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CREATING THE LEGAL FRAMEWORK:
Legislative and Procurement Issues

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Traditional Procurement Tradeoffs

Advantages:

- Government maintains total control over design
- Competitive initial construction cost
- High transparency and low political risk

Disadvantages:

- No guarantee of lowest ultimate price
  - Limited cost control over design process
  - “Overdesign”
  - Exposure to change orders
  - Life cycle cost no taken into account
- 100% public funding

Delivery of New Projects through Long-Term Franchises/Concessions

Advantages:

- Large, new sources of capital
- Minimizes dependence on public revenues
- Developer assumes more environmental and development period risk
- Developer assumes traffic and revenue risk

Disadvantages:

- For-profit entities require taxable financing – PABs now available
- Less public control over operations
- Limits on rates and charges must be set by contract

Monetization of Existing Assets through Long-Term Concessions

Advantages:

- Large, new sources of capital to fund other projects
- Private sector assumes long-term revenue risk and O&M burden

Disadvantages:

- Future rates and charges may be higher than if asset retained in public ownership
- Public share in future net revenue gains is limited
- Difficult contractual issues

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PPPs: Key Public Sector Objectives

- Effective Competitive Procurement Methods
- Maximize Private Sector Investment and Risk Sharing
- Limited Public Financial Exposure
- Reasonable Tolling Structure and Profits
- Opportunity for Revenue Sharing
- Quality Design, Construction, Operation and Maintenance
- Effective Assurances of Performance
- Effective Remedies

Essential Elements of Authorizing Legislation, cont.

- PPP Contracting Authority
  - Contract with private party to design, build, finance, operate and maintain
  - Any of the above

Essential Elements of Authorizing Legislation

- Procurement Authority
  - Solicited proposals
  - Unsolicited proposals
  - Best price / best value (price and other factors) / quals-based selection
  - Negotiating authority
  - Evaluation factors

Essential Elements of Authorizing Legislation, cont.

- Tolling Authority
  - Electronic
  - Post-concession
  - Delegable
- Strong toll enforcement mechanisms
  - Video tolling
  - DMV data access
  - Administrative fees and penalties
  - License/registration denial
  - Civil infraction
  - Efficient court processes
  - User privacy

Path from Policy to Procurement (PPP for PPPs)

- Financing Authority
  - To issue toll revenue bonds
  - To mix public and private capital funding
- Sovereign immunity/immunity from suit
  - Private party ability to sue and obtain enforceable judgments
- Condemnation Power
  - Right to condemn property for projects that private sector will lease and operate as a business

Some Legislative Obstacles

- Legislative approval of contract (CA)
- No public contribution
- Removal of tolls upon termination (Miss.)
- 100% payment and performance bonds (various)
- No private debt issuance (WA)
- No ad valorem property tax exemption (AK)
- Short, inflexible maximum term
- Regulated utility model for setting future tolls

Model Legislation

- Several sources of model legislation
  - http://www.fhwa.dot.gov/ppp/legis_model.pdf
  - ABA Model Code for Public Infrastructure Improvement
  - Nossaman's Public-Private Partnerships in Transportation Act
  - VA, OR, FL, TX etc.
- Comparison of FHWA, ABA and Nossaman model legislation

Additional Policy Issues

- Transparency vs. Confidentiality
  - Protect confidentiality of procurement data, documents, information before award
  - Protect confidentiality of private sector trade secrets and proprietary information
- Competing Facilities Protection
- Term and Extension – 35, 50, 57, 99 years?
- Limit on Return on Investment

Reasonable Tolling Structure and Profits

- Public sector objective:
  - Maximize its upfront income or long-term revenue share?
  - Minimize toll rates?
  - Prevent excessive profit?
  - Manage traffic demand and congestion?
  - Depoliticize setting toll rates?
  - Toll exemptions for critical public purposes?

Reasonable Tolling Structure and Profits - Tools

- Indexed toll rate schedule – caps future toll rates,
- Use of stated caps or inflation indices (CPI)
- Banded revenue sharing – generates public partner revenues, prevents excessive profit
- Examples:
  - Pocahontas: 40% of real net cash flow after IRR on total investment = 6.5%; 80% after IRR=8.0%
  - Segments 5 & 6: 4.65% of gross revenue until IRR on equity = 11%; 9.3% of next band of gross until IRR = 15%, 50% of all further gross

Competing Facilities

Private sector concern	protection of originally expected revenue stream
Public sector concern	maintain right to meet future mobility and safety needs
Solution #1	Public sector free to build what it wants, but compensates for net revenue impact
Solution #2	Developer takes risk in physically constrained or high-cost area

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Competing Facilities

- **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

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

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Quality Design, Construction, Operation and Maintenance

- Issues
  - How can public partner assure quality?
  - Operation and maintenance standards?
  - Major rehab and restoration?
  - Capacity enhancements, tech'y upgrades?
  - Operation within regional network?
  - Congestion pricing?
  - Interoperability?

Effective Assurances of Performance

- Lender skin in the game
- Bonds from design-build contractor
- Guarantees from parents of design-build contractor, O&M contractor
- Letters of credit for specific obligations – routine O&M; renewal and replacement work; handback work
- Reserves

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Quality Design, Construction, Operation and Maintenance

- Tools
  - Performance-based measures and standards – specify outcomes, and inspections to measure outcome achievement
  - Regular reports by private partner to determine and maintain asset condition
  - Financial audits, monitoring, spot testing and inspection
  - Renewal and replacement scheduling and reserves
  - Handback requirements

Effective Remedies

- Scale remedies to the type and severity of breach
- Liquidated damages – for delayed completion, noncompliance with routine covenants
- Step-in rights, including receivership
- Anticipatory breach and assurances of future performance for persistent default
- Termination for major uncured default
  - Lender rights to notice and cure

Payment on Termination

- 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

Manage for Success

- Bring in experts that have “been there, done that”
- Obtain knowledge of the market
- Develop internal expertise
- Obtain public buy-in
- Start with one, suitable project to learn the process

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Mitigating Political Risks

- Need for new/additional legislation
- 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

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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