

McKenna Long & Aldridge LLP

Rebuilding America

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Things That Can Go Wrong — Political and Legal

- Trans-Texas Corridor
 - **Political Risk** -- The Texas House of Representatives imposed a 2 year moratorium on privatization of transportation assets. Lessons Learned --- Issues can be non-project specific.
- Chicago Skyway
 - **Labor Risk** Toll road employees chose not to work for the new private management team and the City of Chicago had to absorb all toll road employees. Lessons Learned - understand the needs of all stakeholders.
- Black Warrior Parkway Toll Bridge
 - **Headline Risk** - Alinda project in Alabama is being highly protested due to a \$0.50 increase in tolls. Lessons Learned -- Understand citizen threshold.

Things That Can Go Wrong — Political and Legal (cont.)

- Detroit Windsor Tunnel
 - **Regulatory Risk** -- Tunnel opened in early 2001 as a short-cut to Canada. After 9/11 traffic moved slowly due to increased homeland security measures. **Lessons Learned**
 - Traffic risks can arise from multiple sources.
- Atlanta Water Privatization
 - **Partnership Risk** -- Concession agreement for the privatization of water was terminated when certain performance measurements were not met. **Lessons Learned**
 - Understand the working relationships of partners early in the process.

American Bar Association 2007 Model Code for Public Infrastructure Procurement (MC PIP)

An Overview of the Model Code for Public Infrastructure Procurement

Introduction

- **Articles 1 through 10: Basic policies for**
 - Procurement of supplies, services, and construction;
 - Disposal of supplies; and
 - Legal remedies.

Introduction (cont.)

- **Article 11: Socioeconomic policies that a State may wish to amplify or tailor to local needs.**
- **Article 12: Ethical standards for public officials and contractors in connection with governmental procurement**

Article 1

General Provisions

- **Describes the general purpose of the Code**
- **Specifies its applicability**
- **Provides guidance for interpretations**
- **Contains definitions of terms**

Article 2

Chief Procurement Officer

- Establishes the Office of Chief Procurement Officer

Article 3

Source Selection and Contract Formation

- **Source selection and contract formation methods**
- **Competitive sealed bidding**
- **Competitive sealed proposals**
- **Small purchase procedures**
- **Sole source procurement**
- **Emergency and special procurements**

Article 4

Specifications

- **Requirements for developing, monitoring and using specifications to maximize competition**

Article 5

Procurement of Infrastructure Facilities and Services

- **Authorizes five different project delivery and finance methods for use by agencies in managing the infrastructure facilities and services in their infrastructure collection.**
- **Delivery methods are structured so that an agency can select from among any of the project delivery methods based on the circumstances of each project and its impact on the overall all portfolio of projects and services**

Article 5

Procurement of Infrastructure Facilities and Services (cont.)

- **Delivery methods**
 - Design-Bid-Build (including Construction Management At-Risk as a permitted variation)
 - Design-Build
 - Design-Build-Operate-Maintain
 - Design-Build-Finance-Operate-Maintain
 - Operations and Maintenance

Article 5

Procurement of Infrastructure Facilities and Services (cont.)

- **Covers the use of**
 - bid, performance and payment bonds
 - contract clauses for
 - change orders
 - differing site conditions
 - variations in estimated quantities
 - suspension of work
 - termination

Article 5

Procurement of Infrastructure Facilities and Services (cont.)

- **Criteria for making price adjustments due to changes and variations in estimated quantities**

Article 9

Legal and Contractual Remedies

- **Provides mechanisms for the resolution of disputes relating to**
 - Solicitations and awards
 - Bid protests
 - Contract performance
 - Debarment or suspension determination

Article 10

Cooperative Purchasing

- **Designed to facilitate cooperative procurement among units of government**
- **Authorizes and encourages Public Procurement Units to enter into cooperative purchasing arrangements with one another**

GOVERNMENT RULES (1)

Rule 1: Establish a jurisdictional P3 constitution.

- This rule is really a meta-rule. Adopt as closely as possible quasi-constitutional provisions to ensure transparency for all P3s.
- The most important requirement for real transparency is that there be consistent and timely budget reporting on anything that smells remotely like a P3.
- Another aspect of transparency that is valuable is the deposit and public availability of all contracts (Siemiatycki, 2007).

GOVERNMENT RULES (1)

Rule 1: Establish a jurisdictional P3 constitution (cont).

- Legitimate trade secrets should be protected through the sealing of specific contract provisions.
- A neutral third party should adjudicate the legitimacy of particular claims to secrecy.

GOVERNMENT RULES (2)

Rule 2: Separate the promotion P3 agency from the delivery P3 agency

- Separate the agencies that:
 - (1) Analyze the desirability of projects; that is, perform the (*ex ante*) social NPV of the project.
 - (2) Decide which of the alternative provisioning forms to employ (government production, contracting or P3): does a P3 provide the best social value?

GOVERNMENT RULES (2)

Rule 2: Separate the promotion P3 agency from the delivery P3 agency (cont.)

- Separate the agencies that:
 - (3) Administer the P3 process the agency that organizes the tendering of bids, selects the partners, makes the final decision whether to proceed with a P3 and monitors contract implementation.
 - (4) Monitors and evaluates the overall success of projects: did the P3 provide the best social value?

GOVERNMENT RULES (3)

Rule 3: Ensure that bidding is reasonably competitive

- Ideology should be kept in check and public sector entities should be encouraged to bid. They may have valuable knowledge that would give them a cost advantage. This will not work for major projects unless mechanisms are in place for them to access private capital markets and package the necessary complementary skills (which may be in the private sector. could result in a “mini-P3” rather than a “maxi-P3”).

GOVERNMENT RULES (3)

Rule 3: Ensure that bidding is reasonably competitive.

- The (government) P3 promoter should be pro-active in searching for bidders when they are not expected to be an “optimal” number of bidders. What is optimal? There is surprisingly little hard empirical evidence on the impact of bidders (competitors) on driving down prices to competitive levels. But, at least 3 or 4.

GOVERNMENT RULES (4)

Rule 4: Be wary of projects that exhibit high asset-specificity, are complex or involve high uncertainty, and for which in-house contract management effectiveness is low.

- When projects involve high uncertainty and are complex (they often go together), changes in plans and/or implementation are inevitable after the project has begun.
- Long-term projects (many infrastructure projects have life-cycles of 40-50 years) involve a fair amount of uncertainty.

GOVERNMENT RULES (4)

Rule 4: Be wary of projects that exhibit high asset-specificity, are complex or involve high uncertainty, and for which in-house contract management effectiveness is low. (cont.)

- Once one participant (usually the private sector participant), has made an asset-specific investment, the costs of renegotiating can be very high. The ability to renegotiate at reasonable cost be thought of as a valuable option (there are usually not many options available with major infrastructure projects as they involve high asset specificity and significant scale).

GOVERNMENT RULES (5)

Rule 5: Include standardized, fast, low-cost arbitration procedures in all P3 contracts.

- This reduces transaction costs from lawsuits. In certain cases, monetary costs have been high. Even more problematically, they have taken an extremely long time to complete.

GOVERNMENT RULES (5)

Rule 5: Include standardized, fast, low-cost arbitration procedures in all P3 contracts. (cont.)

- It will normally make sense to think about two distinct arbitration procedures:
 - (1) One be for those disputes that the parties agree are minor.
 - This procedure should be subject to strict specified time limits (never more than several weeks).
 - It probably makes sense to have “shotgun” decisions: the arbitrator simply announces a decision and the remedy (if so, obviously remedies and penalties must be specified ex ante).

GOVERNMENT RULES (5)

Rule 5: Include standardized, fast, low-cost arbitration procedures in all P3 contracts. (cont.)

- It will normally make sense to think about two distinct arbitration procedures (cont.):
 - (2) One for disputes that at least one party considers to be a major breach of contract.
 - In this case, the arbitrator would be able to declare a breach of contract sufficient to abrogate the contract.
- While these procedures may seem draconian, the reduction of legal dispute costs provides reasonably symmetric benefits to both parties.

GOVERNMENT RULES (6)

Rule 6: Avoid stand-alone private sector shells with limited equity from the real principals.

- Discourage the private sector partners from establishing a subsidiary, stand-alone corporation. If this does occur, make the parent company co-sign the contract and accept significant liability. Of course, in a few circumstances it may be difficult to work out which corporation this is.

GOVERNMENT RULES (6)

Rule 6: Avoid stand-alone private sector shells with limited equity from the real principals. (cont.)

- If there is a stand-alone corporation, ensure that that a required debt-to- equity ratio for the project is clearly specified. A too low debt-to- equity ratio can make it profitable (on the margin) for equity participants to declare bankruptcy.

GOVERNMENT RULES (6)

Rule 6: Avoid stand-alone private sector shells with limited equity from the real principals. (cont.)

- Limit large consortia of equity holders. With large numbers, it may not be in the interests of any equity holder to provide organizational leadership (a public good), even though it means walking away from a significant equity investment. This “large numbers” phenomenon certainly played a role in the collapse of Metronet.

GOVERNMENT RULES (7)

Rule 7: Have a direct, legally-enforceable conduit to debt holders.

This rule, of course, begs the question of why governments could access this capital directly themselves. Of course, some do. But, that is a story for another day.

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