TEME, г. XXXIX, бр. 2, април – јун 2015, стр. 427–444

Оригиналан научни рад
Примљено: 27. 1. 2015. UDK 343.21
Ревидирана верзија: 30. 3. 2015.
Одобрено за штампу: 18. 6. 2015.

OPPORTUNISM OF PRIVATE ACTORS IN PUBLIC-PRIVATE PARTNERSHIPS[a]

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Abstract

This paper deals with the issue of opportunism of private actors in Public-Private Partnerships (PPP). The problem of opportunism in the implementation of a PPP project stems from the fact that the parties' relations are strained by the tension stemming from their conflicting interests. The organizational structure and the *modus operandi* of a public actor are aimed at accomplishing and promoting a general (public) interest. The aim of a private actor is to make a profit. This paper analyzes the reasons for the opportunism of a private actor in a public-private partnership, with emphasis on the *"hold-up"* problem imposed on the public actor. In particular, the *hold-up* problem is reflected in the fact that a public actor has to agree with the changes proposed in the PPP agreement by a private partner. This agreement is based on the fact that a public partner has no actual opportunity to protect the "initial agreement" contained in the original contract. The author proposes that the problem of opportunism shall be resolved *ex ante* by introducing relevant clauses in the PPP agreement. These clauses shall oblige the private partner to pay the price for their opportunistic behaviour. Therefore, the proposed methodology has a pre-emptive effect on the possible opportunism of a private actor.

Key words: public-private partnership, opportunism, "hold-up" problem, project-specific investments.

[a] This paper is the result of the research on the project "Harmonizing the Serbian Legislation with the EU Law", which is financially supported by the Faculty of Law, University of Niš, in the period from 2013 to 2018.

ОПОРТУНИЗАМ ПРИВАТНОГ АКТЕРА КОД ЈАВНО-ПРИВАТНОГ ПАРТНЕРСТВА

Апстракт

Рад се бави питањем опортунизма приватног актера из јавно-приватног партнерства (ЈПП). Проблем опортунизма у реализацији ЈПП пројекта потиче из чињенице да однос његових актера карактерише тензија супротстављених интереса. Јавни актер је својом структуром и начином функционисања усмерен ка остваривању и развијању општег (јавног) интереса. Приватни актер има за циљ остваривање добити. Рад анализира разлоге опортунизма приватног актера ЈПП-а у, уз акценат на проблем „ограничења избора" јавног актера. Конкретна манифестација проблема ограничења избора је саглашавање јавног актера са изменама уговора које је предложио приватни партнер. Ова је сагласност резултат чињенице да је јавни партнер без суштинске могућности да заштити „првобитну погодбу" из немодификованог уговора. У раду се предлаже коришћење уговорног решавања проблема опортунизма кроз *ex ante* стипулисање одређених клаузула у споразуму јавног и приватног партнера. Овим се клаузулама приватном партнеру ставља у изглед плаћање „цене" за опортуно понашање. Стога описана методологија има преемптивно дејство на могућност опортунизма приватног актера.

Кључне речи: јавно-приватно партнерство; опортунизам; „hold up" проблем; пројектно специфичне инвестиције

INTRODUCTION

Public-Private Partnership (hereinafter: PPP) is a framework for resolving the tension between the public and the private sector, primarily for the purpose of raising the quality of establishing, accomplishing, protecting, and developing the public interest (Cvetković & Milenković-Kerković, 2011, 758−759). This tension is generated by the conflicting nature of the basic characteristics of these two sectors. The organizational structure and the *modus operandi* of the public sector are aimed at protecting, accomplishing, and developing the general (public) interest. The private sector is based on private initiative, primarily aimed at making a profit. This distinction is the key factor in understanding the structure and the implementation of a public-private partnership.[1]

[1] In Serbian legislation, the subject matter of public-private partnerships is regulated by the Public-Private Partnership and Concessions Act (Official Gazette of the Republic of Serbia, No. 88/2011). Public-private partnership is one of the three methods of putting infrastructure project into effect and exercising the public interest activities. The other two are: the implementation of these projects by using private financial, personal, and other resources (the so-called "in house" method), and financing these projects by means of loan capital. As compared to the other two methods, the PPP profitability is estimated by comparing the values obtained by applying each of the three methods in a specific project. The Commission for Public-Private Partnership and Concessions of the

OPPORTUNISM OF PPP ACTORS

The problem of opportunism in the implementation of PPP projects stems from a general attitude that the actors of a public-private partnership feature the elements of "*bounded rationality*" – the boundaries of their rationality are defined by their interests.

The rationality of a public partner is based on the achievement of political goals. In transition countries, this rationality seldom lasts longer than an election period, which is inconsistent with the prospects of considering the rights, duties, and responsibilities of the PPP project parties in a period of several years or even decades[2].

The rationality of a private partner is governed and restricted by the market-oriented action model, which generally does not make allowances for the public interest whose exercise is a constituent part of a public-private partnership.

The potential for opportunism is largely determined by the interest-based rationality of the PPP actors. The opportunism of parties involved in a public-private partnership is reflected in a tendency of one party (either the public or the private entity selfishly pursuing its own interests) to oblige the other party to act in a manner which is contrary to the governing PPP principles *in concreto* stipulated in the PPP agreement.

The opportunistic behaviour of a private actor is illustrated in the following example. Upon entering into an agreement with a public partner, a private partner assumed the obligation to carry out a project concerning the construction and exploitation of a waste processing facility. The project

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Republic of Serbia adopted a document called "Methodology for the Earned Value Analysis in Relation to the Invested Funds ("*Value for Money*") in Public-Private Partnerships and Concessions". This document concisely defines the notion of the "value for money" methodology (paragraph 3, page 1): "The assessment of the earned value in relation to the invested funds (determining "*Value for Money*", VfM) refers to the application of an analytical procedure involving the use of quantitative tools in order to determine whether tax payers would have more benefits from the application of the traditional investment model, where a public entity acts as the investor assuming all or a substantial part of the public investment risk, or whether it would be more beneficial to use the services of bidders from the private sector, thus transferring (allocating) most of the risk involved in a public-private partnership relations onto them. Therefore, the idea of maximizing the earned value for public funds is based on the transfer of certain public investment risks onto the private partner. The public sector acts as a procurement agent whose goal is to provide some public service to the end-user, whereas the private sector acts as a contractor who provides the agreed services stipulated in the contract". This methodology is available at the Commission website: http://www.ppp.gov.rs. For more information on the application of the PPP concept in specific fields, see: Lepotić-Kovačević, 2012.

[2] The Serbian Public-Private Partnership and Concessions Act prescribes that a PPP agreement may be contracted for a period of at least 5 years and that it shall not exceed a period of 50 years. See: Article 18, par. 2 of this Act.

was to be realized in two stages: the construction stage and the exploitation stage. Although the contract covered a period of ten years, the private partner intended to terminate the contract after five years (which was the due date for finishing the construction stage and beginning the exploitation stage). Thus, after finishing the construction stage and collecting the payment for construction works, the private partner decided to terminate the contract before the expiry of the agreed term. First of all, this means that the private partner is no longer entitled to receive payment from the exploitation of the facility; second, the private partner is obliged to pay damages for the breach of contract. The breach of contract was justified by a more convenient pending business opportunity which called for a relocation of the private partner's human resources and logistic capacities onto another more lucrative project; the profit margin from that project enabled the private partner to incur considerable financial gain, even after paying damages for the breach of contract.

In the PPP context, the direct reason for the occurrence of opportunism is the fact that the selection of a private partner is performed within the competitive, market-based discourse, in the process of a public procurement.[3] On the other hand, negotiations about amending and supplementing a contract are a matter of bilateral agreement. Therefore, the public procurement procedure, which implies the selection of the most favourable (cost-effective) offer in line with the market-based criteria[4], is

[3] Under the Serbian legislation, the public procurement procedure on awarding the right to carry out a PPP project is regulated by the Public-Private Partnership and Concessions Act and the Public Procurement Act (Official Gazette of the Republic of Serbia, No. 124/2012) to which the PPP Act explicitly refers. The Public Procurement Act is incorporated by reference in the content of the PPP Act. The wording of the PPP and Concessions Act leads to the following conclusions: the provisions of the Public Procurement Act regulate the procedure for awarding a public contract to carry out a PPP project without the elements of concession; the provisions of the Public-Private Partnership and Concessions Act regulate the procedure for entering into a public contract on a PPP project with the elements of concession (Cvetković & Sredojević, 2012, p. 49).

[4] According to Article 85, paragraph 1 of the Public Procurement Act, the offer evaluation criteria are 1) the most favourable (cost-effective) offer or 2) the lowest bid. The criterion for the most favourable (cost-effective) offer is based on different elements, depending on the subject matter of the public procurement; these elements may be: 1) the offered price set by the bidder; 2) a discount on the prices stipulated in the buyer's pricelist; 3) terms of delivery or performance of services/works, including the minimally acceptable and ultimate time limits which do not affect the quality of goods, works, or services; 4) current costs; 5) cost-effectiveness; 6) quality; 7) technical and technological benefits; 8) environmental benefits and environment protection; 9) energy efficiency; 10) post-sales maintenance and technical support; 11) warranty period and type of warranty; 12) obligations in terms of spare parts; 13) post-warranty maintenance; 14) number and quality of hired personnel; 15) functional characteristics, etc.

replaced by bilateral agreements, in which case the private partner essentially has a monopoly (considering the private partner's lack of flexibility in terms of finding a new contractor within the specified time limit).[5] Given the lack of proper methodology, the contract proceeds are redistributed in favour of the private partner, which ultimately entails "less value for (taxpayers') money" and results in economically inefficient administration and procurement of services of public interest.[6] The likelihood of opportunism arises from the fact that public-private partnership agreements are basically incomplete contracts.

The possible opportunistic behaviour of a private partner in the process of creating a public-private partnership may be regarded as a risk for the public partner. As the binary enumeration of risks includes endogenous and exogenous risks, the risk of opportunism has the characteristics of an endogenous risk which can be prevented (or generated) depending on the way a contract is formed. On the other hand, exogenous risks are a result of unpredictable circumstances which are beyond the influence of the contracting parties.[7]

The opportunistic behaviour of a private partner can occur *ex ante* (before the contract is signed, i.e. during the bidding stage) or *ex post* (after the private and public partners signed the contract).

An example of *ex ante* opportunism is the so-called aggressive (opportunistic) offer by a private partner. In this kind of offer, the bidder (a potential private partner) assumes that he will not be obliged to perform all the contractual obligations either because there is the "asymmetry of information" (a disproportion in the quality and scope of knowledge of public and private partners) or due to high transaction costs and/or the political consequences of substituting the selected partner with a new one.[8]

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[5] For more, see *infra,* in the discussion about the public partner's "hold-up" problem.

[6] See *supra* note 1.

[7] This classification is taken from: Radulović & Nenezić, 2012, pp. 195−196.

[8] The relation between the quality and the scope of knowledge of public and private partners in a PPP is called the "asymmetry" of information. For example, in a PPP related to water supply, a public partner has an advantage in relation to a private partner because the former has the knowledge about the quality of the existing infrastructure of the water supply system, its distribution, availability, etc. Local governments have their own ("private") knowledge about the quality of the infrastructure (pumps, pipelines, measuring system); this kind of knowledge is an added value considering that the assessment of the quality of the water supply structure is an excessive financial burden for a private partner (if possible at all); in comparison to electric power plants which are easily accessible, the pipelines of the water supply system are mostly underground, which makes the evaluation more difficult. As opposed to the public partner, a private partner has special knowledge about the technological aspects and modes of funding the water supply project. However, the public partner is not aware of the technological capacities of the private partner, nor is he familiar with the structure of his costs and productivity level (all this knowledge is in possession of the private partner). As both

Ex post opportunism (which occurs in the process of putting a PPP agreement into effect) may be illustrated by a restricted number of options available to the public partner in the process of deciding on its course of action (hereinafter: the *"hold-up"* problem) in case the contract was breached by the private partner. This issue will be discussed in the next section of this article.

THE PUBLIC PARTNER'S "HOLD-UP" PROBLEM

The *"hold-up*" problem is a type of opportunistic behaviour of a private partner in the context of public-private partnership relations. It occurs when the scope and the structure of the optimal transaction (including the quality of service, time of delivery, the quantity of products/services) cannot be *ex ante* defined with considerable certainty. [9]

The *"hold-up*" problem is a form of *ex post* opportunism of one contracting party stemming from the specific purpose of the transaction elements. Therefore, the other party is in an inflexible position (without alternatives). In the PPP context, this specific feature primarily refers to technology, human resources, and the *know-how* of a private partner. The success of the public partner's investment depends on the actions of the private partner, who has the knowledge and ability which cannot be easily substituted on the market.

In essence, the "*hold-up*" problem in the PPP context refers to a situation where a public partner allows an investor to invest funds into a PPP project, after which a private partner modifies the distribution of benefits so as to gain more profit from the PPP project than he is reasonably expected to collect on the basis of his own investments.

The "*hold-up*" problem has significant effects on the relationship between the contracting parties in a public-private partnership.

First of all, there is a rise in the cost of contract negotiations; in order to avoid the *hold-up* problem, the public partner takes actions aimed

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parties have an "information advantage" in some segments, the information they have on specific issues is asymmetric (Cvetković, 2013). In law, the issue pertaining to the asymmetry of information is partially resolved in the discourse of Game Theory. See: Douglas G. Baird, Robert H. Gertner, Randal C. Picker, 1994. For more information on the application of Game Theory to the structure and concept of public-private partnerships, see: Ping S. Ho, 2013, pp. 175−207.

[9] The paradigm of the "*hold-up*" problem dates back to the 1920s. *Fisher Body, a* company specializing in the production of automobile bodies, was the only company which produced components according to the *General Motors* specifications. Given the significant increase in demand for the components, the manufacturer *Fisher Body* took advantage of this unexpected opportunity and increased the cost for the additional quantities of delivered goods. As a result, *General Motors* took over *Fisher Body* in 1926 (Rogerson, 1992).

at eliminating the risk of opportunistic behaviour of the private partner. These actions include their own costs, and they eventually fall onto consumers and users of goods and services of public interest.[10] Even if such situations were predictable and clearly stipulated, the contract transaction costs remain high as they include the costs of determining *ex ante* the contract terms through negotiations, the guarantees for contract performance, the *ex post* costs related to modifying the contract given the problems in the enforcement of contractual obligations arising from legal voids, and the like.

Secondly, the contract stability and legal certainty are undermined because the private partner is now given an opportunity to be more flexible in accessing his own interest and to make use of the inflexible position (the "*hold-up*" problem) of the public partner; namely, the public partner is not in a position to choose an alternative private partner, either due to the extremely high costs of the private partner selection process or because it is highly unlikely that a new private partner (who is supposed to replace the previous one after the contract is terminated) would be in the same factual position as the previous one.

Finally, the "*hold-up*" problem leads to reducing the effects of applying the market-based principles in the process of selecting the most suitable partner; the current private partner has an advantage due to the inflexibility of the public partner who has limited alternative solutions at his disposal. The ultimate consequence is that investments in the public sector have a lower efficiency rate; the "value for money" generated for the benefit of the public sector[11] is inadequate in comparison to what it would be if the "*hold-up*" problem did not exist.

A concrete manifestation of the "*hold-up*" problem in the PPP context is the situation in which a public partner (as the party in the "*hold-up*"

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[10] This increase in the contract-related "transaction costs" is a direct result of the intrinsic nature of a PPP agreement, which is largely relation-driven and thus "incomplete" (the consequence of which is that the contracting parties may not predict the changes which may stem from altering the context of the contractual relation. Incomplete agreements define the transaction in which both parties agree that it is impossible or economically inefficient (to an extent which makes the contract meaningless) to *ex ante* define future difficulties and circumstances of the contract *(Ayres, Ian & Robert Gertner, 1992, pp. 729−730).* The relation-driven nature of a contract is the subject matter of analysis of the theory of relational contracts. The theory of relational contracts was developed as a result of recognizing the existence of the so-called "incomplete" contracts. As compared to the "complete" contracts, the parties to "incomplete" contracts define only the key elements of the contract; the other elements are subject to silent/tacit agreement on future adjustments. The reason for this approach lies in the fact that a detailed planning of complex contractual relations is financially and logistically demanding. The key to reading a relational contract is an attitude that a contractual relation changes alongside with altering the context of the contractual relationship (Cvetković, 2014). For more about the notion and characteristics of relational contracts, see: Macneil, 1978.

[11] See *supra* note 1.

position) agrees to modify the contract by introducing changes proposed by a private actor. The feature underlying the parties' agreement in this "*hold-up*" situation is as follows: the agreement is not the result of a market-driven evaluation of the public partner's interests (i.e. the assessment is not based on the "*Value for Money*" analysis). The given consent is a consequence of the fact that a public partner (the consenting party) is not in a position to actually choose the method of exercising his rights (interests) by protecting the initial agreement (contained in the original contract). The decision of the public partner (who is subject to the "*hold-up*" situation) to terminate the contract would (even in case of a civil dispute) significantly degrade the quality and quantity of performed activities and services provided in the public interest. This degradation is a result of the fact that finding a relevant substitute for an opportunistic private partner in the PPP construction is not a simple task; in addition, the legal remedy for the incurred damage shall not be limited to the award of monetary (pecuniary) damages but it should also include (non-pecuniary) damages for the loss of the public partner's reputation on the "political market".[12]

"Asset-specific investment". The *hold-up* problem is related to the nature of the investment by a subject whose flexibility is limited; namely, it is an investment without the alternative use value, i.e. an "*asset-specific investment*". Asset-specific investments are permanent investments whose value is smaller or non-existent if they are used in an alternative way (which is not stipulated in the contract). The re-use of asset-specific investments (beyond the form of exploitation envisaged in the basic contract) is not possible without the loss of their intrinsic value in case the contract is terminated before the expiry of the agreed term.

The result of an asset-specific investment is the occurrence of *sunk* costs; this term refers to irreversible costs which cannot be recovered. An example of this kind of costs is an investment in the construction of a network for the transport of energy; in case a private partner abandons/ withdraws from the project and stops the supply of energy, their prior investments in the project becomes sunk costs; as the network does not have an alternative use value, these costs cannot be redeemed by involving a new private partner. Klein and Leffler (1981, 619) define *sunk* costs as "*the non-salvageable part of an advance commitment*". Therefore, in case of a "*hold-up*" situation, "*sunk*" costs become the (key) argument for the partner who has limited options at his disposal to accept the changes in the contract which are opportunistically proposed by the other partner. The offer of the opportunistic partner is based on his flexible contractual position, as

[12] **As contrasted with the benefits from economic activities, the benefits of the public actors are not measurable.** The political "market" (which *is* the place where the "goals" of public actors are achieved) is not expressly regulated by the laws of supply and demand.

compared to the inflexible position of the other contracting party, whose options are limited. This places the market mechanisms into a subordinated position in relation to the opportunism of the party who takes advantage of the "*hold-up*" paradigm in a specific contractual relationship.

Bearing in mind that practice generates different types of specific investment relations, the asset-specific investment may have various forms. These forms can be narrowed down to four types of asset-specific forms of investment:

a) A *situs*-specific form of investment occurs when two facilities are located near one another for the purpose of minimising transportation costs; it occurs when the facilities are not mobile or cannot be relocated due to unsustainable costs of such allocation. For example, if the project refers to the construction of a waste processing facility, the significance of this type of asset-specific feature is extremely high due to the costs of dismantling the facility and its transfer to another location.

b) An object-specific form of investment occurs when specialised equipment is used for the production of certain goods; for example, the efficiency of coal-fired boilers in a power plant producing electric energy from coal (a thermal power plant) can be increased if the boilers are designed for the use of a specific type of coal. However, if the production process involves the use of a type of coal which has not been taken into consideration during the construction of boilers, there is a probability that the working efficiency of these boilers will be significantly reduced due to the distinctive characteristics of the newly-used type of coal (different calorific value, composition and the like)[13]. Therefore, an alternative use of such a facility (the machines and equipment constructed for specific production processes) outside the context of the initial transaction has a significantly lower value.

c) A principal-specific form of investment refers to the user of products of investment (a principal). The investor (agent) has constructed a facility in order to provide a public service to a specific principal. If the relationship between the agent and the principal ends too soon or changes in any way which reduces the economic profitability of the project, the investor (agent) is left with significant capacities but without the possibility to change their purpose. Here is a hypothetical illustration of such an unjust situation:[14]

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[13] A similar example of a highly specific form of investment is an investment in a waste management facility: **if the facility was originally constructed to be used as an incinerator but has to be transformed into the facility for the production of electric energy, such transformation is financially unreasonable.**

[14] The following example shows that it is also possible for a private partner to experience a "hold-up" problem. It should also be noted that there is a possibility of efficient protection of the private partner by using the so-called "stabilisation clause" from Article 52 of the Public-Private Partnership and Concessions Act. See more in: Jovanović, 2012.

an entrepreneur has constructed a factory for the processing of electronic waste (old mobile phones, computer chips, etc.) under the assumption that he will receive government subsidies for this type of processing (given that removal of hazardous waste is a form of protection of the public interest). This fact is an important element of the context of the agreement which the entrepreneur contracted with the buyers of raw materials, which are manufactured from the processed waste. The absence of government subsidies changes the context of the agreement between the entrepreneur and the buyers of raw materials, whereby the investment is deprived of the substantive cause for which it has been originally made: the investment has been put into effect in order to meet the specifically defined characteristics of the principal (the state government whose policy is to eliminate electronic waste). In this case, the change of the context of agreement is equal to contract abandonment, and the agent is left with the facilities which are useless from the aspect of economic efficiency.

d) Investment in human resources refers to the investment in knowledge, development of subject-specific experts, and building trust through a continual learning process. This form of investment occurs when one party values the knowledge of another party more than a third party; for example, the design and development of the model of a specific facility is a complicated and time-consuming process which requires cooperation between public and private partners. Therefore, the private partner gains some knowledge about the needs and ways of satisfying the specific needs of the public partner: it is a "know-how" which has no substitute on the market (as the knowledge is available only to the participants of a specific project).

Therefore, asset-specific investments have an adequate market value for partners if they serve the purpose of fulfilling a concrete contract; however, their value is significantly smaller for any third party or for the contracting parties in case the contract is terminated. At this point, there is an issue of the criterion for establishing the difference between the investment value working towards the contract performance (on the one hand), and the investment value in case the asset has an alternative use (if possible at all), on the other hand. This difference may justify the conclusion that an investment is an asset-specific investment. Concurrently, it should be borne in mind that any minor difference between these values is not a sufficient argument for drawing such a conclusion. In order to determine the "asset-specific" value of an investment, the criterion for differentiating between the investment value aimed at contract performance (on the one hand) and the investment value which may have an alternative use (on the other hand) is as follows: an *asset-specific* investment is deemed to be an investment whose value, in the event of being sold to a third party for an alternative use, is lower than the original investment amount. In case of a PPP, this definition has to be aligned with the subject matter of the public partner's investment project; hence, an asset-specific

investment refers to the disposition of a public resource for the benefit of a private partner and for the purpose of accomplishing a more efficient performance of public services. The analogy with this criterion for determining which investment is deemed to be "asset-specific" in the context of a PPP is that, in case a contract with a specific private partner has been terminated, the overall level of quality in performing services of public interest may be lower than the one which was present before the performance of activities was transferred to the public partner.[15] Namely, private partners will tend to use their activities and profit to cover their expenses first (to pay back a loan and to make a profit) rather than increase the value of an investment as such. They do not have such an interest considering the fact that, in the long run, the benefit from an increased value of an investment goes to the public partner (after the PPP expires). The above situation can jeopardize the security and the quality of providing services of public interest; namely, after the expiry of the agreed term for the private partner's exploitation of the facility, there may be some maintenance, replacement, or repairs costs which are too high because the private partner did not invest sufficient funds in those activities in the previous period (the private partner had no interest to invest further considering that the ownership of the facility was to be transferred to the public partner).[16]

The previously described evaluation of the difference between the investment value serving the purpose of contract performance and the value of investment which may have an alternative use makes sense if it is performed *ex ante*; when the results of such evaluation show that an investment is an asset-specific one, it is necessary to apply methodological mechanisms in order to prevent the risk stemming from the aforementioned investment feature.[17]

The consequences of the "hold-up" problem. Legally speaking, the "*hold-up*" problem is manifested as a disruption of the contractual balance. This imbalance can also be anticipated: a potential contracting party shall not enter into the agreement because he anticipates that, once he performs his due obligation, the other party will pursue the modification of the contract and thus disrupt the originally agreed contractual balance. In case of a public-

[15] In the context of the legal system of the Republic of Serbia, the sub-criteria for determining the quality of the performance of an activity should be the same as the criteria for the most favourable offer, as prescribed in the Public Procurement Act (whose norms are incorporated by reference in the content of the Public-Private Partnership and Concessions Act, which includes a referral to the provisions of the Public Procurement Act). See *supra* note 4.

[16] See more on the lack of necessary investing in the described situation in: Robert E. Scott & Paul B. Stephan, The Limits of Leviathan: Contract Theory and the Enforcement of International Law, 2006.

[17] See more about the methodology *infra* in the discussion about the methodology of overcoming opportunism.

private partnership, an "asset-specific" investment by a public partner implies the disposition of a public resource for the benefit of a private partner. This disposition *per se* does not create a "*hold-up*" situation. Namely, the problem of limited options in a PPP has its dynamic genesis. In the first phase, a private partner first acquires specific knowledge about the project, which is his comparative advantage in relation to other private partners who are interested in continuing the activity after the expiry of the original contract between public and private partners (it implies knowledge about the structure of network facilities in infrastructure projects, the necessary investments needed for maintaining the level of provided services, establishing and developing contacts in a relevant markets of goods and services, the coordination with activities conducted by a private partner in other projects, etc.). Having all this knowledge, in the second phase, the private partner is in a position to use the "inflexibility" of a public partner who is not in a position under reasonable conditions, to easily replace the former private partner with a new one via market.[18]

The anticipation of the "*hold-up*" problem in the process of deciding on the implementation of a PPP project may result either in the public partner's withdrawal from the investment or in the decline of the investment efficiency. In the former case, the withdrawal is caused by the public partner's incapacity to eliminate the "*hold-up*" problem by using a specific methodological approach (allocation of risk, insurance, bank guarantees). Ultimately, the result of the decision not to invest is the lack of the sustainable renewal and development of the public sector. In the latter case, even if the public partner opts to perform activities or provide services of public interest either independently or by using the loan capital, the fact is that the described forms of investment will not be optimal if the "value for money" analysis shows that a higher value is earned for public resources in case the project is carried out in the form of a PPP.[19]

METHODS OF OVERCOMING OPPORTUNISM

Opportunism is an inevitable working assumption in the process of contracting. Yet, opportunism may be limited or even fully excluded from contractual relations[20] by means of cooperation and the mechanisms for

[18] For more about the imbalance of negotiation power as a result of a "hold-up" situation, see: *Posner*, 2010, p. 118.

[19] See *supra* note 1.

[20] One of the mechanisms for acquiring this knowledge is the competitive dialogue procedure. The Public-Private Partnership and Concessions Act expressly recognizes the competitive dialogue procedure (see: Article 23, paragraph 2, item 2, of this Act, Official Gazette of the Republic of Serbia, No. 88/2011), which is elaborated in detail in the Public Procurement Act (see: Article 37 of the Law, Official Gazette of the

discovering relevant information in the process of drafting a contract (in order to curb the problem of the asymmetry of information).[21] Ultimately, the lower level of opportunism enables the optimal level of investments.

The problem of opportunistic behaviour is resolved *ex ante* by stipulating relevant provisions in the contract between the public and private partners. The *ex post* method, which is reflected in the use of market mechanisms and the process of selecting a new partner, is of no significance for the concept of a PPP; if such a possibility existed, the question of opportunism would not be raised at all since the public partner would not experience a "*hold-up*" problem.

Firstly, the contract clauses can be used to secure that the public partner keeps the benefits arising from the results of a PPP. For example, if a PPP is related to the field of waste management, the public partner can prevent opportunism by retaining the ownership right over all

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Republic of Serbia, No. 124/2012, passim). It is a procedure whose primary purpose is the realization of long-term infrastructure projects and other projects of public interest, and projects which are realized in modern market-based economies in the form of public-private partnerships. In essence, a competitive dialogue enables the public partner to act as a private partner in the course of the selection process proceeding; he is able to search for the best possible solutions available on the market in order to satisfy his own needs. The effects of a comparative dialogue can be illustrated by the following example: in PPP projects, there is a risk that some technology, which has been defined as relevant in the contract with a public partner, becomes outdated in the contract period. This situation occurs if a public partner, while defining the conditions for the participation in the process of selecting a private partner, has left out the obligation of interested parties to replace their existing technology with the new one if the existing technology becomes outdated during the contract period (the risk of outdated technology). For the public partner, this lack of this obligation creates "known-unknowns"; in general, a technological development may occur during the implementation of a PPP project (the longevity of these projects only increases the probability). Anyway, the public partner may underestimate this risk or may not have enough information about it. When such technology becomes outdated, the public partner finds himself in the position where he has to pay to the private partner the same amount which he could have used to buy more advanced and more efficient technology (if he had provided himself with such a possibility *ex ante*). Concurrently, public partners from other countries (in case of international competition) or other local communities (in case of the national market competition) use the new technology or pay a lower price for the old technology (which is lower than the one paid by the public partner who has not anticipated the possibility of replacing the technology). Therefore, in essence, a public partner who has not anticipated the possibility of replacing the outdated technology may potentially suffer economic deprivation. This situation may be overcome by a competitive dialogue if the participants are required to specify the technology which they will use in a specific case, providing extensive information about its origin, characteristics, the deadline of technological depreciation, etc. Using these data, the public partner can evaluate with more certainty the probability of risk stemming from the outdated technology. For more on the competitive dialogue procedure, see: Veličković, 2013, pp. 526−538.

[21] For more about the asymmetry of information, see: Cvetković, 2013.

facilities and mechanization (subject to the terms of contract) which were in the private partner's possession at the moment when the contract was terminated prior to the expiry date. This significantly reduces the likelihood of the private partners' opportunistic behaviour. An example of the "retention of benefit" clause is a contractual provision which regulates the issue of transferring a project from the existing to a new private partner who has been selected after the contract with the existing private partner has been terminated. Namely, given that the realization of a PPP project requires cooperation between public and private partners, the latter acquires some knowledge about the requirements and methods of fulfilling contractual obligations towards the public partner. This knowledge is highly specific: it refers to a "*know-how*" which is acquired in the course of contract performance. The transfer of this knowledge requires an active attitude of the titleholder of that knowledge (the original private partner). This active attitude has to be defined as a contractual obligation of the original private partner, which implies a specific sanction if the original partner does not fulfil his obligations during the "transitional period" (the period of transferring the contract from the former to the new private partner). This sanction has to be actually applicable and independent from court mechanisms (for example, retaining a certain amount of the due payment if the original private partner does not fulfil his obligations during the transitional period).[22]

Secondly, opportunistic behaviour may be prevented by imposing an obligation upon a potentially opportunistic partner to "pay the price" for his own opportunism. Thus, contractual clauses may include provisions defining the securities for the public partner, which imply the payment of monetary compensation by the private partner in case the contract is terminated before the expiry date. These securities must be credible: a credible security instrument is the one which provides for the full compensation of the public partner, in case the contract has been breached/terminated by the other party before the expiry date (for example, the obligation of paying damages for the breach of contract by a private partner who breached the contract without cause). In legal terms, a credible security instrument is the one which makes the termination of contract unsustainable from the perspective of the private party who acts opportunistically. The legal credibility is a consequence of the economic credibility of providing securities for the public partner. The economic credibility of securities makes the breach/termination of contract an unprofitable option for the private partner, which (in turn) diminishes the likelihood of his opportunistic conduct. At this point, it should be noted that the contract may be preserved (even if the private partner insists on the termination) by ensuring the financial support of a PPP project financier. The

[22] The described retention of benefit by a public partner is also applicable in case the selection of a private partner is a result of the expiry of the PPP contract (and not necessarily due to the breach or termination of a contract).

financier may "enter" into the agreement only providing that there is a direct contract between a public partner, a private partner, and a financier in accordance with Article 49, paragraphs 3-6 of the Public-Private Partnership and Concessions Act.[23]

An opportunistic behaviour can also be prevented by providing contract clauses which define the consequences of an initially opportunistic offer by a private partner. For example, a private partner has been authorized to carry out a PPP project after making an aggressive (opportunistic) offer and bidding a lower price. The offer is based on the expectation that the public partner will find himself in a "*hold-up*" position as soon as the parties embark on the contract implementation, either due to the fact that the private partner eventually gains relevant project knowledge which is unparalleled on the market or given that the process of replacing the existing private partner would be financially and logistically draining to an extent that makes the effort inconsequential. The private partner will take advantage of this new (anticipated) position of the public partner by requesting some changes in the terms of contract for his own benefit. The likelihood of the private partner's opportunism, which is based on the "*hold-up*" position of the public actor, may be reduced by introducing a relevant clause in the model contract (which is defined *ex ante* in the process of selecting the most favourable private partner); this clause shall_stipulate that the private partner has the right to change the original terms of contract only if the contract implementation costs exceed a specific percentage of the contract value. If the agreed percentage limit is high (e.g. 10 percent or above), it will influence the private partner's decision to withdraw his initial opportunistic offer; yet, if he decides to stand by the aggressive (opportunistic) offer, the project business results may turn out to be less lucrative than he anticipated when placing the aggressive offer. For example, if he has made an aggressive bid by stipulating a lower contract value and the contract implementation costs eventually exceed a specific percentage (which is lower than the agreed percentage limit stipulated as a requirement for changing the contract terms), he is at a loss because he is not entitled to change the contract. Considering the fact that he may not pursue the change of the contract value as long as the contract implementation costs do not exceed a specific percentage, he will not be able to transfer the costs of his *ex ante* opportunism (prominent in the bidding phase) onto the public partner by demanding *ex post* (after being authorized to embark on the implementation of the contract) the increase of the contract value.

[23] See an extensive analysis of this option in: Nenezić & Radulović, 2012, p. 65.

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ОПОРТУНИЗАМ ПРИВАТНОГ АКТЕРА КОД ЈАВНО-ПРИВАТНОГ ПАРТНЕРСТВА

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Резиме

Јавно-приватно партнерство оквир је решавања тензије између јавног и приватног сектора, а у циљу подизања квалитета реализације, заштите и развоја јавног интереса. Актере јавно-пројектног партнерства карактеришу различити интереси: јавни актер је начином функционисања усмерен ка заштити, остваривању и развијању јавног интереса. Приватни сектор заснован је на приватној иницијативи усмереној ка остваривању добити.

Интересима дефинисана рационалност актера ЈПП-а установљава потенцијал за њихов опортунизам. Опортунизам приватног актера јавно-приватног партнерства је настојање да захтева од јавног актера понашање које је супротно принципима дефинисаним у уговору о ЈПП-у. Одредбе овог уговора, дефинисане кроз поступак јавне набавке у коме се о најповољнијој понуди одлучује кроз тржишне критеријуме, замењује се билатералним погодбама у којима приватни партнер суштински иступа са позиције монополисте. Описана ситуација, у одсуству одговарајуће методологије, води до редистрибуције резултата уговора у корист приватног партнера, што има за резултат „мању вредност за новац“ пореских обавезника, односно економски неефикасно вршење услуга од јавног интереса.

Опортунитет приватног партнера може се јавити ex анте (пре него што је уговор закључен, дакле у фази подношења понуде), односно ex post (након закључења уговора са јавним партнером).

Пример ex ante опортунизма је тзв. агресивна (опортуна) понуда приватног партнера. Ова понуда садржи податке и обавезивања за која понудилац (потенцијални приватни партнер) претпоставља да неће морати да их испуни у целости, било због чињенице да постоји асиметричност информација у односу на јавног партнера, било због високих трансакционих трошкова односно политичких последица замене изабраног партнера новим.

Пример ex post опортунизма (који се јавља у током реализације уговора о ЈПП-у) јесте ограничења опција за избор понашања јавног партнера у случају повреде уговора коју чини приватни партнер (проблем „ограничења избора“; е. „hold up“ проблем).

“Hold up” проблем је облик ex post опортунизма који настаје због специфичне сврхе елемената трансакције. Стога је друга страна у нефлексибилној позицији (без алтернативних опција). Суштински, проблем ограничења избора у контексту јавно-приватног партнерства је ситуација у којој јавни партнер омогући да инвеститор уложи новац у ЈПП пројекат, а да потом приватни партнер изврши модификацију дистрибуције користи на начин да има виши ниво добити од ЈПП пројекта него што је то оправдано улагањима која је учинио.

“Hold up” проблем има значајне последице за однос страна јавно-приватног партнерства. У коначном, проблем ограничења избора води до редукције деловања тржишних законитости у прибављању најповољнијег партнера: постојећи приватни партнер је партнер у предности због нефлексибилности јавног партнера чију позицију карактерише ограничење избора. Крајња последица је да се инвестиције у јавном сектору реализују уз мањи степен ефикасности: вредност

која се добија за новац јавног сектора мања је него што би то био случај да нема "hold up" проблема.

Решавање проблема опортуног понашања решава се ex ante стипулисањем одређених одредби у уговор јавног и приватног партнер, попут: одредбе којом јавни партнер задржава корист од резултата ЈПП-а; потом одредбе којом се потенцијално опортуном приватном партнеру ставља у изглед обавеза да плати "цену" свог опортунизма, као и одредбе којом се дефинишу последице иницијално опортуне понуде приватног партнера на начин којим се преемптивно спречава његово могуће опортунистичко понашање.

Proofreading: Gordana Ignjatovic.