MSU Business Topics*, pp. 73-80;

- (C) Breach of contract Risk: any repudiation or breach of a contract by a host-government, when either there is no recourse to judicial or arbitral forum to determine the claim; or a decision by such forum is not rendered within reasonable period of time, or such decision cannot be enforced.
- (D) Political violence: acts of war, civil war, insurrection/civil disturbance, terrorism, sabotage, or landowner and/or indigenous people's disturbance in the host country.
- (E) Legal, regulatory, and bureaucratic risks: risks within the administrative process that cannot be directly attributed to one of the above. These include the legal enforceability and execution of laws, conflict of authority, corruption, transparency, issuing of approvals and consents, change of government causing changes in law, policy, and taxation, and obstruction during arbitration processes.
- (F) Non-governmental action risks: risks that the government has no direct influence on and do not fall within any of the above categories. These include actions by environmental and union activists, religious fundamentalism, ethnic tensions etc.<sup>27</sup>

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<sup>27</sup> Sachs, T. *et al*, 'Analysis of political risks and opportunities in public private partnerships (PPP) in China and selected Asian countries: Survey results', (2007) Vol. 1 Issue 2 *Chinese Management Studies*, pp. 126 – 148

### 5.3 Theoretical Basis for Political Risk

There is no single principle or theory on which the discipline of political risk rests. The journey in theory building in this area has been one of a compilation of types of non-economic conditions and events; both government and at times even societal as well as internally or externally based events that can affect or influence foreign business activity and profitability in a host country. Jarvis sums the situation succinctly:

Most methodological and theoretical approaches to political risk analysis have been discursive and discrete, emblematic of the episodic interest in the area and discipline based research approaches that have tended to produce scattered clustering's of theory.<sup>28</sup>

It is posited that without a theoretical framework for political risk, even an agreeable definition of the concept will be arduous because it will be difficult to define its ambit. Due to the disparate nature of the risk, there will be a tendency to view each political risk situation as unique to a particular country. A theoretical framework on the other hand provides the string that ties the concept together. It makes it easier to identify and bring together the recurring patterns and trends of political risk across

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<sup>28</sup> Jarvis, D. (July 2008) 'Conceptualising, Analyzing and Measuring Political Risk: The Evolution of Theory and Method'. Lee Kuan Yew School of Public Policy Research Paper No. LKYSPP08-004 (online) at: <http://www.lkyspp.nus.edu.sg/docs/fac/jarvis/Political%20Risk.pdf> > [last accessed August 24, 2012]

nations under one umbrella.<sup>29</sup> This will make its forecast, identification, assessment and management easier.

Some of these strands of political risk theories are highlighted below. First is that political risk is dependent on certain specific characteristics in a host country. This strand of theory was first championed by Root<sup>30</sup>, who viewed political risk as arising out of the attitudes and behaviour of host governments. He focused on certain country-specific characteristics which affect political risk, some of which were transfer risk (relating to the transfer of funds, products, technology and people), operational risk (relating to uncertainty about policies, regulations and government administrative procedure which could hinder operations) and risk on control of capital (which involves discrimination against foreign firms, expropriation and forced shareholding).<sup>31</sup>

Secondly, is that political risk is linked to country-specific political events that cause unanticipated discontinuities in the business environment.<sup>32</sup> Some of these sources according to Robock, include political unrest and disorder and new international alliances generated by foreign governments or their agencies, which lead to breaches or unilateral

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<sup>29</sup> *ibid*

<sup>30</sup> Root, F. 'US Business Abroad and Political Risks' *Supra* Note 26

<sup>31</sup> Root, F. (1973), *Analysing political risks in International business*, in A. Kapoor, and Grub, P. eds. *Multinational enterprise in Transition*, Darwin Press, Princeton. Cited in Clark, E. and Tunau, R. 'Evolution of International Political Risk 1956-2001' [online] at: <http://repec.org/mmfc05/paper37.pdf> [last accessed on August 24, 2012]

<sup>32</sup> Robock, S. H. and Simmonds, K. *Supra* Note 25

revisions of contracts.<sup>33</sup> This approach has been criticised because it only linked one cause of political risk to a single group through which it can be generated, when in fact certain risks such as expropriation or breaches of contract can arise from different sources and can be generated by a number of different groups.<sup>34</sup>

A third school of thought posits that issues such as national interest and national sovereignty are the motivating factors behind host government's restrictions on foreign business activities.<sup>35</sup> The proponents urged corporations not only to cope with, but also to actually take advantage of government's move towards nationalistic policies.<sup>36</sup> This is also consistent with the position of Kobrin who argues that government interference may not always be negative.<sup>37</sup> Fourth, is the theory based on the principle of relative deprivation. This theory may be linked to the work of Knudsen<sup>38</sup> who posits that the level of national frustration can be a key determinant of expropriations, with the host government using multinational enterprise as a scapegoat for the country's problems.<sup>39</sup>

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<sup>33</sup> Robock, S. H. 'Political Risk: Identification and Assessment'. (1971) Jul/Aug, 6 (4) *Columbia Journal of World Business*, pp. 6-20.

<sup>34</sup> Simon, J.D. *Supra* Note 25

<sup>35</sup> Boddewyn, J. and Cracco, E.F. 'The Political game in world Business' (1972) *Columbia Journal of World Business*, pp. 45-56

<sup>36</sup> Simon, J.D. *Supra* note 34

<sup>37</sup> Kobrin, S.J. 'Political Risk: A Review and Reconsiderations', (1974), 5 *Journal of International Business Studies*, pp. 51-71

<sup>38</sup> Knudsen, H. 'Explaining the National Propensity to Expropriate: An Ecological Approach' (Spring, 1974) *Journal of International Business Studies*, pp. 51-71

<sup>39</sup> *ibid*

The fifth theory is based on the argument that the type of government affects political risk. Whilst analysing the relationship between modernisation and radical political change, Green classified types of government to their tendency for radical political change. The assumption here is that the more democratic a government is, the slimmer the chance that it would expropriate (compared to new independent states).<sup>40</sup> This theory has been criticised for being rather limited because it ignores other variables that also affect radical political change or irregular turnovers in government like ethnic/religious conflict, foreign government intervention and economic stress. Also, radical political change is only one type of political risk amongst many others.<sup>41</sup> Lastly, the relationship between host and home countries has also been said to affect the political actions and reactions of host countries.<sup>42</sup>

#### **5.4 Political Risk Assessment**

Studies have shown that most firms do not have any systematic method of assessing political risk.<sup>43</sup> There are different tools that have been used in conducting political risk assessment including forecasting, trend analysis and prediction. Mortanges and Allers have categorised the

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<sup>40</sup> Green, R.T. 'Political Structures as a Predictor of Radical Political Change' [1974] *Columbia Journal of World Business* pp. 28-36

<sup>41</sup> Simon, J. D. Supra Note 36

<sup>42</sup> *ibid*

<sup>43</sup> Root, F. 'US Business Abroad and Political Risk' Supra Note 481; Kobrin, S.J. *et al.* 'Assessment and Evaluation of Non-Economic Environments by American Firms: A preliminary Report', (1980) *Journal of International Business Studies*, Spring – Summer pp. 32-47; Palud de Mortanges, C. and Allers, V. 'Political Risk Assessment: Theory and Experience of Dutch Firms', (1996) Vol. 5 No.3 *International Business Review* pp. 303-318; Simon, J.D. 'A Theoretical Perspective on Political Risk', (1994) Vol.15. No.3 *Journal of International Business Studies* pp. 123-143

methods of forecasting political risk broadly into qualitative unstructured methods, qualitative structured methods and quantitative methods.<sup>44</sup> Qualitative unstructured methods involve either the reliance on the judgement and intuition of managers or the use of expert opinions. The qualitative structured method is the use of Delphi techniques. This may involve the use of statistical analysis of the opinion of experts; a standardised checklist where managers review all items on the checklist and, thirdly the formulation of possible scenarios occurring in a country. The Quantitative method involves the use of data for analysis. This approach reduces the bias of the subjectivity of qualitative methods and increases precision in the analysis. The disadvantage of course is that the data being used may be out of date especially where the data originates from a developing country host state.<sup>45</sup>

There is no evidence that any of these methods have yielded desired results because political risk is not easy to predict, due largely to the heterogeneous nature of the risk.<sup>46</sup> The profile and characteristics of political risk is in a constant flux, changing along with world events. For instance, during the Latin American crisis the most feared political risks were nationalisation and expropriation but recently, with the increasing economic instability in the world compounded by increasing

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<sup>44</sup> Palud de Mortanges, C. and Allers, V. *ibid*

<sup>45</sup> *ibid*; Sachs, T. *et al*, 'Political risk quantification using fuzzy set approach', (2007) Vol. 12 Issue 2 *Journal of Financial Management of Property and Construction*, pp. 107 – 126

<sup>46</sup> Hill, C.A. 'How Investors React to Political Risk', *Supra* Note 22



globalisation of markets, currency and exchange control risks are now more prominent in investors' minds.<sup>47</sup>

Most of the literature on political risk identification and assessment is concerned with whether an overseas investor should make an investment in a foreign country. However, in reality, political risk affects not only foreign direct investment but also domestic investments. Besides, it may be overly simplistic to try and draw a clear distinction between foreign investments and domestic investments with the advent of globalisation and the global flow and mix of capital. It is thus becoming increasingly difficult to classify the origin of a particular investment as either foreign or domestic. For instance, financing structures of PPPs are often times complex involving investors who hold interest in the project either as equity or debt financiers. Typically, the investors are a syndicate of banks from different jurisdictions including the home country. In such situations, it is difficult to classify the capital as either "foreign" or "domestic".

However, this section of the thesis is not concerned solely with the decision by a firm to invest in a particular destination or not, but also on the issue of allocation of political risk after the decision to make the investment has already been done and how the likelihood of the occurrence of political risks is effectively mitigated.

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<sup>47</sup> *ibid*

## **5.5 Political Risk Mitigation**

There are a number of instruments available for the mitigation of political risk depending on the nature of the particular risk event. For instance, it is generally agreed that whilst items listed in A-D in the categorisation by Tilmann Sachs *et al* above are insurable, E and F are not.<sup>48</sup> In the case of the latter, alternative mitigation techniques need to be employed. There are different ways of mitigating political risks some of which are the observance of good project governance, use of contractual clauses and also some of the risks can be tackled through the purchase of risk mitigation instruments.

### **5.5.1 Good Project Governance**

The bedrock of a good project governance process is the employment of a transparent procurement process.<sup>49</sup> Any "fast track arrangement" favouring a particular firm or bidder may lead to public suspicion of corruption and underhand deals. This toxic public opinion may force the hands of host governments, especially succeeding governments, to nullify the tainted deals in order to score political gains with the public. It is therefore essential that clear and unambiguous rules and regulations should be put in place prior to the commencement of the procurement phase. Such regulations should be strictly adhered to in order to avoid undue benefits accruing to any particular entity.

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<sup>48</sup> *ibid.*

<sup>49</sup> United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) Transport Division, 'Public-Private Partnership in Infrastructure Development': A Primer, Bangkok June 2008 pg. 79.

## **5.5.2 Contractual Clauses**

The PPP contract if properly negotiated is a good tool for mitigating political risk. Some of the contractual clauses or provisions that may be employed for this purpose are Arbitration clauses, Multilateral, Bilateral Investment Treaties and Free Trade Agreements, Government guarantees, force majeure clauses and stabilization clauses.

### **5.5.2.1 Arbitration Clauses**

An Arbitration clause is one of the commonly used contractual remedies. Most disputes arising out of the occurrence of a political risk event are usually referred by the contract to arbitration. More potency may be added to the arbitration clause by the use of a "favourable jurisdiction clause" and the use of a "favourable governing law clause", which may suggest for instance the application of a neutral law and jurisdiction for the resolution of disputes between the parties. However, the agreement to refer a dispute to arbitration is itself a contract that can also be breached and is in most cases difficult to enforce.

### **5.5.2.2 Multilateral, Bilateral Investment Treaties and Free Trade Agreements**

According to the International Institute for Sustainable Development (IISD), there exist approximately 3000 investment treaties, including bilateral investment treaties, regional agreements and investment

protection provisions in free trade agreements.<sup>50</sup> The typical clauses found in an investment treaty are “a) Clauses providing for rules on indirect expropriation, b) clauses on fair and equitable treatment of foreign investors and c) clauses on the protection of investment agreements concluded between a foreign investor and a host country (“umbrella clauses”)”.<sup>51</sup> The major advantage of Investment treaties and free trade agreements is that a private sector party who suffers or anticipates a violation of its contractual rights under the treaties may have recourse to arbitration through for instance the International Centre for the Settlement of Investment Disputes (ICSID) rather than subjecting itself to the courts of the host state.<sup>52</sup> The uniqueness of these treaties is that even though they are entered into between states, private sector entities can enjoy the benefit of the treaties. These treaties have however been criticised for their tendency to limit the sovereignty of host states and may result in reverse discrimination to the detriment of investors who are nationals of a host state as they contain only rights for foreign investors.<sup>53</sup>

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<sup>50</sup> International institute for Sustainable Development (online) <http://www.iisd.org/investment/law/treaties.aspx> (last accessed on November 18, 2012)

<sup>51</sup> Dolzer, R. ‘The Impact of International Investment Treaties on Domestic Administrative Law’, (2004-2005) 37 *New York University Journal of International Law and Politics* pp. 953-957

<sup>52</sup> *ibid*

<sup>53</sup> *ibid*

### **5.5.2.3. Government Guarantees**

The government may also be compelled by the private sector to issue guarantees to mitigate political risk and reduce the financial cost to the private sector of assuming some of the risks. However, guarantees have been criticized because they create contingent liabilities for the government. It has been suggested that providing for impartial arbitration, regulatory independence and/or re-negotiation can lower the probability that political guarantees will be called,<sup>54</sup>

### **5.5.2.4 Force Majeure Clauses**

The creative use of *force majeure* provisions in contracts may also contribute to the mitigation of political risk. For instance, certain political events like strikes by sector unions may be categorised as a force majeure event, the occurrence of which will bring the contractual relationship between the parties to an end and compel the host government to pay the private sector partner compensation. This device is commonly used in power purchase agreements.

### **5.5.2.5 Stabilisation Clauses**

These clauses are risk management devices used to stabilize the expectations of investors for example, preventing changes in the laws from adversely affecting the investment contract during the term of the investment. Depending on which side you are, stabilization clauses are

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<sup>54</sup> IMF (2006) Public Private Partnerships, Government Guarantees, and Fiscal Risk, Prepared by a staff team led by R. Hemming, Washington DC.: International Monetary Fund

either an absolute necessity or out rightly dubious. For foreign investors, it protects them from sovereign risks in the host states like nationalisation, expropriation or obsolesce bargain.

There are different types of stabilization clauses, which for the purpose of this thesis are broadly categorized into three groups. They are: freezing clauses, consistency clauses and economic equilibrium clauses. Freezing clauses “freeze” (or restrict) the laws of the host countries by ensuring that the domestic law applicable to the contract is the one in force at the time the contract is concluded to the exclusion of subsequent legislations. Consistency Clauses stipulate that it is only the domestic legislation of the host state that is consistent with the investment contract that should apply to the project. Therefore, a new legislation will only be applicable to the project if it would not adversely affect the contract. Finally, Economic Equilibrium Clauses permit regulatory changes as long as any adverse effects are negated by taking action to restore the economic equilibrium of the project. These clauses link alterations of the terms of the contract to a re-negotiation of the contract in order to restore its economic equilibrium or in the absence of that, to the payment of compensation.

Stabilization clauses have been criticised for making the public the guarantor or insurer of the private contractors expected revenues and also clothes private contractors with quasi-government status with powers to influence new laws, judicial decisions and other government

actions.<sup>55</sup> Thus these clauses might unwittingly delegate government's constitutional powers to the private sector.

#### **5.5.4 Formal Risk Mitigation Instruments**

Risk mitigation instruments come either in the form of guarantees or insurance products. A guarantee contract assures the holder of a debt or other obligation of timely payment of the debt (including principal and interest) when due or if the guaranteed event should occur. If there is a default of the debt service obligation, the guarantor pays the amount due under the guarantee. This is done through a simple guarantee call procedure.<sup>56</sup> An insurance contract on the other hand insures payment to the holder of the debt obligation or the equity investor once the insurer evaluates the claim and determines that it is liable.<sup>57</sup> As noted previously, guarantees may be deceptive because they do not demand immediate cash outlays from the government but rather the government assumes certain contingent liabilities. If these are given recklessly, they may unduly burden the country in the future because they often have potentially significant fiscal consequences.<sup>58</sup> It is therefore advised that governments should be especially careful in the

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<sup>55</sup> Dannin, E. 'Infrastructure Privatization Contracts and their Effect on Governance' The Pennsylvania State University, The Dickson School of Law, Legal Studies Research Paper No. 19-2009. Electronic Copy (online) at: <http://ssrn.com/abstract=1432606>; Dannin, E. Supra Note 202 Pg.1

<sup>56</sup> Matsukawa, T. and Habeck, O.(2007) 'Recent Trends in Risk Mitigation Instruments for Infrastructure Finance: Innovations by Providers Opening New Possibilities', Gridlines Note No. 20 May 2007

<sup>57</sup> *ibid*

<sup>58</sup> IMF (2006) Public Private Partnerships, Government Guarantees, and Fiscal Risk, Supra Note 54

use of guarantees because they may be dubiously used to bypass imposed fiscal constraints; due to their discretionary nature, undermine good governance and may lead to a guarantee culture where the private sector seeks guarantees as an alternative to properly managing project risks.<sup>59</sup>

Two of the most popular of these instruments are the political risk insurance and the Political Risk Guarantees (PRG).<sup>60</sup> These instruments typically cover losses arising from the breach of host government's contractual obligations to private sector investors. In summary, they cover risks such as expropriation, breach of contracts, sovereign debt default and currency transfer or convertibility risk. Some of the providers are Government export credit agencies (e.g. EDC, OPIC), the World Bank (MIGA) and private insurers (Zurich, AIG etc.). When multilateral institutions offer these instruments, they are usually complementary to the credits offered to the host countries by these agencies. They have the advantage of upgrading the host government's credit rating and lowering financing costs of the project because the premium placed on the insured or guaranteed risk by the private sector when pricing the risk is considerably lower.

The disadvantage of these instruments is that it usually has limited coverage. For instance, it does not cover political violence and does not

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<sup>59</sup> *ibid*

<sup>60</sup> PRG is also used as an abbreviation for a similar instrument called partial risk guarantees



extend to all projects and countries. Thus it has been suggested, "Risk mitigation instruments are no panacea. However they will help bridge the gap while a country establishes a sound legal and policy framework that will reduce the risk and even afterwards can support efficient risk sharing".<sup>61</sup> It is therefore obvious that the long term and most effective mitigation instrument for political risk is the enactment of a sound regulatory framework. It is on this basis that a comprehensive analysis of the present legal regime for PPPs in Nigeria is done below. It is believed that if all the inconsistencies were resolved that political risk would be appropriately mitigated.

## **5.6 Case Study: Concession of 26 Federal Ports**

In 2006 the Federal Government of Nigeria (FGN) commenced the reform of the ports sector in the country. That reform has been described as one of the most ambitious port concessioning programmes ever attempted<sup>62</sup> and one of the biggest infrastructure concessioning programmes undertaken anywhere in the world.<sup>63</sup> The reforms in the sector became imperative due to the low level of efficiency existing in the ports, resulting in long turnaround times for vessels and container dwell time, rampant incidences of theft, excessive port charges, over centralization of decision making in the ports, inefficient labour practices

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<sup>61</sup> Matsukawa, T. and Habeck, O. Supra Note 56

<sup>62</sup> PPIAF (2007) 'Port reform in Nigeria' Gridlines, Note No17- March 2007 pp. 1-4

<sup>63</sup> *ibid*

and the lack of funds to develop infrastructure within the ports.<sup>64</sup> Royal Haskoning BV of the Netherlands was commissioned by the Nigerian Government through the Ministry of Transport with funds received from the World Bank to advise it on how to resolve these issues. Royal Haskoning presented its Report in 2002 (The Haskoning Report).<sup>65</sup> The report pointed out that root causes of all these problems was that the ports sector in Nigeria was over-centralised; the Nigeria Ports Authority (NPA) acted as both regulator and operator of port services; NPA required approvals from the Minister of Transport before carrying out any key operations decisions.

The Report recommended 3 major institutional reforms of the Nigerian port sector to resolve these issues. Firstly, that the Minister of Transport should be primarily responsible for developing broad policies within the sector and no longer be concerned with the day to day operations of the ports. Secondly, that NPA should be divided into several autonomous ports authorities along geographical zones in line with the location of the ports. Also, that NPA should also now play the role of “landlord” of the port, limiting its functions to ownership and administration of the ports, ports planning, development of ports infrastructure, leasing and concessioning of ports land, developing a tariff policy and providing nautical services, such as vessel traffic management. Finally, that the

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<sup>64</sup> PPIAF *ibid*; Royal Haskoning (2002) ‘Technical and Financial Assessment of the Nigerian Port Sector: Recommendations for Port Reform’ Report to the Federal Ministry of Transport Nigeria.

<sup>65</sup> *ibid*

private sector should be responsible for actual port operations and services like terminal operations, cargo handling, stevedoring, warehousing and delivering, including investments in port infrastructure and equipment and assume all the commercial risks for operation.<sup>66</sup>

The first two aspects of the reform required some form of legislative backing because the extant NPA Act did not contemplate any of these institutional arrangements. <sup>67</sup> Naturally, the Government assumed the duty of putting the appropriate legislations in place and therefore the political risk resided with it. The Bureau of Public Enterprises (BPE) in conjunction with the Federal Ministry of Transport engaged consultants to draft new legislations that revoked the existing legislation and incorporated the recommendations of the Haskoning Report. They also drafted a new Transport Sector Policy that was approved by the National Council on Privatisation (NCP). Since 2005 when this Bill was presented to the federal legislature, it has not been passed to law despite the various political concessions that have been made by the NCP and the Executive arm of government.

It is noteworthy that the existing Port Act did not completely bar the government from granting concessions as the Act permits the NPA to grant leases with the consent of the president for a period not exceeding

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<sup>66</sup> Mohiuddin, A. (2002) 'Technical and Financial Assessment of the Nigerian Port Sector: Recommendations for Port Reform' Report to the Federal Ministry of Transport, PPIAF, Washington, DC; Kieran, P. (2005) CPCS Transcom Unleashing Finance and Infrastructure for Africa. April 25, 2005 Reform and Restructuring of Nigerian Ports.

<sup>67</sup> Nigerian Ports Authority Act No. 38 of 1999 Cap N126 Laws of the Federation 2004.

5yrs.<sup>68</sup> It was based on this provision that the Government decided to enter into concession agreements with the different private sector concessionaires. This arrangement was meant to be temporary at the time as BPE always assumed that the new law would subsequently regulate the relationship between the parties. Indeed, the Concession Agreement signed by the parties defined the word “Act” to mean “the Nigerian Ports Authority Act No.38 of 1999 Cap N126 Laws of the Federation of Nigeria or such other law governing port authorities or port operations applicable to the Port as may supersede or succeed the same from time to time”.<sup>69</sup> Unfortunately no new law has been passed by the National Assembly to date.

Despite the relative success of the limited port reforms such as reduction in the ship turnaround times, elimination of theft and increase in cargo throughput, the concession has created a number of anomalies and confusion in the sector. In the absence of an appropriate enabling legislation to regulate the port reforms, the parties have by and large been regulated through contract vide the tripartite lease agreements entered into by the NPA, BPE and the Private sector concessionaire. Effectively, NPA now performs the multiple functions of landlord, technical and economic regulator and other marine functions. This was never the contemplation of the reforms. The absence of a credible

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<sup>68</sup> S.25 (1) and (2) of the Nigerian Ports Authority Act, CAP. N126, Laws of The Federation of Nigeria 2004

<sup>69</sup> Article.1.1 of the Lease Agreement

independent regulator has severely diminished the success of the reform project.

The Federal Government of Nigeria (FGN) had assumed a number of responsibilities under the Lease Agreements with the concessionaires, which it has not been able to meet. Subsequent Government administrations have simply lacked the political will to carry out those covenants entered into by the reforming administration before it. For example, under the concession agreement, it is the duty of the government through NPA to maintain the berths and all navigational aids within the port, maintain maritime approaches, canals, turning circles and breakwaters and other ancillary services.<sup>70</sup> Also, Article 9.5 of the Agreement provides that failure to provide pilotage, towage, berthing, unberthing and shifting of vessel services may lead to the throughput fee payable by the Lessee to the Lessor to be withheld as compensation. Article 9.6 also provides that the Lessor (the government) shall be responsible for the dredging of the channel to the port.

The Government in several instances has not been able to comply with these provisions of the Agreement and consequently have lacked the moral authority to demand compliance from the private sector of its own obligations. For these reasons, it has been difficult for the

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<sup>70</sup> Article 4.4 of Lease Agreement

government to ensure effective regulatory control of the private sector concessionaire.<sup>71</sup>

There is also no independent regulator that would compel the parties to perform their respective obligations. The only option open to the parties to resolve their contractual dispute would have been to activate the dispute resolution mechanisms in the contracts but the parties have not done this to date. The NPA, which is a party to the Agreement, is also the regulator. This situation in practice has led to conflict of interest and some of the regulatory decisions taken by NPA is said to have been for its own selfish advantage.<sup>72</sup>

Thus whilst the executive arm of government in Nigeria at the time when these concessions were done had the political will to carry out the reforms conclusively, they have not been able to convince the legislative arm to buy into its policy and therefore the reform of the ports sector in Nigeria is presently still-born. The deficiencies inherent in using the various Lease Agreements to regulate the entire port sector in Nigeria became very apparent immediately after the signing of the Agreements. There was an increase in the number of regulatory and security agencies flooding the ports, this increased bureaucracy and inefficiency at the ports.<sup>73</sup> This led to a reversal of most of the gains that had earlier been

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<sup>71</sup> This is the view of Government officials interviewed during the course of the semi structured interviews

<sup>72</sup> This is the view of some of the private sector operators of the concessioned terminals obtained from semi-structured interviews.

<sup>73</sup> This information was obtained from the semi-structured interviews. The Government had also set up a presidential committee on port decongestion as a result of this.

recorded as it became more expensive and took a longer period of time to clear goods from the ports. The extant regulation did not confer any one with authority to manage these kinds of issues and it took the intervention of the president who set up a special task force to take care of these issues.

## **Analysis**

According to Ward *et al*<sup>74</sup> Edwards<sup>75</sup>, and Flanagan and Norman<sup>76</sup>, several conditions must be satisfied to ensure the proper allocation of risk:

- a) Risk should be allocated to the party with the best capability to control the events that might trigger its occurrence.
- b) Risk must be properly identified, understood and evaluated.
- c) A party must have the technical/managerial capability to manage the risks.
- d) A party must have the financial ability to sustain the consequences of the risk or prevent it from occurring.
- e) A party must be willing to accept the risk.

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<sup>74</sup> Ward, S. *et al* 'On the allocation of risk in construction projects' (1991) 9 (3), *International Journal of Project Management* pp. 140–147

<sup>75</sup> Edwards, L. (1995) *Practical risk management in the construction industry*, Engineering management series Thomas Telford, London

<sup>76</sup> Flanagan, R. and Norman, G. (1993) 'Risk management and construction' Oxford-Blackwell Scientific Publications

Abednego *et al*<sup>77</sup> point out that these criteria only reveal the party who should bear the risk and consequently suggest that proper risk allocation should also acknowledge the appropriate time to allocate the risks and provide alternative solutions. The authors contend that besides determining which party (who) has the best capabilities to accept the risk (what), the when and how factors should also be considered to ensure proper risk allocation. Since the “what question” has already been answered i.e. this section of the thesis is considering political risk, relying on this work by Abednego, focus will now shift to assessing whether political risk under the project was allocated to the right party.

**Whether the political risk in this project was allocated to the party with the best capability to control the events that might trigger its occurrence?**

Political risk is primarily within the control of the government. All the events that will trigger the occurrence of the risk are all within the control of the government and so it is appropriate that the risk should be allocated to the government as was done here. However, there are doubts whether the legislature was effectively carried along in the reform process; otherwise the passage of the new law would not have been stagnated at the National Assembly.

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<sup>77</sup> Abednego, M.P. Ogunlana, S.O. 'Risk and its Management in the Kuwaiti Construction Industry: A Contractors Perspective', (2001) Vol. 19 *International Journal of Project Management* pp. 622-634



### **Whether risk was properly identified, understood and evaluated?**

The political risk was identified, understood and evaluated. The private sector was concerned about the lack of an enabling legislation and the government assured them that the Ports Act allowed the BPE to carry out the concession. Indeed this formed the basis of the government commencing with the process of enacting an appropriate legislation to regulate the sector. The Lease Agreements signed by the parties were also designed to fill some of the gaps in the existing Ports Act. For example, the private sector party insisted on the inclusion of certain compensation clauses if the government failed to meet some of its undertakings. One of the major reasons why the government decided to continue with the concession of the port despite the unavailability of a supporting enabling legislation was the fear that reform process might not be concluded by subsequent administrations. This was based on previous experiences where institutional reforms and other attempts to restructure the ports administratively had been reversed.

In conclusion therefore, it is clear that the parties identified, understood and evaluated the political risk and tried to deal with it. The problem however, is that the solutions proffered did not entirely resolve all the issues.

**Whether the party to whom the risk was allocated has the technical/managerial capability to manage the risks?**

The government appointed consultants who drafted the sector legislation and so it may be concluded that indeed the government possessed the requisite technical and managerial skills to draft an enabling legislation that would have effectively managed the political risk. The government however lacked the managerial capability to manage the risk as there is no indication that the executive government carried the National Assembly along in the reform process. Neither is there any indication that it had a concrete plan to ensure that the National Assembly would subsequently pass the enabling legislations that would back up the concessions.

**Whether the party to whom the political risk was allocated has the financial ability to sustain the consequences of the risk or prevent it from occurring?**

The government is better equipped to prevent the occurrence of, and/or bear the consequences of the political risk. However, government officials interviewed in the series of semi-structured interviews opined that the government did not have the financial capability to carry out most of its contractual obligations under the concessions like dredging of the ports, thereby raising questions regarding the government's capacity to sustain the consequences of the risk materialising. Also, the interviews revealed that the institutional

arrangement of government prevented it from sustaining the consequences of the risk.

**Whether the party to which the risk was allocated is willing to accept the risk?**

The government was apparently willing to accept the political risk and took measures to mitigate the risk by drafting the sector legislations that would have prevented or mitigated the occurrence of the risk. However, the government has been in breach of its contractual obligations and this has also led to the private sector refusing in some instances to meet its own obligations. For instance, under the contract it is the responsibility of the Government to repair the quay walls but it has failed to do this and the private sector has capitalised on this by refusing to complete some of the construction obligations it undertook to perform under the contract.<sup>78</sup> In essence, whilst the government was formally willing to accept the political risk there are doubts whether it was in concrete terms willing to accept the consequences of that risk because it never made budgetary provisions for carrying out its obligations under the contract.

It may be concluded with respect to the allocation of political risk in Nigeria's port concession that the federal government of Nigeria was the appropriate party to be allocated political risks. This conclusion flows from the analysis based on the framework suggested by Ward *et al*,

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<sup>78</sup> This was the view of both the private and public sector respondents during the semi-structured interviews

Edwards, Flanagan and Norman above. This thesis will now consider the final two questions of whether the political risks were allocated at the appropriate time and through the proper process.

### **Whether the risk was allocated at the appropriate time (when question)?**

There are questions whether the port concessions ought to have proceeded despite the absence of appropriate legislations. There are opinions that the government should have put everything in place before commencing with the concession process. On the other hand, it is also argued that the concession of the ports would never have taken place if BPE had waited for the passage of the laws. The obvious certainty now is that most of the niggling issues facing the ports concession to date have arisen from the non-enactment of relevant port-sector legislation. It is good practice to put in place an enabling legislation before commencing a transaction of this magnitude, as an enabling legislation is the best way to allocate political risk. Consequently, it is concluded here that all facets of the political risk were not transferred to the government at the appropriate time.

### **Whether the process used in allocating the risk was appropriate (how question)?**

Under this heading, the thesis questions whether the best strategy was applied in dealing with this risk in order to prevent or minimize the consequences of the risk. Most of the literature discussed above stipulate that the best way to deal with political risk is to pass appropriate

enabling laws that clearly state the rules of “the game” and delineate the roles of the parties. However, the strategy which was adopted in this instance of concluding the transaction first and then seeking to enact the legislation *ex post facto*, was wrong. The cart was basically put before the horse. Therefore, despite the risk being allocated to the right party, there are doubts regarding the instrument used for the allocation i.e. the risk was allocated contractually instead of using a legislation which could have been a better instrument for allocating the risk.

### **5.7 Other issues with Political risk in PPP in Nigeria**

The case study above also revealed other pertinent issues that should be tackled in order to ensure the proper management of political risk in Nigeria. Some of these issues and proposed solutions are discussed under this section.

1. Strong political support is imperative for the success of PPP in Nigeria. Privatisation was a relatively successful government policy because of the existence of a “political champion” in the form of the successive vice presidents who were handed the responsibility under the Privatisation Act. Also, no long-term project can proceed successfully without the continued support of government. However, it is very difficult to continue to receive this support in Nigeria over the long term especially after any change in government administration whether or not the executives are from the same party. New governments come in with their own

policies. Also, the complex and unique socio-political context in Nigeria and most of the developing world ensures that subsequent administrations are suspicious of previous ones and assume that the previous one might have unduly benefitted from any transaction negotiated during the term of that administration.

2. The lack of coordination between the different arms of government and the different agencies of government in issuing guarantees, warranties and other commitments to the private sector. This ultimately leads to the non-fulfilment of obligations. The Ministry of Finance recently issued a blanket restriction on the issuance of guarantees. This act should contribute to the reduction of the indiscriminate issuing of sovereign guarantees. However, there are fears that the decision might hinder PPP transactions. There must therefore be a means of ensuring that transactions, which deserve such guarantees, benefit from it.

A classic example of government authorities entering into obligations unilaterally on matters requiring the consent of another department of government is the warranty by FAAN under S. 2.2 (e) of the Concession Agreement in respect of MMA2, where it undertook to give the first right of refusal in event that BPE decides to privatise the airport terminal. Officials of the BPE confirm that they were not parties to that agreement and so could not have been aware of such obligation. In the event of privatisation, there

is a serious doubt that the obligation would have been honoured. There is perhaps a need for a central unit within government, preferably within the Ministry of Finance that should be charged with tracking the government's contingent fiscal obligations in PPP transactions. This will ensure that the government is not indiscriminately burdened with obligations that it is unable to meet as well ensuring that where those commitments are made, the appropriate budgetary provisions are made to meet them.

3. The government agencies usually make “politically correct” decisions to the detriment and failure of PPP transactions. A number of projects in Nigeria have failed because government agencies have been too cautious of public perception and therefore refused to take bold decisions for the ultimate benefit of the country. For instance, in one of the semi-structured interviews, it was revealed that government agencies had in some instances refused to accept lower financial bids from the private sector. These bids were in fact more sustainable than the excessive and even outrageous bids that they knew were unsustainable. An example is the Nigerian Telecommunications Corporation (Government owned telecommunication company) Privatisation where on several occasions when the company was privatised; the winning bids were over 4 times the value of Government's reserved price, yet the government agency accepted the higher unrealistic bid from unknown inexperienced investors in favour of

more realistic bids from more reputable international telecommunications companies. At the end of the transactions, the preferred bidders were unable to raise funding to pay for the asset. This apprehension and fear of public perception by government agencies is borne out of the lack of trust between the citizens and the government, which has accumulated over the years.

4. Parties to the contract must have a realistic and honest perception of what each of the parties is able to bring to the transaction and thereby ensure that the parties' offers are in tune with the realities on ground. The government in particular must desist from making overambitious promises that it is incapable of redeeming. The result of doing this as shown from the case study above is that in situations where the government is unable to fulfil its bargain, it loses the moral right to demand compliance from the private sector.
5. There is need to put in place independent sector regulators. The situation where the government, which is an interested party in the contract also acts as regulator does not promote equity and fair play. The government should put in place fair policies and legislations and also allow independent third party regulators oversee its relationship with the private sector. One of the transport sector bills pending before the National Assembly, the National



Transport Commission Bill, had proposed this. The Port Sector Bill also adopts this position. However, these Bills are yet to be passed into law several years after they were presented to the National Assembly

6. Corruption is pervasive in the Nigerian public service. This increases the cost of doing business in Nigeria drastically. It therefore becomes very expensive for the private sector investor to receive the necessary government support to sustain its business in the long term. This has a tendency of draining profits and sometimes the efficiency of the private sector is compromised. This also detracts from the credibility of the process and scares away some foreign investors.
  
7. Lack of capacity in the public sector is a major problem in Nigeria and this has usually resulted in government assuming risks and obligations during negotiations that it would not ordinarily have acceded to if the public officers negotiating on its behalf were better aware at the time. When the government finds out in subsequent years that it did not get a fair deal, it is usual for government to renege on its obligations to the private sector and try to force the private sector to re-negotiate the terms of the agreement. This has happened in so many transactions. The MMA airport concession is in court for this reason.

Also, the Ministry of Aviation and the Federal Airports Authority of Nigeria (FAAN) recently in March 2012, requested for the renegotiation of the Agreement it signed with Maevis Limited, a private sector integrated airport management system provider at the airport because according to the organisation, it was not making enough money from the contract which it signed in 2007.<sup>79</sup> Despite the matter being in court, FAAN took forceful possession of Maevis' data centre and transferred operations to another provider. The public authority had once more discovered after nearly 5 years of entering into a contract with the private sector that the terms of the agreement were not favourable and sought forceful re-negotiation. The same is the case with the concession between FAAN and I-Cube West Africa, the company that won the concession to manage FAAN toll gate. The parties are also in court asking for the refund of over 2.8 billion Naira being money paid upfront to FAAN as bank guarantees due to the fact that FAAN is trying to terminate the concession.<sup>80</sup>

The solution is simply for the government to ensure that it builds up the capacity of its workforce. On the other hand the private sector should also desist from taking undue advantage of the naivety of the public sector and try as much as possible to always seek

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<sup>79</sup> Etegehe, D. 'Concession-FAAN, Maevis Part Ways at Last' Vanguard Newspaper April 2, 2012. (online) at: <http://allafrica.com/stories/2012042020725.html> (Last accessed on August 11, 2013)

<sup>80</sup> Okunbor, K. O. 'Aviation Concessionaires, Govt Set for Battle Over Pacts' The Nation Newspaper, October 26, 2011. Pg. 6

equitable “win-win” deals. This is because only equitable deals are likely to be sustainable in the long term.

8. The inadequacy and multiplicity of the federal legislation on PPP is also a big problem. It is a fact that the best method of mitigating political risk is through the enactment of appropriate enabling legal framework that supports PPP and eliminates loopholes for the manipulation of the system. Below in section 5.8 is an analysis of the present legal framework for PPPs in Nigeria. It is anticipated that if the issues raised below are properly resolved the severity of political risk will be curtailed.

## **5.8 Managing Political Risk through better PPP Regulation**

There is presently a complex web of regulations and policies governing PPP transactions in Nigeria. Therefore, a potential private sector investor needs to weave through a plethora of regulations and policy guidelines before initiating PPP transactions in Nigeria. Despite this obvious duplicity, an analysis of these laws and policies reveal that the laws are nevertheless still generally inadequate and contain conflicting provisions thus contributing to uncertainty and thereby inordinately increasing transaction costs. It is also true that these laws are even inadequate to address all the issues that crop up during transactions. An analysis of the existing regulations is given below:

## **The Infrastructure Concession Regulatory Commission Act 2005**

The primary law regulating PPP in Nigeria is the Infrastructure Concession Regulatory Commission Act (the ICRC Act)<sup>81</sup>, which was enacted into law in 2005. This law provides the basic legal framework for private sector participation in infrastructure development in Nigeria.

The ICRC Act is divided into two parts: The first part vests government ministries and other agencies of government with power to enter into contract with or grant concessions to the private sector for the financing, construction, operation and maintenance of any viable infrastructure<sup>82</sup>. While the second part establishes the Infrastructure Concession Regulatory Commission (the ICRC), which is managed by a 12-member board that includes a part time chairman, the Attorney- General of the Federation, the Governor of the Central Bank and a person from each of the six geopolitical zones of the country. The main function of the Commission is to take custody of every concession agreement or contract entered into by the Government Ministry or Agency, and monitors its compliance with the ICRC Act and the efficient execution of any such Concession Agreement.<sup>83</sup> The Act also gives the Ministries, Departments and Agencies of Government, albeit without clarity, the

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<sup>81</sup> ICRC Act 2005

<sup>82</sup> S.1 ICRC Act 2005

<sup>83</sup> SS. 14, 15, 16 and 17 of ICRC Act 2005

powers to manage the procurement process for the award of the concessions contracts.<sup>84</sup>

Despite the use of the word "regulation" in the title of the ICRC Act, a cursory look at the contents of the law reveal that what the ICRC is involved in is not regulation in the strict sense of the word. For instance under the Act, the ICRC is not involved in any form of economic or technical regulation but the Commission exists for the limited purpose of keeping custody of the concession agreements and ensuring that its terms are complied with. This is not regulation by any stretch of the word. At best, the function of the ICRC is merely that of a depository or custodian of concession agreements while monitoring the execution of these agreements. Therefore, legally speaking there is no regulator for PPP transactions in Nigeria. Presently, ICRC fills this void by acting as the regulator but the law setting up the Commission never contemplated the existence of a regulator.

To cure this obvious defect, the Commission relied on the provisions of S.34 of the ICRC Act to draw up a National Policy on Public Private Partnership, which was duly approved by the Federal Executive Council (FEC) in April 2009. S.34 of the ICRC Act provides:

- (1) The Commission may, with the approval of the president, make such regulations as in its opinion are necessary or expedient for

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<sup>84</sup> SS.2, 4, 5 and 6 of ICRC Act 2005

giving full effect to the provisions of this Act and for the due administration of its provisions.

(2) Without prejudice to the generality of subsection (1) of this section, the Board may issue guidelines to give full effect to the provisions of this Act.<sup>85</sup>

However, the National Policy cannot amend a statute. The policy is therefore insufficient to confer on ICRC, the necessary powers required to perform its regulatory functions *vis-a-vis* PPPs. This fact is acknowledged by the Policy, which contemplates that the Government will review the ICRC Act and amend it or enact an entirely new legislation.<sup>86</sup> Till date, the National Assembly has neither amended the ICRC law nor has it passed a new Act.

### **The Public Enterprises (Privatisation and Commercialisation) Act 1999 (Privatisation Act)<sup>87</sup>**

The Privatisation Act provides the legal framework for the privatisation and commercialisation of various public assets in Nigeria. It also creates the NCP as the apex body charged with the responsibility of setting and administering the Federal Government's policies and objectives on privatisation and also approving transactions.<sup>88</sup> The Act also established

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<sup>85</sup> S.34 ICRC Act 2005

<sup>86</sup> National Policy on Public Private Partnerships Pg. 4

<sup>87</sup> Privatisation Act 1999

<sup>88</sup> SS. 9,10 &11 of the Privatisation Act 1999

the BPE to function as the secretariat of the NCP and carry out the actual day-to-day privatisation activities.<sup>89</sup>

A number of transactions had been consummated under this law including concessions<sup>90</sup>, which are also covered by the ICRC Act<sup>91</sup>. This has led to a lot of confusion and friction between the two organisations. The ICRC Act being a later legislation ought to have taken into consideration all the existing laws, including the Privatisation Act and other infrastructure legislations like the Electric Power Sector Reform Act (EPSRA) in order to avoid conflict and eliminate the inconsistencies, which are now manifesting. The Act ought to have repealed the Privatisation Act or clearly distinguished the ICRC Act from it.

There have been attempts to distinguish between the two laws and institutions. One of the compromise agreements reached was for NCP/BPE to do only brownfield (existing) projects whilst the ICRC will regulate only greenfield (new) projects. However, this classification or arrangement is not supported by any extant legislation and even leads to more confusion, being in conflict with the provisions of both laws. For instance, the definition of infrastructure in the ICRC Act<sup>92</sup> is very wide and

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<sup>89</sup> S.12 of the Privatisation Act 1999

<sup>90</sup> For example the concession of the 26 Ports and mining assets were done under this law.

<sup>91</sup> The ICRC Act deals with contracts and concessions. See for example SS. 1,2& 3 of the ICRC Act 2005

<sup>92</sup> S.36 of the ICRC Act 2005

includes development projects existing before the commencement of the Act. It covers all utilities and network facilities including telecommunications, electric power plants (including hydro projects), sea ports, airports, railways, trade fair complexes, warehouses, tourism projects, etc. Most of these are within the privatization and commercialisation functions of the National Council of Privatisation (“NCP”) under the Privatisation Act.<sup>93</sup> The Privatisation Act gives NCP powers to privatise enterprises listed in that Act, with further powers to add more enterprises to the list.<sup>94</sup> The EPSR Act also gives NCP express powers to privatize the Successor Electric Power Companies by whatever mode it deems fit;<sup>95</sup> putting it in direct conflict with S. 36 of the ICRC Act.

Again, in order to differentiate between the BPE and ICRC, it has been argued that “privatization” is different from “concession” which is one of the exclusive methods of conducting PPP transactions under the ICRC Act. While this argument may hold sway in some jurisdictions, this position is not supported by any law in Nigeria. In fact, a contrary argument exists that “privatization” is wider than, and indeed includes “concession”. In practice, concession is often a major strategy adopted by BPE in privatising public infrastructure assets as it involves transfer of control, without ownership, to the private sector. Indeed, NCP and BPE have successfully adopted concessions as one of their strategies to privatise

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<sup>93</sup> See S.1 and Parts 1&2 of the First schedule to the Privatisation Act 1999.

<sup>94</sup> . S.1 (3) of the Privatisation Act 1999

<sup>95</sup> S.24 of the Electric Power Sector Reform Act, 2005



some public assets including seaports, airport, railway and solid mineral assets.

There is also a conflict between the provisions of the ICRC Act and the commercialization powers of the NCP. Under the Privatisation Act, the NCP has powers to commercialise the enterprises listed in the schedule to the Act.<sup>96</sup> Although the term “commercialise” is not defined in the Privatisation Act, it provides that a commercialised enterprise shall operate as a purely commercial enterprise. It may also, subject to the general regulatory power of the Government of the Federation, fix the rates, prices and charges for goods and services it provides, capitalise its assets, borrow money and issue debenture stocks and sue and be sued in its corporate name.<sup>97</sup>

Commercialisation therefore involves the application of commercial principles, practices and techniques used by the private sector to an enterprise, assets or activities to improve accountability, value for money and efficiency. It could be pursued through some forms of PPP including service contracts, management contracts, lease or *affermage*, or public sector entity with private investments. It follows therefore, that there would definitely be a conflict between the powers granted under the ICRC Act to government and that granted to NCP under the Privatisation

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<sup>96</sup> S.6 of the privatisation Act 1999

<sup>97</sup> S.8 of the Privatisation Act 1999

Act because there would be clash of authority between the departments of government.

With regards to monitoring, the ICRC Act empowers the ICRC to be a depository of concession agreements and to monitor the performance of the agreements by the contracting parties. The Privatization Act on the other hand, gives the NCP the powers to monitor on a continuous basis, the privatized and commercialised enterprises to ensure that the objectives of privatization and commercialization are met. In performance of this function, the BPE set up the Post-Privatization Monitoring Unit with functions that cover monitoring performance of privatization; including concession agreements. Unless the public sector would agree to subject itself to multiple monitoring and regulation and the attendant confusion which it will bring, it is difficult to see which of the two agencies have the overriding powers to monitor the concession contracts. Also, there is also bound to be conflict between both agencies and the sector regulators who also have powers to monitor the same agreements.

The provisions of the ICRC Act are evidently in conflict with the Privatization Act, the EPSR Act and indeed with other sector legislations with respect to concession procurement and monitoring. The conflicts lead to roles overlap, thereby paving the way for confusion and in-fighting between government organisations which necessitate precious time and resources to resolve.

Before drafting a law there must be an understanding of how the law will work in practice, in addition to understanding the objects of the law. There is a need to move beyond a general desire to have a law for PPP and concessions towards a deep and comprehensive understanding of the details and issues that will derive from the law. During the drafting process, the draftsmen ought to specify clearly and in detail the administrative machinery that will drive the law and identify areas of possible conflict between different agencies of government and resolve them. Without resolving potential disputes during the drafting process of a law, there will be devastating battles between different branches of the Government and wasteful duplication of effort or failure to act. There will also be confusion and uncertainty for those whom the law is intended to benefit. Avoiding clarification will result in a negative impact for the achievement of the objects of the law.

Apart from these two principal laws analysed above, there are also other laws, which have either not been contemplated by the ICRC Act or taken the ICRC Act into account. These laws are discussed below:

### **The Public Procurement Act 2007**

The Procurement Act applies to procurement of goods and services carried out by the Federal Government of Nigeria and any public body engaged in procurement. This also applies to all entities, which derive at least, 35% of the funds appropriated or proposed to be appropriated for any type of procurement from the Federation share of the Consolidated

Revenue Fund.<sup>98</sup> By implication therefore, the Act does not apply to procurement carried out by the constituent states of the Federation.

The Procurement Act does not expressly mention procurements done under PPPs like concessions and so it is believed that it only applies only to traditional forms of procurement done by the Federal Government of Nigeria. This is however questionable because the Procurement Act also applies to procurement of goods and services for infrastructure projects.<sup>99</sup> It is obvious that the Procurement Act did not take the ICRC Act or Privatisation Act into contemplation, as it ought to have, being later in time. It ought to have expressly eliminated the application of the Act to PPPs if such was its intention. The procurement guidelines under the ICRC Act are however very sparse and limited mainly to the requirement to advertise in newspapers and seek approvals from the Federal Executive Council (FEC).<sup>100</sup>

Even though the PPP policy and operational guidelines have tried to elaborate further on the procurement aspect of PPPs, there are still doubts as to the application or otherwise of the Procurement Act. The policy guidelines provide that the ICRC through its PPP resource centre

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<sup>98</sup> S.15 of the Procurement Act, No.14 of 2007

<sup>99</sup> It is however silent on the non-tender aspects of PPP transactions or handling of unsolicited bids.

<sup>100</sup> Ss.2, 3, 4 & 5 of the ICRC Act 2005

will work with the Bureau of Public Procurement<sup>101</sup> to develop appropriate procurement processes for PPPs.<sup>102</sup>

### **The Debt Management Office Act 2003**

The Debt Management Office Act<sup>103</sup> established the Debt Management Office to *inter alia* prepare and implement a plan for the efficient management of Nigeria's external and domestic debt obligations and set guidelines for managing the country's risk and currency exposure with respect to all loans.<sup>104</sup>

PPP transactions will obviously require the Government of Nigeria to borrow both externally and internally as well as issue guarantees. Therefore, the Debt Management Office will necessarily be involved. However, there is nothing in any of the existing laws regulating PPPs that takes this fact into consideration and therefore potential investors are likely to be stranded. The National PPP Policy acknowledges the importance of the Debt Management Office by encouraging project teams within the MDAs to consult it, prior to engaging multilateral agencies to provide guarantees or other financial instruments.<sup>105</sup> There is however nothing in the extant legislations that remotely considers or integrates the role of the Debt Management Office in the PPP process.

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<sup>101</sup> S.3 of the Procurement Act established the Bureau of Public Procurement to administer the provisions of the Procurement Act.

<sup>102</sup> National PPP Policy pg.10

<sup>103</sup> Debt Management Office Establishment, (etc.) Act 2003.

<sup>104</sup> See S.6 of Debt Management Act 2003.

<sup>105</sup> National PPP Policy pg. 9

## **The Fiscal Responsibility Act 2007**

The Fiscal Responsibility Act<sup>106</sup> ensures the prudent management of the country's resources by ensuring greater accountability and transparency in fiscal operations and also by imposing limits on the country's spending and borrowing. The Act establishes the Fiscal Responsibility Commission to ensure that the objectives of the Act are met.<sup>107</sup>

From the foregoing, it is apparent that there ought to be coordination between the ICRC, which is the primary body charged with PPP transactions in Nigeria and the Fiscal Responsibility Commission. If there is any kind of borrowing or spending on infrastructure, which naturally there would be in PPP transactions, then the Fiscal Responsibility Commission ought to sanction it. However, neither the Fiscal Responsibility Act nor the ICRC Act mentions any sort of interface between the organisations. It is doubtful to see how ICRC will be able to conclude transactions without any sort of reference or interface with the Fiscal Responsibility Commission. Potential investors run the risk of being stuck in the middle of their projects, suffering cost over-runs and project abandonment if the Fiscal Responsibility Commission ever decides to flex its muscle.

The proper thing to do is to ensure that the PPP laws and regulations clearly legislate for the extent, period and method of involvement of the Fiscal Responsibility Commission.

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<sup>106</sup> Fiscal Responsibility Act, No.31 of 2007.

<sup>107</sup> S.1 of the Fiscal Responsibility Act 2007

## **The National Planning Commission Act 1993**

The National Planning Commission was established by Act No.12 of 1992 and later amended by Act No. 71 of 1993.<sup>108</sup> The major function of the Act as it relates to infrastructure development is in relation to designing, coordinating and monitoring the implementation of the Nation's infrastructure master plan. It is therefore necessary that the ICRC will need to first ensure that any of the projects ear-marked for PPP is included in the nation's master plan designed by the National Planning Commission and also ensure that its activities are in concordance with that of the National Planning Commission. There is therefore a need for the PPP legislations to recognise this important synergy. Again the National PPP Policy belatedly recognised this omission and provides that the National Planning Commission (NPC) will be tasked to develop a 15-year investment strategy for all infrastructure services provided by the Federal Government.<sup>109</sup> However, there is no clarity on whether MDAs will be compelled to follow the strategy.

## **Various infrastructure sector Acts and Bills (currently before the National Assembly)**

A number of existing infrastructure sector legislations e.g. the Electric Sector Reform Act, are also in conflict with the ICRC Act. This is the same with a number of bills that are currently before the National Assembly. These Bills seem to have been drafted in complete isolation of one

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<sup>108</sup> National Planning Commission Act No.71 of 1993

<sup>109</sup> National PPP Policy, pg. 8

another as they do not inter-reference one another or other economy wide legislations like the ICRC Act, the Procurement Act or Fiscal Responsibility Act.

The main problem will arise from the responsibility given to the ICRC under the ICRC Act to monitor PPP contracts. Virtually all these other sector legislations also give regulatory powers to the different bodies that have been created under these laws. This is definitely going to lead to a lot of confusion, unless these laws are properly synchronised with one another and also with the wider legislations.

## **5.9 Conclusion**

Firstly, this chapter looked at the different definitions of political risks and concluded that an acceptable definition must be broad enough to include any action of government or its agencies that adversely affect PPP transactions. It also acknowledged that political risk is not always negative and may also lead to positive outcomes.

Secondly, the chapter noted the problem involved in formulating a single theoretical framework for political risk due to the disparate nature of the different events that make up the risk. However, it recognises the need to provide a theory that ties together the different events that constitutes the risk together as it will help in forecasting, identifying, assessing, and management of the risk.



Thirdly, this chapter noted that there is no systematic method of assessing political risk. This thesis concludes that this is because of the heterogeneous nature of the risk. It suggests that the present methods of assessment that focus on the differentiation between foreign and domestic investments are redundant under PPPs. This is because the advent of globalisation and the financing structures under PPPs makes it increasingly difficult to differentiate between foreign and domestic investments.

The case study of the 26 ports and the analysis that followed showed that political risk has not been properly handled in Nigeria. This is because the reforms and the projects involving private sector investment were not accompanied with the enactment of appropriate enabling legislation to regulate the activities of the private sector investors and public sector owners of the facilities.

This chapter therefore concludes that an effective and sustainable way to deal with political risk is by ensuring that a legislative framework exists which will promote a conducive political atmosphere to conduct business. Such legal framework should create institutions and processes that provide and promote stability. It will provide appropriate guarantees to the private sector investor that the PPP projects will not be adversely affected by political decisions that were never within the contemplation of the investor at the time when the investments were made. Nigeria presently does not have such legislation in place.

Consequently, it is proposed that Nigeria enacts a new PPP law that will revoke and replace the existing ICRC Act and Privatisation Act. A primary purpose of this new law should be the resolution of the conflicting extant legislation and the merger of the two major institutions involved in PPPs in Nigeria; that is the BPE and ICRC. The existence of multiple laws and institutions are doing more harm than good. Apart from exacerbating confusion in the system, it is also unduly expensive to run both agencies with the duplication of staff and resources. Furthermore, the efficacy and the legality of the use a policy document to bridge the gap in an enabling legislation is inappropriate. It is imperative that a suitable PPP legislation that will match the country's ambitions is developed to boost private sector (local and foreign) confidence towards investment in infrastructure development in Nigeria.

## **CHAPTER 6**

### **DEMAND RISK**

#### **6.1 Introduction**

This chapter discusses demand risk. The chapter commences with an analysis of how demand risk affects projects generally and PPPs in particular. The next section evaluates how demand risk is allocated in PPPs. This is followed by a discussion of the incomplete contract theory, which is the theoretical framework used in analysing demand risk in this thesis. In the subsequent sections of this chapter, a case study of the MMA2 Airport is carried out to evaluate the management of demand risk in Nigeria, followed by recommendations for dealing with the risk.

#### **6.2 Demand Risk and PPPs**

Demand volume is one of the principal determinants of project viability. The quantity of demand from users that a project is able to attract is one of the most significant factors in determining the project's cash flow and consequently the features of the debt service repayments.<sup>1</sup> Indeed, demand risk is the most critical risk facing project partners regardless of

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<sup>1</sup> Alasad, R. *et al* [2011] 'Identifying Demand Risk in Public Private Partnership (PPP) infrastructure Projects' In *Proceedings of CIB-TG72/ ARCOM Doctoral Research Workshop on Public Private Partnerships*, at University of Central Lancashire, Preston, United Kingdom, October 12, 2011.

the country or the sector.<sup>2</sup> Interestingly, there are claims that demand risk is not perceived as an important risk factor affecting PPPs in Nigeria. Akerele and Gidado argue that Nigeria has a large and increasing population and abundance of skill and natural resources and will therefore always have abundant consumers to patronise PPP services.<sup>3</sup>

The above observation is however limited by the failure of the authors to make two cogent observations. First, they failed to consider demand risk from the economic perspective, i.e. to determine whether the large population could afford the services. Secondly, and more relevant to this thesis, they failed to consider that consumers may have the options of substitutes. Indeed, most products and services have substitutes and sometimes factors outside the control of the private sector service provider determine which substitute the end user patronises. This situation is exacerbated where the substitute is within the control of the public sector such as the provision of most essential infrastructure related services. In such cases, the private sector will try to protect the demand for its services or mitigate the demand risk arising from these external factors. This situation is the more challenging issue with demand risk

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<sup>2</sup> Norton, R. (2006) 'Infrastructure PPP in Asia' (online) at: <<http://ebookbrowse.com/nortonrose-infrastructure-ppp-in-asia-2006-pdf-d5316336>> [last accessed November 26, 2012] cited in Alasad, R. *et al* *ibid*

<sup>3</sup> Akerele, D. and Gidado, K. (2003) 'The Risks and Constraints in the Implementation of PFI/PPP in Nigeria'. In: Greenwood, D. J. Ed. *19th Annual ARCOM Conference*, 3-5 September 2003, University of Brighton, United Kingdom. Association of Researchers in Construction Management, Vol. 1, 379-91 also found (online) at [http://www.arcom.ac.uk/publications/procs/ar2003-379-391\\_Akerele\\_and\\_Gidado.pdf](http://www.arcom.ac.uk/publications/procs/ar2003-379-391_Akerele_and_Gidado.pdf) (last accessed on January 1, 2012)

because if the private sector does not mitigate the risk, the project will likely fail despite any initial positive projections regarding viability of the project. However, where it mitigates, the measures adopted might distort the initial risk allocation framework sometimes leading to disastrous consequences for the infrastructure development of the country.

It is an expected fact of business that demand for a product or service will increase or decrease during the lifespan of the business and therefore should naturally be allocated to the private sector because it is a commercial risk that is tied to operations and the private sector partner ought to have provided for it in its business plan and cash flow projections.<sup>4</sup> However, where demand for a service is affected because of issues external to the private sector or natural causes, but within the control of the public sector, the private sector would naturally refuse or be sceptical to assume the demand risk. This can happen where for instance the government constructs a parallel road to a tolled road or renovating or developing or even subsidizing other means of transportation to compete with the concessioned road.

The refusal of the private sector to assume demand risk in any of these situations could be considered as proper because the factor determining demand for the services has been effectively taken out of its

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<sup>4</sup> Iossa, E. *et al* (2007) 'Best Practices on Contract Design in Public-Private Partnerships', Report Prepared for the World Bank (online) at: <http://www.gianca.org/papersHomepage/Best%20Practices%20on%20Contract%20Design.pff> (last accessed on November 19, 2012)

control. This is also contrary to the basic rule for risk allocation that suggests that a particular risk should be allocated to the party in control of the factors that lead to it eventuating.<sup>5</sup> Where the public sector insists on forcing the demand risk on the private sector in these situations, the private sector will protect its earnings by mitigating the occurrence of this risk with “protective” contractual clauses. However, as pointed out above, these protective contractual clauses in most instances cause more harm than good.

Consequently, it is a major contribution of this thesis that the main problem with demand risk in Nigeria arises where the private sector tries to mitigate the risk by protecting itself from factors outside of its control and market forces. Certainly, one of the high profile disputes relating to PPPs in Nigerian courts confirms this fact.<sup>6</sup> The effect of this dispute on the growth of the Nigerian aviation sector is the reason why demand risk is chosen as one of the 3 project risk categories that is studied in this research. It is thus part of the hypothesis in this thesis that if demand risk in that project was properly allocated and mitigated, the issues that have arisen with the project would never have materialised.

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<sup>5</sup> Abednego, M.P. and Ogunlana, S. ‘Good Project Governance for Proper Risk Allocation in Public Private Partnerships in Indonesia’, (2006) *International Journal of Project Management*, 24 (7) Pg. 622

<sup>6</sup> Bi-Courtney Limited V. Attorney General of the Federation, (Unreported), Suit No. FHC/ABJ/CS/50/2009

### 6.3 Allocation of Demand Risk

The principal means through which demand risk is allocated is the payment mechanism specified in the contract. Using the payment mechanism therefore as a basis for classification, there are two main contract types for delegating public services to private operators. These are contracts where the private sector bears no demand risk, known as availability contracts and those where the private sector bears all or some of the demand risk, known as user charge or concession contracts.<sup>7</sup>

In availability contracts, services are paid for directly by the public sector procuring agency based on the provision of the services according to contract specifications.<sup>8</sup> The private sectors' remuneration is in this case directly related to the quality and quantity of services it provides. This, it has been argued, provides less incentive to the private sector to pursue user satisfaction.<sup>9</sup> However, in user charge contracts, the private sector provider of the services sells its services directly to the public and receives remuneration through charges to the end-users. Thus, the private sector's

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<sup>7</sup> Iossa and Martimort identifies three payment mechanisms in PPPs, these are user charges, usage payments and availability payments. The usage payments are technically variants of the user charge and availability payments. See Iossa, E. and Martimort, D. [2008], 'The Simple Micro-Economics of Public-Private Partnerships', Working Paper, (online) at: [http://papers.ssrn.com/paper.taf?abstract\\_id=1318267](http://papers.ssrn.com/paper.taf?abstract_id=1318267) [last accessed on May 5, 2012]

<sup>8</sup> This is common in PFI Contracts in the United Kingdom and *Contrats de partenariat* in France. Several other countries have started to use this contract type exclusively, irrespective of the sector.

<sup>9</sup> Brux Gregor, J. and Desrieux, C. (2012) 'Public Private Partnerships and the allocation of Demand Risk: An incomplete Contract Theory Approach' (online) at: [http://extrant.isnie.org/uploads/isnie2012/de-brux\\_desrieux.pdf](http://extrant.isnie.org/uploads/isnie2012/de-brux_desrieux.pdf) [last accessed August 13, 2012]

remuneration in this instance is dependent on the demand by the public for the services.<sup>10</sup>

There are also mixed forms of both types of contracts, where for example end users pay charges to the private sector contractor in an availability contract. In this case, the private sector collects such user fees on behalf of the Government. Another example is the use of shadow tolls which are in reality concession contracts. This is because despite the fact that users do not pay fees in shadow toll contracts, demand risk is borne by the concessionaire as payments to it by the Government, is dependent on the frequency of the use of the facility. In concrete terms, these mixed contractual arrangements either fall into one of the two broad classifications of concession or user charge contracts where the demand risk is borne by the private sector or availability contracts where demand risk is borne by the public sector. For this reason, subsequent analysis in this chapter will be based primarily on these two broad classifications.

The level of demand for a facility or service is very difficult to predict.<sup>11</sup> It is even more testing under long term contracts like PPPs. Usually, due to the competitive procurement process typically employed in selecting a

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<sup>10</sup> Athias, L. (2007) 'Political Accountability, Incentives, and Contractual Design of Public Private Partnerships' MPRA Paper No. 17089 (online) at: <<http://mpra.ub.uni-muenchen.de/17089/>> [last accessed on May 5, 2012]

<sup>11</sup> For example, so many factors may affect the continued use of a tolled road like shift in the use of mass transit, increase in the cost of petrol and the relocation of people from a particular area. Whilst the use of air transport in Nigeria even locally depends on economic conditions as passengers are likely to turn to cheaper forms of transport like using buses in lean times. This is also true in periods after air mishaps, where people abandon air transportation in preference to other competing means of transport.



concessionaire, there is a tendency for bidders to be overly optimistic, reckless or even predatory in their estimation.<sup>12</sup> This has led to re-negotiations<sup>13</sup> and failures of a number of PPP projects.<sup>14</sup> Due to this unpredictability of demand, the private sector and their financiers are usually wary of participating in projects unless the government pledges guarantees against demand risks.<sup>15</sup> The disadvantage of these guarantees is that concessionaires are able to renegotiate and shift losses to taxpayers whenever they get into financial trouble<sup>16</sup> or walk away from deals to the detriment of the public.<sup>17</sup> This trend has led to the increased use of availability contracts as opposed to concession

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<sup>12</sup> HM Treasury, (2003) 'Green Book, Appraisal and Evaluation in Central Government', HM Treasury London pg. 85; MacDonald, M. (2002) 'Review of large Public Procurement in the UK', HM Treasury UK; Bain, R. and Plantagie, J.W., (2003) *Traffic Forecasting Risk: Study Update 2003*, Standard & Poor's, London; Bain, R. and Plantagie, J.W. (2004) *Traffic Forecasting Risk: Study Update*, Standard & Poor's, London; Bain, R. and Polakovic, L. (2005) *Traffic Forecasting Risk Study 2005: Through Ramp-Up and Beyond*, Standard & Poor's, London.

<sup>13</sup> Viegas, J.M. 'Questioning the Need for Full Amortization in PPP Contracts for Transport Infrastructure' (2010) Vol. 30, Issue 1 *Research in Transportation Economics* pp. 139-144

<sup>14</sup> Choi, J. *et al* 'Risk perception analysis: Participation in China's Water PPP Market' (2010) 28(6): *International Journal of Project Management* pp. 580-592

<sup>15</sup> For instance in Chile, in 9 out of 10 highways franchised, the government provided a guarantee that the revenue will equal 70 % of the construction and maintenance costs. See Engel, E. *et al*. 'Least Present Value of Revenue Auctions and Highway Franchising', (2001) Vol. 109 No. 5 *Journal of Political Economy* pp. 993-1020

<sup>16</sup> For instance in Spain, where 3 firms went bankrupt as a result of traffic projections being less than one-third of original projections, government permitted toll increases and term extensions. Also in Mexico, most of the concessions were renegotiated after cost overruns and low revenues at the cost of USD 6 million to the government. See Engel, E. *et al* *ibid*,

<sup>17</sup> This might not necessarily lead to a loss to the private sector as the private sector may be paid reasonable compensation for transferring the asset back to the public sector. See for instance Lossa, E. *et al* 'Best Practices on Contract Design in Public-Private Partnerships, (2007) Report Prepared for the World Bank (online) at: <http://www.gianca.org/papersHomepage/Best%20Practices%20on%20Contract%20Design.pff> [last accessed on November 19, 2012]

contracts around the world as a means of shielding the private sector from demand risks.<sup>18</sup>

However, this thesis proves that the widespread use of availability contracts in place of concession contracts does not resolve all the problems due to the fact that PPPs are incomplete contracts.<sup>19</sup> The argument for the use of availability contracts is that due to its long-term nature, PPPs are basically based on *ex post* unanticipated adaptations rather than *ex ante* screening.<sup>20</sup> This therefore makes it nearly impossible to predict the demand for a service throughout the duration of the contract term or write verifiable objectives into the contract for all possible contingencies occurring during the life span of the contract.<sup>21</sup> The argument therefore is that it is better for the government to bear the demand risk since it is difficult to determine at the beginning of the contract. Also, this situation encourages the re-negotiation of contracts where the demand risk is borne by the private sector, which portends some negative consequence.

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<sup>18</sup> Laure, A. 'Political Accountability, Incentives and Contractual Design of Public private partnerships: Demand Risk on Private Providers or Public Authorities' (2007) (online) at: [http://mpr.ub.uni-muenchen.de/10538/1/ATHIAS\\_Political\\_accountability\\_dec.pdf](http://mpr.ub.uni-muenchen.de/10538/1/ATHIAS_Political_accountability_dec.pdf) [last accessed November, 26 2012]

<sup>19</sup> For more discussions on incomplete contract theory/framework see section 6.2 below

<sup>20</sup> Bajari, P. *et al.* 'Bidding for Incomplete Contracts: An Empirical Analysis', National Bureau of Economic Research Working Paper (2006) (online) at: [http://www.nber.org/papers/w12051.pdf?new\\_window=1](http://www.nber.org/papers/w12051.pdf?new_window=1) [Last accessed on November 26, 2012]

<sup>21</sup> Brux Gregor, J. and Desrieux, C. *Supra* Note 9

However, despite the argument above, it is a fact that where the government bears the demand risk, it leads to the exertion of lower effort by the private sector. This is consistent with the theory that the incentive of a party to be efficient is weakened when it does not bear demand risk in incomplete contracts.<sup>22</sup> This is the conundrum that this thesis attempts to resolve through the application of the incomplete contract theory to the problem.

#### **6.4 Incomplete Contract Theory**

The origin of the Incomplete Contract Theory can be traced to the theory of the firm. A 21-year-old undergraduate student of the London School of Economics had asked a simple question on why transactions still took place between firms despite the market being an efficient method of resource allocation? In other words, if the price mechanism was so good at allocating resources, why did firms still exist?<sup>23</sup> This question was later further explored in his essay written in 1937 raising questions about the boundaries of the firm.<sup>24</sup>

Williamson<sup>25</sup> tried to answer this question through the use of the

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<sup>22</sup> Laure, A. and Soubeyran, R. 'Demand Risk Allocation in Incomplete Contracts: The Case of Public Private Partnerships' (2012) Conference on Economics PPPs IESE, Barcelona, April, 20-21(online) at: < [http://www.iese.edu/en/files/20\\_Athias\\_tcm4-80532.pdf](http://www.iese.edu/en/files/20_Athias_tcm4-80532.pdf)> [Last accessed November 26, 2012]

<sup>23</sup> Aghion, P. and Holden, R. 'Incomplete Contracts and The Theory of the Firm, What have we Learned Over the Past 25 Years' (Spring 2011) Vol. 25, No. 2 *Journal of Economic Perspectives*, pp. 181-197

<sup>24</sup> Coase, R. 'The Nature of the Firm.' (1937) 4(16) *Economica*, pp. 386-405

<sup>25</sup> Williamson, O. (1985), *The Economic Institutions of Capitalism*, Free Press, New York; Williamson, O. 'Comparative Economic Organization: The Analysis of Discrete Structural Alternatives', (1991) Vol. 36, No. 2 *Administrative Science Quarterly*, pp. 269-296

transaction cost theory, which is based on the principle that market transactions can become very costly when agents have to make relationship specific investments.<sup>26</sup> For instance, when a strong bilateral interdependence exists in a relationship, vertical integration enables one of the parties to protect its specific investments against the potential hold up that the other party's opportunistic behaviour could generate when contracts are incomplete.<sup>27</sup> It is predicated on the tripod that parties to trade fear opportunistic behaviour; that insufficient contractual safeguards can result in inefficient levels of such investment; and that avoidance of such inefficiencies provide a key element in the boundaries of the firm.<sup>28</sup> Williamson later shared a Nobel Prize in 2009 for his work relating to this theory.<sup>29</sup>

However, Williamson's theory raised further questions: The first is whether there are no costs to vertical integration as opposed to just benefits that could explain why firms have boundaries? Secondly, why were all transactions not taking place within a single firm?<sup>30</sup> In 1986, Grossman and Hart answered these questions and also extended the transaction cost theory by using the theory of incomplete contract to explain the

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<sup>26</sup> Aghion, P. and Holden, R. Supra Note 23

<sup>27</sup> Brousseau, E. and Fares, M. (2000) 'Incomplete Contracts and Governance Structures: Are Incomplete Contract Theory and New Institutional Economics Substitutes or Complements?' In Menard, C. (ed.), *Institutions, Contracts, Organisations, perspectives from New Institutional Economics*, Edward Elgar Publishing, Adelshot.

<sup>28</sup> Lyons, B.R. (1996) 'Incomplete Contract Theory and Contracts between firms: A preliminary Empirical Study', *Centre for Competition and Regulation Working Paper*, CCR 01-1

<sup>29</sup> Aghion R. and Holden, R. Supra Note 26

<sup>30</sup> *ibid*

benefits of vertical integration to a firm.<sup>31</sup> According to them, economic actors are only boundedly rational and cannot anticipate all possible contingencies, therefore it is possible that certain states of nature or actions cannot be verified by third parties before they arise and thus cannot be written into an enforceable contract, i.e. these contracts are incomplete.<sup>32</sup> Subsequently, incomplete contract theory has been extended and is used extensively for analysing economic efficiency in relationship specific investments like PPPs.<sup>33</sup>

There are no clear definitions of incomplete contracts.<sup>34</sup> An incomplete contract has however been defined as one whose contractual obligations are observable to contractual parties but not verifiable *ex post* by third parties, typically like a judge or arbitrator to whom parties might eventually refer to when controversies arise.<sup>35</sup> A complete contract is therefore one for which the list of conditions on which the actions are based is expressly exhaustive.<sup>36</sup> Care must be taken to emphasize that there are slight dissimilarities between the nature of the incompleteness referred to by the economist and the perspective from

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<sup>31</sup> Grossman, S.J. and Hart, O.D. 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration.' (1986.) 94(4) *Journal of Political Economy*, pp. 691–719

<sup>32</sup> Aghion, P. and Holden, R. *Supra* Note 29

<sup>33</sup> *ibid*

<sup>34</sup> See Schmitz, P. 'The Hold Up Problem and Incomplete Contracts: A Survey of Recent Topics in Contract Theory' (2001) Vol. 53, Issue 1 *Bulletin of Economic Research* pp. 1-17

<sup>35</sup> Nicita, A and Pagano, U. (2002) 'Incomplete Contracts and Institutions' in Cafaggi, F., Nicita A. and Pagano, U. eds., *Legal Ordering and Economic Institutions*, Routledge, London, pg. 145

<sup>36</sup> *Ibid*

which a lawyer would view an incomplete contract. Whilst an economist views a contract as being incomplete or complete from an efficiency viewpoint, a lawyer looks at an incomplete contract strictly as one which has gaps regarding the obligations of the parties. Robert Scott and George Trantis aptly analyze this difference thus:

The incompleteness of a contract has a different meaning to an economist than to a lawyer. To a lawyer, a contract may be incomplete in failing to describe the obligations of the parties in each possible state of the world. Should a state of the world materialize that falls within the gap, the enforcing court must choose either to decline to enforce the contract or to fill the gap with a default obligation... Economists use incompleteness in a different sense. A contract is incomplete if it fails to provide for the *efficient* set of obligations in each possible state of the world. Such a contract is “informationally incomplete” even though it is “obligationally complete” in the sense that it does not contain any gaps.<sup>37</sup>

Incomplete contracts can either be exogenous or endogenous. Exogenous incomplete contracts are unverifiably independent of the parties' actions whilst endogenous incomplete contracts refer to the idea that the degree of unverifiability could also be determined explicitly

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<sup>37</sup> Scott, R.E. and. Trantis, G.G. 'Incomplete Contracts and the Theory of Contract Design', (2005) Vol. 56:1 *Case Western Law Review* pp. 1-15. Electronic copy (online) at: <http://law.bepress.com/uvalwps/olin/art23> (last accessed October 6, 2012)

by contracting parties who may deliberately decide to leave unspecified, some essential contractual terms in the presence of uncertainty. The distinction between exogenous and endogenous incomplete contracts is important because it shows clearly the distinction between opportunism and adaptation, which are central to incomplete contract theory. According to Antonio Nicta and Ugo Pagano, when the degree of unverifiability is exogenous, it weakens the probability that parties will achieve a contractual agreement in the first instance, given that at least one party could be exposed to a counterpart's post contractual opportunism at the renegotiation stage (opportunism). Secondly, when parties explicitly agree upon the degree of unverifiability, it may support contract formation and encourage parties' performance (adaptation).<sup>38</sup>

The reasons for the unverifiability of these contractual terms may be due to circumstances such as parties bounded rationality, uncertainty concerning events and high transaction costs incurred in writing the contract etc.<sup>39</sup>

## **6.5 Incomplete Contract Theory and Demand Risk**

Incomplete contract theory has been used to analyse PPP contracts because under such contracts, public authorities cannot fully specify the quality of services provided by the private sector, nor can they write

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<sup>38</sup> Nicta, A. and Pagano, U. *Supra* Note 36

<sup>39</sup> *ibid*

verifiable objectives for all possible contingencies occurring in the long run. Using the incomplete contract theory as a basis for analysis, the point which this thesis makes is that due to the fact that long term PPP contracts are incomplete and without a process for renegotiation, parties try to protect themselves by requesting for guarantees and other incentives for situations not covered by *ex ante* agreements. These guarantees instead of eliminating the risk, merely transfers it to the other party thereby distorting the initial risk allocation framework.

PPPs involve a degree of asset specificity, which creates a lock-in effect against the private sector party once it has made the investments for the provision of infrastructure. This exposes the private sector to economic dependency.<sup>40</sup> This lock-in effect generates the risk of opportunistic behaviour by the public sector;<sup>41</sup> leading to the first hold up problem.<sup>42</sup> It is these risks of asset specificity and the likelihood of opportunism that would prevent the private sector from investing in a particular project without proper assurances. The private sector usually seeks protection

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<sup>40</sup> The degree of asset specificity is defined as the degree to which an asset cannot be redeployed to alternative uses and by alternative users without sacrifice to productive value; see Nicita, A. and Pagano, U. *Supra* Note 38

<sup>41</sup> Ownership of the asset matters when contracts are incomplete because the owner has residual control rights. Since the government owns the PPP asset, it makes all decisions concerning the asset not included in the contract, for instance it can build another road to compete with an existing toll road managed by the private sector. See Hart, O. 'Incomplete Contracts and Public Ownership: Remarks, and an Application to Public Private Partnerships', (2003) Vol.113, No. 486 *The Economic Journal*, pp. C69-C76

<sup>42</sup> Hold up occurs for example when parties renegotiate the incomplete contract. During renegotiation the party in the better position is the one who can potentially hold up the other party and therefore obtain better payoffs or better conditions. See for example Ping Ho, S. and Chun-Wei-Tsui, 'The Transaction Cost of Public-Private Partnerships: Implications on PPP Governance Design' (2009) (online) at: [http://www.academiceventplanner.com/LEAD2009/papers/Ho\\_Tsui.pdf](http://www.academiceventplanner.com/LEAD2009/papers/Ho_Tsui.pdf) (last accessed on November 19, 2012)



from the likelihood of hold up or opportunistic behaviour by demanding the insertion of protective clauses in the contract. When the government consents to these clauses the demand risk shifts to the public sector party with the government bearing the risk of being the victim of the opportunistic behaviour of the private sector, leading to the second hold-up.

Using the analogy of Antonio Nicta and Ugo Pagano, these mitigation clauses transfer all the *ex post* bargaining power to the private sector party.<sup>43</sup> The party, that bears the demand risk usually, has more hold-up opportunities. This is the conundrum that PPPs face especially in relation to demand risk. This is in line with the position of Williamson that inefficiencies that lead to incomplete contracts, occur where investments have to be made regarding specific assets and at least one agent in the investment contract is opportunistic.<sup>44</sup>

Whilst it is not possible to draw up a complete contract that deals with demand risk because of its unpredictability, a detailed contract nevertheless also come with some disadvantages. It is more likely to reduce opportunism but inhibit future efficiency leading to possible future re-negotiation of the contract. In designing a framework for demand risk allocation and mitigation, the task that this thesis seeks to achieve, is therefore to provide a structure which provides the private

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<sup>43</sup> Nicta, A. and Pagano, U. *Supra* Note 40

<sup>44</sup> Williamson, O. (1985) *Supra* Note 25

party appropriate safe guards against the initial opportunism of the public sector without unwittingly shifting contractual dependency or the risk of it to the public sector at a future date.

## **6.6 Concession Contracts versus Availability Contracts**

There are advantages to be gained from the use of concession contracts over the use of availability contracts. The reason for this is that in concession contracts the private sector has more incentive to take user satisfaction into account, as this will influence the number of people using its service and therefore leads to the increase of its revenue.<sup>45</sup> It is also argued that it will motivate the public sector to respond to the public demands more because the consumers are better empowered.<sup>46</sup> The consumers have the power to oust the private sector provider by refusing to use the service depending on the availability of alternative options.<sup>47</sup> It is believed that this will compel the private sector to better innovate and therefore increase the quality of service provided<sup>48</sup>.

However, the consequence of the use of concession contracts is that the private sector will always try to protect its investment and ensure that the actions of the public sector do not negatively affect the demand for its services and therefore its revenue. For instance in a road project, it might be disastrous to the private sectors projected revenue in situations

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<sup>45</sup> Iossa, E. and Martimort, D. Supra Note 7

<sup>46</sup> Athias, L. Supra Note 10

<sup>47</sup> *ibid*

<sup>48</sup> Brux, J. and Desrieux, C. Supra Note 21

where the government decides to build an alternative road close to a private sector operated tolled road. This will certainly drive demand away from the tolled road. For these reasons, the private sector concessionaire will ensure the insertion of safety clauses in the contract like “non-compete”, “demand guarantee” and “compensation events” clauses. These clauses have potentially serious consequences for the government.

It has been suggested in some quarters that these clauses have the effect of making the government the insurer and guarantor of the earnings of the private sector and destroys competition and consumer choice.<sup>49</sup> More disturbing however is the likelihood that these clauses may stunt economic growth and even lead to stagnation in the development of infrastructure in a country. For instance, the net effect of the use of these clauses might be to forbid the government from the building of competing infrastructure near the location of the private sector managed facility in order to guarantee the revenue streams of the private sector. In a country like Nigeria where the population continues to grow rapidly and where the government is ambitious in growing the economy rapidly<sup>50</sup>, this might become a big issue in years following the concession as the citizens might be left with obsolete

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<sup>49</sup> Dannin, E. ‘Crumbling Infrastructure, Crumbling Democracy: Infrastructure Privatisation Contracts and Their Effects on State and Local Governance’, (2011) Vol. 6 *North Western Journal of Law and Social Policy* Pg.47

<sup>50</sup> Nigeria's Vision 2020 documents aims to make Nigeria the 20<sup>th</sup> biggest economy in the world by the year 2020.

infrastructure unless government is willing to breach its agreement with the private sector.<sup>51</sup>

In majority of the PPP transactions to date in Nigeria, there has been a preference for the use of concession contracts over availability contracts. The Murtala Mohammed Airport (MMA 2) BOT contract under study in this chapter for instance, is a concession contract. Apart from the lack of government funds to pay the private sector if the availability contract model was chosen, the other reason for the use of the concession model in Nigeria is that PPPs have been sold to the citizens under the erroneous or even deceptive notion that the Government is not going to pay for the asset or contribute in any way and therefore it becomes politically expedient to transfer all risks, especially demand risk to the private sector.

It is obvious that both the availability contracts and the concession contracts have their advantages and disadvantages. It is therefore the submission of this thesis that the nature of the project should ultimately determine the choice of the demand contract that is entered into by both parties and therefore who bears the demand risk. There is a consensus that availability contracts should be used when there cannot be revenue receipts from the users of a facility or where the government is in control of the demand for the facility like a prison or school for instance. It is the government that determines the number of inmates

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<sup>51</sup> Dannin, E. Supra Note 49

that are sent to prison and the specific prison that particular inmates would be sent to. However, this thesis argues that availability contracts should also be used in certain instances where the use of concession contracts will whittle down the powers of the government to continue to provide for its citizens due to the insistence by the private sector for the insertion of certain risk mitigation clauses into the contracts.

If we follow the basic rule that the party in control of an event should bear the risk arising from that event because that party is likely to make more effort to prevent the risk from eventuating, then in determining who should bear the demand risk, it follows that the party responsible for control of the demand for the service should shoulder the risk. For instance, it will be ineffectual to ask the private party to bear demand risk in a prison or school PPP where usage mainly reflects government policy in the sector.<sup>52</sup> Also certain types of transactions especially where the welfare of the citizens is paramount should be done through availability contracts while other contracts where there are credible user alternatives can be done through concession contracts. Where however, the public authority is insistent on using concession contracts, then it must ensure that its use does not stunt the economic development of the country or fetter its right to provide adequately for its citizens.

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<sup>52</sup> Laure, A. and Soubeyran (2012) *Supra* Note 22

This position discussed in the preceding paragraph goes to the root of the proper pricing of risk and the value for money question in PPPs. If the consequence of the private sector assuming the demand risk is properly priced at inception including the social and political costs, then the public sector, would be in a better position to make an informed decision on whether it is able to bear the consequences of its decisions or even be able to make contingency arrangements where that is possible. In essence, the public sector should be more realistic and better informed in determining whether it is cost effective and value for money is served by allocating demand risk to the private sector.

In the case study below, the thesis determines how demand risk has been treated in PPP contracts in Nigeria by analysing the MMA2 concession. This project was chosen because it was the first major BOT project in Nigeria and also because of the multitude of disputes and court cases that have emanated from that single transaction. The question this thesis asks is whether these disputes would have arisen if the demand risk in the project was handled differently?

## **6.7 CASE STUDY OF THE CONCESSION OF MURTALA MOHAMMED AIRPORT, TERMINAL 2 (MMA2)**

Since the commencement of operations of the MMA 2 local airport in Lagos about 5 years ago, there have been at least 5 suits in court either directly questioning the legality of the concession, duration of the concession or for breach of the concession contract. A number of the

suits have been filed by either the public sector (the Ministry of Aviation), and private sector partners (Bi-Courtney Limited) against each other or by the Federal Airports Authority (FAAN), who are the sector regulators against Bi-Courtney Limited (the Concessionaire). Others have been filed by the private sector users of the airport (Arik Air, a local airline) as well as the worker's union at the airport against Bi-Courtney Limited.<sup>53</sup> What was supposed to have been the first major PPP project in Nigeria in the transport sector and an advertisement of the readiness of the country to embrace PPP has not worked. With pending lawsuits, the business environment will be uncomfortable, particularly if the decisions favour the private sector partner.<sup>54</sup> With 31 years left on the concession term, the private sector partner will have to continue to deal with an upset partner (FAAN) that happens to also be the regulator of the airport sector.<sup>55</sup>

It is the submission of this thesis that majority of the law suits, disputes or issues regarding the concession can directly or indirectly be tied to the

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<sup>53</sup> Tell Magazine Tuesday June 26, 2012. Some of the major cases which are all reported in This Day Newspaper, Wednesday, October 31, 2012 are Bi-courtney Limited v. Attorney General of the Federation (unreported) Suit No. FHC/ABJ/CS/50/2009; Ojemaie Investments Limited (claiming as Landlords to Arik Air) v. Bi-Courtney Limited (unreported) Suit No. CA/A/141/M/2009; Safiyanu Dauda Mohammed and National Union of Air Transport Services, Air Transport Services Senior Staff Association of Nigeria (ATSSAN) v. Bi- Courtney Limited (This was an action filed by the workers union) (unreported) Suit No. CA/A/141/M/2009 ; Arik Air v Bi-Courtney Limited; The Federal Airport Authority of Nigeria v. Bi-Courtney Limited & Anor. (2011) LPELR 19742 (CA) pg.1-57; Suit No: CA/A/239/M/2010 and Attorney General of the Federation v. Bi-Courtney Limited reported in This Day Newspaper, Wednesday, October 31, 2012.

<sup>54</sup> The trial court and the court of Appeal have already decided in favour of the concessionaire. It is possible that FAAN might appeal further to the Supreme Court.

<sup>55</sup> This is already manifesting as there are suspicions that the cancellation of the Lagos-Ibadan road concession granted previously to Bi-Courtney Limited (the concessionaire of MM2) by the government and the subsequent prosecution of the majority shareholder of the company for money laundering is as a result of the dispute.

allocation and management of demand risk in the project. Consistent with the central argument of the thesis, it is argued that if the demand risk in this project had been better allocated and managed, it would have led to better project performance and majority, if not all, of the suits would not have arisen.

### **6.7.1 Project Background**

The government entered into 3 agreements with Bi-Courtney Limited (BCL) - the concessionaire - within a period of less than 4 years. The original agreement was a BOT Agreement signed in April 2003 between FAAN and BCL for a period of 12 years. A supplementary agreement was signed in June 2004 mainly increasing the construction period from 18months to 33 months after the slow pace of work had meant that the earlier agreed construction period was no longer realistic.<sup>56</sup> A third agreement, the Addendum Agreement, was signed in February 2007 that extended the concession period from 12 to 36 years.

Operations commenced at the airport terminal in May 2007. A few years later, the relationship between the public sector and the private sector partners degenerated to the extent of multiple court cases, legislative hearings and press wars. In summary, it is the case of the government that the concessionaire, BCL, has not remitted to the government the concession fee or rent for the use of MMA 2 which is 5% of the

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<sup>56</sup> See the recital to the Supplementary Agreement.



concessionaire's turnover as stipulated in the Agreement. Also, that the concession is for a period of 12yrs and not 36yrs as claimed by the concessionaire because the Addendum Agreement between the parties which increased the duration of the concession to 36 years was not approved by the Federal Executive Council (FEC) in line with the mandatory provisions of the ICRC Act.<sup>57</sup> According to FAAN, as at 2012, BCL owes the government \$6.7m, being 5% of the concessionaire's annual turnover.

The concessionaire's case is that the concession from the government, which is for 36 years, bars FAAN from renovating or operating any other terminal within Lagos State and that this includes the General Aviation Terminal (GAT), which is a second terminal located a few meters from the MMA2 terminal under concession. Consequently, BCL argues that FAAN is currently operating the GAT terminal in breach of restrictive covenants in the Concession Agreement with the government not to do so and that this is impacting negatively on its revenue streams because the action of the government agency is drawing demand away from the MMA 2 terminal.<sup>58</sup> Therefore the concessionaire contends that the government owes it \$73m being proceeds from the operation of the GAT.

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<sup>57</sup> Infrastructure Concession Regulatory Commission Establishment, (etc.) Act, 2005

<sup>58</sup> Arik Air the biggest local airline operator in Nigeria currently operates out of the GAT.

## 6.7.2 Analysis and Findings

It is evident from the history of contractual negotiations and re-negotiations on this transaction that the parties had probably not carried out thorough feasibility studies on the project, otherwise there would not have been any need for the subsequent two re-negotiations of the duration of the contract just 3 years after signing the initial agreement.<sup>59</sup> It is safe to assume that the reason for the subsequent final Addendum Agreement of February 2007 was due to the realisation that the level of demand (and therefore revenue) accruing to the private sector would be insufficient to enable the BCL recover its costs and make sufficient profits within the initially agreed 12-year period. This is presumably why the duration of the concession was subsequently increased to 36 years amidst speculation that recurrent re-negotiations were made possible by undue political influence, collusion and corruption in the procurement of the project.<sup>60</sup>

Whilst conceding that demand risk is difficult to predict, the margin of difference between the term of the concession in the initial contract and that in the subsequent amended Addendum Agreement is considerable (24 years). Despite this accepted difficulty in accurately predicting the demand for the use of these types of services, it is submitted that if the

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<sup>59</sup> It is claimed in some quarters that KPMG recommended the elongation of the term of the concession for 36 yrs, in order to allow the concessionaire recover its investment. See Tell Magazine Supra.

<sup>60</sup> Editorial, 'Power Tussle Over MMA2' Vanguard Newspapers, Monday August 11, 2013 pg. 11

parties had seriously conducted a demand and revenue analysis of the project prior to completing the transaction, they would have been able to determine in closer and more realistic terms, the number of years it would take to recover enough revenues from the project. Contract duration in this type of cases should be determined with the primary purpose of providing appropriate investment incentives. The duration of the contract must therefore always have a correlation with the future certain payments and the funds invested into the project by the private sector partner.<sup>61</sup> The residual value of the asset may also be taken into consideration.<sup>62</sup> It is unacceptable that a second feasibility study would determine that an initial study had not accounted for two-thirds of the period it would take the private sector to recover its investments.

### **6.7.3. The Allocation and Mitigation of Demand Risk**

The payment mechanism under the contract was the 'user charge' or concession model as opposed to the availability payment model. Based on our prior analysis, this means that the demand risk under the contract was transferred to the private sector partner BCL. Article 11 of the concession agreement reinforces this fact. Article 11.1 agreement provides that:

The Concessionaire shall throughout the Concession Period be entitled to collect from the Users of the Terminal and retain for its

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<sup>61</sup> Note it may also be argued that there is an inverse relationship between the service charge and the duration of the concession contract i.e. the lower the service charge the longer the concession.

<sup>62</sup> Lossa, E. and Martimot, D (2008) *Supra Note 7*

benefit, all revenue accruing from specified sources of income ceded to the concessionaire by FAAN

Article 11.2 goes on to specify the charges that are ceded to the concessionaire as:

- a) Passenger service charge collectible from departing passengers including avio-bridge charges.
- b) VIP lounge(s) usage charge.
- c) Car park charges.
- d) Rents/concession franchise fees.
- e) Service charge payable by concessionaires within the Terminal.
- f) Advertisement royalties payable by advert concessionaires within the Terminal excluding advertisements along the roads, and
- g) Associated revenue derivable from the use of associated facilities in the Terminal.

Article 11.4 allows the concessionaire to put in place a suitable tariff/charge collection mechanism or system as it may deem expedient and may engage any person or entity to collect the said tariff/charge on its behalf<sup>63</sup>. These provisions unequivocally allocate the demand risk to the private sector.

Article 2.2 deals with the mitigation of demand risk in the contract. It provides that:

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<sup>63</sup> Article 11.4 of MMA 2 Concession Agreement 2003

- a) Save as otherwise provided in Articles 17.4 (rights of lenders) and 20.2 (Assignment by concessionaire) the concession granted to the Concessionaire pursuant to this Agreement is exclusive. The Grantor shall ensure that no part of the concession shall be granted to any other party unless the Concessionaire is in breach of its obligations under this Agreement that would give rise to a right of termination by the Grantor under Article 17 or is in breach of Nigerian Law in relation to the Concession
- b) The Grantor guarantees and assures that it will not build any new domestic terminal in Lagos State and that no existing domestic terminal will be materially improved throughout the Concession Period that would compete with the Concessionaire for the same passenger tariff. Provided that the Concessionaire shall have the right of first refusal in the event that the passenger traffic during the Concession Period necessitates an expansion of the Terminal and the first right of consideration if the Grantor elects to build a new domestic terminal in Lagos State.
- c) The Grantor further guarantees and assures that all scheduled flights in and out of FAAN's Airport in Lagos State shall during the Concession Period operate from the Terminal
- d) FAAN further assures and guarantees that it shall not during the Concession period cause or authorise the erection or development of a shopping mall or any facility(ies) within 200 meters from the perimeter of the Site capable of impeding and or threatening the Concessionaires revenue generation

e) In the event that the Grantor decides to privatise or otherwise dispose of FAAN or the Terminal, the Concessionaire shall have the right of first refusal to acquire the Terminal or any other aspect of ownership or right created by the privatisation process under the Public Enterprises (Privatisation and Commercialisation) Act 1990 or any other enabling statute to this effect.

From the forgoing, it is clear that BCL having assumed the demand risk under the contract had tried to protect its revenue stream through the use of guarantee and non-compete clauses. First of all, the Agreement bars the government from building any domestic terminal in Lagos and also implied that the GAT, which was in disrepair at the time of the concession, would not be repaired. If however due to congestion, the government decides to build another airport terminal, then BCL shall have the first right of refusal to build the terminal. The net effect of these clauses is to ensure that for the duration of the concession, the government is prevented from improving the airport infrastructure in Lagos State, the country's commercial centre. The only other option will be to request the concessionaire to build another airport if the government can show proof that MMA2 is congested. This is a win-win situation for the concessionaire because it has effectively secured a second project without going through any form of competitive bidding. The alternative option for the government is not to improve the aviation infrastructure in Lagos State for the concession period. This is despite the likelihood that the state would soon require an additional airport due to

increase in population. The contract also ensures exclusivity for BCL for any flight leaving Lagos state and for other infrastructure like shopping malls, hotels or any facility near the airport.

It might be conceded that at the time the initial contract for 12 years was negotiated, the danger of an elongated period of being restrained from developing other facilities would not have been very obvious to the public authority because of the relative short duration of the contract. However, the public authority ought to have looked at the contract in its entirety when the contract was renegotiated for an additional 24 years period and priced the risks and benefits of increasing the contract duration appropriately. From the transaction documents, especially the reports written by the consultants justifying the increase in the length of the concession and the recital to the Addendum Agreement, it can be deduced that the increase was justified solely on the basis of cash flow and the fact that the construction phase of the contract had taken longer than expected. There was neither costing of the ancillary benefits that are likely to accrue to BCL as a result of the renegotiation of the length of the Agreement. Nor was the possibility that it would be entitled to build an additional terminal in Lagos State without competition from other investors contemplated. There was also a lack of consideration for the issue of whether the project still provided value for money for the public sector. Simply, the additional social costs to the public sector and the country were neither considered nor evaluated.

Again, using the framework developed by Abednego<sup>64</sup> discussed in chapter 5, we test the efficacy of the risk allocation and mitigation mechanisms adopted in the contract. First of all, we test whether demand risk has been allocated to the right party; (the who question) in demand risk in the MMA2 project is considered below.

### **Has Demand Risk Been Allocated to the Right Party?**

#### **Was the risk allocated to the party with the best capability to control the events that might trigger its occurrence?**

Demand risk in this project was allocated to the private sector party, BCL. However, BCL has no direct control over the demand for the use of the airport terminal by passengers. This is because the use of the terminal is influenced more by government policies than the efforts of the private sector. Therefore, it is safe to say that the government has the best capability to control events that might affect the demand for the use of the terminal. This explains why BCL employed the use of non-compete clauses and guarantees to protect the demand for the facility and thereby mitigate the risk. BCL also claims that its initial agreement with the government was to charge ₦3000 per passenger as Passenger Service Charge (PSC), with the estimation that 4 million passengers will pass through the terminal. However, government had reneged on this and instead approved only between ₦300 to ₦1000.<sup>65</sup> This reinforces the fact that government policies more than anything shapes

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<sup>64</sup> Abednego, M and Ogunlana, S. (2006) Supra Note 5

<sup>65</sup> Business Day Newspaper June 7, 2012 pg. 23



the demand for the use of the airport terminal. Thus the risk was definitely outside the control of BCL.

**Was the risk properly identified, understood and evaluated?**

There is no indication that the risk was properly identified, understood and evaluated by the parties at the beginning of the transaction; at least from the Government's perspective. There is however some indication, though not conclusive, that the private sector identified and understood this risk as evidenced from the different contractual amendments that took place within a very short period of time and its insistence on the insertion of the non-compete clause to protect its investment. Also, if the risk was properly identified by the public sector at the very beginning, the risk would have been appropriately priced and a suitable value placed on the risk. Every party including the public authority would be aware of the premium it was paying for the transfer of the demand risk to the private sector. The government would have then evaluated whether the transfer of demand risk to the private party represents value for money based on the social and economic costs it was going to assume. In conclusion, the demand risk was not properly identified, understood or evaluated by the parties prior to entering the contract.

**Does the party to whom the risk was allocated have the technical/managerial capability to manage the risk?**

This was the first BOT transaction in the country and BCL did not have any previous experience in doing any PPP transaction. It is also impossible for BCL to manage a risk that was never within its control. Also, the fact that BCL failed to carry out proper feasibility studies before entering into the initial agreement also proves that it probably does not have the technical and managerial capacity to manage the demand risk. This is also consistent with the views of the staff of the regulator interviewed during the course of this research. They opined that issues that have so far arisen from the concession show that both BCL and the government had no technical and management capacity to manage the demand risk at the time of entering into the contract.

**Does the party have the financial ability to sustain the consequences of the risk or prevent it from it occurring?**

Newspaper reports indicate that the management of BCL claim that it has lost \$73m to date over the dispute that has arisen out of the decision of the government to breach the terms of the contract by operating a parallel aviation terminal. Also, that the company made a loss of =N=12billion Naira overall, for the first 5 years of operation.<sup>66</sup> It has also been reported that the financiers of the project have approached the government directly to inquire about the project, as they now fear that

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<sup>66</sup> ibid

they might not be able to recover their loan to BCL. All these point to the fact that without the public authority's adherence to its restrictive undertakings under the concession contract not to run any competing terminal, BCL would not be able to deal with the consequences arising from the assumption of the demand risk. It is also very unlikely that BCL will be able to influence government policy in the long run, by preventing the government for instance from building a high speed rail network between Lagos State and other major cities which will also likely affect the demand for the use of the local terminal. In contrast, it is the government that has the financial ability to sustain the consequences that arise from the demand risk materialising and not the private sector party to whom the risk was allocated.

### **Is the party willing to accept the risk?**

It is obvious that BCL is only willing to assume the demand risk at a very huge price, i.e. if the necessary guarantees are provided and the non-compete clauses are adhered to. From the outcome of the ensuing dispute between the parties, these seem to be a very big price which the government is not prepared to pay. Therefore, it is safe to conclude that BCL is not willing to accept the demand risk in the form in which the government now wants to pass it.

### **Was the risk allocated at the appropriate time?**

The right time to allocate demand risk is at pre-contract stage because it is vital to determining the financial sustainability of the project. At the

pre-contract stage, the parties would determine whether proposed revenues from the project would be enough for the private sector party bearing the risk, to recover its investment and make sufficient profits. The available transaction documents do not reveal whether the issue was discussed. However, the general provisions of the concession agreements specifically show that the issue had crossed the minds of both parties, leading to the insertion of the mitigating clauses in favour of BCL. The recent decision of FAAN to operate the parallel GAT terminal alters the allocation framework of the demand risk in the contract between the parties and further increases the burden of the risk on BCL. This is a wrong time to change the complexion of the risk because it generally distorts the economic equilibrium on which the transaction was consummated. In conclusion therefore, whilst the risk seemed to have been allocated at the appropriate time, the current decision of the government changes the character of the risk that was assumed earlier by BCL and this is definitely not the appropriate time to alter the character of the risk.

### **Was the process used in allocating the risk appropriate?**

From the analysis above, it is clear that the concession contract model that was used in allocating and managing the demand risk in this project failed. This is because it resulted in the private sector party using a number of risk mitigating clauses to protect itself. The consequence is that the government, trade unions and other stakeholders affected by the consequences of the use of this demand risk mitigating contractual

clauses have become disenchanted less than 5 years into the concession. One of the easiest solutions would have been to allow the public authority/government bear the risk through the use of availability contract.

The government should still have allowed BCL to build and operate the terminal in line with pre-defined standards and remunerated BCL from the proceeds of the terminal. In such a situation, it would still have been able to run its GAT terminal, built additional infrastructure in the future through whatever process it desired and at the end of the concession period (whether 12 years or 36 years), take ownership of the terminal provided by BCL. The Unions would have been happy with this arrangement, as they would not have any reason to assume that BCL had been favoured by the previous government administration, which had granted the concession. Also, some of the private airlines that do not presently want to operate through the MMA2 terminal would still have been able to operate through whichever preferred terminal.

Thus if the availability contract model had been used to allocate demand risk in this project the private sector would have avoided its current predicament because its income would have been guaranteed through this model, instead of being left at the mercy of an uncompromising government and regulator.

## **6.8 RECOMMENDATIONS FOR FUTURE APPLICATION OF DEMAND RISK IN NIGERIA**

In allocating demand risk in infrastructure projects, parties to PPP contracts, particularly the public authorities, must not tie themselves to the use of concession contracts like what happened in the MMA 2 airport project and a number of other PPP concessions, to the exclusion of availability contracts. The decision to use either of the two options must be predicated on sound project evaluations. Regarding the MMA 2 project, it is the opinion of this thesis that a number of the existing disputes surrounding the project would not have arisen if the availability contract model was used instead of the concession model.

Several studies have proved that it is erroneous to assume that either of the two contract types is better than the other.<sup>67</sup> The key is to understand when to use one option in favour of the other. According to Julie de Brux and Claudine Desirux, the decision whether to use either of them depends on a number of factors.<sup>68</sup> This includes firstly, whether it is a captive market where users of the service are forced to use the service because of the lack of an alternative. There might be no incentive for the private sector to

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<sup>67</sup> Brux, J. and Desirux, C. *Supra* Note 48; Athias L. and Soubyeran R. *Supra* Note 6

<sup>68</sup> Brux, J. and Desirux, C. *Supra* Note 67 above; Athias L. and Soubyeran R. *Supra* Note 67

innovate in terms of quality in service delivery and price. It is suggested that availability contracts are more suitable in these situations.

Secondly, the sensitivity of users to quality variations and user fees is also a big determinant. If the demand is elastic to the quality of service and level of fees, then users of the service play a more prominent role. This influences the private sector operators to improve service quality, reduce service fees and invest more in the project. In this case, concession contracts are preferred. If the reverse is the case, then availability contracts are a better option.

Thirdly, it must be decided whether the quality of output is contractible. In situations where it is possible to prescribe the standards of the quality of service to be provided by the private sector, then it is possible to use availability contracts. Otherwise it will be difficult to find a benchmark on which availability payment can be made as payments in availability contracts are tied to the private sector party meeting predetermined standards.

Finally, the existing social and political norms in the society where the project is located might determine the type of demand model adopted. Since the availability model, due to its characteristics, will increase access to the service as it is assumed that the government will be interested in getting as many citizens as possible to use the service, it should be used when there is a need

to accommodate as many users as possible. The concession model however incentivises the private sector to improve the quality of service and should be used where the quality of service is a priority<sup>69</sup> and there are competing providers of the same service.

For the avoidance of doubt, there is generally nothing wrong with the public sector passing demand risk to the private sector. Indeed, it is commonly accepted that there are advantages in doing this, some of which are the incentives it gives the private sector to innovate, improve service delivery and reduce price as the realisation that its revenues are inextricably tied to the willingness of the public to patronize the service pushes it in that direction. However, all these advantages are only realisable where there are real and competitive options available to users.

As we have seen in the case study above, to be able to pass this risk adequately, the private sector will demand and the public sector must be willing to provide sufficient incentives to the private sector to assume this risk. The public authority must also assess whether it is able to live with the consequences of such decisions instead of resorting to breach of contract as in the case study above. This requires a conscious evaluation and pricing of the risk

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<sup>69</sup> *ibid*



including non-commercial factors like the satisfaction of citizens both in the short and long term.

In situations where the government decides that it will transfer demand risk to the private sector, there are other less onerous methods of achieving this than was done in the MMA2 concession. These techniques will ensure the protection of the interest of the private sector and also guarantee equity between the parties instead of the resort to the use of non-compete and similar clauses. These methods are basically demand risk mitigation instruments that have been used around the world and discussed in more detail below.

### **Demand Risk Mitigation**

For countries like Nigeria where the government is bent on using concession contracts especially in the transport sector like the MMA2 concession, the most common strategies used to mitigate traffic demand risk is to either allow the term of the concession or the revenue accruable to the concessionaire to adjust with demand realisations. The three most common mechanisms are: “modification of the economic balance” of contracts; traffic guarantee contracts and duration adjusted contracts.<sup>70</sup>

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<sup>70</sup> Transport Research Centre (TRANSYT) ‘Evaluation of Demand Risk Mitigation in PPP Projects’ (2007), pg.8

## **Modification of the Economic Balance of Contracts**

This method is thought to have originated in France<sup>71</sup> and subsequently applied in Spain with some differences.<sup>72</sup> Under this approach, if the Internal Rate of Return (IRR) of the project falls below a minimum threshold stipulated in the contract, then the “economic balance” of the concession is re-established. In most cases, a minimum IRR is accompanied by a maximum IRR. This ensures that the concessionaire’s profits are limited if traffic is much higher than expected.

Generally, the compensation measures to be adopted for re-establishing the economic balance of the contract are not pre-determined but rather negotiated when the IRR falls below or rises above the target levels.<sup>73</sup> The nature of the compensation may take the form of change in toll levels, adjusting the contract length or the provision of other public subsidies.<sup>74</sup> These subsidies may take the form of capital expenditure contributions (capex), which can either be in the form of loans or equity as capital grants to the private sector.<sup>75</sup> The problem with this approach is that it involves a long and tiresome re-negotiation process between

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<sup>71</sup> *ibid*; see also Gomez Ibanez, J.A. and Meyer, J.R. (1993) *Going Private: The International Experience with Transport Privatization*, The Brookings Institution, Washington DC

<sup>72</sup> Vasello, J.M. and Gallego, J. ‘Risk sharing in New Public Works Concession Law in Spain’;(2005) *Transport Research Record* 1932 pp.1-8; Vassallo, J.M. ‘Traffic Risk Mitigation in Highway Concession Projects: The Experience of Chile’, (2006) Vol. 40, No.3 *Journal of Transport Economy and Policy*, pp. 359-381

<sup>73</sup> Vassallo, J.M. (2006) *ibid*

<sup>74</sup> *Ibid*

<sup>75</sup> See Iossa, E. et al, ‘Best Practices on Contract Design in Public Private Partnership’ *Supra Note 622* for a discussion of these subsidies.

the concessionaire and the government since the way to re-establish the economic balance of the contract is not fully specified. Also, the concessionaire has no incentive to reduce operating costs when the project IRR is close to the lower limit since falling below the limit allows a re-negotiation of the contract.<sup>76</sup>

### **Traffic Guarantee Contracts**

This approach involves guaranteeing either the traffic or revenue levels in the contract. The failure to reach this minimum levels triggers compensation from the public sector. Many countries such as Korea, Colombia, Chile, Dominican Republic, Malaysia and Spain have used this method.<sup>77</sup> In many contracts, the lower limit is often complemented with an upper limit above which the revenues are “clawed back” and shared between the government and the concessionaire. The main problem of the guarantee approach is that it cannot ignore the strong correlation between the volume of traffic and economic growth; thus the guarantee can have very negative consequences for the public budget if a recession occurs.<sup>78</sup> Nevertheless, it has been shown that the method has worked quite well in some countries such as Chile where, even during an economic recession, only 4 out of 29 transport concessions in operation at the end of 2004 performed below the

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<sup>76</sup> Transport Research Centre, Supra Note 70

<sup>77</sup> Irwin, T. (2003) ‘Public Money for Private Infrastructure: Deciding when to offer Guarantees Output based Subsidies and other Fiscal Support’, World Bank Working Paper 10, Washington DC; Transport Research Centre *ibid*; Vassello, J.M. Supra Note 74

<sup>78</sup> Transport Research Centre Supra Note 76

minimum income guarantee band. This meant a subsidy from the government of only 6.24 US\$ million compared to the 350 US\$ millions invested. Surprisingly however, it did not reduce pressure from the concessionaires for contract re-negotiations.<sup>79</sup> This mechanism has not worked so well in more unstable countries such as Colombia where traffic volume turned out to be lower than guaranteed levels for many of the concessions in that country.<sup>80</sup> In situations like this, this mitigation method is capable of becoming a large burden on the government's fiscal position.<sup>81</sup>

### **Duration Adjusted Contracts**

This method, which has been adopted in several countries, involves matching the duration of the concession to a predefined verifiable target, usually related to traffic or revenues. This approach was first applied in 1990 in the concession of the Second Severn Crossing in the United Kingdom.<sup>82</sup> Although the government initially decided that the maximum period for the concession should be no longer than 30 years, the concessionaire -Severn River Crossing Plc. - proposed the basis of the length of the concession be pegged to a fixed target of "Required Cumulative Real Revenue".<sup>83</sup> This way, total project revenue was

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<sup>79</sup> Vassallo, J. and Solino, A. "Minimum Income Guarantee in Transportation Infrastructure Concessions in Chile" *Transport Research Record: (2006)1960(1) Journal of the Transportation Research Board* pp. 15-22

<sup>80</sup> Transport Research Centre *Supra* Note 78

<sup>81</sup> *ibid*

<sup>82</sup> Vassello, J.M. *Supra* Note 77

<sup>83</sup> Foice, D. (1998) 'Second Severn Crossing ', Proceedings of the Seminar PPP Risk Management for Big Transport Projects, Ministerio de Fomento Spain.

established at 1989 prices (NPV), which, once collected from tolls income, would end the concession. Based on traffic levels during the early years of the concession, it was expected that the concession duration would be ultimately 22 years, considerably less than initially predicted.<sup>84</sup> Another similar concession was awarded in Lusoponte, Portugal at the end of the 1990's. The concession agreement was designed in order for the concession to expire no later than March 2028 or at a total cumulative traffic flow of 2,250 million vehicles, if the traffic is higher than expected the concession will finish earlier than 2028.<sup>85</sup>

A good enunciation of this mechanism is called "Least Present Value of the Revenues (LPVR)" and has been extensively developed by Engel, Fischer and Galetovic.<sup>86</sup> The authors were of the opinion that fixed term contracts do not allocate demand risks optimally. They therefore advocated for a least present value of revenue auction instead of the bidding process being based on the length of the toll period.<sup>87</sup> Under this procedure, the lowest bid wins i.e. the bidder who offers the least present value of accumulated revenues, discounted according to the

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<sup>84</sup> Transport Research Centre Supra Note 81

<sup>85</sup> Lemos, T.D. *et al* 'Risk Management in Lusoponte Concession- A Case Study of the Two bridges in Lisbon, Portugal', (2004) 22 *International Journal of Project Management*, pp. 63-73.

<sup>86</sup> Engel, E.M. *et al* 'Highways Franchising Pitfalls and Opportunities', *American Economic Review*, (1997) 87, pp. 68-72 ; Engel, E.M. *et al* 'Least Present Value of Revenue Auctions and Highway Franchising', (2001) Vol.109 No.5 *Journal of Political Economy*, pp. 993-1020

<sup>87</sup> Engel, E.M. *et al* (1997) *ibid*; Engel, E.M. *et al* (2001) Supra Note 16

discount rate fixed in the contract and the concession comes to an end when that lowest bided amount is recovered by the concessionaire. Therefore the concession comes to an end earlier if the demand is high and lasts longer when the demand is low. They also claim that significant welfare gains can be made from using LPVR auctions.<sup>88</sup>

Another major advantage is that since the concession term adjusts to demand realisations in LPVR auctions, the concessions are less sensitive to demand information and thus more cost-oriented than fixed term concessions.<sup>89</sup> However, this mechanism has been implemented with minimal success in Chile.<sup>90</sup> The major reason for this is said to be the lukewarm reception of the method by concessionaires.<sup>91</sup> An advantage of this option is that apart from being a demand risk mitigation method, LPVRs provides the public sector authority with a price with which to buy out the concession. A fair compensation for the concessionaire is the difference between the winning bid and the revenue collected thus far, unlike in fixed term contracts where compensation is based on estimates of expected profits during the remainder of the concession period, the calculation of which is always subject to disputes.<sup>92</sup> It is presumed that this will act as a disincentive to a private sector party seeking to re-

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<sup>88</sup> Ibid

<sup>89</sup> Ibid

<sup>90</sup> It was used in the Santiago-Valparaiso Vina del Mar Concession in Chile

<sup>91</sup> Vassallo J.M. *Supra* Note 82

<sup>92</sup> Engel, E.M, *et al.* (2001) *Supra* Note 89

negotiate a concession since the public authority can opt to buy out the concession.<sup>93</sup>

The major criticism of the LPVR method is that it does not provide sufficient incentive for the concessionaire to exert effort in enhancing the quality of service.<sup>94</sup> It has been suggested that this could be overcome by complementing the method with other regulatory inventions, such as the appointment of third parties who verify the minimum quality standards and appropriate fines for non-compliance with those standards.<sup>95</sup>

There is also an interesting suggestion put forward by Quiggins, that PPPs will be improved by the inclusion of "put and call" options in contracts which allow either of the contracting parties to terminate after a predetermined period which he proposed should be every 7 years with the public sector having an option of buying off the remainder of the unamortised period by the private sector.<sup>96</sup> In a similar vein, Veigas argues that concessions are better designed in successive shorter term contractual cycles of a maximum of 15 years each. Each cycle will involve a revision of objectives, policies, technological standards and demand forecasts. This is aimed at the partial amortisation of the private

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<sup>93</sup> Vasallo J.M. *Supra* Note 91

<sup>94</sup> Engel E.M, *et al* (2001) *Supra* Note 92

<sup>95</sup> Tirole, J. "Comentario a la propuesta de Engel, Fischer y Galetovic sobre licitaci3n de carreteras." *Estudios Pu3blicos* 65 (Winter 1997): 201–14. cited in Engel, E.M, *et al.* (2001) *Supra* Note 654

<sup>96</sup> See Quiggins, J. 'Public Private Partnerships: Options for Improved Risk Allocation' (2005) 38 *Australian Economic Review* pg. 445; Quiggins, J. 'Public Private-Partnerships: Options for Improved Risk Allocation' (2006) Vol. 29(3) *UNSW Law Journal* pg. 289.

sector party's investment. At the end of the concession period the concessionaire would collect a payment equivalent to the value of the unamortised payments.<sup>97</sup> The Government does not need to have recourse to funds from the budget to make these payments. It may raise the money by organising a subsequent concession for another period of similar duration without the cost of a new construction. It can be done in a manner that allows the new rent to cover the exit payment of the first concessionaire.<sup>98</sup>

It is suggested that in projects like the MMA 2 concession, the use of this method might have given the government the flexibility to pay a predetermined compensation if it decides to opt out of the contract and also be able to build a new facility without being in breach of contract.

Furthermore it is suggested that if the use of availability contracts are preferred to concession contracts, then the public sector must ensure that payments are only made according to predefined and measurable outputs in the contract. These outputs must act as targets, which the private sector must comply with.<sup>99</sup> To compel adherence to the standards of the specified output and encourage efficiency from the private sector, the contract should provide for deductions to penalise any failure to comply with specified standards and where complete

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<sup>97</sup> Viegas, J.M. 'Questioning the Need for Full Amortisation in PPP Contracts for Transport Infrastructure' 30(2010) *Research in Transport Economics* pp. 139-144

<sup>98</sup> Ibid

<sup>99</sup> Iossa, E. and Martimot, D. *Supra* Note 45



failure of availability occurs. It is suggested that when making provisions for deductions, a scale to measure the degree of service unavailability should be specified in the contract where possible.<sup>100</sup> In the same vein, bonuses may also be introduced for instances where the private sector records performances above the target levels. This will encourage the private sector partner to continue to innovate. The use of bonuses will also partially address the issue of lack of incentive to improve service quality that is normally attributed as one of the disadvantages of availability contracts.

Finally, from the private sector point of view, in order to consummate a successful PPP project in the transport sector, the goal should be to prepare a painstaking and sophisticated cost benefit and competition analysis which ensures the long term viability of the project without the need for government financial support whether in the form of capital expenditure contributions, guarantees or other forms of concessions.<sup>101</sup> The government should also be able to commission consultants to do the same on its behalf. It is unacceptable for such studies to be ignored or not properly done because the consequences can be grave as the MMA 2 case study revealed. This is said to be one of the major shortcomings of another airport concession done in recent times- the Kassel- Calden local airport PPP project in Germany.<sup>102</sup>

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<sup>100</sup> *ibid*

<sup>101</sup> European Commission (2004) 'Resource Book on PPP Case Studies EU Brussels

<sup>102</sup> *ibid*

## 6.9 Conclusion

This chapter critically evaluated the management and mitigation of demand risk in Nigeria. Firstly, it argues that demand risk is one of the very important risks which PPP projects face in the country. The problem with managing demand risk arises mostly when the private sector tries to mitigate the risk by protecting itself from market forces and factors outside of its control through the use of non-compete clauses or similar risk mitigating devices. This distorts the allocation of the risk and is consequently harmful to the success of the project and even the country's infrastructure in the long run.

This problem is exacerbated due to the fact that PPPs are incomplete contracts i.e. that due to its long-term nature, it is nearly impossible to predict the demand for a service throughout the duration of the contract term. Using the incomplete contract theory as a basis for analysis, the point which this thesis makes is that due to the fact that long term PPP contracts are incomplete, and without a process for re-negotiation, parties try to protect themselves by requesting for guarantees and other incentives for situations not covered by *ex-ante* agreements. These guarantees instead of eliminating the risk, merely transfer it to the other party with serious consequences if it eventuates.

Secondly, it was observed that the principal means through which demand risk is allocated is the payment mechanism specified in the contract. These are contracts where the private sector bears no demand risk, known as availability contracts and those where the private

sector bears all or some of the demand risk, known as user charge or concession contracts. It was argued that in allocating demand risk in infrastructure projects, parties to PPP contracts, particularly the public authorities, must not tie themselves to the use of concession contracts to the exclusion of availability contracts. The decision to use either of the two options must be predicated on sound project evaluations.

In the case study in this chapter, the thesis determines how demand risk has been treated in PPP contracts in Nigeria by analysing the MMA2 concession. This project was chosen because it was the first major BOT project in Nigeria and also because of the multitude of court cases that have emanated from the transaction. The conclusion of this thesis in this regard, is that these disputes would not have arisen if demand risk in the project was handled differently.

The major contribution of this chapter to the thesis is to show how the attempt at risk mitigation can distort the intended risk allocation framework. Therefore, there is a need for the parties, especially the public sector, to a PPP contract to be mindful of how it chooses to allocate risk. Whatever advantage is initially gained from a misallocation of risk in favour of the public sector is usually lost, leaving it in a worse state, as a consequence of the private sector protecting itself by mitigating the risk. This chapter also reemphasises the recurrent theme of this thesis that risks in PPP projects have not been handled properly in Nigeria leading to the emergence of very fragile projects. This affirmatively answers the research question.

## **Chapter 7**

### **STAKEHOLDER OPPOSITION RISK**

#### **7.1. Introduction**

This chapter discusses stakeholder opposition risk. It commences with an analysis of the different definitions of “stakeholders” available in extant literature. The subsequent sections examine the theoretical basis for stakeholder engagement in projects, which is the stakeholder theory and by extension the stakeholder accountability theory that are both employed to analyse stakeholder opposition risk. In the concluding sections, a case study of the Lekki toll road concession is carried out along with recommendations on how to better manage stakeholder opposition risks in Nigeria.

#### **7.2. Definition of Stakeholders**

This chapter uses the term “stakeholder opposition risk” as opposed to “public opposition risk” because the phrase “public opposition” seems very limited in scope, as it does not take into consideration the wider range of individuals or organizations that affect, influence or oppose the PPP project. The use of the word “stakeholder” cures this defect and also aligns the concept of engaging people affected with a project with its theoretical foundations namely the stakeholder theory, which has its origins in the discipline of business ethics and company law. However, It is not uncommon to see the use of the words “public opposition risk” instead of “stakeholder opposition risk” in PPP literature. Even as this thesis

adopts the phrase “stakeholder opposition risk”, it is however admitted that the most important stakeholders are members of the public in their role as citizens and end users of the infrastructure services and this is reflected in most of the analysis in this chapter.

Whilst project management literature is replete with discussions on the influence of stakeholders on projects, very little attention has been paid to the consideration of stakeholder opposition as a risk.<sup>1</sup> Nevertheless, there exists literature that identifies public opposition as a risk in PPPs, albeit with limited discussions.<sup>2</sup> This thesis recognizes the gap in literature and aims to make valuable contribution to extant literature that critically analyses the role of stakeholder opposition risk in PPP projects.

The available definitions of “stakeholder” in literature have been predicated on different factors like the nature and extent of stakeholder involvement in the project, the nature of their relationship with the project, the nature of the stakeholder claim and position towards the

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<sup>1</sup> See however the following where a brief mention has been made: Farrel, F.M. ‘Principal-agency risk in project finance’, (2003) 21(8), *International Journal of Project Management*, pp. 547-561; Kutsch, E. and Hall, M., ‘Intervening conditions on the management of project risk: Dealing with uncertainty in information technology projects’, (2005) 23(8) *International Journal of Project Management*, pp. 591-599; Shen, L-Y. *et al*, ‘Role of public private partnerships to manage risks in public sector projects in Hong Kong’, (2006) 24(7) *International Journal of Project Management*, pp. 587-594; Yeo, K.T. and Tiong, R.L.K. ‘Positive management of differences for risk reduction in BOT projects’, (2000) 18(4) *International Journal of Project Management*, pp. 257-265

<sup>2</sup> See the following where it has been mentioned as one of the PPP project risks: Karim, N. A. ‘Risk Allocation in Public-Private Partnership (PPP) Project: A Review of Risk Factors’, (2011) Vol. 2, Issue 2 *International Journal of Sustainable Construction Engineering & Technology*

project, the stakeholders' role in the project and the degree to which stakeholders' behaviour towards the project can be anticipated.<sup>3</sup>

Stakeholders have therefore been defined as those whose interests may be positively or negatively affected as a result of project execution.<sup>4</sup> Smith *et al.*, define stakeholders as representatives, direct and indirect, who may have an interest and can make a contribution to the proposed project.<sup>5</sup> This definition is consistent with project management parlance, which tends to look at the stakeholder group from a wider perspective, encompassing people or groups that have, or believe they have, legitimate claims against the substantive aspects of a project.<sup>6</sup> These may even include the project team's families, people who buy the product or are affected by the end product and the local community at large.<sup>7</sup> There have also been attempts at including the environment as part of stakeholders.<sup>8</sup>

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<sup>3</sup> Aaltonen, K. 'Stakeholder Management in International Projects', PhD Thesis, Aalto University School of Science and Technology Department of Industrial Engineering and Management

<sup>4</sup> Jergeas, G.F. *et al.*, 'Stakeholder management on Construction Projects', (2000) *AACE International Transaction*, pp. 12.1-12.5; PMI (1996) *Project Management Body of Knowledge*, Newton Square, PMI PA

<sup>5</sup> Smith, J. *et al.*, 'To Build or Not to Build? Assessing the strategic needs of construction industry clients and their stakeholders', (2001) 19(2) *Structural survey*, pp. 121-132

<sup>6</sup> Turner, J.R. (1999) *The Handbook of Project-Based Management 2nd Ed. Improving the processes for achieving strategic objectives*, McGraw-Hill Companies, London; Moodley, K. (1999) 'Project Performance enhancement-improving relations with community stakeholders', in Ogunlana, S. (Ed.), *Profitable Partnering in Construction Procurement*, E&F Spon, London.

<sup>7</sup> Takim, R. *et al.* 'The Malaysian Private Finance Initiative and Value For Money' (2009) 5(3) *Asian Social Science* pp. 167-175

<sup>8</sup> Starik, M. 'Should Trees have Managerial Standing? Towards Stakeholder Status for Non-Human Nature', (1995) 14 *Journal of Business Ethics*, pp. 207-217; Orts, E. and Strudler, A. 'The Ethical and Environmental Limits of Stakeholder Theory Business' (2002) Vol. 12 *Ethics Quarterly*, pp. 215-233

Winch's definition is closer to the way the concept is used in this thesis. He defines stakeholders as those actors, who will incur a direct benefit, or loss, as a result of the project.<sup>9</sup> Winch goes on to classify stakeholders as either internal or external.<sup>10</sup> The internal stakeholders are people who have access to the project proponent such as employees and financiers. External stakeholders are groups that are not formal members of the project coalition but may affect or be affected by the project.<sup>11</sup> External stakeholders have also been referred to as non-business stakeholders or secondary stakeholders<sup>12</sup> and can be either public or private. Public stakeholders are regulatory agencies and other agencies of government. The members of the public belong to the external stakeholders who may be in favour, against or indifferent about the project. In a PPP, it is pertinent to point out that the government is more of an internal stakeholder than an external one.

Stakeholders have also been classified into primary and secondary stakeholders.<sup>13</sup> Primary stakeholders refer to groups whose support is necessary for the firm to exist and to whom the firm have special duties towards. Secondary stakeholders on the other hand have no formal

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<sup>9</sup> Winch, G.M. (2002) *Managing Construction Projects: An Information Processing Approach*, Blackwell Science Ltd, Oxford

<sup>10</sup> See also Eesley, C. and Lenox, M.J. 'Firm responses to Secondary Stakeholder Action', (2006) 27(8) *Strategic Management Journal*, pp. 765-781.

<sup>11</sup> Aaltonen, K. *Supra* Note 3

<sup>12</sup> Cova, B. *et al*, (2002) *Project Marketing: Beyond Competitive Bidding*, John Wiley & Sons Ltd, Chichester, England pg.179

<sup>13</sup> Clarkson, M.B.E. 'A stakeholder framework for analyzing and evaluating corporate social performance', (1995) 20(1) *Academy of Management Review*, pp. 92-117

claim on the firm and management has no special duties to them.<sup>14</sup> Stakeholders have also been classified as either claimants or influencers<sup>15</sup> and also as strategic and moral stakeholders.<sup>16</sup> Strategic stakeholders are those that are able to affect the project and therefore the management of their interests is said to be essential for the success of the project. Moral stakeholders are those who are affected by the project but whose claim to the project is merely moral as opposed to legal.

The discussion of stakeholders in this thesis appreciates that the public *qua* citizens or end users of the project are the major and most important stakeholders of a PPP project.<sup>17</sup> However, it is also understood that the public interact within a social milieu and their roles take different shapes and forms during that interaction. These different roles of the "public" or citizens who are capable of influencing a project are as users of the infrastructure, owners, ratepayers, NGOs, social institutions, environmentalists, community based organizations and even the media.

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<sup>14</sup> Carroll, A.B. and Bucholtz, A.K. (1993) *Business & Society: Ethics & Stakeholder Management*, OH: Western Publishing, Cincinnati pg. 512; Gibson, K. 'The Moral basis of stakeholder theory', (2000) 26 *Journal of Business Ethics*, pp. 254-257

<sup>15</sup> Savage, G.T. *et al*, 'Strategies for assessing and managing stakeholders,' (1991) 5(2), pp. 61-75

<sup>16</sup> Fooman, J. 'Stakeholder influence strategies'. (1999) 24(2), *The Academy of Management Review*, pp. 191-205.

<sup>17</sup> See for example the empirical study done by Karlsen, J.T. 'Project Stakeholder Management', (December 2002) Vol. 14 No. 4 *Engineering Management Journal*. This study determined that client's end users are the most important stakeholders.



As noted earlier, this is consistent with the definition offered by Winch above.<sup>18</sup>

Consistently, project management literature has realized the link between the success of projects and the project managers' ability to forge a fruitful alliance between these stakeholders and the end product, which is the project.<sup>19</sup> It is recognised for instance, that if stakeholders are not properly managed, the project proponents might not even understand a clear and comprehensive definition of the project. The project manager may therefore end up attaining project goals that were never intended by the stakeholders<sup>20</sup> and this will lead to negative reactions to the project.<sup>21</sup>

### **7.3. Theoretical basis for Stakeholder Engagement**

The theoretical foundations for stakeholder engagement can be traced to the stakeholder theory, which the thesis adopts as a basis for discussing stakeholder opposition risk. The reason is that due to the public nature of the services provided under PPPs, the need for partnership towards stakeholders is more pronounced. Also, the concept is the central theoretical perspective used in studying the influence and management of stakeholders in projects. Extant research on the

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<sup>18</sup> Ibid

<sup>19</sup> See for example Jergeas G.F. Supra Note 4; see also Achterkamp, M.C. and Vos J.F, 'Investigating the use of the stakeholder notion in project management literature, a meta-analysis' (2008) 26 *International Journal of Project Management* pp. 749–757

<sup>20</sup> Takim, R. Supra Note 7; Meredith, J.R. and Mantel, S.J. (2003) 'Project Management: A Managerial Approach,' 5<sup>th</sup> ed. John Wiley, New York pg. 34

<sup>21</sup> Black, K. 'Causes of Project Failure: A survey of professional engineers', *PM Network*, November 1996, pp. 21-24.

management of stakeholders draws nearly exclusively from this theory. To ignore the stakeholder theory, would therefore be to do away with valuable insights and rich contributions developed over the years in managing stakeholders in complex projects like PPPs.

### **7.3.1. The Stakeholder approach**

The foundation of the stakeholder theory is based on morality and pragmatism, i.e. that involving stakeholders in project decision-making is morally the right thing to do and that by doing this, the project manager is assured of the success of the project.<sup>22</sup> These principles also apply to the management of end user rights in PPPs. Social science stakeholder theory focuses on the concepts of justice, equity and social rights having a major impact on the way that stakeholders exert moral authority over project development.<sup>23</sup> The basis of the stakeholder theory itself is the principle that firms ought to be managed to take care of the interests of their various stakeholders which include shareholders, employees, customers, suppliers and communities in contrast to the erstwhile notion that managers are fiduciaries for and ought to manage firms in the interest of only shareholders.<sup>24</sup>

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<sup>22</sup> Gibson, K. Supra Note 14

<sup>23</sup> *ibid*

<sup>24</sup> Marcoux, A.M. 'A fiduciary Argument against Stakeholder Theory', (2003) Vol. 13 No. 1 *Business Ethics Quarterly*, pp. 1-24 Also (online) at <http://www.jstor.org/stable/3857856>; Freeman, R.E. (1984) *Strategic Management: A Stakeholder Approach*, Englewood Cliffs NJ, Prentice Hall Pg. 8

Ever since the concept of the stakeholder was made prominent in management literature through the seminal work of Freeman<sup>25</sup> in 1984,<sup>26</sup> discussions about the stakeholder theory has taken the discipline of business ethics by storm.<sup>27</sup> According to Donald and Preston, by 1995 there were about a dozen books and more than 100 articles with primary emphasis on the stakeholder concept.<sup>28</sup>

There are three dominating aspects of the stakeholder theory: the descriptive approach, the instrumental approach and the normative approach.<sup>29</sup> The descriptive approach describes the corporation as a constellation of corporative and competitive interests possessing intrinsic value<sup>30</sup> and describes whether stakeholder interests are being taken into account in the management of the corporation.<sup>31</sup> Instrumental approach is based on the interaction between stakeholders and managers of the firm. It assumes that corporations practicing stakeholder management will be relatively successful i.e. stakeholder management

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<sup>25</sup> Freeman R.E. *ibid*

<sup>26</sup> Freeman notes that Dill was the first to extend the stakeholder concept beyond such groups as shareholders and customers. See Dill, W.R. 'Public participation in corporate planning: Strategic management in a Kibitzer's world' (1975) 8(1) *Long Range Planning*, pp. 57-63

<sup>27</sup> Buchholtz, R.A. and Rosenthal, S.B. 'Towards a Contemporary Conceptual Framework for Stakeholder Theory'. (Apr-May) 2005 Vol. 58, No. 1/3 *Promoting Business Ethics, Journal of Business Ethics*, pp. 137-148.

<sup>28</sup> Donaldson, T. and Preston, L.E. 'The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications', (1995) 20(1) *Academy of Management Review*, pp. 65-91

<sup>29</sup> *ibid*

<sup>30</sup> *ibid*

<sup>31</sup> Gibson, K. *Supra* Note 22

will be instrumental to their success.<sup>32</sup> Normative approach is used to interpret the functions of corporations, including the identification of moral or philosophical guidelines for the operation and management of corporations.<sup>33</sup> It specifies the obligations that companies owe to their stakeholders. This strand of the stakeholder theory is predicated on the principle that corporations ought to consider stakeholder interests even in the absence of any apparent benefits.<sup>34</sup> Donaldson and Preston<sup>35</sup> claim that the normative branch of stakeholder theory is the central core of the theory and all other parts play a subordinate role.<sup>36</sup>

Jones and Wicks have however argued for a unification of these theories in what is widely referred to as the convergent stakeholder theory. This is based on their conviction that there are important connections amongst the different strands of the stakeholder theory and that the differences between the different features of the theory are not as sharp and categorical as Donald and Preston suggest.<sup>37</sup> The theory stresses the need for project managers to develop mutual trusting and cooperative relationships with shareholders and that their actions should

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<sup>32</sup> Gibson, K. Supra Note 31; Donaldson, T. and Preston L.E. Supra Note 28; Kaler, J. 'Differentiating Stakeholder Theories' (2003) Vol. 46 No. 1 *Journal of Business Ethics*, pp. 71-83

<sup>33</sup> *ibid*

<sup>34</sup> Gibson K. Supra Note 32

<sup>35</sup> Donaldson, T. and Preston, L.E. Supra Note 32

<sup>36</sup> This is disputed by the convergent theory; See also Freeman, R.E Supra Note 688

<sup>37</sup> Jones, T.M. and Wicks, A.C. 'Convergent Stakeholder Theory' (1999) 24(2) *Academy of Management Review* pp. 206-221

be based on ethical standards.<sup>38</sup> This convergent theory has been questioned by a number of commentators<sup>39</sup> for not being practical. However, even though Freeman doubts the usefulness of the convergent theory he supports the fact that all the branches of the stakeholder theory have all the elements of the others embedded in them and therefore refutes the fact that we can distinguish between the different branches of the theory.<sup>40</sup>

Stakeholder theory has been variously criticized.<sup>41</sup> Firstly, it is claimed that stakeholder theory is an excuse for managerial opportunism. By providing more groups for whom management may argue their cause, managers are more likely to engage in self-dealing than if shareholder theory was their sole purpose.<sup>42</sup> In response, it has been stated that stakeholder theory makes managers more accountable as they have more obligations and duties of care to more constituencies and therefore less likely to engage in self-dealing.<sup>43</sup> It is also pointed out that much of the current managerial opportunism that has been witnessed in

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<sup>38</sup> *ibid*

<sup>39</sup> Donaldson, T. 'Response: Making Stakeholder Theory Whole', (1999) Vol. 24 No. 2 *The Academy of management Review*, pp. 237-241; Gioia, D. 'Response: Practicability; Paradigms and Problems in Stakeholder Theorizing' (1999) Vol. 24 No. 2 *Academy of Management Review* pp. 228-233; Freeman E.R. 'Response: Divergent Stakeholder Theory' (1999) Vol. 24. No. 2 *Academy of management Review* pp. 233-236

<sup>40</sup> Freeman E.R. *ibid*

<sup>41</sup> For extensive discussions and replies to the various criticisms, see the following: Freeman, E.R. *et al*, *Stakeholder Theory: The State of the Art*, Cambridge, Cambridge University Press, 2010;

<sup>42</sup> Freeman, E.R. *et al* *Ibid*.

<sup>43</sup> *ibid*

recent times like Enron and WorldCom were done under the banner of shareholder maximization.<sup>44</sup>

Secondly, it has been argued that stakeholder theory is primarily concerned with the distribution of financial outputs as it deals primarily with who receives the resources of the organization. Consequently, it is contended that the theory poses a stark and inherent conflict between shareholders and other stakeholders in terms of who gets what.<sup>45</sup> In response, it is argued that distribution of resources is only a minor part of what the stakeholder theory is about. The critical part of the theory is about process and procedural justice. The type of distribution contemplated by the theory involves more than the distribution of financial resources. Information is also something that can be shared amongst stakeholders and this does not pit shareholders against other stakeholders.<sup>46</sup>

Thirdly, stakeholder theory is criticized on the grounds that its efficacy requires changes to current laws. The reason for this argument is that doing anything other than shareholder management is illegal and that if stakeholder theory is to be practiced without violating the law, there is need to amend present laws to accommodate the theory.<sup>47</sup> The

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<sup>44</sup> *ibid*

<sup>45</sup> *ibid*

<sup>46</sup> *ibid*; Freeman, E.R. and Phillips, R.A. 'Stakeholder theory: A libertarian defense', (2002) 12(3) *Business Ethics Quarterly*, pp. 331-349

<sup>47</sup> *ibid*

contrary argument presented is that whilst there may be useful reasons to consider various changes to the law to give efficacy to the theory, stakeholder theory does not necessarily advocate changes to present laws rather it works under the present legal regimes by the use of for instance, principles like the business judgment rule.<sup>48</sup>

### **7.3.2. Stakeholder Accountability Theory Approach**

It is obvious that the conventional stakeholder theory will not fit into the realm of PPPs without adjustments because the theory has its origins in the theory of the firm and is widely used in the discipline of business ethics and therefore relates principally to corporations. It considers the relationship between the firm and other claimants or influencers of its business interests who are not shareholders, whereas PPPs also involve the government or public sector as active players.

In PPPs, the government and private sector jointly assume the position of the managers of the firm under the stakeholder theory and the firm in this instance would be the infrastructure project or services. For this reason and also the vital nature of the infrastructure services provided under PPPs, It is safe to conclude that the government or public authority has an interest, if not a more overriding interest, in the success of the project. Therefore any appropriate theory in this area must effectively capture this element. The fact that PPP is a partnership between the public sector

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<sup>48</sup> Marens, R. and Wicks, A. 'Getting Real: Stakeholder Theory, Managerial Practice, & the General Irrelevance of Fiduciary Duties Owed to Shareholders', (1999) 9(2) *Business Ethics Quarterly*, pp. 272-293

and the private sector means that both parties are joint project owners and must collectively look after stakeholder interests. Indeed, the fact that the public authority (the government) is usually elected to look after these very stakeholder interests places a greater burden on the government.

The accountability stakeholder theory is derived from the stakeholder approach but is shaped by the unique interplay of relationships existing in PPP projects. The importance of the type of infrastructure projects consummated through PPPs to the wellbeing of citizens cannot be overemphasized. In fact, the provisions of some of these infrastructure services may be equated to the status of fundamental human rights, or at least fundamental services, which guarantee those rights such as water, electricity, and healthcare. The provisions of these services therefore form the bedrock of the social contract between the government and its citizens.<sup>49</sup> The nature of representative democracy that is prevalent in most countries around the world is predicated on elected representatives being completely representative of and accountable to the electorate. Since provisions of fundamental services are one of the cardinal reasons for the election of the government as the representatives of the people, they are accountable to the people on how they provide these services. When the government decides to

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<sup>49</sup> Social Contract theory is based on the fact that governments only exist to serve the will of the people and that the people are the source of all political power enjoyed by the government. The origin of social contract theory can be traced from the writings of Plato, Thomas Hobbes, Jean Jacques Rousseau, John Locke, John Rawls and more recently David Gauthier.



delegate these responsibilities to the private sector, they must also be accountable to the people on how they intend to do this. An agent (the government in this case) cannot sub-delegate its responsibilities without the consent of the principal (citizens) and consent that is not based on full disclosure and understanding is not valid consent.<sup>50</sup>

The duty of the government to account to and involve the citizens in decision-making is based on social contract and agency theories. The right of the citizens to be involved and informed can be said to be constitutional. It is based on these principles that this thesis argues that stakeholders' (at least, the public qua citizens) involvement in PPP is a constitutional right, and differs from other stakeholder theories because it should not be pursued merely because it is morally desirable to do so or because it guarantees the success of projects like the other business ethics stakeholder theories. Rather, it is accepted that both the private sector and the government ought to pursue stakeholder accountability because it is morally desirable, necessary for successful project delivery and also legally or even constitutionally obligatory on the part of government.

The advantages of the stakeholder accountability theory are that it extends the extant stakeholder theory as it recognizes the government as an active participant in the business of providing infrastructure and therefore also in the process of informing and engaging stakeholders.

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<sup>50</sup> Stakeholder Accountability theory can also be explained using the Agency theory.

The current practice, consistent with the theory of the firm, is that this responsibility is left solely in the hands of the private sector contractor since the private sector is the operator of the services. The theory also gives the citizens a legal and not just a moral right to be consulted and informed.

Presently, stakeholder theory has manifested in the principles of Corporate Social Responsibility (CSR) and the law has attempted some form of codification of the principle through the use of codes and regulations in different jurisdictions that target its optimization. It is expected that PPP laws would also follow suit and enshrine the principles of stakeholder accountability theory into law. As a note of caution, it must be mentioned here that in legislating for stakeholder accountability, PPP laws must delimit the extent of the responsibilities and the boundaries of the right of citizens to be accounted to so that for instance, vindictive stakeholders, motivated by other considerations that are not altruistic, do not hold the PPP transaction process captive unnecessarily.

#### **7.4. Stakeholder Opposition Risk**

It is not uncommon to hear that PPP projects failed due to opposition from stakeholders.<sup>51</sup> By its very nature, PPPs are very political and controversial primarily because they pursue the divesting of public

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<sup>51</sup> Olander, S. and Landin, A. 'Evaluation of Stakeholder Influence in the Implementation of Construction Projects', (2005) 23 *International Journal of Project Management*, pp. 321-328

control and the operation of public assets to a private sector operator. The citizenry usually do not take kindly to the divesting of “public treasures” in any way, whether through privatisation or PPPs. There is a need therefore to properly gauge the acceptance of the public for a project and find ways of mitigating any apprehension before the commencement of a project. It is for this reason that it is advocated that parties to a project must identify the risk that the public might be opposed to the project, evaluate it and allocate it appropriately. The public and private sector parties to the project must then commence a process of mitigating the risk by designing a stakeholder inclusion and consultation programme.

The present tendency is for the parties to allocate this risk to the private sector who suffer with reduced demand for the services in situations where the risk eventuates and therefore they are usually entrusted with the sole responsibility on consulting with the stakeholders. However, this is not in accordance with the stakeholder accountability theory, which presupposes the allocation of stakeholder risk between both parties. The reason is simply that in PPPs the public sector and private sector partners have different priorities in the project and this extends to the management of stakeholder interests. According to a study carried out in Malaysia, whilst the government favoured social and political matters as the most important aspects regarding managing stakeholder needs, the private sector was of the view that forming project coalitions and employing lobby tactics mechanisms was the best way to manage

stakeholder needs.<sup>52</sup> This is consistent with the views canvassed in this thesis that for the private sector, it is a moral obligation and business necessity to engage the public or end users, while for the government, it is also a moral as well as a legal duty. In essence, it is a risk that is better shared and mitigated jointly by both parties.

In his report to the United Nations Human Rights Council, John Ruggie, the UN Special Representative on Business and Human Rights stressed the significant costs associated with stakeholder resistance to companies operations. According to him, stakeholder challenges may lead to significant project delays, higher costs for financing and even project cancellations.<sup>53</sup> The risk of stakeholder opposition is therefore very real. This risk becomes further exacerbated under PPPs as these transactions also involve the public sector as partners of the private sector and therefore change the dynamics of public accountability in government decision-making and project delivery. Most times, the mere fact that private sector companies are taking over government functions may trigger public resistance. For instance, the Trans-Texas corridor transportation PPP project came under sever public opposition because of the equity involvement of foreign corporations.<sup>54</sup>

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<sup>52</sup> Takim, R. (2009) *Supra* Note 20 pp. 167-175

<sup>53</sup> United Nations General Assembly (2010) Report of the Special Representative of the Secretary General on Issues of Human Rights and Transnational Corporations and Other Business Enterprises- Ruggie, J. 'Business and Human Rights: Further Steps Towards the Operationalization of "Protect, Respect and Remedy" Framework. A/HRC/14/27 April 2010

<sup>54</sup> Forrer, J. et al 'Public Private Partnerships and the Public Accountability Question', (May/June 2010) *Public Administration Review*

According to Chan *et al*, one of the most significant risk factors for PPPs in China is public opposition risk.<sup>55</sup> The authors define public opposition risk as the various reasons leading to public interests being unprotected and damaged which in consequence causes the public opposition to the project success.<sup>56</sup> According to Li *et al*, this risk should be allocated to the public sector. According to them, this is because the chances of the risk eventuating in the UK are more remote than in most developing countries.<sup>57</sup> Ibrahim A.D. *et al* in their analysis of risk perception in PPPs in Nigeria ranked public opposition to PPP projects as the 53<sup>rd</sup> most important risk factor in Nigeria out of the 61 risk factors considered and opined that the allocation of the risk to either the private or public sector should be project dependent.<sup>58</sup> The facts on ground however, do not support this conclusion as the public has shown resistance to a number of privatization projects including the Lekki toll road concession, the case study in this chapter.

Public opposition to projects has occurred in many other projects in several countries. For examples, in Argentina, Aguas del Aconquija, a

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<sup>55</sup> Chan, A.P.C. *et al*, 'Empirical Study of Risk Assessment and Allocation of Public-Private Partnership Projects in China', (2011) *Journal of Management Engineering* pg. 137, (online) at: <http://www.meng-pm.org/wsg/Paper/AlbertChang-RiskAssessAndAllocationOfChinaPPPrisk.pdf> (last assessed on September 29, 2012)

<sup>56</sup> *ibid*

<sup>57</sup> Li, B. *et al*, 'The allocation of Risk in PPP/PFI Construction Projects in the UK', (2005) 23 (1) *International Journal of Project Management*, pp. 25-35.

<sup>58</sup> Ibrahim, A.D *et al*, 'The Analysis and allocation of Risk in Public Private Partnerships in Infrastructure Projects in Nigeria' (2006) Vol. 11, Issue 3 *Journal of Financial Management of Property and Construction* pp.149 – 164 pp. 149 - 163

subsidiary of Vivendi won a 30-year concession to run the water supply system in Tucumán in 1995. The private partner doubled water tariffs within a few months of taking over the concession in order to meet the aggressive investment requirements specified in the concession by the government. 80 percent of residents stopped paying their bills and In October 1998, the government terminated the concession.<sup>59</sup>

In 1999, the Bolivian government granted a 40-year concession to run the water system to a consortium led by Italian-owned International Water Limited and U.S.-based Bechtel Enterprise Holdings. Rate structures were immediately modified, putting in place a tiered rate and rolling in previously accumulated debt. As a result, many local residents received increases in their water bills. The private sector company maintained that the rate hikes would have a large impact only on industrial customers. However, the poor peasants claimed that increases as high as 100 percent were experienced. In October 1998, groups gathered in protests from which an outbreak of violence followed. During the protests, the Bolivian army killed as many as nine, injured hundreds, and arrested several local leaders. Subsequently, the government cancelled its contract.<sup>60</sup>

In Senegal, a national privatisation programme came to halt in 1994

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<sup>59</sup> The Encyclopedia of the Earth 'Support and Opposition of Public-private Partnerships, (online) at: <[http://www.eoearth.org/article/Support\\_and\\_opposition\\_of\\_public-private\\_partnerships#gen15](http://www.eoearth.org/article/Support_and_opposition_of_public-private_partnerships#gen15)> [last accessed September 29, 2012]

<sup>60</sup> *ibid*

after meeting with considerable resistance from the society at large. Stakeholders were not properly informed and therefore had concerns about the redistributive use of privatization proceeds amongst other issues.<sup>61</sup> In Bangladesh In 1990, the government neglected to involve local workers in the decision-making process to privatise a dockside warehouse. Uniform workers who feared losing their jobs opposed this move vehemently. The government's first communication with the workforce came too late and this led to the entire transaction stalling for years.<sup>62</sup>

## **7.5. CASE STUDY: LEKKI TOLL ROAD CONCESSION**

### **7.5. 1. Background**

The Lekki Toll Road Concession Project was awarded to the Lekki Concession Company (LCC); a Special Purpose Vehicle (SPV) set up by an indigenous finance company, Asset Resource Managers (ARM) with Macquarie Bank of Australia and Old Mutual of South Africa also shareholders. The project was consummated under the now repealed Lagos State Roads, Bridges and Highway Infrastructure (Private Sector

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<sup>61</sup> Oliver, C. *et al*, (1998) Privatization in Africa, Directions in Development series, World Bank, Washington, D.C (online) at: <http://siteresources.worldbank.org/INTFINDINGS/685507-1161268713892/21098649/find132.htm> (last accessed on September 29, 2012)

<sup>62</sup> Calabrese, D. (2002.) *Public Communication Programs for Privatization Projects: A Toolkit for Task Team Leaders and Clients*, Washington, D.C., The World Bank.

Participation) Development Act 2004<sup>63</sup> at a total project cost of USD\$340m.

The project is a 30-year Build Operate and Transfer (BOT) project for the upgrade, expansion and maintenance of approximately 49.4km of the Lekki Epe Expressway (Phase 1) and the construction of the 20km of Coastal road (phase 2). It was proposed that the new road would eliminate traffic congestion around the area, ensure for shorter journey times and better law enforcement around the project area. The project was financed using long-term debt and equity and the project cost is to be recovered principally through charging of user tolls.

The project was enabled by the provision of a =N=6.5billion abridged works guarantee and =N=5 billion mezzanine loan to LCC pledged by the Lagos State Government. Also the State Government waived all state taxes, charges, stamp duties and consent fees under the Land Use Act. The Federal Government also weighed in with a sovereign guarantee and Federal Support Agreement to ensure the bankability of the project.

LCC has so far completed the 4km stretch of road from the Law school end of Ozumba Mbadiwe to the Maruwa bus stop and set up a toll at the Admiralty road end but was initially unable to collect any tolls. The

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<sup>63</sup> This law was repealed by the Lagos State Roads (private Sector Participation) Authority Law 2007 which in turn has recently been repealed by the Lagos State Public Private Partnership Law 2011



residents in the Lekki area simply refused to pay any tolls. Toll collection was supposed to begin on 3<sup>rd</sup> of January 2011 and was to relate to only the completed portion of the road. However, after several protests by the residents, two weeks after its initial announcement of the commencement of the operation of the toll facility, the Lagos State Government announced the indefinite suspension of toll collection on the road.<sup>64</sup> Since then, several splinter stakeholder groups<sup>65</sup> have emerged either threatening to sue the government or have actually commenced legal proceedings against the government and the concessionaire.<sup>66</sup> Some of the stakeholder groups have even asked the government to terminate the contract and pay the concessionaire off.

On December 18 2011, the State Government reverted to the collection of tolls on the road. The government had been placed under considerable fiscal burden by having to pay shadow tolls to the concessionaire over the period. It was suggested by Governor Raji Fashola that the state had spent over ₦4b on shadow tolls<sup>67</sup> being money which could have been used in other developmental projects.

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<sup>64</sup> The Director General of the Lagos State Public –Private Partnership Office, Mr. Ayo Gbeleyi said that the suspension was to enable the State Government engage with the Concessionaire and other stakeholders

<sup>65</sup> Stake Holder Forum (comprising indigenes, businesses, and residents of the Lekki-Ajah axis of Lagos State and the Eti Osa Heritage Group

<sup>66</sup> For example a Lagos based lawyer and resident of the area, Egun Olu Adegboruwa went to court alleging fraud and challenging the government's right to toll the road as he considered the toll an infringement of his constitutional right to free movement. He also insisted that the Government should make available provisions of the contract for everyone to see and read. See Benson, D. 'Lekki/Epe Expressway Toll Plaza: Lagos Govt Violated our Fundamental Right to Protest – Adegboruwa' Vanguard Newspaper, December 22, 2011 pg.8

<sup>67</sup> This assertion was made by the Governor whilst presenting the 2012 budget. See This Day Newspaper, December 11, 2012

The decision to resume with the tolling of road, led to a massive protest by the residents of the area,<sup>68</sup> who were allegedly dispelled by thugs and policemen loyal to the State Government.<sup>69</sup> At the end of the protest, a number of people were severely injured and 23 people were arrested including a governorship candidate of the opposition party.<sup>70</sup> This has led one of the opposition parties in the state, Peoples Democratic Party (PDP), to call for the impeachment of the governor if he continues with the collection of tolls on the road.<sup>71</sup>

In carrying out a case study of the reasons for the stalling of the project, a number of affected parties were spoken to and newspaper articles and interviews were also relied on. To get a balanced view of the reasons for the dispute, the views of the State Government was also sought and obtained. In summary, the reasons given by the stakeholders for the imbroglio are:

Firstly, that the road sought to be tolled had always been in existence and was in fact constructed in 1982 by a previous government; therefore the whole process of upgrading and then collecting toll on an existing road was fraudulent. The opposing public argued that the State

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<sup>68</sup> Tagged "Occupy Lekki" See Sahara Reporters 'Occupy Lekki: Lagos Protests Against Lekki Toll Gate' (online) at: <http://www.saharareporters.com/news-page/occupy-lekki-lagos-protests-against-lekki-toll-gate> (last accessed August 12, 2013)

<sup>69</sup> Pedro, E. 'Nigerian Stars Support Lekki Protest' Daily Times Newspaper, December 18, 2012 pg. 15; Iremeka, C. 'Anxiety Mounts Over Second Toll Gate' The Guardian Newspaper, December 17, 2012 pg. 2

<sup>70</sup> Okoruwa, S. and Olabulo, O. '1 Killed, Many injured in Lekki Tollgate Protests' Nigerian Tribune Newspaper, December 18, 2011 Pg. 4

<sup>71</sup> Compass Newspaper 'PDP Calls for Fashola's Impeachment Over Lekki Toll Plaza Nigeria Compass Newspaper, December 16, 2011 pg. 12

Government and the Concessionaire ought to have constructed and tolled a new road entirely and not the existing one. Secondly, it was contended the toll rate - ranging from =N=120 to =N=350<sup>72</sup> depending on the type of vehicle - was exorbitant and led to a concomitant increase in bus fares.

Thirdly, that the publicised reason given by the government for the upgrading of the road which is to improve traffic congestion has not been achieved. The Concessionaire had increased the number of roundabouts to 10 and tolled the 49km road at 3 different spots. The stakeholders argued that the numerous roundabouts and the multiple toll plazas means that the traffic congestion will not abate but that it will only ensure the worsening of the present traffic situation.

Fourthly, that the government ought to have provided an alternative route before tolling the existing road. The Concessionaire argued that there is indeed an alternative route, through the Oniru Market Road. The stakeholder groups readily dismissed this position. They contended that any alternative route must run parallel with the existing road and that they must not be made to go through a complicated route to get to their homes and businesses. Again, that the decision to fence off the highway by the concessionaire was inconsiderate. The Concessionaire however argued that the decision to fence off the highway was for

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<sup>72</sup> Between 80 cents to 2.25 dollars

safety reasons; the stakeholder group alleges that the sole reason was to raise money through advertising on the erected walls.

Furthermore, it is averred that the erection of the toll plaza will artificially disconnect communities that have been socially and historically connected for a long time. In addition, the decision to start collection of tolls on a proposed 49km road, where only 4km of the total network was completed was unacceptable. That if any collection should take place at all that it should commence after the completion of the entire network of roads. The Concessionaire however says that it was allowed under the PPP contract to set up its toll plazas and begin collection at this point.

Also, that the financial arrangement is shrouded in a lot of secrecy and therefore the people suspect foul play by the government and the concessionaire. People question how much capital was employed in the project and in what proportion of debt to equity ratio and what exactly the relationship is between the concessionaire and some individuals within the government? Finally, the construction on the road constituted health hazards by contributing to flooding of houses around the area.<sup>73</sup>

The reasons listed above by concerned stakeholders about the project, whilst not completely accurate and objective is indicative of the ease

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<sup>73</sup> On July 5, 2011 there was a protest staged by residents of the area where some contractors working for the concessionaires were beaten up by an angry mob. Flooding caused the protests, which were experienced in the homes of a number of residents who alleged that the flooding was as a result of the on-going construction work. The concessionaire later issued a statement to the effect that it was not responsible for any of the flooding in the area.

with which improper or lack of stakeholder consultation may adversely affect a project. The lack of consultation and transparency in the project has left details of the project open to inaccurate conjectures. Indeed, sometimes it has been easier to get details of the project from people opposed to the project than from the government or the private sector partner and this has not helped the credibility of the project.

Firstly, it is argued that if the Lagos State government had engaged the public early enough before embarking on this project it would have been able to feel the pulse of the public. It would have decided early on whether the public actually wanted the project or not and on what terms if any they were willing to accept the project. Merely, dumping or forcing a project on to the public and then requiring them to pay toll fees is not a very wise decision. The issue of the availability of alternative routes could have been resolved prior to the commencement of the project. The fact that the State Government had to suspend collection of the toll in the first instance pending completion of the alternative route reinforces the argument that the project was commenced hastily without due consideration and consultations with stakeholders.

Secondly, it is obvious that the stakeholders never had any input into the design of the project nor the user charge they would pay for the use of the road. If they did, the issues of the multiple roundabouts and toll plazas would have been flagged very early in the initial stages of design and compromise arrangements reached. There could have also been a

robust debate about the merits or otherwise of erecting fences on the highway and a compromise decision reached, rather than the residents now dreading that the fence would alienate them from their kith and kin on the other side of the fence. There should also have been consultation on user charges. The decision to unilaterally fix user charge without input from the public also affected the project.

Thirdly, the stakeholders were not involved in the procurement or tender stage in any shape or manner; this has led to a high level of distrust and allegation of fraud and corruption. This does not help anyone of the parties. There are reports though, that there was actually a tender process where only three companies participated. Opposition claims differently and alleges that the procurement was conducted in secret so that the government would concession the road to its cronies.

There is dispute regarding when the concessionaire should start collecting tolls on the road. Whilst the stakeholders argue that it should be after the entire 49km of road is fully completed, the concessionaire argues that they were allowed under the Concession Agreement to start toll collection even though only less than 10 per cent of the road had been completed. It does not help the government and the concessionaire that the public is trying to second-guess the content of an Agreement made for their benefit. Whilst conceding that the concessionaire might have some confidential issues which it might not want in the public domain, the essential portions of this contract could

have been made available to members of the public. This will not only reduce the level of public mistrust but will also give the public better parameters with which to evaluate and monitor the concessionaire.

From the case study it is discernible that this project is in its present state of impasse because of the lack of stakeholder engagement and management. Stakeholder opposition risk in the project was not identified and dealt with properly at the beginning of the project. Neither was it properly allocated to any of the parties to the project and therefore not properly mitigated. The private sector party however claimed to have done some form of stakeholder consultations but there is no evidence of this. The consequences of not dealing with this risk is gradually manifesting in the chaos and discontent. The full consequences might yet be worse.

Indeed, due to lack of public support for this project, there is great fear that the project will not survive especially if a different political party assumes power in Lagos state in the 2015 elections. Therefore, it is still important for the initiation of serious engagement with stakeholders to convince them to buy into the project. Some of the genuine concerns by the stakeholders should be addressed and compromise solutions found, it might not be the same as doing it very early in the life of the project but it will help. The alternative will be for the Government and its private sector partner to resort to the use of force to continue to compel the public to accept the project as it presently is and it is doubtful

whether the project and the private sector will not pay for this in the future when the present administration leaves political office.

### **7.5.2 Analysis**

Using the framework developed by Abednego<sup>74</sup> and discussed extensively in chapter 5 of this thesis, we test below whether the stakeholder risk in the Lekki toll road concession project has been allocated to the right party (the who question), at the right time (when) and allocated in the proper way (how question).

#### **Was the stakeholder opposition risk allocated to the party with the best capability to control the events that might trigger its occurrence?**

There is no evidence that there was a formal or conscious decision to allocate this risk to either party in this project. There is also no evidence that this risk was even identified by the parties during the planning stages of the project. Whilst it is obvious that the state government had not consulted with any section of the public on the project, LCC alleges that it consulted stakeholders, albeit not extensively. However, there is no evidence of such consultation. In another vein, the government's decision to pay shadow tolls to LCC when toll collection was suspended as a result of the public protests suggests that this risk was either originally allocated to the government or allocated to LCC, who mitigated the risk

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<sup>74</sup> Abednego, M.P. and Ogunlana, S. 'Good Project Governance for Proper Risk Allocation in Public Private Partnerships in Indonesia', (2006) *International Journal of Project Management*, 24 (7) Pg. 622



by ensuring that the government assumed responsibility for losses suffered by LCC from stakeholder opposition or the emergence of similar situations.

Therefore, it is difficult to determine the basis on which the government assumed the consequences of risk; whether it was contractual or as compensation to the private sector since the government had assumed political risk of the project, which also included riots and strikes, or perhaps as a compromise arrangement between the parties.

In conclusion, from the foregoing, it is safe to say that this risk was probably not allocated at all and definitely not shared between both parties in the manner suggested by this thesis. However, one thing that is clear is that the State Government assumed the consequences of the risk eventuating by spending =N=4billion<sup>75</sup> as compensation through the payment of shadow tolls to LCC. Therefore, in the final analysis it can be said that the risk was assumed by the party with the best capability to shoulder its consequences even though not initially allocated the risk. Despite shouldering the risk, the government was not the only party that was in control of the events that triggered its occurrence.

### **Was the risk properly identified, understood and evaluated?**

There is no indication that stakeholder risk was identified. There was also no indication that it was understood and evaluated. This is because both

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<sup>75</sup> Approximately USD 25,400,000.

the state government and its private sector partner seem to have been taken unawares when the residents of the area who are the primary users of the facility voiced opposition to the project.

**Does the party to whom the risk was allocated have the technical/managerial capability to manage the risk?**

It seems that the risk, even though not assumed by any of the parties, appeared to have been managed by the private party. However, there are doubts that LCC has the competence to manage the risk. LCC seemed to be more comfortable with performance of its CSR obligations rather than actively engaging with end-users. The only indication that it involves in any form of stakeholder management is a statement on the company website after the protests that reads:

Lekki Concession Company (LCC) is committed to operating and managing its business in an ethical manner and to contributing to economic development while improving the quality of life of its various stakeholders - ranging from its internal human capital to the local communities in which it operates and society at large - to produce an overall positive impact on society.<sup>76</sup>

This is obviously not the best way to handle the risk and therefore confirmation that the private sector party does not have the technical or managerial capacity to manage the risk.

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<sup>76</sup> Lekki Concession Company (online) at: <<http://www.lcc.com.ng/tolls.asp?pid=22>> [last accessed on August 22, 2012]

**Does the party have the financial ability to sustain the consequences of the risk or prevent it from occurring?**

While LCC lacked the financial ability to sustain the consequences of the risk, it is believed that it did not have enough resources to prevent it from occurring. The government appeared to have undertaken responsibility for the consequence of the risk occurring. They obviously also had the financial ability to sustain the consequences of the risk because they continued to pay shadow tolls until they were able to compel the road users to start paying.

**Is the party willing to accept the risk?**

The private party seemed willing to assume the risk provided that the government bears the financial consequences of the risk occurring. In real terms therefore, it only accepted this risk at a huge premium. This risk allocation scheme is not efficient because the party that assumed the risk is not the party bearing the consequence of its occurrence. It therefore blunts the incentive of the private sector to prevent the risk from eventuating.

**Whether the risk was allocated at the appropriate time (when question)?**

The circumstances appear to suggest that the risk was not allocated at the beginning of the project when it ought to have been allocated. The risk allocation strategy adopted was never designed to prevent the risk from arising but was reactionary, aimed at problem-solving following the

materialization of the risk.<sup>77</sup> Ideally, stakeholder consultation should start from project conception stage all through to the operational phase of the project. The incidence of the risk was only born by the government after the public revolt. The government had to step in to save the project from total collapse because it had also given guarantees and loans, which meant that its own finances were also at stake.

**Whether the process used in allocating the risk was appropriate (how question)?**

There is no evidence that the process used in allocating the risk was appropriate. As pointed out above, there is a discordance between the party that managed the risk and the party that bore the actual consequence of the risk.

**7.6. Prerequisites for Adequate Stakeholder Risk Management**

On the basis of the stakeholder accountability theory, it is the position of this thesis that PPPs are multifaceted and complicated long-term investment projects that involve the ceding of risks, rights and responsibilities which hitherto resided with the public and were held in trust on their behalf by their governments. Governments do not therefore have the moral or even constitutional right to cede these powers to the private sector without any recourse to the public who actually own these rights and conferred the responsibilities. It is on this basis that this thesis

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<sup>77</sup> See for example Abednego, M. and Ogunlana, S. (2006) Supra Note 74

argues that stakeholder consultation and involvement is not merely desired good governance or moral practice but even a constitutional right of the citizens. By its nature, PPPs entail a partnership. It is argued that this partnership is in real terms between the citizens (represented by their governments) and the private sector; not between the government who are merely agents of the people and the private sector.<sup>78</sup> It is for this reason that the government must therefore ensure that it actively engages the citizens and keeps them informed.

There is no uniform or formal systematic stakeholder management approach discernable from available literature.<sup>79</sup> What we have is a random affair,<sup>80</sup> characterised by spontaneity and causal action which usually leads to unpredictable outcomes.<sup>81</sup> Several authors<sup>82</sup> have however proposed various models for managing stakeholders during projects. Their suggestions range from identification; analysis of characteristics and influence of stakeholders on a project; developing

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<sup>78</sup> See also Hayler, M.R. 'Public-Private Partnerships in Hong Kong: Good Governance – The Essential Missing Ingredient', (March 2010) Vol. 69 *The Australian Journal of Public Administration*, pp. S99 -S119

<sup>79</sup> Terje, K.J. 'Project stakeholder management', (2002) 14 (4), *Engineering Management Journal*, pp.19–24.

<sup>80</sup> Chinyio, E.A. and Akintoye, A. 'Practical approaches for engaging stakeholders: findings from the UK' (2008)26 (6), *Construction Management and Economics*, pp. 591–599.

<sup>81</sup> Karlsen, J.T. 'Project Stakeholder Management', (December 2002) Vol. 14 No. 4 *Engineering Management Journal*

<sup>82</sup> Terje, K.J. (2002) *Supra Note 79*; Elias, A.A. *et al.*, 'Stakeholder Analysis for R&D project management', (2002) 34 (2) *R&D Management*, pp. 301–310; Young, T.L. (2006) *Successful Project Management*, 2<sup>nd</sup> ed. Kogan Page, UK; Bourne, L. and Walker, D.H.T. 'Visualizing stakeholder influence—two Australian Examples', (2006) 37 (1), *Project Management Journal* pp. 5–22; Walker, D.H.T *et al.*, (2008) 'Stakeholder and the supply chain.' In: Walker, D.H.T and Rowlinson, S. (Eds.), *Procurement Systems: A Cross-industry Project Management Perspective*, Taylor & Francis, UK, pp. 70–100

an engagement strategy; communicating and sharing information with them to monitoring and evaluating the effectiveness of the engagement strategy. These models have been criticised for being based on superficial rather than deep knowledge.<sup>83</sup> Therefore, it has been advocated that these guidelines should be considered as conceptual frameworks rather than instructions on how to do real world stakeholder analysis.<sup>84</sup> There is no single most effective approach<sup>85</sup> and the selection of a particular method or strategy should be based on the particular context.<sup>86</sup>

In a similar vein, there has been robust study of the critical success factors for stakeholder management. For example, Jergas<sup>87</sup> after carrying out an empirical study found that communication with stakeholders and setting common goals, objectives and project priorities can improve the performance of project stakeholder management. Olander and Landin<sup>88</sup> compared the project stakeholder management of two railway development projects in Sweden and identified five crucial factors for implementing stakeholder management. These

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<sup>83</sup> Jepsen, A.L and Eskerod, P 'Stakeholder analysis in projects: Challenges in using current guidelines in the real world', (2009) 27 *International Journal of Project Management* pp. 335–343

<sup>84</sup> *ibid*

<sup>85</sup> Yang, J. *et al.*, 'Stakeholder management in construction: An empirical study to address research gaps in previous studies', *International Journal of Project Management* 29 (2011) pp. 900–910

<sup>86</sup> *ibid*; Bourne, L. and Derek, H.T. Walker, 'Using a Visualising Tool to Study Stakeholder Influence- Two Australian Examples, *Supra* Note 82

<sup>87</sup> Jergas *Supra* Note 19

<sup>88</sup> Landin, O.S. 'A comparative study of factors affecting the external stakeholder management process', *Const. Manage. Econ.* (2008) 26(6) pp. 553-561

include analysis of stakeholder concerns and needs, communication of benefits and negative impacts, evaluations of alternative solutions, project organisation and media relations. Jepsen and Eskerod<sup>89</sup> were of the opinion that identification of sufficiently important stakeholders and warranting information gathering concerning expectations is critical to meet the challenge of project stakeholder management. Yang et al<sup>90</sup> were most comprehensive and prioritised 15 critical success factors for project stakeholder management. According to them, the most critical were “managing stakeholders with social responsibilities”, “assessing the stakeholder needs and constraints to the project” and “communicating with stakeholders properly and frequently”.

If there is any coherent model discernable from these authors, it is that stakeholder engagement or involvement means adopting a stakeholder participatory approach. This entails engaging and involving stakeholders meaningfully at every stage of the project as early as from the project inception stage up to post project monitoring stage. Initiating early and constant communication with various stakeholders is key to the success of infrastructure projects.<sup>91</sup> Also, capturing the inputs obtained from

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<sup>89</sup> Jepsen, A.L. and Eskerod, P. Supra Note 83

<sup>90</sup> Yang, J. *et al.*, ‘Critical success factors for stakeholder management: construction practitioners’ perspectives’, (2010) 136 (7) *Journal of Construction Engineering Management*, pp. 778-786; Yang, J. *et al.*, ‘Exploring critical success factors for stakeholder management in construction projects’, (2009) 15(4) *Journal of Civil Engineering Management*, pp. 337-348.; Yang, J. *et al.*, (2011), Supra Note 85

<sup>91</sup> Bakens, W. *et al.*, ‘Engaging stakeholders in Performance- based building: lessons from the Performance-Based Building (PeBBu) Network’, 33 (2) *Building Research & Information*, pp. 149–158. ; Jergeas, G. E. *et al.*, Supra Note 681, pp. 1-12.5; Olander, S. Landin, A. ‘A comparative study of factors affecting the external stakeholder management process’, (2008)26 (6)*Construction Management and Economics*, pp. 553

stakeholders as a result of that communication process, and incorporating them into the execution of the project is a crucial aspect of the project development process and must be taken seriously. It is important to note and integrate the concerns of stakeholders into the execution of the project. This will better facilitate the development of a project that will meet the needs of the stakeholders and not just execute what the government or the private sector entity thinks is what the public desires.

Also it is important that the public is assured that their concerns are taken seriously. Participatory decision-making has been found to generate better buy-ins, thereby limiting delays, mistakes and eventual lawsuits that delay whole projects.<sup>92</sup> It helps create trust and there is sufficient evidence that stakeholders are more likely to accept a decision reached in a participatory manner even when it is not the individually preferred outcome, because they believe it was reached in a fair manner.<sup>93</sup> Finally, it is evident that the particular method used to engage stakeholders depends on several factors including the nature of the

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<sup>92</sup> Moynihan, D.P. 'Normative and instrumental perspectives on public participation: citizen summits in Washington, D.C.', (2003) Vol. 33 *American Review of Public Administration*, pp. 164–88; Kweit, M.G. and Kweit, R.W. 'Participation, perception of participation, and citizen support' ,(2007) Vol. 35 *American Politics Research*, pp. 407–25

<sup>93</sup> Bies, R.J. and Shapiro, D.L. 'Voice and justification: their influence on procedural fairness judgments,' (1988) Vol. 31 (3) *The Academy of Management Journal*, pp. 676–85; Tyler, T. and DeGoey, P. 'Collective restraint in social dilemmas: Procedural justice and social identification effects on support for authorities', (1995) Vol. 69 (3) *Journal of Personality and Social Psychology*, pp. 482–97; Smith, P.D. and McDonough, M.H. 'Beyond public participation: fairness in natural resource decision making', (2001) Vol. 14 (3), *Society & Natural Resources*, pp. 239–49.



project, the resources available for the project and the objectives to be attained from the engagement.<sup>94</sup>

From a project risk management perspective, stakeholder opposition risk should be clearly identified very early in the project through the use of risk matrixes.<sup>95</sup> The risk should also be shared appropriately between the parties and not just allocated to the private sector as occurred in the case study above.

When PPP projects fail because of stakeholder opposition, they are usually because:

1. The public is unaware or fails to understand the reasons behind the project or completely do not understand the project.
2. No.(1) above happens because the public are not properly informed about the project
3. No. (2) above would most likely happen because the public are denied access to detailed information relating to the project.<sup>96</sup>

Stakeholders have concerns that cut across every stage of the project and therefore must be actively engaged and encouraged during every stage of the project.

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<sup>94</sup> Yang, J. *et al* Supra

<sup>95</sup> See Chapter 3. for a discussion of risk matrix

<sup>96</sup> *ibid*

#### a) Project Tender Stage

At this stage, stakeholders have concerns about the nature, objectives and rationale for the project, the relative costs and identification of those to whom the costs might fall.<sup>97</sup> Value for money and loss of jobs considerations are also of concern to stakeholders at this stage. Lack of or inadequate consultation at this stage may lead to suspicion of collusion, fraud, corruption and favouritism against the government, as was the case under the Lekki toll road project. Accordingly, failure to sufficiently involve and consult with potential stakeholders can lead to distrust from the public, conflict of interests and ultimately project failure.<sup>98</sup> Sometimes, enthusiasm for PPPs can give rise to hastily crafted partnerships that are likely to trigger public opposition.<sup>99</sup>

#### b) Project Design

At this stage stakeholders are concerned about design efficiency and whether for instance; designs are going to affect the culture, values, traditions, religion and heritage of the people. One of the complaints raised by stakeholders against the Lekki Concession was that the toll plazas artificially disconnected communities that have been socially and historically connected over a long time.

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<sup>97</sup> Hayllar, M.R. 'Public-Private Partnerships in Hong Kong: Good Governance- The Essential Missing Ingredient?', Vol. 69, no 51 *The Australian Journal of Public Administration*, pp. S99-S119 at pg. S99

<sup>98</sup> OECD (Organisation for Economic Cooperation and Development) 2007 OECD Principles for Private Sector Participation in Infrastructure

<sup>99</sup> Forrer, J. *et al* Supra Note 54 pp. 475-485

Another example will be a situation where for instance, innocently designing a National monument to look like a Mosque might offend the sensibilities of a section of Christian communities in a multi-religious country like Nigeria and this may derail an otherwise good project. Such concerns can be flagged early and necessary adjustments made to address the issues. The private sector is advised to adopt a high degree of transparency and provide as much information as possible regarding technological options, costs etc.<sup>100</sup>

### c) Construction

At this stage the stakeholders are concerned about how construction activities by the private sector impact on their daily routine and lifestyle. For instance, there might be concerns about issues such as environmental degradation, public nuisance and traffic congestion. These were all issues that affected the Lekki toll road project. Also, there might also be concerns relating to whether projects are going to be delivered within the stipulated and agreed timeframes.

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<sup>100</sup> OECD (2007) 'OECD Principles for Private Sector Participation in Infrastructure' (online) at: <http://www.oecd/investment/investmentpolicy/38309896.pdf> (Last accessed on September 29, 2012)

#### d) Post Project Monitoring

Issues of service efficiency, adequate regulation, contract violation and variation may cause concerns for stakeholders. It is vital at this stage that targets and key performance indicators are set out. This will lead to better accountability and will enable the stakeholders to better monitor and evaluate the project<sup>101</sup>.

Stakeholders should actively be encouraged to participate in every step of the project especially from project conception and all through to implementation and monitoring. The public should have a say on whether a particular project is initiated or not. If the public take a decision to go along with the project, their input in the PPP decision-making process and any suggested alternative course of action advised by them ought to be taken on and be seen to have been incorporated in the final decisions taken with respect to the project. It also makes sense on the part of government to bring in end-users and the private sector involved in providing the service together as early as possible. That way, both parties reach consensus early and their objectives, needs and concerns can be identified and addressed fully in project execution.<sup>102</sup>

Due to differences in the project objectives of the private sector and

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<sup>101</sup> This is limited by the fact that PPP contracts are usually very complex and difficult to understand and that the private sector might insist that certain aspects of the contract is confidential and therefore limits the amount of the information that may be in the public domain.

<sup>102</sup> The Guidebook on Promoting Good Governance in Public Private Partnerships, Supra

that of the public sector and also members of the public, there is bound to be disagreements. Therefore, it is essential to provide avenues for resolving differences in the PPP decision-making process which are ultimately bound to occur, between the private sector and the public before they develop into full-blown disputes.

An important resource for stakeholder engagement in PPPs is the Organization for Economic Cooperation and Development (OECD) principles for Private Sector Participation in Infrastructure<sup>103</sup> which also recommends most of these doctrines discussed above. Countries like Nigeria, aspiring to use PPPs as a method of infrastructure finance should look towards adopting several of them. The Council of the OECD<sup>104</sup> on 20 March 2007, approved the OECD principles for Private Sector Participation in Infrastructure to help governments work with private sector partners to finance and bring infrastructure projects to fruition in areas such as transport, water, power supply and telecommunications.<sup>105</sup>

The principles were developed through a process of consultation with broad groups of public and private sector experts from OECD and non-OECD countries as well as from non-governmental organisations.<sup>106</sup> They

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<sup>103</sup> OECD principles for Private Sector Participation in Infrastructure, Supra Note 100

<sup>104</sup> A forum where the government of 30 democracies work together to address the economic, social and environmental challenges of globalization.

<sup>105</sup> Preamble to the OECD principles for Private Sector Participation in Infrastructure, Supra Note 103

<sup>106</sup> *ibid*

provide a template for the improvement of governance in Private Sector Participation in infrastructure as well as a tool for government assessment, action plans, reporting international cooperation and public private partnerships.<sup>107</sup> Of particular interest to this thesis are Principles 3, 9, 13, 23 and 24.

*Principle 3: The allocation of risk between private parties and public sector will be largely determined by the chosen model of private sector involvement, including the allocation of responsibilities. The selection of a particular model and an associated allocation of risk should be based upon an assessment of the public interest.*

This principle summarises the principal theme of this section of the thesis, which is that risk allocation should not be based only on commercial principles; the interest of the public should also be taken into consideration.

*Principle 9- Public Authorities should ensure adequate consultation with end-users and other stakeholders including prior to the initiation of an infrastructure project.*

PPPs are likely to fail unless public authorities have assured themselves before hand that the projects are for public interest and are acceptable to consumers and other stakeholders.<sup>108</sup> This involves consultation with all affected parties especially if the transfer of infrastructure services to the

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<sup>107</sup> *ibid*

<sup>108</sup> OECD (2007) 'OECD Principles for Private Sector Participation in Infrastructure' (online) at: <<http://www.oecd/investment/investmentpolicy/38309896.pdf>> [Last accessed on November 27, 2012]

private domain is linked with a cessation of subsidies as consumers may see this as a denial of well-earned rights.<sup>109</sup>

*Principle 13-To optimize the involvement of the private sector, Public Authorities should communicate clearly the objectives of their infrastructure policies and they should put in place mechanisms for consultations between the public and private sectors regarding these objectives as well as individual projects.*

*Principle 23- Private sector participants should contribute to strategies for communicating and consulting with the general public including vis-à-vis consumers, affected communities and corporate stakeholders with a view to developing mutual acceptance and understanding of the objectives of the parties involved.*

Corporate approaches to communication and consultation with the public and other affected persons generally work better when applied in concert with rather than in lieu of public sector communication strategies.<sup>110</sup> End users should have appropriate access to information about the financial and technical aspects of the project and get a chance to make their priorities heard. If this is not done, the public might respond with hostility to tariff adjustments and any other shortfall in services relative to expectations, potentially leading to a backlash against both the government and the private sector partners.<sup>111</sup>

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<sup>109</sup> Ibid. This explains some of the reasons for public revolt to the Lekki toll road concession.

<sup>110</sup> Ibid. In the Lekki Concession, the entire process of stakeholder consultation was left solely to the private sector.

<sup>111</sup> Ibid

*Principle 24- Private sector participants in the provision of vital services to the communities need to be mindful of the consequences of their actions for those communities and work together with public authorities to avoid and mitigate socially unacceptable outcomes.*

Issues such as affordability of services and promoting and upholding of human rights are some of the issues that the private sector should pay attention to.<sup>112</sup> Private parties, whilst not being directly responsible for these issues, must show willingness to take into account these concerns whilst engaging with the public sector in PPP transactions.

These principles provide a broad outline and create responsibilities for both the public and private sectors in the stakeholder engagement process. It is recommended that Nigeria, despite not being a member country of the OECD, will use these broad guidelines in developing a comprehensive framework for stakeholder engagement.

### **7.7. Stakeholder Engagement in PPPs In Nigeria**

The National Policy on PPPs recognizes the need for public interest consideration in PPPs. It provides as follows:

1. Public authorities should ensure adequate consultation with end-users and other stakeholders prior to the initiation of an infrastructure project.
2. Private sector participants in a PPP project will contribute to strategies for communicating and consulting with the general

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<sup>112</sup> *ibid*



public, customers, affected communities and corporate stakeholders, with a view of developing mutual acceptance and understanding of the objectives of the public and private parties.

3. Private sector contractors in the provision of vital services to the communities need to be mindful of the consequences of their actions for those communities and work together with the public authorities, to avoid and mitigate socially unacceptable outcomes.<sup>113</sup>

Despite these express provisions, in practice scant attention has been paid to this very important aspect of the National Policy. The reasons for this may be traced to the very foundations of PPP in Nigeria. The government has always seen the use of PPPs primarily as a means of raising the much needed off-budgetary finance for infrastructure projects. The other associated advantages that come with PPPs such as better value for money and better service delivery have only recently been articulated for the first time and encapsulated in the PPP national policy document. Hitherto, the idea had been basically to “dump” the project, risks and other project responsibilities to the private sector and utilise the money saved for other pressing needs. There is perhaps now a need to codify the requirement for public consultation in a legal instrument, taking cognisance of the stakeholder accountability theory articulated in this thesis.

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<sup>113</sup> National Policy on Public Private Partnership, *Supra*

When a government decides to enter into long-term PPP contracts, it inevitably cedes some of the constitutionally rights granted by its citizens through the electoral process and constitutionally guaranteed obligations it owes its citizens, to the private sector. Unlike elected governments, the private sector owes no duty to the people beyond that which have been documented in a contract, which in any case most times is hidden away from the people in the guise of protecting private sector confidentiality. This can lead to the public feeling completely alienated in the whole PPP process.

Again, most long-term contracts usually contain clauses that are designed to protect the income of the private sector like stabilization clauses<sup>114</sup> and non-compete clauses.<sup>115</sup> These clauses have the effect of for instance, preventing the passage of new laws that will adversely affect the revenue of the private sector investor. Neither the executive nor the legislature has the power to cede this constitutional right to make or execute laws. It is argued that if indeed there is a need to enter into such a contract where these rights or obligations are going to be curtailed, then only the citizens to whom those obligations are owed or who bestowed the right on the government in the first place, should be

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<sup>114</sup> These clauses are risk management devices used to stabilize the expectations of investors for instance preventing changes in the laws from adversely affecting the investment contract during the term of the investment. Depending on which side you are, stabilization clauses are either an absolute necessity or out rightly dubious

<sup>115</sup> Some PPP contracts prevent the building or improvement of competing infrastructure in order to leave no alternative but using the private sector's infrastructure and thus guaranteeing its revenues. See generally Dannin, E. (2009) 'Infrastructure Privatization Contracts and Their Effect on Governance', *The Pennsylvania State University, The Dickson School of Law, Legal Studies Research Paper No.19-2009*, pg. 9.

allowed to decide. This further emphasises the constitutional right of the public to be properly engaged and consulted throughout the private sector engagement process.

This problem enumerated in the case study above is not unique to the Lekki Road Concession Project; it is prevalent in nearly all the PPP projects in Nigeria. In fact, the problem dates back to the privatization era under BPE. However, the limited consultation in that case may be excused because of the complete transfer of the public asset that occurs under privatisation. The same conditions that dictate the limited method of stakeholder engagement during privatisation is non-existent in PPPs. PPPs require a higher degree of stakeholder involvement and the government should build in a mechanism for early, useful and real stakeholder engagement into its PPP procedures and rule books. The present practice of merely paying lip service to the need for stakeholder engagement in the different PPP Policies is not enough. There should be a detailed exposition of how the engagement of stakeholders would take place in practice and the consequences of not following them.

Partnership Victoria in Australia has a best practice procedure that is recommended by the Guidebook on Promoting Good Governance in Public- Private Partnerships.<sup>116</sup> Under this practice, the decision on whether or not a PPP should go forward or not depends on three questions:

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<sup>116</sup> *ibid*

1. Which, if any part or parts of the proposed service, is a service that the government itself should deliver to its citizens? ( the core service question)?
2. For all other aspects of the service and supporting physical infrastructure, what is the project model that delivers the best value for money (the value for money question)?
3. Do the outcomes of the value for money question satisfy the public interest criteria articulated in the policy? If not, can the public interest criteria be satisfied by either building safeguards into the contract or through regulatory measures (and at what cost)? Or should the project be reconceived to 'reserve' further areas of service for provision directly by the government (the public interest question)?

The PPP process must put people first. Government and the private sector must communicate with affected stakeholders to develop mutual understanding of the project objectives. This is crucial for the private sector as well as its public sector partners. For the private sector, stakeholders play a very important role in their success; they pay the user charges that ensure that they recover their investments and make a profit for their shareholders. Opposition to the project might limit its ability to do this. For the government, the stakeholders qua citizens are responsible for putting them into power and the success of most governments depends on what the citizens perceive as the

government's achievements. Where the public have doubts about government policies, it may mark the end of the particular government. From a project governance perspective, the public can play an active role in improving project accountability and service quality. The people may not just play the role of service receivers but can also be active service partners<sup>117</sup> and this can happen only when they are properly engaged.

PPPs are usually complex and difficult to understand. This problem is even more pronounced in a country like Nigeria where PPP is a novel concept and there is greater suspicion and lack of trust because of government's antecedents. Perhaps the government and the private sector need to invest a little bit more in educating the people about the nature and merits of PPPs so that they are equipped to play a more participatory role in the process which affects their lives more than that of the government officials who make these decisions on their behalf.

## **7.8. Conclusion**

This chapter examined stakeholder opposition risk. Firstly, it compared the use of the term "public opposition risk" and "stakeholder opposition risk" in different literature and opted for the use of the term "stakeholder opposition risk" because of its wider scope and theoretical foundations.

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<sup>117</sup> Ahmed, S.A. and Ali, S.M. 'People as Partners: Facilitating People's Participation in Public Private Partnerships for Solid Waste Management', (2006) 30 *Habitat International*, pp. 781-796.

The chapter emphasizes the correlation between the success of projects and proper stakeholder management. It points out that this is even more relevant under PPPs because PPPs are very political and controversial, primarily because it pursues the divesting of public control and the operation of public assets to private sector operators. There is therefore a need to properly gauge the acceptance of the public for a project and find ways of mitigating any apprehension before the commencement of a project; otherwise there is a risk that the public will oppose the project.

The chapter further advocates for the extension of the stakeholder theory into the stakeholder accountability theory as the theoretical basis for analysing stakeholder opposition risk in PPPs. This is because both the private sector and the government ought to pursue stakeholder accountability not only because it is morally desirable and necessary for successful project delivery but also because it is legally or even constitutionally obligatory on the part of government.

Finally, the case study of the Lekki toll road concession reveals that stakeholder opposition risk is not being properly managed in Nigeria. The project nearly collapsed for this reason and continues to suffer credibility issues arising from this lack of consultation. This further emphasizes the need for proper risk allocation and mitigation as a *sin qua non* to the emergence of good projects in Nigeria.

## **CHAPTER 8**

### **CONCLUSION**

#### **8.1 Introduction**

This thesis examined how project risks have been managed in PPP projects in Nigeria. Its hypothesis or central argument is that a fundamental cause of the failures of the few PPP projects that have been completed in Nigeria so far is the lack of proper management of risks. The main proposition of the thesis is that the quality and sustainability of PPP projects in Nigeria will be enhanced if risks in the projects are better managed i.e. identified, evaluated, allocated and mitigated. The thesis aims to fill a gap in extant research by identifying why PPP projects in Nigeria have not recorded the expected successes through the lens of risk management. Furthermore, the research, aims to proffer suggestions on how future PPP projects in Nigeria can avoid the pitfalls of the past by highlighting the importance of proper risk management.

In the light of the forgoing, the thesis pursued the following objectives:

1. To determine the most critical requirements for successful PPP projects.
2. To discover the perception of the parties on proper risk allocation
3. To investigate and analyse risk allocation schemes and how they affect PPP projects in Nigeria.

4. To suggest better ways, based on international best practices and local conditions, on how to manage risks in PPP in Nigeria.

From these research objectives, three principal research questions were constructed:

1. Does better risk identification, evaluation, allocation and mitigation lead to better PPP projects?
2. How have risks been managed so far in PPP projects in Nigeria?
3. How can project risks be better handled to enhance PPP projects in Nigeria?

## **8.2 Major Findings**

Firstly, after an evaluation of the theoretical as well as empirical analysis of risk allocation and mitigation methods around the world, the thesis concluded that even though there were several factors that enable the success of PPP transactions, proper risk allocation and mitigation was key and the most critical.<sup>1</sup>

Secondly, by conducting an extensive mapping of different types of risk factors available in PPP literature, it was noted that there are different basis upon which risk may be classified. While different authors conceptualise risk differently, risk perception also differs across sectors

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<sup>1</sup> Arthur Anderson (2000) 'Value for Money Drivers in Private Finance Initiative', London, Arthur Anderson and Enterprise LSE; See also Grimsey D and Lewis M.K. (2004), *Public Private Partnerships: The worldwide Revolution in Infrastructure Provision and Project Finance*, Edward Elgar, Cheltenham; Megens, P. 'Construction Risk and Project Finance- risk allocation as viewed by contractors and financiers' (1997) Vol. 14, No. 1 *The International Construction Law Review*, pp. 5-32



and from country to country. This situation makes a uniform classification and even assessment of risk difficult. In essence, risk perception is a social construct because it varies according to people's point of view, attitudes and experience.<sup>2</sup>

Thirdly, the thesis measured the performance of PPP projects that have been concluded in Nigeria within a risk management framework. The concession of the 26 ports around the country was used to study political risk, the MMA 2 local airport BOT transaction in Lagos was used to study demand risk, while the Lekki toll road concession project was used to study stakeholder opposition risk. The thesis confirmed that the projects suffered major shortcomings principally because risks were not managed properly. Below are the summaries of the findings based on risk factors.

### **8.2.1. Political risk – the Ports Concession**

The thesis concluded that under this transaction, political risk was rightfully allocated to the government primarily because The government controls all the factors responsible for its occurrence. However, the thesis posited that the risk was not properly allocated and/or mitigated because the country lacked an enabling regulatory framework, the most important instrument for political risk mitigation. In fact, the concession of the 26 federal ports took place before the enactment of the enabling legislation that would have regulated the

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<sup>2</sup> O.A Awodele and Ogunsemi D.R 'An Assessment of Success Factors and Benefits of Project Partnering in Nigerian Construction Industry' in Proceedings W092- Special Track 18<sup>th</sup> CIB World Building Congress, May 2010 Salford, United Kingdom pg. 180

transaction. To date, this crucial legislation is yet to be enacted even after several years since the conclusion of the transaction. As opined, the lack of an enabling legislative framework has not only exacerbated the problems facing the ports concessions but also several other PPP projects in Nigeria.

The study of political risk also provided an opportunity for the thesis to analyse the legal framework for PPPs generally in Nigeria. The thesis concluded in this regard that there are too many laws regulating PPPs in Nigeria. While some contradict with each other, others do not take cognisance of the existence of other extant legislations. Therefore, the thesis advocated for a review of the entire legal framework for PPPs in Nigeria.

#### **8.2.2. Demand Risk - MMA 2 local airport BOT transaction**

The demand risk on this transaction was allocated to the private sector which was not comfortable with assuming the risk, and therefore demanded a major premium for taking the risk. The premium charged was safeguarded with non-compete clauses to protect the private sector from competition from the government or other private sector parties. This clause effectively prevents the government from providing additional airport infrastructure within the environs of the MM2 Airport. The government subsequently attempted to extricate itself from the Agreement leading to a plethora of court cases and stress in the aviation sector.

Another important finding of the thesis is the inter-relatedness of the different categories of risk. Hence mitigation of a particular risk could inadvertently shift the burden of the risk onto another party or increase the profile of another category of risk not even contemplated by the parties. Thus it is critical that parties to PPP transactions are aware of this possibility and try to avoid it as much as possible when they choose their risk mitigation strategies.

### **8.2.3 Stakeholder Opposition Risk - Lekki toll road concession project**

The Stakeholder opposition risk was allocated to the private sector party, however the government assumed responsibility for the consequence of the risk eventuating. There was therefore dissonance between the party that assumed the stakeholder opposition risk (the private sector) and the party that was responsible for the consequences of the risk (government). This is not good practice and definitely at variance with the basic rule of risk allocation that risk should be allocated to the party that will suffer loss as a result of its occurrence.<sup>3</sup> There was also no incentive for the private sector to manage the risk properly, since it would not bear any loss as a result of the risk eventuating.<sup>4</sup>

## **8. 3. Value of Findings and Recommendations**

This thesis is unique in the sense that it first evaluation, from a risk management perspective, of PPP transactions that have been concluded in Nigeria to date. The findings from this empirical research

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<sup>3</sup> Abrahamson M. 'Contractual risk in tunneling: how they should be shared', (1973) *Tunnels & Tunneling* pp. 587-598

<sup>4</sup> Ibid. This effectively compromised on the efficient management of the risk.

therefore provide useful and novel information to investors, practitioners and governments involved in PPP transactions in Nigeria and even much of sub-Saharan Africa.

For investors, whether local or international, it signposts likely pitfalls for their projects and provides suggestions on how to navigate through them. Practitioners will benefit from the evaluation of international best practices for handling project risks and also discussions of critical success factors for PPPs undertaken in this thesis. Finally, governments will benefit from understanding the reasons for the shortcomings in PPP projects and tailor policies and regulations towards overcoming them.

Below are some of the recommendations for handling of the three different project risks studied in this thesis. It is believed that these recommendations will undoubtedly aid in the successful outcome of future PPP projects in Nigeria and much of sub-Saharan Africa.

### **8.3.1 Recommendations for Political Risk**

1. Strong political support is imperative for the success of PPPs in Nigeria and all over sub-Saharan Africa, as no long-term project can proceed successfully without the continued support of successive governments or administrations. Parties to the PPP contract, especially government must also have a realistic and honest awareness of what they are able to bring to the transaction, instead of making reckless and spurious undertakings either in the form of representations or

warranties. This will ensure that their undertakings under the contracts are in tune with the abilities and resources available to the parties

2. The lack of coordination between the different arms of government and the different agencies of government in issuing guarantees, warranties and other commitments to the private sector increases the contingent liabilities of government. However, the thesis concedes that there must be a means of ensuring that transactions, which deserve such guarantees, benefit from them. The suggestion is that the government should create a central risk management unit, ideally in the Ministry of Finance, to have an overview of, and track the contingent liabilities that may arise from these guarantees, warranties or other commitments.<sup>5</sup>

3. There is a need to have independent regulators in place in the different infrastructure sectors. The situation where the government is both a party in, and regulator of, the contract leads to conflict of interest. Invariably, this affects contractual equity and fair play.

4. Corruption is pervasive in the Nigerian public service and this increases the cost of doing business in the country. This takes its tolls on not just the transactions, which suffer from lack of credibility, but also private sector profits and ultimately the sustainability of the business. There is therefore need for this malaise to be tackled effectively for the sustainability of PPP projects.

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<sup>5</sup> This is also a recommendation of the National PPP Policy

5. Lack of human and institutional capacity in the public sector is a major problem. This obvious deficiency usually results in government assuming risks and obligations during contractual negotiations that it would not ordinarily have acceded to if the public officers negotiating on its behalf were better aware at the time. The short-term solution for the government is to engage competent transaction advisers and in the long run, to build the capacity of its workforce. The private sector parties should also ensure the fairness of contracts instead of taking undue advantage of the naivety of the government because one-sided contracts have a high tendency to backfire as government tries to assert its authority to the detriment of both parties.

6. The inadequacy and multiplicity of the federal legislation on PPP is also a big problem. As the thesis noted in chapter 5, the best method of mitigating political risk is through the enactment of appropriate enabling legal framework that supports PPP and eliminates loopholes for the manipulation of the system. It is therefore imperative that that Nigeria enacts a new PPP law that will revoke and replace the existing ICRC and privatisation laws as these laws conflict and the roles of the institutions created under both laws overlap.

### **8.3.2 Recommendations for Demand Risk**

1. In allocating demand risk in infrastructure projects, parties to PPP contracts particularly the public authorities, must not be slaves to the use

of concession contracts, to the exclusion of availability contracts. The decision to use either of the two options must be predicated on sound project evaluations. Several studies have shown that it is erroneous to assume that either of the two contract types is better than the other.<sup>6</sup> The key is to understand when to use one option in favour of the other.

2. There is generally nothing wrong with the public sector passing demand risk to the private sector. However, to pass this risk appropriately, the public sector must realise that the private sector partner will demand certain incentives. The public authority must also assess whether it is able to bear the consequences. This requires a conscious evaluation and pricing of the risk including non-commercial factors like the satisfaction of citizens both in the short and long term.

3. In situations where the government decides that it wishes to transfer demand risk to the private sector, there are other less onerous methods of doing it than has been done in some of the concession contracts in Nigeria. If the use of availability contracts is preferred to concession contracts, then the public sector must ensure that payments are only made according to predefined and measurable outputs in the contract.

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<sup>6</sup> Brux Gregor, J. and Desrieux C. 'Public Private Partnerships and the allocation of Demand Risk: An incomplete Contract Theory Approach' (2012) (online) Available at [http://extrant.isnie.org/uploads/isnie2012/de-brux\\_desrieux.pdf](http://extrant.isnie.org/uploads/isnie2012/de-brux_desrieux.pdf) [last accessed August 13, 2012]; Athias L. 'Political Accountability, Incentives, and Contractual Design of Public Private Partnerships' MPRA Paper No. 17089 (2007) online Available at <<http://mpra.ub.uni-muenchen.de/17089/>> [last accessed on May 5, 2012]; Athias L and Soubeyran R. 'Less Risk, More Effort: Demand Risk Allocation in Incomplete Contracts' (2012) (online) Available at [www.lameta.univ-montp1.fr/Documents/DR2012-20.pdf](http://www.lameta.univ-montp1.fr/Documents/DR2012-20.pdf) (last Accessed on 11th of August 2013).

These outputs must act as targets, which the private sector must fulfil.<sup>7</sup> To compel adherence to the standards of the specified output and encourage efficiency from the private sector, the contract should also provide for penalties and bonuses.<sup>8</sup> This will encourage the private sector partner to continue to innovate.

### **8.3.3. Recommendations for Stakeholder opposition risk**

1. The thesis argues that stakeholder consultation and involvement is not merely desired good governance or moral practice but even a constitutional right of the citizens. The thesis also opined that the real partnership in PPPs is actually between the citizens (represented by their governments) and the private sector not between the government who are merely agents of the people and the private sector.<sup>9</sup>
2. Stakeholder engagement or involvement means adopting a stakeholder participatory approach. This entails engaging stakeholders meaningfully at every stage of the project, from inception to operational phase. Integral to effective stakeholder participation is the initiation of and constant maintenance of communication with various stakeholders.<sup>10</sup>

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<sup>7</sup> Iossa, E. and Martimort, D. [2008], 'The Simple Micro-Economics of Public-Private Partnerships', Working Paper, (online) at [http://papers.ssrn.com/paper.taf?abstract\\_id=1318267](http://papers.ssrn.com/paper.taf?abstract_id=1318267) [last accessed on May 5, 2012]

<sup>8</sup> *ibid*

<sup>9</sup> See also Hayler M.R., 'Public-Private Partnerships in Hong Kong: Good Governance – The Essential Missing Ingredient', (2010) Vol. 69 *The Australian Journal of Public Administration*, Pg. S99 -S119

<sup>10</sup> Bakens, W., *etal.*, 'Engaging stakeholders in performance-based building: lessons from the Performance-Based Building (PeBBu) Network' (2005) 33 (2), *Building Research &*



Also the particular method used to engage stakeholders should depend on several factors including the nature of the project, the resources available for the project and the objectives to be attained from the engagement.<sup>11</sup>

3. From a project risk management perspective, stakeholder opposition risk should be clearly identified very early in the project through the use of risk matrixes. The risk should also be allocated appropriately between the parties and not just shifted to the private sector as is the case currently in Nigeria. Stakeholders should actively be encouraged to participate in every step of the project, especially from project conception and all through to implementation and monitoring. Public opinion should always be taken into serious cognisance when decisions are taken on whether particular projects should be initiated or otherwise.
4. Despite the express provisions of Nigeria's National PPP Policy on the need for stakeholder engagement, the public have hardly been engaged in practice. There is therefore need for a mandatory requirement for public consultation to be taken more seriously by codifying the provision in a legal instrument. From a project governance perspective, the public can also play an active role in improving project accountability and service quality. The people may not just play the role

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*Information* 149–158. ;Jergeas, G.E., *et al.*, 'Stakeholder management on construction projects'. (2000) *AACE International Transactions* 12, 1–5. ;Olander, S. and Landin, A. 'A comparative study of factors affecting the external stakeholder management process'. (2008) 26 (6), *Construction Management and Economics*, 553

<sup>11</sup> Yang, J. *et al* *Supra*

of service receivers but can also be active service partners<sup>12</sup> and this can happen only when they are properly engaged.

5. PPPs are usually complex and difficult to understand. This problem is even more pronounced in a country like Nigeria where PPP is a novel concept and there is greater suspicion and lack of trust because of previous Government antecedents. Perhaps the Government and the private sector need to invest a little bit more in educating the people about the nature and merits of PPPs so that they are equipped to play a more participatory role in the process.

#### **8.4 Postscript**

This thesis dealt broadly with PPPs in Nigeria, a contemporary topic with events unfolding during the course of the research. Interestingly, a significant event that gives credence to the thesis' arguments and findings began to unfold towards the conclusion of writing-up and submission.

Specifically, on August 27, 2013, the Lagos State Government announced the cancellation of the Lekki toll road concession.<sup>13</sup> The Government proposed to buy out the unexpired term of the concession from the concessionaire. The Governor explained that the move is

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<sup>12</sup> Ahmed, S.A. and Ali, S. M. 'People as Partners: Facilitating People's Participation in Public Private Partnerships for Solid Waste Management', (2006) 30 *Habitat International* 781-796.

<sup>13</sup> Dada A. and Bisiriyu R. 'Lagos Cancels Lekki-Epe Expressway Concession' Punch Newspaper, August 28 2013; Akinsanmi G. 'Lekki-Epe Road: Lagos to Raise ₦87.5bn to Acquire Concession Rights' This Day Newspaper August 29, 2013

designed to “leave the State with wider policy options” regarding the infrastructure.<sup>14</sup> However, it is widely believed that this move by the government is in reaction to the continued public opposition to the project.<sup>15</sup>

It may be recalled that stakeholders had opposed the project leading to public demonstrations, court cases and even the death of a demonstrator. This thesis concluded that the intensity of the resistance faced by the project was a result of the lack of consultation with stakeholders before the road was built. Even though toll collection had resumed on the road after its initial suspension by the government, there was a sense that the collapse of the project was inevitable. This cancellation is the final act in the chain of events precipitated by the opposition of stakeholders to the project.

This cancellation of the project validates two of the conclusions reached earlier by this thesis. The first is that the mismanagement of project risks in PPP transactions in Nigeria could lead to their ultimate collapse. Evidently, this has happened with the Lagos Toll Road concession and the possibility of this happening with the other two projects discussed in this thesis is real. Clearly, urgent remedial action is required to avert such an occurrence in order to establish strong investor confidence in

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<sup>14</sup> Dada A. and Bisiriyu R. *ibid*

<sup>15</sup> See for example Defender Newspaper ‘Lekki-Epe Expressway Cancellation: I wont withdraw suit against Lagos, lawyer says’ (online ) <http://www.osundefender.org/?p=118622> (last accessed on September 14, 2013)

Nigeria's PPP sector to ensure the future of infrastructure development in the country. As the thesis argued, proper risk management is a prerequisite to successful PPP projects.

The second conclusion of this thesis that is further reinforced by this event is the interrelatedness of project risks. In this case, due to the fact that stakeholder opposition risk was not identified, allocated and mitigated, it exposed the project to political risk. At the end, the decision to cancel the project was motivated by political considerations that were precipitated by stakeholder opposition to the project.<sup>16</sup>

The problem with the collapse of PPP projects is that it is usually expensive and the biggest losers are usually the citizens. For instance, Lagos State Government has proposed to buy back the concession from the concessionaires through an additional ₦7.5 billion<sup>17</sup> budgetary allocation<sup>18</sup> and by raising ₦87.5 billion<sup>19</sup> through the issuance of bonds.<sup>20</sup> In this case, both sources of funds are going to be provided by taxpayers in one way or the other. In contrast, the private sector concessionaire walks away with a profit. This is because the concessionaire would have factored in transaction costs, estimated

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<sup>16</sup> There are views that the cancellation of the project was based on the desire of the government to ensure victory at the 2015 elections. See for e.g. Osun Defender Newspaper 'Lekki-Epe Expressway Cancellation: I won't withdraw suit against Lagos, lawyer Supra

<sup>17</sup> USD46.8m

<sup>18</sup> Dada A. and Bisiriyu Supra Note 14

<sup>19</sup> USD547m

<sup>20</sup> Akinsanmi G. Supra Note 13

income and a very liberal return on investment into the agreed buy-out amount. All these add up to make the project more expensive than it would have been if it had been consummated through traditional procurement.

The alternative and better solution as proposed in Chapter 6 of this thesis would have been first to insert a put and call option into the agreement so that a pre-negotiated figure for buying back the concession or formula for determining the figure is inserted in the agreement. Secondly, the Government should then offer a new concession to another concessionaire so that it can raise the funds to repay the original concessionaire. This ensures that the government is able to raise interest free funds to repurchase the concession and ensures that the citizens continue to enjoy the benefits of having a private sector managed infrastructure.

## **8.5 Scope of Future Research**

Most of the existing literature and empirical studies analysed in chapter 3 and 4 tended to view risk as a static construct. However, in reality, project risks continue to change during the course of a project. Also, the attempt at mitigating of one type of risk may increase the likelihood of another type of risk occurring. This is evident from chapter 6 where the use of non-compete clauses in the MMA 2 concession to protect the

private sector from demand risk led to the increase in political risk as government was more likely to breach the concession contract rather than suffer the consequences arising from that clause. In the light of this, questioning the effect that different risk mitigation techniques, especially contractual clauses, have on other risk categories in PPPs will make a good research focus. This will help the partners in PPPs look at risk mitigation more holistically rather than dealing each risk category separately.

In chapter 3, this thesis identified that in deciding whether to finance a project through PPP rather than through traditional public sector procurement, the major consideration for most Governments involved in PPP across the globe is usually whether the PPP alternative presents better VFM to traditional public procurement. VFM is often computed in most jurisdictions by using a benchmark called the Public Sector Comparator ("PSC"). The issue of PSC is not yet topical in Nigeria because the focus for the government now is primarily to raise much needed private sector finance for PPP projects. Indeed PPP is the most veritable source of infrastructure development and as the country continues to mature in PPP project delivery, VFM and by extension the use of the PSC will become more important considerations. Despite this, the PSC remains a useful tool as it performs other functions apart from determining VFM.

Firstly, it promotes full costing of alternatives at an early stage in project development; secondly, it provides a key management tool during the procurement process by focusing attention on the output specification, risk allocation and comprehensive costing. Thirdly, it provides a consistent benchmark and evaluation tool that can be used to assess the project. Finally, it encourages competition by generating confidence in the market that financial rigor and probity principles were applied to the project.<sup>21</sup> Currently, the National Policy on PPPs does not provide any discernible basis for PSC computation, conceding that there is no simple rule that can be used to satisfy a VFM test because of the difficulty in measuring quality and cost of the service as well as the unavailability of relevant data.<sup>22</sup> While admitting that Nigeria must not necessarily use the PSC as the basis for determining VFM in projects, it remains a fact that the PSC or a credible alternative is an important policy instrument that the country urgently needs. There is therefore need for further research not only to determine the best method of computing VFM in Nigeria but also to achieve the policy goals ascribed to the use of the PSC in other countries.

Thirdly, this research only focused on three types of risk factors: political risk, demand risk and stakeholder risk. As pointed out earlier, these are not the only risks that affect PPPs in Nigeria. There is need to do a wider analysis and consider a number of other different risk factors to achieve

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<sup>21</sup> Grimsey, D. and Lewis, M.K . (2004) Supra Note 1

<sup>22</sup> National Policy on Public-Private Partnerships pg. 35

a complete understanding of how all PPP project risks have been managed so far in Nigeria.



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