



## **PUBLIC-PRIVATE PARTNERSHIPS: UNIQUE OPPORTUNITIES AND RISKS**

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*As published in the Fall, 2011 edition of CONSTRUCTION ink!*

America's infrastructure – the transportation, energy and telecommunication networks that constitute the physical platform of our economy – is showing its age. The funding sources we have relied on in the past to repair, replace and develop public infrastructure projects are increasingly incapable of keeping pace with rising construction and maintenance costs alongside increased user demand. As budgets are reduced with the constraints of today's economy, state and federal governments are gradually turning towards Public-Private Partnerships (“PPP”) as a means to fund public works projects and, in particular, infrastructure projects<sup>1</sup>.

A PPP is a contractual agreement between a public agency (federal, state or local) and a private sector entity that allows for greater private sector participation in the delivery and financing of projects. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares the risks and rewards associated with the delivery of a public service and/or facility. In light of the increased risks shifted to the private sector partner/contractor, the private partner is typically a joint venture of two or more entities equipped to shoulder the financial and technical requirements of a particular PPP project. Joint ventures typically include the contractor, a designer and a financier/developer. The projects are normally financed with private market debt or equity that is repaid from project-derived revenues, either in the form of tolls paid by users or “shadow tolls”, which are payments made by the government based on the volume of facility usage over time.

Florida is one of many states utilizing PPPs to develop public infrastructure projects. Popular PPP projects currently underway in South Florida are The Port of Miami Tunnel Project and I-595 Improvement Project. The Port of Miami Tunnel, which was one of the first PPP projects in Florida, has an estimated cost of \$1 Billion and is not expected to be completed until 2014. According to local reports, this project created almost 900 construction jobs, with 70% of them coming from Miami-Dade County. Of even greater magnitude, the I-595 Improvement Project

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<sup>1</sup> While this article focuses on traditional “hard infrastructure” projects for transportation, energy and the like, readers should be aware of a growing trend in other countries towards utilizing PPP delivery programs similar to those discussed below for “social infrastructure” projects including hospitals, government administration buildings, convention centers and similar traditionally public facilities. Many in government and in the private construction market believe that it is inevitable that the US will follow this trend in taking the PPP model to the building segment of the construction industry.



is expected to cost \$1.79 Billion, including long-term maintenance costs, and is the largest road project in Florida's history. Clearly, the importance of PPPs on Florida's construction industry cannot be understated. And, it seems obvious that the popularity and importance of PPP projects is only going to increase.

Understanding PPPs, the different roles played by the various players on these non-traditional projects, as well as the associated risks and rewards is critical to executing a successful PPP project.

### **Legislative Authority**

PPP projects are owned and operated at the state or local level and as a result, express authorization must be obtained from relevant state or local legislative authority for public and private parties to enter into PPP agreements. Within the United States, thirty-six states, including Florida, have enacted legislation enabling the use of various PPP mechanisms for the development of its transportation infrastructure.

Florida has enacted Section 334.30 of the Florida Statutes pertaining to Public-Private Transportation Facilities. Fla. Stat. § 334.30(1) states that Florida's transportation department may "receive or solicit proposals and, with legislative approval as evidenced by approval of the project in the department's work program, enter into agreements with private entities, or consortia thereof, for the building, operation, ownership, or financing of transportation facilities." Interestingly, with respect to the terms of the PPP agreements, Section 334.30 states that such should be limited to 50 years, but upon "written findings" that an agreement requires longer terms, the department may enter into agreements with 75-year terms. Anything longer than that requires specific legislative approval. See Fla. Stat. § 334.30(12).

It is very important to note that the Federal Government favors and encourages the growth of PPP agreements and projects through various programs, which includes providing the private sector with access to tax-exempt interest rates. This helps to level the playing field between public and private sources of capital.

### **The Contractor's Role**

There are many different PPP structures and the contractor's role, as well as the degree to which a contractor assumes responsibility, including financial risks, differs from one application to another. While this list is by no means exclusive, contractors should look for the following types of commonly used PPP partnerships:



*Design-Build.* As the phrase is traditionally used, the private partner provides the design and construction to the public agency, which owns the property. This is similar to the *Design-Build-Maintain* and *Design-Build-Operate* approaches, except that in those partnerships the private partner takes on the additional role of either guaranteeing maintenance and/or general operations of the completed public facility.

*Design-Build-Finance-Operate-Maintain.* As the phrase suggests, this approach allocates to the private partner the obligations to design, build, finance, operate and maintain a project. While the specifics vary, these are commonly used for toll roads, where the government maintains ownership, but the private partner procures financing and recoups expenses through collection of tolls. The private partner is often required to make periodic usage payments back to the government. In the *Design-Build-Finance-Operate-Maintain-Transfer* approach, the private entity owns the facility for a specified period of time and at the end of the contractual period (which can differ depending, obviously, on the circumstances) transfers title back to the public partner.

*Build-Operate-Transfer.* In this partnership the private partner builds the facility as required (and designed) by the government, operates the project for a specified period of time (maintaining the associated revenues to repay its costs) and, upon completion of the agreed-upon period of time, transfers title to the public agency.

*Operaten and Maintain.* Under this type of partnership, the public agency contracts the private partner to operate and maintain a facility, yet the public partner retains ownership and overall management of the facility. In another similar form, known as *Operations, Maintenance and Management*, the private partner has management responsibilities of the publicly owned facility.

*Build-Own-Operate.* The private contractor that builds the project maintains ownership and does not transfer title to the government. This is somewhat similar to the *Buy-Build-Operate*, except the latter is typically used for existing facilities sold by the government to the private entity, which is tasked to expand or rehabilitate an existing facility. (See the National Counsel for Public-Private Partnership's website ([www.ncppp.org](http://www.ncppp.org)) for a more detailed discussion of the different types of PPPs, including those identified above.)

## **Associated Risks**

As is clear, the different types of PPP projects and partnership agreements come with different risks and considerations to be addressed by all participants. The contractor in a *Design-Build-Finance-Operate-Maintain* obviously takes on significantly more risk (and different types of risk) than with a more traditional *Design-Build* approach. The contractor must be provided a



significantly greater fee opportunity to "reward" the additional risk and must be sure to have the financial and technical wherewithal to discharge its contractual obligations. Some of the other approaches, such as those that also require the contractor to operate and maintain facilities, require a longer-term assessment of conditions and risks associated with applicable contractual period.

Understanding the contractor's risks associated with each approach and individual project is obviously important. Some of the risks generally shifted to the private contractor partner through the use of a PPP include, but are by no means limited to, procurement of environmental permits and compliance with applicable regulations, conflicts and delays due to design flaws and unknown conditions, and longer-term liability for maintenance-related costs and repairs. Once the risks are understood, proper pre-project planning, including appropriate contract drafting and negotiations, becomes critical to ensuring success.

### *Contractual Risk Management*

One of the most important issues to consider is the contractor's relationship with its private design and developer partners. When framing this relationship, the partners must carefully consider their construction and other project obligations moving forward. Considerations include the sharing of proposal costs among the private partners, managing the implications of environmental impact studies, financing obligations between the private partners themselves (as well as those between the private entity and the public agency), political factors that may impact a particular project (particularly important in longer-term contractual periods where the private partner has operational, maintenance and/or other obligations after construction), right-of-way acquisitions, if any, and potential liability to third-parties.

With regard to contractual relations between the private entity partners, the stakeholders must mutually agree on the terms of their deal, which include the sharing of the risk as well as the rewards of a particular project. The private entity partners should collectively capture the risks transferred from the public partner, including those non-traditional risks not assumed in the purely design-build delivery methods. For instance, the *Design-Build-Operate-Maintain-Transfer* approach includes significant risks beyond the construction risks generally accepted by the contractor, including even the additional maintenance and operational risks associated with the *Design-Build-Maintain* and *Design-Build-Operate* partnerships. Assuming the private entity partner is a joint-venture of a designer, contractor and financier, an agreement must be reached as to whether all of them will equally share the risks/rewards, and/or whether they will be more appropriately allocated towards the partner with most control over a particular risk. For instance,



the designer should be responsible for the design, bearing the risk associated with the design, and reaping the rewards of a successful design. This approach would require the joint venture partners to allocate risks and calculate the reward associated with each risk, making sure that the allocation of the rewards matches the risk borne by each participant..

On large public works projects, such as transportation projects, compliance with environmental regulations can pose a significant risk. The private partner is typically required to prepare an environmental impact study, a document required by the National Environmental Policy Act (“NEPA”) for certain actions that significantly affect the quality of the “human environment”. See 42 USC §§ 4321-4347. This study must be completed before the project is approved, and thus, is a significant pre-project risk. Following this study, the project must receive a “Record of Decision” or “ROD”, which is the formal government approval for a proposed project. This is typically required for financing, procurement of construction contracts, receipt of development fees from the public partner, and other key development steps.

Another construction risk is the potential loss of political good will as a result of shifts in a particular jurisdiction’s politics. The risk is greater for those projects with longer life cycles and partnerships between the public and private entity. This risk must be addressed both internally between the private venture partners and perhaps with the public partner.

The financing requirements of the private partner obviously pose significant risk and are typically some of the major contributions furnished by the private partner to a PPP project. Whether the project is financed through private debt or equity, or through access to traditional public financing, the PPP private partner will ultimately bear at least some of the financial risk. (For many PPP projects, the private partner bears all of the financial risk.) Note that some projects may be structured with long-term private financing, with the private party’s return on investment coming from operational revenue, while private partners on other projects are more timely reimbursed from construction profit or a development fee paid at project completion. Every project is different and the financial structure and risk of each must be carefully considered. Also, statutory frameworks must be followed to ensure compliance with all laws and avoidance of unintended tax consequences.

Transportation projects typically involve and require acquisition of the “right of way”, a phrase used to describe the property needed to build the project. Acquisition of the “right of way” can be difficult and is a common cause of delay on transportation project. The contractor may be required to acquire the “right of way” on a PPP project, which is a traditional role of the



public entity. In doing so, contractors must understand their role in “right of way” negotiations and the available legal tools and options. When the private partner holds title to the “right of way” acquired for the project, it faces potential tort liability for third-party injuries on the property—a significant risk for transportation projects. The appropriate insurance coverage and indemnification provisions are vital to risk management, especially when holding title to the “right of way”.

### Construction-Related Risks

Because the scope of the private venture’s overall responsibilities may be considerably broader on a PPP project, the potential challenges to technical feasibility increase proportionately from the typical design/build model. Technical challenges, as well as other unforeseen events, may cause a growth in scope. The risk of such unexpected costs must be considered in the context of a potentially constrained revenue stream from which to pay for the added scope.

Knowledge and understanding of the legal framework in which the PPP project is being developed is also very important. In addition to the state statutes regulating the PPP, the contractor must be familiar with federal statutes authorizing PPP agreements, such as those on pilot highway projects using federal funds. The interaction between the federal requirements and the state regulations must be carefully reviewed to evaluate the risk-sharing provisions in each, and the impact these requirements may have on contractor performance. PPP state statutes often strike a balance between promoting innovative project development with public policy needs such as encouraging local content and open competition. Traditional procurement policies such as disadvantaged and small business set-asides may carry over in the PPP statutes and must be considered.

The risk that existing laws may change during construction must also be considered. The PPP agreement must recognize this potential risk and skillfully address the impact of a change to existing laws. For instance, on PPP projects with long-term operational or management rights serving as the source of repayment, the invalidation of an exclusive use provision would be fatal to the private partner’s ability to be reimbursed its costs and rewarded for the significant risk undertaken. The private partners must understand and make provisions for this type of risk.

This is obviously not an exclusive list of risks associated with PPP projects and partnerships, but an introduction into those issues and considerations to review before and during the execution of a project.



## **Conclusion**

While the role of PPPs in developing and improving our nation's infrastructure is still evolving, it is important that contractors identify the risks and rewards of participation. PPPs often present contractors with new and increased fee opportunities, but they also present significant risks not associated with traditional design-build projects. Despite the shifting of risk among players in a PPP team, especially between the public and private partners, construction and delivery of a successful PPP project requires a complete team effort. Contractors should always evaluate PPP opportunities on a case-by-case basis, giving great consideration to the strengths and weaknesses of all partners to be involved, both private and public, as well as those of the potential project itself.