

Concessionaire's Performance Assessment in Public-Private Partnerships:

The Case of the Autonomous Province of Bolzano in Italy

Alberto Germani and Karl Zeller*

This article describes the authors' experience with Public Private Partnerships (PPPs) being dealt with by the Italian Autonomous Province of Bolzano/South Tyrol. All PPPs considered by the Province and other local authorities must be compulsorily envisaging the enforcement of an effective performance control system during operations, in order to provide a timely assessment of key performance indicators (KPIs) and, in case of non-compliance, to levy relevant penalties to the private partner. Measuring a concessionaire's performance during operation stage in PPP arrangements is an essential requirement set forth by European standards, in order for PPPs to be accounted off public balance. In the Guide to Statistical Treatment of PPPs, Eurostat sets out that PPP contracts must contain provisions that allow for the Operational Payments to be adjusted for unavailability of the asset and poor service performance by the private partner. Unlike concessions, where the private party bears most of the risks and the majority of revenues come directly from user charges, in PPPs the public party is the major purchaser of the services provided by the operator. The investment repayment is assured for the greatest part by regular availability-based payments granted by the acquiring administration throughout contract duration. In the latter case, it is essential to ensure that a substantial risk portion is transferred to the private party, by contractually defining a clear set of performance levels to be matched during Operations, and making sure that an efficient and sound performance control system is in place to check if requirements are met.

Keywords: PPP; concession; PAB; KPI; performance indicator

I. Introduction

The measurement of performance during the management phase of public-private partnership (PPP) contracts is an essential aspect, not only for the purpose of efficient operation of publicly owned infrastructures or services, but also for correct application

of the accounting principles that ensure off-balance classification of the investment in European Standard public accounting.

The Standard Concession Contract Scheme for the design, construction and management of public works, recently approved in Italy by the National Authority for Public Contracts (ANAC)¹, in section V dedicated to management, explicitly establishes that the provision of services in the contract (defined either as availability or accessories) must reach a level defined as 'Objective', corresponding to the established contractual standard. If these services are not provided or provided sub-standard, a penalty is envisaged, in the form of a reduction in the fee paid by the granting Administration to the Concessionaire,

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* Alberto Germani, Engineer, PPP Team of Specialists UNECE Member, PMF Technical Director (www.piemef.com). Karl Zeller, Lawyer and former MP, Thurin, Vinatzer, Zeller & Partner Law Firm Principal (www.tvzlaw.com). Translation from Italian by Monika Kandut.

¹ ANAC, *Partnership: a proposal for restarting*, Resolution no 1116 of 22 December 2020.

according to a principle of direct proportionality between service not provided and amount of reduction. Article 29 paragraph 7 of the ANAC 2021 Contract Scheme in fact states that 'the Grantor will deduct the amounts for services not rendered from the payment deadline immediately following the ascertained non-fulfilment'. The new ANAC Scheme also provides, in Article 45, that the Concessionaire is required to organise a monitoring system accessible by the Grantor in real time, to allow verification of compliance with contractual obligations including quality levels achieved during the service rendered.

Contractual documentation of partnerships must therefore envisage the presence of both a suitable performance control system and a penalty regime in case of non-compliance or delays. The control system, much more than a mere attachment to the contract, must be a real feature which, with the help of IT support, is able to ensure the detection of parameters in the most automatic form possible. It also needs to create a report which allows the Grantor to implement compensatory or remedial measures in real-time. In cases of prolonged non-compliance, it must allow the execution (also in automatic form) of sanctions and provide support for decisions to be made, including legal ones, on contract management.

This control system is usually implemented through a two-tier method: (i) Service Level Agreement (SLA), which defines the service levels provided by the Concessionaire, and (ii) so-called Key Performance Indicators (KPIs), namely the minimum performance parameters associated with service levels Concessionaire has to meet and possibly exceed. We believe that, with this article, we offer the experience gained by the writers in designing such systems, with particular attention to the effectiveness of their operation and compliance with existing regulations. Reference is made in particular to PPP operations in the Autonomous Province of Bolzano in Italy, which can rightly be defined as a 'laboratory' for the implementation of control systems in long term concession contracts.

II. The Experience of South Tyrol/Alto Adige in the Implementation of Control Systems for Partnerships

For several years now, the Autonomous Province of South Tyrol/Alto Adige has been carrying out struc-

tured experiments of performance control systems for PPPs, promoted by both provincial Authorities and private operators alike.

The most significant PPP operations in progress, from the New Bolzano Correctional Facility to hospital projects, student residences, urban transport infrastructures, public car parks or public offices for the Province, require that within the concessions' mandatory documentation there should be a study of performance control system and associated penalty regime (briefly called 'the KPIs Document') which constitutes an element of careful evaluation by the Administrations, both at provincial and municipal level.

Until now, PPP initiatives submitted for Authorities' consideration, for a total value in excess of €500 million in concessions already awarded or underway, have been compulsorily accompanied by such KPI documentation.

The thrust generated by these initiatives has made it possible to develop increasingly more efficient systems, capable of combining technical and legal / administrative aspects, in order to fully respond to the requirements dictated by European legislation and international practices.

III. Performance Control and Sanction Regime in the European Legislative Framework. Eurostat's Position

The forecast of ANAC 2021 Standard Contract on the subject of performance control and penalty regime applicable to PPP contracts, fully reflects the longstanding position expressed by European bodies on partnership and concessions, particularly by Eurostat.

Since 2004² Eurostat has placed under a magnifying glass the partnership operations, otherwise called PPPs according to Eurostat's definition, in which a public body is the main payer of the services provided by the concessionaire under management, to be distinguished from concessions, where the major part of revenues arises from users' charges and there is no substantial market risk borne by the private party.

2 Eurostat, 'Decision on fiscal treatment of Public-Private Partnerships' (2004) 11.2.2004_STAT_04-18.

The issue has a direct, important reflection in the transaction's accounting treatment, which can be classified off-balance for Eurostat purposes (ie the investment is not to be registered on the debt of the public body that awarded the concession) only on condition that risks associated with the transaction are effectively transferred to the Contractor. These risks were initially identified in construction, availability and market.

The biggest advantage of the 2004 decision was to provide clear and simple platform that all Member States had to comply with. Indeed, it was clear that putting partnership operations off public balance sheet in reality may hide investments paid in full with public finances without any appreciable transfer of risk to the private party. Thus, the 2004 Eurostat decision proved to be an easy and straightforward rule to counter this concrete possibility.

Unlike concessions (according to the Eurostat definition), where market risk is always transferred entirely, or mostly, to the private sector (demonstrated by, for instance, toll motorway), in PPP operations (again according to Eurostat's definition) the availability-based payment system which they rely upon, ensures that the only real risk transferred to the private party lies in making the infrastructure available according to the terms established by the contract, as well as delivering the services on time and according to the expected quality / quantity.

The three risks considered by Eurostat in 2004 (construction, availability and market) were replaced in 2016³ by a more extensive and more in-depth analysis of the overall risks incurred by the project, for which is verified, whether the analysis of the contractual documents have been effectively transferred to the private party. Only in presence of an effective transfer of risks, especially those of construction and management, can the application of the off-balance clause be envisaged.

As a consequence, risk assessment involves a thorough performance check during the execution of the contract (ie, mainly at construction and operation stage) and the execution of an effective, preordained

system of penalties in the unlikely event of under-performance of the holder of an availability contract.

The contractual definition of an effective penalty system is a substantial part of the risk transfer mechanism. In order for the risks to be effectively transferred, Eurostat recommends that additional costs (remedy costs) and associated penalties in case of a non-compliant event be fully borne by the private party.

As for the part of provision of maintenance, availability and management services, Eurostat refers to the following guiding principles:

- *Contractual definition of management and maintenance standards* (otherwise defined SLAs, Service Level Agreements), which must be accurately described in contract's technical documents signed by the parties (Management Regulations, Quality Plan, etc);
- *Subsistence of a Management and Maintenance Plan*, that the Contractor submits to the Administration for approval before management activities start;
- Subsistence of a constant and organised control, monitoring and reporting system in progress, ensuring that essential data useful to calculate compliance of performance are assessed against the SLAs, and automatically and promptly lead to non-conformities detection. This system consists primarily of the IT-aided Self-Control System that the Contractor must implement, maintain and keep continuously updated with information uploaded regularly, as part of his concession duties;
- *Deductions from monthly fee due to unavailability of the areas*⁴ (structure availability fee) and from contractual asset's components, proportional to the actual unavailability of the total;
- *Proportional execution of the penalty* (as per Eurostat's clear stance 'zero availability - zero payment') to be applied up to the amount of due penalty, therefore leading to significant deductions of the fee in case of multiple and serious inefficiencies. The only exception is where penalty exceeds 100% of the fee, whereby a limit (so called cap) is allowed. It should be noted that Eurostat recalls that the eventual application of a cap to the deductions on the fee, if it substantially alters the principle of proportionality between unavailability and sanction, can influence the statistical treatment of the PPP and lead to its on-balance classification⁵.

3 Eurostat EPEC, *A Guide to Statistical Treatment of PPPs* (September 2016).

4 *ibid*, Theme 4 - Payment Mechanism, part 4.1 - Structure of Operational Payments.

5 *ibid*, part 4.7.4 - Caps on deductions.

IV. Services Monitored and Criteria Adopted for Calculating Penalties

As defined by Eurostat and envisaged by ANAC 2021 Standard Contract, services associated with partnerships are essentially of two types:

- a. Space Availability, having the purpose of making contractual areas (internal or external) available either for users or Administration itself, according to certain parameters (for example air conditioning, cleaning, maintenance, etc) set by Service Levels. The common measuring parameter associated with Availability is the sqm / day, or the measure of contractual area made available according to standards in the time unit;
- b. Ancillary Services and those with subsidiary role to accessibility. This includes, for example, laundry, security guard, preparation of meals, gardening of outer areas, etc. Measuring the parameters of these services is linked to the specificity of the service rendered (for example, number of meals/days, kg of laundry, man-hours of security, etc).

A so-called standard service level is defined for each of the contractual services, linked with one or more performance parameters (the KPIs). Whenever the services are not provided according to standards, sanction system is triggered.

To estimate the penalty associated with failure to achieve the KPI, four main criteria are customarily adopted:

1. *Penalties for single violation (one-off penalties)*: associated with the failure or insufficient execution of individual services provided in the specifications. They are sanctioned with a fixed amount multiplied by the number of violations (or non-compliances) detected. One-off penalties are, for example, failure to carry out checks required by law, or in general violations detected as result of field inspections.
2. *Time-related penalties*: associated with the continuation of violations or non-compliances detected. They are sanctioned through a sum multiplied by the days (or hours, accordingly) of delay, generally to be calculated after a period of time in which sanction is exempted from execution (grace period). Time-related penalties typically include delayed submission of mandatory documents or reports, failure to activate services by a certain date,

delay in the expected intervention times in the event of emergency repairs.

3. *Penalties for exceeding a percentage of detected non-compliances (above-the-threshold penalties)*: triggered when the percentage of controls reporting negative results is outreaching thresholds allowed in the agreement. All inaccuracies registered above the threshold are the subject of penalty. That includes, for example, penalties for non-compliances found in preparation and administration of meals, in failure of disinfecting spaces, washing and ironing linen or in room cleaning services.
4. *Penalties for temporary unavailability of the area or service (availability penalties)*: associated with the unavailability of parts of the structure, malfunctions or other serious obstacles that make it necessary to temporarily close contractual areas. To take into account the fact that the unavailability of an area has a different impact depending on its specific function performed (in a hospital, closing an operating theatre does not have the same impact as closing a service room), areas are usually classified on the basis of functional criticality levels, in relation to the degree of safety applied and the dangers that may arise from situations of unavailability.

The typical classification of the area 'criticality' is as follows:

- a. Highly critical areas, whereby any reduction of optimal environmental conditions (standard) or in the available surface is not admissible. These areas may be made temporarily unavailable only as a result of planned maintenance included in the agreement and expressly approved by the Administration. In a healthcare facility, for example, therapeutic areas, operation theatres, inpatient clinics can be classified as highly critical areas;
- b. Medium critical areas, for which a temporary reduction of optimal operating conditions and availability is admissible. As seen before, temporary unavailability of these areas is the subject of a schedule agreed between the Concessionaire and Administration, and approved by the latter. Following the example of the health facility, administrative offices, service rooms, technical spaces and warehouses can be areas of medium criticality. Hence, in the event of their temporary closure, the functioning of the service is not significantly compromised;

c. *Areas of low criticality*, for which functional decrease or minor deviations from standard availability conditions, areas are consented, assuming that appropriate intervention measures have been promptly implemented by the Concessionaire, in agreement with the Grantor, in order to minimise unavailability and curb the adverse impact on structure functionality. External areas, car parks (in case of parking alternatives available) and multipurpose areas can be reasonably considered as low criticality areas.

V. Calculation of Penalties for Unavailability

Further to the areas unavailability, a penalty is calculated in the following ways:

- a. the area made unavailable is calculated as percentage of the total contractual area, and in relation to the time (in days / month) for which the closure has happened;
- b. unavailability percentage as previously assessed is deducted from the availability fee of the structure, by applying corrective factors according to the severity of the impact (ie, if the closure affected an area with High, Medium or Low Criticality respectively).

The application of corrective factors based on the criticality in calculating deductions for the areas of unavailability is expressly allowed by Eurostat⁶.

In case of total prolonged closure of the structure over 30 days, the condition set by Eurostat of zero payment due to total unavailability of the structure must always be verified. We therefore have:

$$P = (\sum_i \text{Unav}_i\% \times \text{Coeff}_i) \times \text{Fee} = 100\% \text{ Fee}$$

Where:

- P = Total monthly penalty applicable for areas unavailability;
- Unav% = Total unavailability (in%) of the areas with high, medium and low criticality in the month;
- Coeff_i = Weight assigned to relative unavailability (High, Medium and Low);
- Fee = monthly fee for availability;

The Coeff_i weights must be chosen in such a way as to ensure that the penalty for monthly unavailability of the structure cannot in any case exceed 100% of the relevant availability fee⁷.

VI. Methods for Applying Penalties

Once penalties have been identified, it is essential to define the methods of their execution and their impact on the fee, distinguishing design and construction phase from operation phase.

During the *design and construction* stage, penalties are applicable only for delays (when construction goes beyond the deadline set in the timeline). There are no other sanctions envisaged in this phase, as the ones related to non-compliance, differences from approved design or insufficient quality level are already covered by other legal provisions (ie the ones set out by civil construction codes or technical norms).

In the current ANAC 2021 Contract Scheme, penalties for delays are deducted from the grant provided by the public party over the course of construction. If penalties exceed the amount of the public contribution, Administration has the right to recover the remaining part from performance bond.

In our opinion, however, it would be more appropriate to deduct the whole penalty directly from the performance bond for the following reasons:

- performance bond covers all risks of non-completion, defects or delays occurring during construction stage. It seems therefore more appropriate to take any penalty linked to the occurrence of such events (including construction delays) directly from the bond rather than from the grant;
- the public contribution (grant) given to PPPs is agreed upon by Administrations, and its level is set with the aim of achieving an economic and financial balance, which the amount of senior debt secured with the bank is also based upon. Having

6 *ibid*, part 4.6.1 - Unavailability deductions: 'Deductions for unavailability are usually determined according to the component or components of the asset that are affected. Weightings are often applied to individual components of the asset and to different time periods to reflect how important these are to the Authority and other end-users.'

7 *ibid*, part 4.6.1 - Unavailability deductions: 'At the extremes, 100% availability justifies the Partner receiving the full Operational Payments and 0% availability must result in the Partner receiving no Operational Payments (sometimes referred to as "zero availability, zero payment")'.

the penalties affecting the public contribution may cause a shortage of funding sources during the construction phase, which could compromise, even severely, the financial soundness and bankability of the entire project. Risk allocation on private party, on the other hand, is not affected in any way by charging the penalties directly to the performance bond instead of the grant.

During the *operation* stage, the Administration takes penalties from due fees at payment deadline immediately following the ascertained non-fulfilment.

Where penalties relate to unavailability, reduction will take place on the relevant availability fee. Where the penalties concern the service management, the reduction will be made on the Services portion of the fee.

If the reduction exceeds the amount of the remuneration, the Grantor may recover the remainder part from the subsequent remuneration. If the above compensations will not be possible in whole or in part, the Grantor will be able to pursue claims under the performance bond.

VII. Contract Termination for Exceeding the Maximum Amount Due by the Concessionaire as a Penalty

The KPIs Document, coordinated with the Concession Agreement, must always provide a rule regarding termination of the contract due to exceeding the maximum amount due by the Concessionaire.

This aspect is based on the combined provisions of Articles 22(4), 29(8) and Article 37 of ANAC 2021 Contract Scheme, which explicitly foresee termination of the contract in the following cases:

- Design and construction phase: the Grantor may terminate the contract if the amount owed by the Concessionaire as a penalty, exceeds the percentage stated in the agreement and calculated on the total amount of the works excluding VAT (Article 22, paragraph 4);
- Management phase: the Grantor can always terminate the contract in accordance with Article 37 in case of failure to achieve the Objective Level. In particular, Grantor may terminate the contract if failure to achieve the above mentioned level in providing availability services and / or accessories to availability may result in a reduction exceeding, as before, a stated percentage of the annual fee (usually 20%, but it may vary depending on the contracts) excluding VAT (Article 29, paragraph 8).

Percentages justifying the claim for contractual termination from Administration must be clearly specified in the KPIs Document and the Concession Agreement.

VIII. Conclusions

The assessment of Concessionaire's performance in a PPP arrangement during management phase by granting Authority, other than an obligation arising from social responsibility, is considered to be part of the 'best practices' that qualify public spending and improve its efficiency.

We hope that the KPI Document, in its full broader meaning, will become rightfully a mandatory element and form integral part of the bid documentation, alongside technical and legal documents already included in any project's financing proposal.