





P3 PUBLIC-PRIVATE PARTNERSHIPS

LAWYERS CAN TAKE CUES FROM THE INTERNATIONAL MARKET WHEN FACED WITH INCREASINGLY COMPLICATED U.S. INFRASTRUCTURE CONTRACTS.

BY DANIEL LEVER

The U.S. Department of Transportation's Federal Transit Administration has taken steps indicating the public-private partnership market will heat up. The developing domestic P3 market offers some lessons learned, and the more mature international P3 market gives some excellent clues on how to successfully maximize participation and minimize client liability exposures.

The "stages" of a public-private partnership for a contractor will vary depending on the form of the initiative, and each P3 offering will inevitably have unique challenges and risks. However, central to all P3 initiatives are the contractual agreements put in place between the parties, which in turn define each party's role in the project. Importantly, these contractual agreements define the apportionment of risk between the parties and, in theory, clearly set forth their expected requirements, responsibilities and liabilities. For the purposes of this article, we address the typical and most comprehensive P3 initiative, the design-build-finance-maintain-operate (DBFMO) model, and focus on the three core "stages" that define the contractor's responsibilities and liabilities/risks: (1) design, (2) build and (3) maintain/operate. (It also should be noted that there are many other variations of the P3 model—e.g., buy-build-operate, lease-own-operate, build-operate-transfer, build-own-operate-transfer.)

A fundamental principle of risk mitigation and liability management is that risks/liabilities should be allocated to the party best able to manage them. This rings even truer in P3 initiatives that involve numerous parties with distinct roles and responsibilities. Today, a P3 initiative can take many forms, each representing a spectrum of risk transfer from the public sector to the private sector over the concession period. To complicate matters, a number of options have developed

ADMINISTRATION'S PUSH

In May 2017, the White House identified public-private partnerships as a "key principle" to advance its infrastructure initiative, which is projected to entail \$1 trillion in spending. Even more recently, on July 31, 2017, the Department of Transportation's Federal Transit Administration issued a notice of proposed rulemaking to set up new so-called "Private Investment Project Procedures." These procedures are aimed at reducing existing regulatory hurdles which purportedly prevent more private participation and investment in planning, developing, financing, designing, constructing and maintaining public transportation projects.

with respect to the funding and financing of P3s: congestion pricing/market-based pricing, government syndication guarantees, the nonprofit distribution model, debt competition, the capital contribution model, tax increment financing, the inverted bid model, the bond market, and the Transportation Infrastructure Finance and Innovation Act credit assistance program, known to many simply as TIFIA.

Stage 1: Design

In the first stage, the contractor carries out the design work for the project, which is often completed in conjunction with preparing its bid; however, some projects contemplate the completion of design work only upon the award of the project. Regardless, the completion of design work is most commonly accomplished through the retention of a designer, with the design contingent upon and reliant upon information gathered and provided by the public authority/client. However, as P3s continue to develop, it is becoming more common for the public authority/client to shift the risk of preconstruction due diligence to the contractor as well.

Simply put, design responsibility is shifted to the contractor; doing so should, in turn, theoretically reduce the number of change orders and identification of de-

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sign flaws during construction. The contractor is then in control of and responsible for the price, process and completion, all of which are critical to both cost reduction and revenue generation in a P3. This means that risks previously retained by the public authority/client are now shifted to the contractor (e.g., major environmental permits, conflicts and delays from unknown geotechnical and soil conditions/archaeological conditions/utility conditions, endangered species, accuracy of design and survey data, differing site conditions, delays due to public interface or interference, the need to work around existing operations, services and facilities, and changes in zoning laws). In response to this shift of risk, contractors must now

carefully negotiate the transfer of that risk to the parties best able to manage it.

Stage 2: Build

In this stage, the contractor carries out construction work and bears the attached risk of having taken out a bank loan to pay for it. There are several universally agreed-upon risk mitigation strategies that a contractor should deploy: diligent project management and contract administration, proactive claim management (where allowed under the contract), and prompt dispute resolution and early intervention/negotiation of issues arising during the building phase. Additionally, the contractor should endeavor to minimize risk by procuring

ORIGINS & DEVELOPMENT

While there is no consensus on how to define a P3, the underlying principle is the same: infrastructure projects are financed, designed, built, and maintained/operated by the private sector against periodic payments from public authorities. The origin of the P3 model has been traced back to the early 1990s in the United Kingdom. Initially referred to as a PFI (private finance initiative), the U.K. model was essentially a design, build, finance, and operate model that consisted of a private consortium (usually comprised of an investment company and a contractor) raising its own financing on a non-recourse basis, via a specially created project company, to design and build a public facility (e.g., hospital, school, road). Once the construction phase was complete, the project company would be paid an annual “fee” by the government or state entity in return for the maintenance of the facility over the remainder of the 25- or 30-year concession period.

With the successful completion and operation of projects based upon this new creative source of funding, other countries embraced the P3 model in an effort to fund large-scale public projects. Each country attempted to improve the original model and to conform it to country-specific issues. As it currently stands, the P3 “poster child” is Canada. Taking the best practices and lessons learned from P3s globally (particularly in the United Kingdom and Australia), Canada developed a model tailored to its needs and culture. A distinguishing characteristic of the Canadian P3 model, which many believe to be the reason for Canada’s success in the P3 market, is that the private finance operation is pursued only when it can be demonstrated that it will save taxpayers money in the long term (providing true “value for money”). In other words, a fourth “P” drives Canada’s use of the P3 model: performance or profitability.

the appropriate insurance. It should be noted that certain minimum insurance will be required under contract; nonetheless, all insurance options (including additional coverage) should be analyzed.

- **Insurance during transportation (including loading and unloading)** – All material and equipment should be insured during shipment to the site, including equipment to be integrated into the works, the temporary plant and the construction contractor's equipment. Depending on where fabrication or supply is taking place, marine cargo insurance may be required. There may be a dispute as to whether damage occurred during transit or after delivery. In such a scenario, a "fifty-fifty claims funding clause" can mitigate this risk by requiring each insurer to pay 50% of the claim.
- **Insurance of project assets** – Once onsite, this coverage applies to equipment and material that is essential to progress or extremely expensive. This insurance is important because the loss of equipment or material could have a significant impact on the progress of construction.
- **Construction all-risk insurance (CAR policy)** – This type of policy provides comprehensive coverage for many types of civil construction risks. This policy typically covers physical loss or damage to the plant or works as well as third-party liability related to work conducted on the contract site. However, there are significant coverage exclusions that could potentially apply—e.g., London engineering group (LEG) clauses that address costs rendered necessary by penalties; defects of material, workmanship or design; and consequential losses.
- **Third-party liability insurance** – The project should be covered from the commencement of construction to the end of the concession period by liability insurance for any claim by third parties for the acts or omissions of the project company or of any of the contractors, subcontractors or

Analyzing the risks involved in each model and the correlated funding/financing vehicle is crucial to understanding and ensuring profitability. P3 projects need to be bankable, and risks must be passed to the supply chain or—depending on the risk and value for money considerations—retained by the public sector. In fact, one of the developments that has occurred in the United Kingdom is that certain risks are now automatically retained by the public sector (commonly referred to as the shift from "PFI" to "PF2"). Additionally, the roles of design-build can be split from the roles of operate-maintain; however, this is a decision that hinges on various factors. A comprehensive understanding can be accomplished only by creating a diverse team that can understand and analyze the financials of the project and the technical aspects that impact constructability, production, productivity and costs while also addressing the legal issues that flow through every aspect of the process.

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other persons for whom it may be responsible during construction and operation of the project. The grantor and the lenders may also want to be covered by this policy. This policy should cover, as far as practicable, any environmental effects of construction and operation (i.e., pollution insurance).

- **Workers compensation, employers liability** – The coverage of this policy will depend on the provisions of local law concerning such liability.
- **Political risk** – Depending on the location of the project, this additional insurance may assist in mitigating this risk.

Contractors and insurers alike should also be cognizant of the difference between claims for consequential losses, which are likely excluded from coverage,

and lost productivity or disruption claims, which are potentially covered as direct damages. Specifically, under United States construction law, as noted in *County of Galveston v. Triple B Services*, "delay damages have a technical definition distinct from disruption damages." Delay damages refer to damages arising out of delayed completion, suspension or acceleration; these damages compensate the contracting party that suffers a loss when a project takes longer than the construction contract specified. Disruption damages, on the other hand, are for a project that may be completed on time but nevertheless includes disruption to the contractor and compensates it for "a reduction in the expected productivity of labor and equipment—a loss of efficiency measured in reduced production of units of work within a given period of time," according to Bruner & O'Connor, 5 Construction

RESPONSIBILITY, LIABILITY/RISK, AND CLAIMS	MITIGATION
<p><i>Responsibility for Design</i> Claims will potentially flow between the contractor and designer. Liability may depend upon the scope of the designer’s responsibility to complete preconstruction due diligence.</p>	<p>Contractors should endeavor to shift this risk to the designer, with no obligations of review/approval. If there is an obligation for review/approval, the contractor should negotiate sufficient time to complete review. Further mitigation of risk can be accomplished through the procurement of professional indemnity insurance.</p>
<p><i>Responsibility for Project Information Relied Upon or Gathered</i> The ultimate responsibility to investigate and assess site conditions. Claims will potentially flow between the contractor and survey/geotechnical firms.</p>	<p>Contractors should endeavor to shift this risk to survey/geotechnical firms; however, this is difficult if not impossible to accomplish because the contractor will inevitably retain some responsibility or limitation of recovery against the survey/geotechnical firm. In such circumstances, the contractor should look to either negotiate a price contingency for such specific site risks or pass these back to the project company (through corresponding exclusions or limitations in its contract) for the project company to pass on to the public authority/client.</p>
<p><i>Minimization of Maintenance Costs</i> The design of the project in order to minimize subsequent maintenance and operation costs, particularly critical in a DBFMO. Claims could potentially arise between consortium parties if the roles of design-build are split from the roles of operate-maintain.</p>	<p>In the event roles are split, the design-build parties should work with the operate-maintain parties to ensure buy-in, which could even go so far as to include formal acceptance of the design by the operate-maintain parties. Direct and interface agreements can also be put in place between the contractor and the operate-maintain parties to govern resolution of unanticipated maintenance and operating costs that are attributable to the design of the project.</p>
<p><i>Design Support During Build Stage</i> The continued design support that will be needed by the contractor.</p>	<p>Contractors should endeavor to work closely with the designer to ensure speedy resolutions of conflicts. A “time is of the essence” clause will likely be heavily negotiated, but its inclusion is paramount because the general rule is that time is not of the essence unless the contract expressly provides.</p>

Law § 15:102.

As for the specific issue of claiming “lost productivity” or “impact” damages, the case of *Kiewit Offshore Services, Ltd. v. Dresser-Rand Global Services, Inc.* is directly on point. In that case, Kiewit sued Dresser-Rand alleging breach of contract. In addition to direct damages, Kiewit claimed lost productivity damages, which it termed “impact damages.” Dresser-Rand argued that the impact damages were actually consequential/delay damages, which were excluded under the

contract. In response, Kiewit argued that the impact damages were direct damages because the damages flowed “naturally and necessarily” from Dresser-Rand’s breaches and misrepresentations. The court ruled in Kiewit’s favor and held that the impact damages were, in fact, direct damages and not excluded consequential damages.

From a contractor’s perspective, the procurement of insurance ultimately comes down to contractual requirements and a cost-benefit analysis, because

certain additional coverage may be cost prohibited. However, insurers can anticipate a wide range of claims that could potentially be made under the above-stated insurance vehicles.

Stage 3: Maintain/Operate

In the third stage of the process, the public authority/client is provided with a range of services by a facility management (FM) firm, which will include “hard” FM (the maintenance of the building) and “soft” FM, such as

cleaning. The public authority or client then pays fees to the operator depending on its performance in the provision of those services. If the FM firm is considered to have underperformed, it is fined/penalized or doesn't get paid. With operational stages conferred for 20 to 30 years, "projects" are now lasting decades, not just months or years. And with longer contractual durations, projects are carrying unique risks, with the most prominent being unexpected change.

Historically, an unexpected change could take many forms—e.g., an increase/decrease in demand for the relevant services or a change in the nature of the services required, an increase/decrease in operation or maintenance costs, and/or a change in applicable technology. While certain risks can and should be addressed during the contract negotiation process, the international P3 market has also seen a need to be more commercially flexible in dealing with such operational changes than would be allowed by simply adopting a traditional construction variation procedure. This has led the market to treat DBFMO contracts as more of a living document, which has in turn created multi-tiered "change protocols" that essentially provide a flexible process by which to raise a change and negotiate a solution that is tailored to the value and complexity of the change in question. These aim to avoid prolonged and costly discussion and disputes and promote a continued team collaboration approach. However, the application of such protocols (and the approval process that goes with them, including funder approval) has been the cause of much debate, especially with regard to the time and cost related to agreeing upon and implementing such changes.

Ensuring the use of a functional design, suitable high-quality materials, and an appropriate design life at the design stage will go a long way to reducing risk and expenses during the maintain/operate stage. Other risks that are prevalent during the maintenance and operation stage can and should be mitigated through the procurement of insurance: (1) operational damage



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insurance, (2) insurance of project assets (post-build), and (3) workers compensation/employers liability.

On the Horizon

In its "Infrastructure Report Card" issued every four years, the American Society of Civil Engineers forecasts that it would cost about \$4.590 trillion over the next decade to bring the country's roads, bridges, public schools and ports up to a safe, functioning level. This, coupled with the recent statements made by the Trump administration and steps taken by the Department of Transportation's Federal Transit Administration, has created a perfect environment for P3s to grow and thrive. The success of these P3 projects certainly lies with government initiatives. But maybe the biggest lesson learned from the global development of the P3 market is that it will ultimately fall or rise with the diligence, foresight and savviness of the project participants, the legal

and technical advice obtained, and the time invested in contract negotiation and planning in the pre-build phase of the project. As project scope, roles, responsibilities and liabilities are determined at the outset, a careful consideration of the likely rewards, risks and effective risk mitigation strategies must always be the first priority for contractors. ■

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