Payment mechanisms

Julien Saint, special advisory services manager at Currie & Brown France, gives his insight into the various types of payment mechanisms in the public-private partnership (PPP) sector.

Getting an infrastructure project right is a complex business. It's not just about money: the thorny issue of who bears risk has to be evaluated, levels of services must be defined, legal jurisdictions assessed and frameworks put in place to ensure that projects are delivered on time and within budget.

When working with PPPs, payment mechanisms contain elements of both carrot and stick, and allocate risk to one or more parties. This is in addition to the obvious objective of paying the private partner for the delivered services. It's therefore imperative to select the correct type of mechanism for a given project.

Payment mechanisms ensure that the contractor is given incentives to perform well and, at the same time, make certain that financial remedies are negotiated and put in place for the contracting authority to apply performance penalties (or liquidated damages) if the agreed KPIs are not met.

There are no general rules when it comes to PPP payment mechanisms, although guidelines do exist. This isn't necessarily a bad thing, as it means the contract is bespoke for each individual project, promoting flexibility and enabling a high level of tailoring to suit the needs of each party.

With that said, there are a number of different models available, and choosing the right one from the options on offer is key.

Legal jurisdictions impact the form of the payment mechanism adopted. In countries that follow civil law (such as France, Spain, Germany and Italy), concessions and related 'user-pays' contracts historically prevailed. These countries later developed the framework for availability-based payments. In contrast, in common-law countries (such as Britain and its former colonies), investor-owned utilities typically provided user-paid infrastructure services. In the 1990s, when all user-paid infrastructures had been privatised, the British government developed the 'government-pays' PPP model (also known as PFI contracts) on social infrastructure. This was based on availability payments.

Both payment mechanism designs (availability-based payments and PFI) encompass many variations.

Availability-based payment schemes vary from simple mechanisms, where the authority remunerates the private partner to make the infrastructure or services available for use at an acceptable standard (such as a given number of road lane kilometres available for a road project), to performance-based payment, where the authority remunerates the private partner according to the quality of service provided, with a bonus included when the private partner reaches or exceeds certain performance targets.

Simple user charges-based payments, where the fee is received by the private partner directly from users of the infrastructure (such as through toll payments on road concessions) is the oldest and the most common method of user charges-based payments. Two other systems derive from this latter: usage-based payments and cap-and-collar payments.

The difference with the 'usage-based' payments mechanism (also known as 'shadow toll') is that remuneration does not come directly from the users but instead from the authority, and is based on how much the infrastructure will be used. This system is in place on PPP French and Belgian penitentiary facilities, where the remuneration varies with the occupation rate of the prison. It is also used on Portuguese and Senegalese road concessions.

The final common form of user charges-based payments is the cap-and-collar method, also known as band payments, whereby the remuneration is similarly undertaken by the authority and not the users. However, this remuneration is determined in relation to usage volumes, quantified through bands.

The main point to note is that these mechanisms aren't set in stone, and - as with other areas of infrastructure planning - it's likely that hybrids, as well as new models, will develop. We'll see further solutions emerge in the marketplace over the course of the next few years, allowing an even greater level of tailoring and flexibility, and further enhancing the importance of payment mechanisms.