

United States Department of Transportation Transportation Infrastructure Finance Workshop

PROCUREMENT AND RISK ALLOCATION ISSUES

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Overview

- Concession Procurement Methods
- Efficient PPP Risk Allocation
- Key Risk Issues

Concession Procurement Methods

- When and How to “Marry Up”
 - “Hard Money” Proposals – public partner role:
 - Defines project
 - Clears it environmentally
 - Achieves public consensus on project and PPP
 - Validates financial feasibility
 - Sets toll rate structure
 - Develops complete business and contract terms, technical specifications
 - Imposes performance requirements rather than regulation of means and methods
 - Liable for fewer claims and change orders than conventional delivery
 - Oversees design, construction, operations, maintenance

Concession Procurement Methods

- “Hard Money” Proposals – private partner role:
 - Completes project
 - Assumes integration and other development risks conventionally retained by public agencies
 - Guarantees price and completion, with limited rights to claims and change orders
 - Assumes life-cycle performance risks
 - Collects tolls in accordance with rate-setting mechanism
 - Pays excess toll revenues to public owner
 - Hands project back in pre-agreed condition
 - Receives “tax ownership” and therefore depreciation tax benefits
 - Closes financing shortly after award

Concession Procurement Methods

- “Hard Money” Proposals - Nature of Competition
 - Qualifications submittal and short listing
 - Industry workshops
 - One-on-one proposal meetings
 - Alternative technical concepts, alternative financial concepts
 - Competing hard money bids
 - Proposer assembles design, construction, O&M pricing and forces
 - Proposer delivers firm equity/debt commitments

Concession Procurement Methods

- Stipends
- Selection by best price:
 - Highest up front/annual payments
 - Lowest public contributions
 - Technical hurdles pass/fail to address non-price elements
- Selection by best value:
 - Price
 - Other relevant factors
 - What weighting to assign to each

Concession Procurement Methods

- “Hard Money” Proposals – Examples:
 - Wide international use; growing domestic use
 - SH 121
 - IH 635
 - North Tarrant Express
 - POMT
 - I-595
 - Knik Arm Crossing
 - Asset monetizations

Concession Procurement Methods

- “Predevelopment” Proposals – Characteristics:
 - PPP formed at beginning or during environmental process
 - Complex, large development project
 - Project definition and configuration fluid
 - Finance plan rudimentary or non-existent
 - Preliminary T&R analysis done and suggests financial feasibility
 - Public partner may lack funds, resources to progress project
 - Public partner seeks private sector innovation to define and accelerate a feasible project

Concession Procurement Methods

- “Predevelopment” Proposals – Nature of Competition:
 - Selection is qualifications based
 - Project understanding
 - Best conceptual development and finance plans
 - Track record
 - Pricing of pre-development work; co-investment
 - Successful work proving project feasibility earns exclusive right to negotiate implementation agreement
 - DBM, DBOM
 - Toll concession
 - Availability payment concession

Concession Procurement Methods

- “Predevelopment” Proposals – Examples:
 - Wide domestic use, little international use
 - Virginia – Pocahontas, I-81 Truck Lanes, I-95/395 HOT Lanes, Dulles Rail Corridor
 - Texas – TTC-35, SH 130 Segments 5&6, TTC-69, North Tarrant
 - Oregon – Sunrise, Newberg – Dundee, I-205 South Corridor
 - Washington – Tacoma Narrows
 - California – SR 125, SR 91
 - Georgia – Northwest Corridor, CA 400 Crossroads

Concession Procurement Methods

	<u>Predevelopment Proposals</u>	<u>Hard \$ Proposals</u>
Private partner participation in predevelopment work	Strategic partner	Minimal Role
Project definition	Strong	Weak
Environmental review	Technical and economic analysis	None
Preliminary T&R work	Yes	No
Investment grade T&R study	Yes	Yes
Value engineering	Yes, all stages	Only via Alternative Technical Concepts at proposal stage, and post-award design
Stakeholder relations	Possibly	More limited

Concession Procurement Methods

	<u>Predevelopment Proposals</u>	<u>Hard \$ Proposals</u>
Technical specification development	Direct participation	Only via industry draft review and comment
Financial planning analysis	Yes	Yes
Nature of Competition		
Predevelopment contract	Qualifications	N/A
Concession contract	Sole source negotiation (price reasonableness analysis)	Price competition
Transparency	Less	More

Efficient PPP Risk Allocation

- Allocate to party in best position to manage the risk
 - More often allocated to developer compared to other contracting structures due to 1) strong project control, 2) ability to spread risk over time, 3) equity cushion
- If neither better situated to manage risk, share it
- Perform project risk assessment before procurement
- Rate project risks according to likelihood and severity

Efficient PPP Risk Allocation

- Reduce likelihood and/or magnitude of risk before procurement through pre-development work, data generation/gathering, and due diligence
- Compare cost of:
 - Risk retention vs.
 - Developer contingency to take risk transfer
- Assess strength of competition
- Assess appetite for risk transfers
- Last, allocate risk

Key Risk Issues

■ Political Risks

- Need for legislative approval
- Change in political will in course of procurement
 - Fear of loss of public control
 - Fear of excessive profit
 - Fear of low quality or safety
- Risk assessment and mitigation
 - Sustained public support for project
 - Assess strength of public opposition
 - Public relations and media effort
 - Educate legislators
 - Contractual standards and requirements for quality, performance, oversight
 - Contract controls on projects via revenue sharing or limits on return on equity

Key Risk Issues

■ Macro-Economic Risks

- Concessionaire takes all these risks
- Inflation, recession, local and regional growth, travel demand influences, capital market conditions, technology change

■ Environmental Risks

- NEPA
 - Concessionaires will not take NEPA risk
 - Lenders typically will not fund if NEPA litigation is pending
 - Possible to close before limitations period expires, but only with agency backstop
- Major environmental permits - several approaches:
 - All in hand before bids
 - Developer responsible; schedule relief for regulatory delay
 - Developer responsible; cost and schedule relief if permit conditions more onerous than an assumed baseline
 - Agency responsible; cost and schedule relief for delay or more onerous conditions

Key Risk Issues

- Competing Facilities
 - Private sector concern – protection of originally expected revenue stream
 - Public sector concern - maintain right to meet future mobility and safety needs
 - Solution – Public sector free to build what it wants, but compensates to cover net revenue impact
 - Exceptions for:
 - ✓ All projects identified in transportation plans
 - ✓ All projects outside a “competing facilities zone”
 - ✓ Improvements for safety, maintenance or operational purposes
 - ✓ Certain capacity improvements – ITS systems, metering devices, intersection grade separations, restriping that adds lanes
 - ✓ HOV/HOT lane additions on other roadways
 - ✓ Transit and other non-highway projects
 - ✓ All projects outside public partner’s control
 - ✓ All projects beyond stated time period
 - Other solutions
 - ✓ First option for developer
 - ✓ Availability payments

Key Risk Issues

- Quality of Work
 - Concessionaire risk/responsibility
 - Tools to achieve quality
 - Performance-based measures and standards – specify outcomes, and inspections to measure outcome achievement, asset condition
 - Private partner project management plan – procedures, processes, quality management systems for all aspects of work. Subject to public partner approval
 - Private partner responsibility for acceptance testing and inspection

Key Risk Issues

- Use of Independent Engineer
- Public partner audit and monitoring of IE and private partner, and spot testing and inspection
- Renewal and replacement scheduling and reserves
- Handback requirements

Key Risk Issues

■ Changes In Law

- General changes in laws – Developer cost risk; schedule risk varies
- Changes in tax laws
 - Income and margin taxes
 - Real property tax
 - Sales tax
 - Toll taxes
- Targeted changes in other laws
 - Toll rates and regulation
- Land-use regulation

Key Risk Issues

- Termination
 - Triggers for early termination can include:
 - Developer material default
 - Agency material default
 - Force majeure
 - Court ruling
 - Environmental permitting
 - Public convenience
 - Compensation to developer upon termination depends on reason terminated
 - Amount designed to (1) motivate behavior, (2) protect specified sources of funds and (3) be legally enforceable

Key Risk Issues

- Developer material default
 - Less than debt
 - No protection of equity
 - Offset by agency's damages
- Force majeure
 - Repay unaffiliated bona fide debt
 - Equity often at risk
- Termination for convenience
 - No single, well established precedent
 - Fair market value
 - Guaranteed internal rate of return
 - Full lender protection

Key Risk Issues

■ Final Observations

- Concession risk allocations and management are unique in many respects
- Full range of revenue and cost risk allocations leads to complex, detailed documents
- Long concession term as a going concern with equity investment and rates of return supports broader private risk assumption

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