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Public-Private Partnerships Tipping Point or Slippery Slope?

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P3: TIPPING POINT OR SLIPPERY SLOPE?

The $625 million Sea to Sky project, designed to widen and improve the highway leading from Vancouver to Whistler, winds its way through some of the most stunning landscape in Canada. The scenery, no doubt, will be a visual feast for the thousands of visitors from around the world who will travel to British Columbia for the 2010 Olympics. The highway also promises to channel significant revenue into the BC economy. Still, the road to Whistler is steep and winding, with many slippery slopes that challenge the best of drivers.

The Sea to Sky project is one of many public-private partnerships (P3s) being undertaken in Canada. Most are large, requiring significant funding to be repaid over 30 or more years. All require the full cooperation and combined talents of multiple stakeholders from the public and private sector.

The public private combination is not the most natural form of partnership. The private sector has long held very different values, goals and behaviours than the public sector. All of these factors coupled with the cost, investment, risk, sheer size and complexity of most P3 infrastructure projects render them as slippery a slope as the steeply winding highway to Whistler.

OPPORTUNITY WITH A CAPITAL O

Canada, a late convert to P3s, is making up for lost time. "There are more than a dozen projects underway in Canada that add up to billions of dollars in investment and opportunities," advises John Casola at Pricewaterhouse-

BY IRENE E. TAYLOR

Coopers. Casola is a partner and national leader of the Infrastructure, Government and Utilities Practice at PwC.

Projects in the pipeline include the 3B Gateway Transport, Sea to Sky Highway and Golden Ear Bridge transportation projects—all in BC—the Lower Churchill Falls project in Newfoundland and Labrador, and alternative financing and procurement (AFP) projects for the North Bay Regional Health Centre and the Sault Area hospital projects in Ontario. As pointed out by Doug Buchanan, a corporate partner and current national managing partner of Davis & Company LLP in Vancouver, "P3s are quite likely the fastest growing area of business legal practice today. They are opening up a multitude of exciting opportunities for Canadian business and legal professionals."

From an economic and social perspective, P3s appear to be a match made in heaven. This is particularly the case for a country such as Canada with its large land mass but relatively small population (32.5 million) and tax base in relation to infrastructure construction and maintenance needs. These needs must also be placed within the context of Canada's strong historical values in terms of providing the highest quality of life for citizens.

All of this spells opportunity for P3 infrastructure development. As corporate lawyers Doug Benson and Doug Younger of Fraser Milner Casgrain LLP (FMC) in Toronto, point out, Canada may have come late to the P3 party, but it is now entering with a considerable splash. "P3 in Canada is at last beginning to hit its stride," note Benson and Younger. "Especially in the three largest provinces. From roads in Quebec and hospitals in Ontario to rail, roads, bridges and health care facilities in BC, major projects are moving ahead on a P3 basis. More than that, the world is taking notice. Many infrastructure projects involving private sector equity sponsors and other consortia members are Canadian affiliates of major international companies, with project debt frequently underwritten by European banks and syndicated in international debt markets." Benson and Younger have considerable experience with such projects. Both lawyers previously held senior management positions with an international investment bank specializing in project finance, P3s and private financing initiatives (PFIs).

These opportunities are being facilitated by new ministries and government agencies, such as Infrastructure Ontario, which was given the mandate in November of 2005 to initiate 38 projects across the province. David Caplan, Ontario Minister of Public Infrastructure Renewal, announced that Ontario will invest, along with its partners, more than $30 billion to build and renew public infrastructure over the next five years. (Not all of these are AFPs. Part of the $30 billion is for traditionally procured projects as well.)

Are Canadian public-private partnerships reaching what Malcolm Gladwell refers to as a "tipping point" in his 2000 best-selling book *The Tipping Point: How Little Things Can Make a Big Difference* (New York, 2000)? Or are they still on the slippery slope?

According to Gladwell, it is under three favourable conditions that innovative new ideas, products and services achieve prominence. First, they become contagious. Second, they grow steadily as small changes result in significant impacts. Third, and most important, the tipping point does not happen gradually but at one dramatic moment.

"Canada has not yet experienced its 'dramatic moment' with respect to P3s and AFPs," notes Mark Bain, a partner in the Toronto office of Bennett Jones LLP. Bain is well-known as one of the leading Canadian experts and pioneers of P3s in health care. "However, the 'slippery slope' and 'tipping point' are not mutually exclusive. This is a concept with a long gestation period. I would say that in some sectors such as health care, energy and transportation infrastructure, the P3 and AFP momentum is becoming stronger and more stable. But there are still some slippery slopes to be navigated before this approach is universally accepted and adopted."

Mark Bain delivers an equivalent of the *Guinness World Records* on P3s in a 60 minute verbal download. One suspects that he caught the P3 bug early. As it turns out, he did. While Bain was still a law student, his father, Bill Bain, was the CEO of the Royal Brompton Hospital, the first UK hospital to propose a PFI alternative development and financing approach to hospital infrastructure under John Major's Conservative Government. Bill Bain was an outspoken advocate of this innovative approach to crumbling infrastructure and advised his son to "keep your eyes open. This is the future."

However, "soft skills" are also central to the success of P3 projects. "We already have the various unions calling upon us with questions and concerns," explains David Livingston, President and CEO of Infrastructure Ontario. "We know the reason we exist is to become the interface between groups such as this, the government and the private consortium. Our most important priority is to ensure we are open and transparent about every aspect of P3s."

GETTING IT

As Michael Nobrega, President and CEO of Borealis Infrastructure Management Inc., points out, "The central issue with respect to public-private partnerships is understanding on an intellectual level what the theory is. And the theory has nothing to do with money." According to Nobrega, public-private partnerships only makes intellectual sense when the private sector brings discipline to large projects that creates taxpayer value. "Alternative financing partnerships are about two things," he emphasizes. "Creating value and accountability."

Borealis, a division of the Ontario Municipal Employees Retirement System (OMERS), just finished the $4.2 billion Bruce Power expansion. As Nobrega explains, "The focus of this project was clear and simple. Essentially, make sure lights are kept on in the most cost-effective and efficient manner. Spelling out who is going to be accountable is also critical. For example, if there are cost overruns on a project, the public does not pay. However, where projects are fully funded by the government, the public does pay for the cost overruns. The theory of public-private partnership is that the government can use its legislative clout in conjuncture with private financing for taxpayers' benefit."

Nobrega does not pull any punches. Nor does he mince words. He is refreshingly direct and disarmingly factual. He believes that Canada has a huge appeal for investors such as Borealis and the international community, but that success and growth in the P3 market will be determined by the extent to which political leaders and senior civil servants can "get it." "That is what partnership projects are—creating taxpayer value. Political leaders and senior civil servants must experience this first-hand."

Nobrega goes on to argue that "Canada has huge appeal and potential. It is a G7 country with an outstanding debt to GDP ratio (35 per cent) and a strong credit rating (AAA at the federal level). We have the legislative framework necessary to protect investors, good governance practices and a strong professional class. What's not to like?"

Nobrega believes that Alberta is the Canadian province that best "gets it" in terms of how P3s should work. "Jay Ramotar [the Alberta Deputy Minister of Infrastructure and Transportation] is one of the most impressive leaders I have met. I generally think that Alberta understands at an intuitive level what this is about. BC has also shown real leadership from the outset. Ontario is trying, but I don't think that everyone 'gets it' yet."

CHAMPIONS AND CONNECTORS

As Tom Peters and Nancy Austin point out in *A Passion for Excellence: The Leadership Difference* (New York, 1985), "The course of innovation from the generation of the idea through prototype development and contact with the initial user to breakthrough and then to final market is highly uncertain. Moreover, it is always unpredictable and very much affected by the determined (irrational) champions and that is the important point."

Michael Nobrega and Mark Bain are classic examples of what Peters and Austin refer to as champion or "skunks" with such descriptors as "tenacious, passionate and persistent beyond belief." But they are more. They are also examples of what Malcom Gladwell calls an "essential connector." That is, the kind of person with a gift for bringing people and ideas together.

It is, in fact, a relatively small group of people such as

Nobrega and Bain; Jeff Merrick and Mungo Hardwicke-Brown at Blake, Cassels & Craydon LLP in Vancouver and Calgary, respectively; Doug Buchanan at Davis & Company in Vancouver; Connie Sugiyama and Paul Harricks at Gowling Lafleur Henderson LLP in Toronto; Dan Ferguson and Brad McLellan at WeirFoulds LLP in Toronto; John Casola at PwC; and Saad Rafi at Deloitte & Touche LLP who are among a small group at the epicentre of P3 activity. They are not only the most familiar names on most major deals, they are a diverse team of professionals who recognize and endorse one another.

"You'll want to speak with Mark Bain over at Bennett Jones," suggests Bob Beaumont, at Osler, Hoskin & Harcourt LLP in Toronto. "He is the leading guy in health care." Bain suggests I must speak with Rafi and Casola or Jane Peach at the Canadian Council for Public Private Partnerships. It immediately becomes evident that these "connectors" not only know all of the key players, potential investors, etc., inside and outside of Canada, they are writing, speaking and generally spending more personal (i.e., non-billable time) on P3s than anyone would imagine. They are a significant and positive driving force for P3s.

There are other driving forces as well. As Dan Ferguson and Brad McLellan, who co-chair the infrastructure and public projects practice group at WeirFoulds point out, being a late convert to new developments has its advantages. "We have been the beneficiaries of learning from everyone else's experience and mistakes." Both Ferguson and McLellan frequently speak at conferences as to what those past mistakes are and what Canada should do differently as a result. They also strongly argue that Canada is now a wide open playing field with strong government support to pave the way and minimize risk.

As is often the case, the devil is in the details. "Sure there is more investment capital than projects out there," acknowledges Jane Peach. "One very good reason for that is a hot labour market with high labour costs and a shortage of skilled people. Even such things as unstable cement prices can throw a wrench into the best made plans and projections."

But what about the slippery slope? Saad Rafi, who heads up the infrastructure project finance group at Deloitte, has his own perspective. Rafi spent 17 years of his career in government, including a stint as Ontario Deputy Minister of Transportation. He sees the need for a much deeper and broader awareness and understanding of P3s among public sector unions, the investment community and other stakeholders as the central issue providing slippage on P3s. "It was only in 2003 that the Liberals in Ontario came to power on a platform that was hostile towards P3s and promised to shut them down. To their credit, in the same way that Tony Blair's Labour Party became the champions for P3s in Britain, the Liberal Government in Ontario have picked up the gauntlet. For example, the May 2005 pre-budget announcement of the ReNew Ontario Plan, which will spearhead more than $30 billion of investment in Ontario's infrastructure."

However, according to Rafi, the negative impact of the 2003 position of the Ontario Liberals is more significant than a temporary stalling of P3 activity. It also signifies the kind of resistance that groups such as labour unions and, indeed, the general public can and often do experience. This means that not only must communication improve but early experiences with projects need to be completely successful.

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David Livingston clearly sees the role and mandate of Infrastructure Ontario to essentially remove the ice from the slopes of P3s, beginning with the name itself. "In Ontario we have renamed these kinds of infrastructure arrangements as AFPs (alternative financing and procurement). This title is more representative of what they really are. There was an over-perception of P3s being more about privatization than partnership, which is not at all our goal or intention."

Infrastructure Ontario, according to Livingston, exists to promote and facilitate AFP projects in moving toward successful completion. It is charged with priority projects and is to act proactively as a liaison between the private and public sector to ensure achievement of the government's five policies under a framework called "Building a Better Tomorrow." These policies are to ensure that all projects serve and protect public interests, that there is appropriate ownership and control by the public, that there is demonstrable value for money, that all stakeholders, both public and private, are accountable and that the projects are chosen and proceed on a basis of fairness, efficiency and transparency. Essentially, adds Jonathan Weisz, a well-known project finance/P3 lawyer at Torys LLP in Toronto, "We like to ensure that everyone has skin in the game."

A PERFECT P3 WORKING EXAMPLE

Effective June 3, 2005, the Sea to Sky Highway Investment Limited Partnership (SSHILP), the Province of British Columbia (the Province) and the BC Transportation Financing Authority (BCTFA) reached agreement on a public-private partnership for the upgrade of the Sea to Sky Highway linking Vancouver and Whistler. Contemporaneously, SSHILP entered a credit facility with Société Générale (SocGen) and The Royal Bank of Scotland plc (RBS) as initial lenders. With a capital cost estimated at $600 million, the deal is one of the largest P3 transactions closed to date in BC and was the first Canadian P3 to be funded on the international market.

The project is one of the steps being taken by BC in its preparations for the 2010 Winter Olympics. Construction on the project is scheduled to be complete by the Spring of 2009 and is intended to meet population growth and travel demands until 2020, with additional improvements phased in as required over approximately 20 years. BC estimates that the project will create 6,000 new jobs as a result of economic activity generated along the corridor and increase provincial GDP by $300 million over the period of 2010 to 2025.

Under the Concession Agreement entered into by SSHILP, the Province and BCTFA, SSHILP will design, build, finance, operate and maintain the Sea to Sky highway for a 25-year term. SSHILP has also entered into a subcontracting agreement with Peter Kiewit Sons Co. (PKS), who will provide design and build services, and Miller Capilano Maintenance Corporation (Miller Capilano), who will provide operation and maintenance services.

The Province and BCTFA were represented by Fraser Milner Casgrain with a team that included Doug Benson, Doug Younger, Colin McIver, Robert Nikelski, Robert Goodrich, Heidi Clark, Janelle Dywer and Sherry Dubo as well as the in-house team of the Ministry of the Attorney General, which included Richard Fyfe, Maria D'Archangelo and Ann Wilson.

SSHILP was represented by Blake, Cassels & Graydon with a team that included Jeff Merrick, Ian MacIntosh, Mungo Hardwicke-Brown, J.P. Bogden, Marshall Pawar, Sabeen Sheikh, Michael Adams, Anne Stewart, Q.C, Neal Wang, Mark Smith, Bill Maclagan, Paul Cassidy, Gloria Chao, Joanne Lysyk and Bryan Duguid.

Caroline Miller Smith and Stephen Le Vesconte of UK-based Linklaters provided UK advice to SSHILP.

Macquarie Essential Assets Partnership, which acted as equity sponsor to SSHILP, was represented by in-house counsel Noreen Flaherty and assisted by Myron Dzulynsky, Tim Wach and Ian Macdonald of Gowling Lafleur Henderson.

SocGen and RBS were represented by UK-based Lovells with a team that included Gavin McQuater, Andrew Gallagher, Andrew Briggs, Shapna Roy, Mhairi Weir, Kavita Kishor and Thomas Seifert. Ron Bozzer, Robert Kopstein, Doug Sanders, Ken Anderson and Rosemary John of Borden Ladner Gervais provided local counsel to SocGen and RBS.

PKS was represented by in-house counsel Sam Gilmore and Mary Carnazzo and assisted by Maurice Chiasson of Stewart McKelvey Stirling Scales and Melissa DiVincenza of Morris, Nichols, Arsht & Tunnell. Miller Capilano and one of its shareholders were represented by Mitchell Welters, with the other shareholder receiving advice from in-house counsel Richard Grant of Miller Paving Limited and Gary Shiff and Marianne Smith of Blakes.

THREE NOTABLE POINTS

Jeff Merrick is one of the lawyers at Blakes that leads the firm's national infrastructure practice, a group which involves 40 lawyers across Canada. They are typical of all emerging infrastructure practice groups in that there is a relatively tight group of lawyers who spend close to 100 per cent of their time going from one P3 project to the next, from RFEI (request for expression of interest) through to the RFP (request for proposal).

"These deals are in many respects more intense in terms of complexity, time and players involved than many M&A deals," explains Merrick. Mungo Hardwicke-Brown and Ian McIntosh of the Blakes group were also part of the core team of the Sea to Sky project.

The Sea to Sky project provides a useful illustration of the complexity of a major P3, including the following features:

1. It was one of the first large projects to be funded on international markets, signaling to the international community that Canada was open for business.

2. The list of participants in this deal number 47 and represent a diverse range of expertise (e.g., engineering, finance, tax, environmental dispute resolution, etc.) This signals the importance of teamwork and synchronized efforts to keep P3s on schedule. It also conveys the level of complexity which is typical.

3. The fact that this project will create 6,000 new jobs and increase provincial GDP by $300M over 15 years illustrate the long-term economic and social benefits that P3s can provide.

SEIZE THE DAY

The emerging opportunities for investors, lawyers, engineers, consultants and others are becoming increasingly evident. It comes as no surprise to find infrastructure practice groups springing up and expanding. Even three years ago it would have been unusual to find an infrastructure practice in most firms. The operative question is how firms and lawyers capitalize on this new "big thing."

The answer is found in the very thing that high-achieving lawyers do best. They adapt and morph into new forms by leveraging off of the strength they already have. Gowlings is an excellent example. Take a top energy lawyer such as Paul Harricks, pair him up with a leading and highly motivated corporate finance, M&A and securities lawyer such as Constance Sugiyama, who has a passionate interest (and practice focus) in health care. Add to this mix a significant national platform with more than 700 lawyers in multidisciplinary practices across Canada and, suddenly, you have all the ingredients for a new but highly experienced infrastructure practice group led by Harricks. "We have both a dedicated core group supported by different specialists that involves about 75 people across the country. Our national platform is highly complimentary and a source of leverage," says Harricks.

Brad McLellan, a commercial real estate lawyer, and Dan Ferguson, a corporate lawyer, both at WeirFoulds, also morphed into P3 practitioners. They were able to build on the existing strengths of their firm's platform, which included a strong practice with significant historical relationships in municipal and land planning work. They have leveraged their own strengths by using the skills and networks of such leading municipal and planning lawyers as George Rust-D'Eye and Barnet Kussner.

What is readily apparent from the lawyers interviewed is that there are a number of skills and practice feeder groups that can be reconfigured into P3s practice groups. These include project finance, corporate real estate, energy, corporate finance, securities and M&A, among others. But more is required. As John Casola emphasizes, "Learning how to interact and negotiate with government, understanding the decision makers and those who influence decisions, and even understanding their special challenges with respect to optics with the public sector places a premium on the soft skills required for success."

SKILLS

Jonathan Weisz at Torys touches on another limiting factor that helps explain why there are not more infrastructure projects moving ahead at a time when the market is awash with investment funding (apparently both Teachers' Pension Plan and OMERS are investing in major infrastructure projects outside of Canada).

Casola's greatest challenge in running a national infrastructure advisory practice for PricewaterhouseCoopers is finding experienced people. "The Canadian pool of experience is shallow and P3s require multidisciplinary skills such as engineering, finance and law. Also, doing deals with the government is very different from doing deal or project finance within the private sector. The optics are different, the decision making is different and so on. Acquiring the hard and soft skills to do this is not easy and we don't yet have a lot of training, books, or other resources to accelerate the learning curve."

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Jeff Merrick, Mungo Hardwicke-Brown and Ian McIntosh believe that the group of people who are working on these projects will always be small because the skills and commitment requirements are so steep. As Merrick explains, "These are like the biggest M&A transactions that just go on and on (Sea to Sky negotiations commenced in July 2004 and closed in June 2005)." At the same time, all those interviewed emphasized the difference between the core group of lawyers who take the lead on these projects and the many other specialist lawyers who can and do contribute on projects. As Merrick, Hardwicke-Brown and McIntosh point out, "These projects are excellent for team learning. They really engage a diverse group of practice specialists and, inevitably, everyone broadens their scope by learning about other specializations."

Is something happening in the socio-economic environment and the way Canadians think about our social infrastructure? Maybe not yet. But as Bill Bain advised his son Mark, "Keep your eyes open."

Irene E. Taylor is a leadership consultant with more than 25 years' experience in coaching and advising senior and top talent in Canada and internationally. She leads Praxis, a talent assessment, recruitment and coaching practice.

