

# private sector

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## Unsolicited Proposals

### The Issues for Private Infrastructure Projects

**Many of the world's most controversial private infrastructure projects originated as unsolicited proposals to governments. This Note explores critical questions for developing policies to deal with unsolicited proposals. For example, under what conditions should governments allow unsolicited proposals? And how can they add competition and transparency to the process? A companion Note reviews the methods used by the governments of Chile, the Republic of Korea, the Philippines, and South Africa to transform unsolicited proposals into competitively tendered projects.**

Governments worldwide have increasingly looked to the private sector to fill the growing gap between the demand for infrastructure services and their supply. In developing countries infrastructure projects with private participation increased dramatically in the past decade, attracting more than US\$750 billion in committed new investment in 1990–2001.<sup>1</sup> Many governments began awarding infrastructure projects to private firms in large part because of public funding constraints, but some also recognized that involving the private sector could improve the performance of infrastructure. In some cases private companies even initiated the process by suggesting project concepts through unsolicited proposals, often including detailed construction, operation, maintenance, and financing plans.

Among the many countries whose governments award infrastructure projects with private

participation, a few have laws prohibiting the acceptance of unsolicited proposals. A few others have laws requiring that unsolicited proposals be thoroughly reviewed and market-tested before being approved. The vast majority of countries, however, have no formal policies for handling unsolicited proposals.

In theory, permitting unsolicited proposals should encourage the private sector to bring governments beneficial ideas for project development that might otherwise have been overlooked. In practice, some governments' experiences with unsolicited proposals have been unfavorable. Many of the world's most controversial private infrastructure projects originated as unsolicited proposals, such as the Dabhol Power Plant in India and many independent power generation plants in Indonesia. In some countries private companies submitting

unsolicited proposals often did so in an attempt to avoid a competitive process to determine the project developer. If successful, they were then able to finalize project details with the government through exclusive negotiations behind closed doors.

### Competition and transparency

One way to reduce public sector corruption and opportunistic behavior by private proponents of projects is to forbid all unsolicited proposals. While this may have advantages, it also deprives governments of the expertise of the private sector in conceptualizing, designing, and developing projects. Moreover, experience has shown that when a government allows unsolicited proposals, projects that attract criticism usually do so not because the project concept was developed in the private sector, but because the project was awarded to the original private proponent without adequate competition and transparency.

Competition by itself does not guarantee greater public welfare. But under normal conditions a competitive process will probably drive down the tariff requested by the private operator as long as it attracts more than one bidder. The winning participant's investment and operating costs should be similar whether the project is awarded through competition or sole-source negotiations. The main effect of sole-source negotiations is a potential increase in the developer's profit margin, which would probably be passed on to consumers through a higher tariff or lower quality (Laffont and Tirole 1993).

The amount of transparency provided during an open competitive tender is usually determined by the government. When a government initiates a project, it can disclose information before, during, and after the award process. When a project is unsolicited, private proponents often argue that they have the right to determine how much information is made publicly available.

### Common arguments for exclusive negotiations

Some private proponents claim that special circumstances dictate a need for sole-source nego-

tiations of their unsolicited proposals. Typical arguments are that:

- The project developer has intellectual property rights to the project concept or to necessary engineering technologies.
- The project is too small, is too remote, or involves too much political risk to attract private sector interest.
- Organizing a public tender may not be cost efficient for the government or the bidders.
- The project will be developed more rapidly through negotiations, an important factor because of an emergency or widespread shortage (Kerf and others 1998).

While these conditions may exist in a few cases, they do not necessarily justify eliminating competitive mechanisms to determine the final project developer.

### Intellectual property rights

Among the most common arguments for requesting exclusive rights to develop a project is that the idea belongs to the private proponent, which has invested time and money in developing it. Many countries acknowledge intellectual property rights for project ideas and recognize them in the tender process by compensating the original project proponent. In Chile, for example, the government gives the original proponent an advantage in an open tender for the project and provides for reimbursement of its project development costs. Other governments may choose to simply purchase the project concept and then hold an open tender for the project.

Many companies submitting unsolicited proposals claim that the project uses new technologies or techniques not available from other sources—such as special engineering know-how for constructing more durable roads or providing cleaner water—and that exposing them in a competitive process would therefore violate the companies' proprietary rights. The procurement laws of several countries authorize exclusive negotiation if a superior good or service is available from only one supplier or if no alternative exists (UNCITRAL 2001, p. 93).

While some companies may have innovative solutions, substitute technologies are often avail-

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able even when original proponents claim that they are not. And even if a company does have special techniques, project objectives can often still be met through lower-cost alternatives. To assess the need for the proposed technique, some governments define a selection process that emphasizes the expected output of the project and allows each bidder to propose its own process or method. Those proposals are then compared with the unsolicited proposal while protecting the original proponent's proprietary rights (UNCITRAL 2001, p. 92). If a project does require the original proponent's proprietary techniques, another possibility is to set up a licensing arrangement for only the products or services needed.

### **Lack of private sector interest**

Another common reason for allowing exclusive negotiations of an unsolicited proposal is the belief that the characteristics of the project will not attract enough bidders. Many unsolicited proposals target remote areas where the government has neglected infrastructure. In these areas, proponents argue, a competition will only delay the project because it is unlikely to attract other bidders.

A government can test this claim by calling for expressions of interest. If there is indeed insufficient interest, the government might be able to make the project more attractive to draw in other potential bidders. One option is to pool smaller projects (as done for some French water concessions) or to include other services in the tender. Another option is to allow bidders to compete on the minimum subsidy required, especially if the original proponent requested a subsidy.

Even with only one bidder, staging a tender process may still provide benefits. Awarding a project to the original proponent without competitive bidding often creates public doubts about the project's legitimacy, because the process makes it easier to conceal corruption. Even where no corruption exists, the lack of transparency will make current administrations vulnerable to accusations of corruption from political opponents. Having an open tender, even with only the original proponent, can demonstrate a government's commitment to transparency and process. And it can show that

there is only one interested bidder rather than leaving this to speculation.

### **Cost efficiency**

Private proponents argue that a government can save money by skipping the tender process when it is confident that the original proponent will win. Putting together a simple tender process may help reduce other costs down the road, however, especially if the project is to be concessioned for several decades.

A competitive bidding process enables a government to define sector development objectives by establishing conditions in the tender documents for the long term. By contrast, with negotiated unsolicited proposals, the private proponent establishes the initial criteria without taking into account the government's long-term strategy. As a result, the project may lead to long-term bottlenecks in overall infrastructure development.

A competitive process may also provide financial benefits to the government even if the original proponent wins with the original conditions. The participation of other bidders gives the government more leverage because it provides a fallback option in case the original proponent fails to complete the project or violates agreed upon terms (Klein 1998b, p. 1). That reduces the likelihood that the original proponent will partially complete the project and then demand a higher tariff or longer concession period because of cost overruns—a common outcome in infrastructure projects.

Still, there is a chance that other bidders will be unwilling to risk money on preparing a bid when the original proponent has already invested so much time and effort. One solution is to have the public share the bidding costs up front. The original proponent would probably pass the project development costs on to consumers indirectly during the operational phase anyway. Some countries have experimented with pooling the total bid costs and offering partial or full reimbursement once the project is operational.

### **Rapid project development**

For some governments, urgent needs may justify exclusive negotiations of unsolicited proposals. For example, after receiving an unsolicited

proposal during a short-term energy crisis, the government of Côte d'Ivoire negotiated a lease contract to operate and maintain the country's main power generation, transmission, and distribution systems. But the experience of several countries shows that sole-source negotiations usually take much more time than originally expected and often end up delaying the project several years.

The initial design and implementation of a well-organized competitive bidding process may take some time. But once the process is in place, future projects may move through the system more quickly and efficiently. Over time both infrastructure companies and financiers will also become more familiar with the government's conditions and expectations.

## Conclusion

The many negative experiences with unsolicited proposals for private infrastructure projects may lead some governments to see blanket refusals as the only way to safeguard against potential problems with corruption and lack of transparency. Naturally, governments should be especially wary of unsolicited proposals requiring substantial support (such as government guarantees or land grants). Many private companies are well positioned to recognize potential demand for infrastructure, however, and governments may want to encourage such companies to submit project ideas. The main challenge for a government then is how to harness and promote private participation during the conceptualization of a project without losing the transparency and efficiency gains of a well-conceived competitive tender process.

## Notes

This Note focuses on infrastructure concessions in markets with little or no competition (such as airports, toll roads, and water distribution) rather than projects that must compete within a market (such as merchant power plants and cellular telecommunications service).

1. Data are from the World Bank's Private Participation in Infrastructure (PPI) Project Database, which records total investment in projects with private participation, not private investment alone.

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