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## Unsolicited Proposals

### Competitive Solutions for Private Infrastructure

**This Note looks at systems some governments have used to transform unsolicited proposals for private infrastructure projects into competitively tendered projects. It focuses on the policies that Chile, the Republic of Korea, the Philippines, and South Africa have adopted for managing such proposals. A companion Note explores the problems associated with unsolicited proposals, especially the risks they raise for competition and transparency.**

Among private infrastructure projects reaching financial closure, the share that originated as unsolicited proposals varies across countries. In the Philippines about 15 percent of such projects have been unsolicited, while in the Republic of Korea the share is as high as 50 percent. The share is also significant in many other countries, and policymakers have begun to recognize the need for formal systems to manage these unsolicited proposals.<sup>1</sup>

Governments could use several approaches to handle unsolicited proposals. One option is simply to adopt a law prohibiting unsolicited projects—and some governments have done this. A second option is for governments to purchase the project concept and then award the project through a competitive bidding process in which no bidder has a predefined advantage. A third option—the one adopted in such countries as Chile, the Republic of Korea, the Philippines, and South Africa—is to offer the original proponent a predefined advantage in a

competitive bidding process. Under this third option two main approaches have developed: the bonus system and the Swiss challenge system.

#### Bonus system

The governments of Chile and Korea support unsolicited proposals by awarding a bonus in a formal bidding procedure to the original proponent. The original proponent's offer is then selected as long as it falls within a stipulated percentage of the best offer.

Consider a hypothetical case in which a private company proposes a new toll road. In exchange for using the proponent's project concept (considered intellectual property in some countries), the government grants the company a 10 percent bonus for use in competitive bidding. The rules of the bidding process require the government to award the project to the bidder offering the lowest tariff per kilometer. The original proponent bids US\$0.100 per kilometer, but another company makes the best offer—

**Table** Bidding results for airport concessions awarded by mid-2002, Chile

Location of airport	Year of privatization	Unsolicited proposal?	Value of bonus (percent)	Participants in tender	Was the bonus a factor?	
					Winner	
Iquique	1995	Yes	20	2	Bonus holder	No
Puerto Montt	1995	Yes	20	2	Non-bonus holder	No
Calama	1997	Yes	10	2	Bonus holder	No
La Serena	1997	No	n.a.	4	n.a.	n.a.
Santiago	1997	No	n.a.	7	n.a.	n.a.
Concepción	1998	Yes	10	5	Non-bonus holder	No
Antofagasta	1999	No	n.a.	5	n.a.	n.a.
Punta Arenas	1999	No	n.a.	2	n.a.	n.a.

n.a. Not applicable.  
Source: Chilean Ministry of Public Works.

US\$0.095 per kilometer. The government would still award the toll road project to the original proponent, since its bid is within 10 percent of the lowest one, and the original proponent can charge the higher tariff that it bid.

In Chile most unsolicited projects involving a bonus for the original proponent have been airport concessions. Surprisingly, receiving a bonus in the airport privatizations provided little advantage to the original project proponent in the bidding. The bonus may have scared away other potential bidders, but in no case did it determine the award of the project: in the absence of the bonus, the same bidder would have won (table 1).

In Korea the maximum value of a bonus is 10 percent, with the exact value determined by other characteristics of the tender process. Projects are usually awarded on the basis of a complete evaluation covering the financial plan, construction plan, operation plan, and social contribution. Of the two projects in which a counterproposal was successful, only in one did the bonus make a difference in the outcome (table 2).

**Swiss challenge system**

Used for several years in the Philippines, the Swiss challenge system, like the bonus system, allows third parties to make better offers (challenges) for a project during a designated period. The original proponent then has the right to countermatch any superior offers. Several other governments now use modified

versions of the Swiss challenge system, including those of South Africa, Guam, and the Indian state of Gujarat.

In the past 20 years the Philippine government has received many unsolicited project proposals. Local governments have also received unsolicited proposals. Among the major projects reaching financial closure, only one was successfully challenged: International Passenger Terminal 3 in Manila’s Ninoy Aquino International Airport.

With existing airport terminals exceeding capacity, a private company submitted an unsolicited proposal in 1996 to construct a new airport terminal. A counterproposal offered substantially

**Table** Status of unsolicited proposals for infrastructure projects submitted by mid-2002, Republic of Korea

Status	Proposals
Under review	4
Rejected	4
Accepted	21
Under preparation for counterproposals	4
No counterproposals received; project awarded to original proponent	12
Counterproposals received; under review	2
Counterproposals received; project awarded to original proponent	1
Counterproposals received; project awarded to challenger	2
<b>Total</b>	<b>29</b>

Source: Private Infrastructure Investment Center of Korea.

higher canon payments to the government. The original proponent decided not to countermatch, and instead filed a complaint with the government claiming that the consortium making the counterproposal lacked the financial and operational qualifications required. Several other issues were raised, the most important being the legal validity of using the Swiss challenge system when a counterproposal contains different specifications than the original proposal. The challenger was eventually awarded the concession, but the project is still surrounded by controversy.

South Africa, where the Swiss challenge system is quite new, originally modeled its regulations on the Philippine system. But it recently adjusted them to increase the possibility of a successful challenge. A few unsolicited proposals had been received in the road sector by mid-2002, but results are still preliminary.

### Policy choices for successfully managing unsolicited proposals

If a government actively pursues private participation in infrastructure, the private sector is likely to come forward with ideas. Governments are under no obligation to accept unsolicited proposals, but time, financial, or political pressures may compel them to consider some of them. The experience of Chile, Korea, the Philippines, and South Africa shows that a government is better equipped to handle these pressures if it already has a transparent system in place for managing unsolicited proposals. A government should consider several policy issues, two important ones being whether to offer cost reimbursement and whether to set time limits for completing certain steps.

### Offering cost reimbursement

Some countries (such as Chile and South Africa) allow reimbursement of original project proponents for their project concept or project development costs. The advantage given to the original proponent in the bidding is usually intended to compensate for use of the project concept. In addition, the bidding documents sometimes specify reimbursement for project development costs by the winning bidder or the government. Other countries (such as Korea and the Philippines) allow no reimbursement of project development costs.

The experiences reviewed here leave it unclear whether providing cost reimbursement influences the quantity or quality of the unsolicited proposals that governments receive. Offering cost reimbursement maintains private sector interest during the development phase of an infrastructure project, helps to ensure that the source of ideas is not limited to large investors with deep pockets, and encourages proponents to allocate the resources needed to ensure that projects are professionally developed. But it may also increase the number of frivolous projects by giving developers an incentive to propose unnecessary projects, lead project proponents to exaggerate the project development costs, or put challengers at a financial disadvantage by adding extra project expenses to their bid.

### Setting time limits

Governments often set time limits on the approval and bidding phases. National laws on private participation in infrastructure usually specify a time limit for reaching preliminary

**Table 3** Time limits for approval and bidding phases in infrastructure projects with private participation, selected developing countries (months)

Country	Preliminary approval	Final approval	Call for open tenders	Submission of counterproposals	Additional time	Total
Chile	7	12	12	2–4	—	33–35
Korea, Rep. of	0.5	4	—	2–4	—	6.5–8.5+
Philippines	2	3	—	2	1 <sup>a</sup>	8+
South Africa	1	9	3	2	2 <sup>a</sup>	17

— Not specified.

a. To countermatch or evaluate.

Source: Chilean Ministry of Public Works; Philippine Coordinating Council for Private Sector Participation; Private Infrastructure Investment Center of Korea; South African National Roads Agency.

approval of a project, reaching final approval, putting the project out to public bid, and submitting counterproposals (table 3).

Time constraints on counterproposals give an obvious competitive advantage to the original project proponent. The proponent has already spent much time and effort preparing the project and thus is much more familiar with its characteristics. By contrast, a challenger may have as little as 60 days in some countries (such as the Philippines) to prepare a counterproposal. Many potential challengers may be unwilling to compete without sufficient time to prepare.

### Conclusion

For a government awarding private infrastructure projects that originate as unsolicited proposals, the objective should be to maximize competition and transparency. Two main ways to do this have developed. The government can purchase the intellectual property rights for a project concept from the proponent and then award the project through a competitive bidding process in which no bidder has a predefined advantage. Or the government can offer the original proponent an advantage in a competitive bidding process. In the second case the government should create rewards that satisfy the original proponent while still allowing a truly competitive process.

In the bonus and Swiss challenge systems it is not easy to find the right balance between incentives to propose beneficial projects and incentives for third parties to submit counterproposals. In theory, both systems give challengers a reasonable chance of winning. In Korea and the Philippines, however, very few projects have been successfully challenged. In Chile the probability of a successful challenge appears to be high, though experience is limited. In an effort to find the right balance, some countries (such as Argentina) have begun to explore hybrid systems combining elements of the bonus system and the Swiss challenge system.

### 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, once

licensed, must compete within a market (such as merchant power plants and cellular telecommunications service). For the Republic of Korea the main source of information was the Web site of the Private Infrastructure Investment Center of Korea (<http://picko.krihs.re.kr/>). For the Philippines it was the Web site of the Coordinating Council for Private Sector Participation (<http://geocities.com/ccpsp/>).

1. Among multilateral organizations, the United Nations Commission on International Trade Law (UNCITRAL 2001) offers general guidelines for managing unsolicited proposals, while the World Bank (1996) finances only projects in which the procurement is carried out in accordance with its procurement guidelines. To be eligible for financing under those guidelines, the borrowing government must select the entrepreneur in an international competitive bidding process in which bidders are treated equally (which would exclude the Swiss challenge and bonus systems), after which the entrepreneur would be free to procure the goods, works, and services required using his or her own procedures. Alternatively, if the government had accepted an unsolicited proposal without putting the project out for competitive tender (or had used the Swiss challenge or bonus system), the entrepreneur would have to procure all goods, works, and services to be financed by the World Bank using international competitive bidding under its procurement guidelines.

### References

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## viewpoint

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