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# The role of contracts in public private partnerships

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# The role of contracts in public private partnerships

## **Abstract**

The very public stoush between Sydney's CrossCity Motorway (CCM) and the 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 private sector - government relationships. 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 risk 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 Kingdom suggests that when and how a legal contract will be used in the context of a PPP is often influenced by the nature of the 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 CCM chief Graeme Mulligan had not degenerated to the level of personal attack and counterattack . 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.

## **Disciplines**

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## **The Role of Contracts in Public Private Partnerships**

The very public stoush between Sydney's CrossCity Motorway (CCM) and the 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 private sector - government relationships. 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 risk 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 Kingdom<sup>1</sup> suggests that when and how a legal contract will be used in the context of a PPP is often influenced by the nature of the 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 CCM chief Graeme Mulligan had not degenerated to the level of personal attack and counterattack<sup>2</sup>.

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.

### **The Problematic Nature of PPPs**

PPPs are rarely what could be described as genuine partnerships. In most PPPs the word 'partnership' has only 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 you have partners with disparate priorities, goals and sets of 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 need to generate profits and meet the 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 while having 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. Subsequently, any commercial relationship involving organisations from these two sections of the economy will always have the potential to be problematic with levels of conflict not expected in any private-private or public-public sector relationship. As in any other aspect of the PPP relationship, these potentials for conflict can be seen in the process of negotiating the PPP contract.

## Negotiating the PPP Contract

Having had the opportunity to be a non-participant observer of several PPP contract negotiations it is surprising how approaches to the bargaining process are so similar. When broken down into its major elements contracts are negotiated in three stages. The first stage, I label as the ‘position idealising’ stage. It is the period when opposing negotiation teams enter the bargaining process with an idealistic view of what they hope to achieve in the final contract for the benefit of their organisation. These views are often based on the miss-belief that their respective organisation is entering discussions in a superior bargaining position. These miss-beliefs are never more evident than when contract negotiations involve individuals new to PPPs. It is not uncommon for inexperienced private sector negotiators to enter discussions believing that the public sector is made up of slow moving; inefficient bureaucratic government agencies straight out of the television series ‘Yes Minister’ who need the private sector to bring them into the twenty first 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 cross over of staff from the public and private sectors means the person sitting on the other side of the negotiating table may until a few months ago have been a senior manager in the same sector as themselves! These idealised positions result in a period of open jostling and bargaining until a point is reached where preconceptions are broken down and individuals begin to realise that neither party has any real edge nor can achieve their organisational goals for the PPP without the cooperation of the other party. It is at this point negotiations enter a second stage of ‘position levelling’. This is a stage in negotiations where compromise and the search for win-win positions bring all parties closer to common points of agreement. It is during this stage that a PPP can take on an identity of its own and individual allegiances begin to shift towards the PPP as well as the organisation with negotiators beginning 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 and final 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. It is also the period when parties will ensure they have in the contract what one lawyer once 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”<sup>3</sup>.

What emerges from the study of these stages of PPP contract negotiation is that although each party is likely to come to the contract table believing they are in a superior bargaining position - in reality they are not. Each party to the PPP holds access to some form of resource that the other needs such as capital, expertise, public land and so on. Only when organisations realise they cannot achieve their own goals for a PPP without the other party do PPP contract negotiations really begin to move forward to the point where all parties are confident enough to sign the contract and commit fully to the PPP project.

In their simplest form PPP contracts attempt to codify the business relationship by defining the roles and responsibilities of the partners and in that process identify who is to take on what share of the risks and rewards. Because of the fundamental differences between the public and private sectors that were outlined previously, parties never approach the contract table on equal terms or with an open mind. It is worth remembering at this point that at the end of the day contracts are negotiated between individuals not amorphous corporate and

governmental entities. These individuals arrive at the contract table with preconceived, and in many cases erroneous, notions based on their past experiences and own sense of the world and their place in it. At the end of the negotiation stage teams of lawyers and managers may congratulate themselves for 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.

### **The Reality of the Legal Contract and the Role of Personal Relationships**

PPPs are complex and dynamic moving 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 counter productive for managers under pressure to keep a PPP project moving forward. Under pressure to stay on budget and on time managers will seek out alternative governance mechanisms to the formal contract to resolve issues of conflict. One of the most common alternative mechanisms is the use of psychological contracts. When personal relationships have been allowed to build up in previous stages of a PPP's life and there are strong personal bonds predicated on high levels of mutual trust, respect and commitment then only issues that represent a significant loss to a partner organisation will find themselves being resolved through the contract. Under these conditions informal ad hoc agreements between individuals will often be used to resolve the majority of conflicts. In contrast, when personal ties are weak even relatively minor issues find themselves being referred to the contract. In one case observed even 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 with the subsequent need to re-enter negotiations and create an amendment for the contract<sup>4</sup>.

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 then the public has cause for concern.

### **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 comes to the fore. Negotiating PPP contracts is problematic due to the underlying fundamental differences between the public and private sectors and the reality that in very few PPP projects are the goals of the public and the private sector partners even remotely aligned. Outdated prejudices and false impressions of superiority can further complicate the early stages of PPP negotiations. It is a wonder that any PPP contract gets signed and this only occurs once the individuals negotiating the contract can move beyond their own parochial positions to a mindset where they can couple together 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 counter productive to managers who are preoccupied with keeping a PPP moving forward. Subsequently, these managers will seek out alternative governance mechanisms such as the use of informal and ad hoc agreements between individuals and only revert to the use of the contract for major issues of difference and 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 contract and sensible discussions. However, when you mix these issues with poor personal relationships the consequences are unavoidable. The lesson, 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 relationship between key players.

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<sup>1</sup> Gary Noble, *Managing Synergetic Momentum: A Grounded Theory of the Management of Public-Private Partnerships* (PhD Thesis, University of Wollongong, 2002)

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

<sup>3</sup> 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.

<sup>4</sup> 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.