

THE ROLE OF CONTRACTS IN PUBLIC PRIVATE PARTNERSHIPS

GARY NOBLE*

I INTRODUCTION

The very public stoush between Sydney's CrossCity Motorway ('CCM') and the New South Wales ('NSW') Government over the Cross City Tunnel provides observers of public private partnerships ('PPPs') with interesting insights into the workings of these unique forms of relationships between the private sector and government. The Cross City Tunnel conflict highlights the significance that formal contracts can have when a PPP goes awry. PPP contracts do not just codify who is responsible for what and how risks and rewards will be shared, they also act as an important safety mechanism when the relationship between partners breaks down. Research I have conducted in both Australia and the United Kingdom¹ suggests that when and how a legal contract will be used in the context of a PPP is often influenced by the nature of personal relationships between key players. It is interesting to speculate whether CCM and the NSW Government would be heading to the courts if the relationship between NSW Premier, Morris Iemma, and the Chief Executive of CCM, Graeme Mulligan, had not degenerated to the level of personal attack and counterattack.²

This paper examines the issue of PPP contracts. Specifically, the paper considers the process of negotiating PPP contracts and the relative positions of both the government and private sector parties at the bargaining table. The paper also comments on how legal contracts can be regarded by those responsible for the day-to-day management of a PPP and how a contract's performance can be influenced by the nature of personal relationships between key individuals.

* Dr Gary Noble is a Senior Lecturer and Director of International Operations in the Faculty of Commerce at the University of Wollongong.

1 Gary Noble, *Managing Synergetic Momentum: A Grounded Theory of the Management of Public-Private Partnerships* (PhD Thesis, University of Wollongong, 2002) <<http://www.library.uow.edu.au/adt-NWU/public/adt-NWU20030729.112025/index.html>> at 19 September 2006.

2 Jordan Baker, 'Tunnel Boss Tells of Threats and Promises in Talks', *Sydney Morning Herald* (Sydney), 1 July 2006, 5.

II THE PROBLEMATIC NATURE OF PPPs

PPPs are rarely genuine partnerships. In most PPPs, the word 'partnership' only has semantic relevance and is used for purely political or ideological purposes. For most people the word 'partnership' conjures up images of working together towards a common goal with a sense of collaboration and equality amongst all those involved. A true inter-organisational partnership is characterised by a shared purpose. Partners, who are prepared to be flexible, share both the risks and the rewards, accept the uncertainty of the relationship, and are willing to rely more on trust and commitment than legal safeguards to overcome issues of conflict. Does this sound like a PPP you know?

The reality of most PPP relationships is that partners have disparate priorities, goals and stakeholder concerns. Although the boundaries between the public and private sectors have become increasingly blurred in recent years, there are still fundamental differences between them. The private sector remains dedicated to the generation of profits and meeting expectations of shareholders and the market. In contrast, the public sector, as seen by the Cross City Tunnel conflict, responds to pressure from the electorate and has a responsibility to act in the interests of the public in an open and transparent manner. In brief, the public and private sectors have starkly different motivations, roles in the economy and governance requirements. These fundamental differences result in the existence of two discrete sets of organisational cultures. As a result, apart from a straight contractual relationship, any relationship involving organisations from these two sectors of the economy has the potential for greater levels of conflict than a private-private or public-public sector relationship. As in any other aspect of the PPP relationship, this potential for conflict can be seen in the process of negotiating the PPP contract.

III NEGOTIATING THE PPP CONTRACT

Having been a non-participant observer of several PPP contract negotiations, I have found that every party approaches the bargaining process in a surprisingly similar manner. When broken down into its major elements, PPP contracts are negotiated through three sequential stages that can be labelled as 'position idealising', 'position levelling' and 'position formalising'.

As a result of the fundamental differences between the public and private sectors, outlined previously, parties never approach the PPP contract table with open minds nor with a sense that they are starting discussions on equal terms. Opposing negotiation teams enter the 'position idealising' stage with an idealistic view of what they hope to achieve in the final contract for the benefit of their own organisation. These idealised views are based on two false beliefs. First, individuals will often believe that their organisation is entering discussions with a superior bargaining position because they have access to some form of valuable resource that the other PPP partner needs such as capital, expertise or public land. This belief is false since, by their very nature, PPPs are about synergies gained from the strengths of all project partners. This means that no one partner can

achieve their own goal by acting alone. The second false belief relates to the fact that all individuals arrive at a contract table with preconceived, and in many cases erroneous, notions based on their past experiences, their own sense of the world and their place in it. It is not uncommon for private sector managers, particularly those new to PPPs, to enter this first negotiation stage believing that the public sector is made up of slow moving, inefficient and bureaucratic government agencies straight out of the television series 'Yes Minister' who need the private sector to bring them into the 21st century. Similarly, the view that the private sector is not to be trusted still exists in the minds of some public sector managers. These stereotypical views of both sectors are outdated. The constant crossover of staff between the public and private sectors means that the person sitting on the other side of the negotiating table to one of the parties may, until a few months ago, have been a senior manager or lawyer in the same sector as that party.

As long as individuals hold on to notions of idealised positions, there is constant jostling and bargaining for advantage. This stage of the negotiation process continues until a point is reached where preconceptions are broken down and individuals realise that neither party has any real edge. They cannot achieve their organisational goals for the PPP without the cooperation of the other party. It is at this turning point that negotiations enter the second stage of 'position levelling'. This is a stage in negotiations where compromise and the search for win-win positions dominate discussions and bring all parties closer to common points of agreement. It is worth remembering that at the end of the day contracts are negotiated between individuals, not amorphous corporate and governmental masses. Agreements in PPP negotiations are reached when individuals alter their mindset and individual allegiances begin to shift towards the PPP as an entity in its own right. Negotiators begin to think in terms of 'what is good for the PPP project *and* my organisation'. Once this breakthrough in thinking is reached, discussions enter the third stage of 'position formalising'.

During this final and often most frustrating stage, partners will try and get that little bit more in terms of risk sharing or reward allocation until a point is reached where one or two individuals will often begin to work within their own organisations to let senior management know that a point of saturation has been reached and further probing for concessions will prove fruitless. This is also the period when parties will ensure that they have in the contract what one lawyer described as 'hidden Houdini clauses' designed to get an organisation 'out of gaol if the PPP begins to go pear-shaped or run off the tracks'.³ For example, in one PPP observed, the public partner inserted a series of performance measures that were to be set by a third party. If these performance levels were not achieved, the public partner could move to dissolve the PPP arrangement. What the private sector partner did not realise at the time was that through an indirect path the public partner actually controlled the actions of this third party

3 Anonymity was a condition of reporting this and other comments, as well as the identity of the public private partnerships ('PPPs') cited in this article.

organisation so that the public sector partner in effect set the performance measures.

At the end of the 'position formalising' stage, a point is reached where all parties are confident enough with their positions to sign the contract. The contract signing is as much a symbolic act as anything else because it demonstrates to the electorate and the market that all partner organisations are fully committed to the PPP project. This is also the point in a PPP's lifecycle when teams of lawyers and managers will congratulate themselves for finally arriving at a document that they believe will provide all the direction and governance needed for the PPP project – this is often far from the reality.

IV THE REALITY OF THE LEGAL CONTRACT AND THE ROLE OF PERSONAL RELATIONSHIPS

PPPs are complex and dynamic relationships and no matter how experienced or skilful a legal team is in putting together a PPP contract they can never cover every contingency, both large and small, that will arise during a PPP's life. In addition, managers responsible for bringing a PPP to fruition are frequently under pressure from senior management and politicians to ensure a PPP project is delivered on time and on budget. These pressures will often determine how the legal contract is used during the construction and operational stages of a PPP.

Attempting to resolve issues through contractual mechanisms is counterproductive for managers under pressure to keep a PPP project moving forward. Consequently, managers seek out alternative governance mechanisms to the formal contract. One of the most common alternative mechanisms is the use of psychological contracts. If personal relationships have been allowed to build up in the previous stages of a PPP's life cycle and there are strong personal bonds predicated on high levels of mutual trust, respect and commitment, only issues that represent a significant loss to a partner organisation will be resolved through the contract. Under these conditions, informal ad hoc agreements between individuals will often be used to resolve the majority of conflicts. For example, in a waste recycling PPP studied, a conflict over who was responsible for dealing with local resident concerns regarding air pollution was resolved over a coffee when two managers agreed on a strategy that the private sector manager would champion with local residents. In this case, the public sector manager had to trust that the interests and image of his organisation would not be compromised by the actions of his counterpart. The alternative would have been to return to the contract and define who was responsible and how they were to respond to ongoing resident concerns. This would have slowed the project. In contrast to the action of these two managers, when personal ties are weak, even relatively minor issues are referred to in the contract. In one case I observed, even the issue of who would pay for office supplies in a project office shared by managers from

the various PPP partners was referred to the contract for resolution. As a result, negotiations were re-entered and the contract amended.⁴

The message to be taken from these observations is that contracts alone do not govern the performance of a PPP project. Often aspects of a contract are ignored or short-circuited by managers in an effort to keep projects moving ahead and remaining on budget. In itself this is not an issue; however, when these ad hoc agreements begin to be used to avoid issues of quality and regulatory requirements, the public has cause for concern. The public should be concerned, for example, if public safety or the safety of workers is compromised through ad hoc agreements that ignore any legal and other statutory requirements simply to keep a PPP project on budget.

V CONCLUSION

As the Cross City Tunnel conflict dramatically shows, PPPs rarely experience smooth sailing and when things go astray they can do so in spectacular fashion. It is in these situations that the role of the formal contract becomes important. Negotiating PPP contracts is problematic due to the fundamental differences between the public and private sectors and the reality that in most PPP projects the goals of the public and the private sector partners are only remotely aligned. Outdated prejudices and false impressions of superiority can further complicate the early stages of PPP negotiations. PPP contracts are signed only when the individuals negotiating the contract can move beyond their own parochial positions to a mindset where they can unite the interests of the PPP itself and those of all the partner organisations.

The performance of the contract is often mitigated by the pressures placed on key managers to maintain budgets and time schedules. Constantly reverting to the contract to resolve issues of conflict is counterproductive to managers who are preoccupied with keeping a PPP moving forward. These managers will seek out alternative governance mechanisms, such as the use of informal or ad hoc agreements between individuals, and only revert to the use of the contract for major issues of difference or when mutual trust and respect dissipates from key personal relationships.

The Cross City Tunnel conflict reminds us that the private and public sectors are answerable to separate sets of stakeholders. In this case, the flow of revenue is of prime concern to CCM and its shareholders, whereas, with a State election looming, the NSW Government is conscious of voter backlash over road closures and toll charges. Perhaps, these issues could have been resolved through the contractual terms and sensible discussions. However, when you mix these issues with poor personal relationships, the consequences are unavoidable. The lesson

4 For more information on the role of these managers in PPPs, see Gary Noble and Robert Jones, 'The Role of Boundary Spanning Managers in the Establishment of PPPs' (2006) 84 *Public Administration* 891.

from all this is that the success of a PPP contract lies in its ability to be flexible and deal with unexpected events, as well as the nature of the personal relationships between key players.