Feature

Important Lessons the United States Can Learn From the More Mature International P3 Market

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For several years now, the "buzz" has been that the United States is "poised to become the largest public-private partnership (P3) market in the world."[9] And there is a good amount of hard statistics to support the argument that the P3 market in the United States has in fact lived up to the "buzz."[10] Still though, there is a lack of empirical data to thoroughly analyze the growth (and more importantly the performance success) of the P3 market in the United States. But, with the White House recently specifically identifying P3s as a "key principle" to advance its infrastructure initiative, which contemplates $1 trillion in spending, the potential growth of the P3 market cannot be ignored.[11] This begs the following question: What can the United States learn from the more mature international P3 market? In other words, what lessons can be learned, not the hard way, but by looking at the historical development, execution and performance of the P3 model globally?

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 U.K. Initially referred to as a PFI (private finance initiative), the U.K. model was essentially a design, build, finance and operation 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., hospitals, schools, roads). Once the construction phase was complete, the project company would be paid an annual "fee" by the government or state entity in return for maintenance of the facility over the remainder of the 25- or 30-year concession period. This fee would be linked to the ongoing availability of the facility and the achievement of specified performance standards in its maintenance, and would be subject to deductions if availability or performance fell below the required standards. The revenue generated by this fee would then be applied to service and repay the loans raised by the project company (usually from commercial banks or, in earlier projects, from a bond issued on the capital markets), and to provide a return to the equity investors. The project company would pass down its construction and maintenance obligations to subcontractors who would often also have an equity stake in the project (although project lenders would insist on a full arm's-length transfer of risk, so as to protect the project company's status as the vehicle for their investment in the project).

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.[12] Taking the best practices and lessons learned from P3s globally (particularly in the U.K. and Australia), Canada developed a model tailored to its needs and culture.[13] A distinguishing characteristic of the Canadian P3 model, which is also the characteristic many believe to be the reason for Canada's success in the P3 market, is that the private-finance operation is only pursued when it can be demonstrated that it will save taxpayers money in the long-term (providing true "value for money").[14] In other words, a fourth "p" drives Canada's use of the P3 model: performance or profitability. Initiated in 2002, the Canadian P3 model is now delivering more than 250 projects worth $122 billion, with transportation ($53 billion), health ($27 billion) and energy ($26 billion) projects consisting of the vast majority (totaling $106 billion).[15]

Lessons To Be Learned

The United States P3 market is certainly unique, as most states have enacted statutes that enable the use of various P3 approaches for the development of transportation infrastructure.[16] Of course, it is important to understand the significance of state-specific rules, regulations and laws, but important lessons can be learned from the more mature international P3 market:

1 Fully Understand The Type Of P3

The "standard" PFI/P3 is no longer. Now, this initiative can take many forms, each representing a spectrum of risk transfer from the public sector to the private sector over the concession period.[17] To complicate matters, a number of options have developed with respect to the funding and financing of P3s: congestion pricing/market-based pricing, government syndication guarantees, non-profit distribution model, debt competition, capital contribution model, tax increment financing, inverted bid model, bond market and TIFIA credit assistance program.[18]

Analyzing the risks involved in each model and correlated funding/financing vehicle is crucial to understanding and ensuring profitability. P3 projects need to be bankable and risks 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 U.K. (the shift from "PFI" to "PF2") is that certain risks are now automatically retained by the public sector. Additionally, the roles of design-build can be split from the roles of operate-maintain; however, this is a structure decision that hinges on various factors. A comprehensive understanding can only be accomplished by creating a diverse team that cannot only understand and analyze the financials of the project and the technical aspects that impact constructability, production, productivity and costs, but also address the legal issues that flow through every aspect of the process.

2 Beware Of "Standardization"

As the P3 model has matured, "standard" P3 documents have become increasing prevalent. These "standard" documents carry with them a sense of comfort because they have been developed over many years and carry with them (or at least should) practices and procedures that have worked in the past. However, as discussed above, P3s are seldom "standard" and can take many forms that create different risks (or in some circumstances may adopt alternative approaches to the transfer of risk, for example in relation to who takes the risk of certain changes of law under a construction contract).

As such, it is important that all documentation is reviewed with the specific project's unique characteristics and structure in mind. Failure to do so could lead to an unexpected and disappointing process or result. A prime example of this is the alternative dispute resolution clause, a contractual clause that often takes a back seat to clauses seen as more commercially important. Nothing could be further from the truth, though, especially in the context of operational P3s where the risk of disputes is often magnified by the temptation to make excessive availability or performance deductions, or by poor communication and unrealistic expectations. The "standardization" of alternative dispute clauses has created a perceived sense of comfort and protection; however, it is important to tailor these clauses based upon the unique controlling factors of each project (e.g., the parties involved, the services being provided, compensation terms, duration, efficiency/complexity considerations).

3 Clear Communication Between Project Participants

Although good communication is universally seen as vital to the success of any project, it becomes increasingly important when joint ventures between two or more companies work together in an effort to win the typically large-scale P3 projects. And, with the additional necessary parties involved in a P3 model (e.g., designers, funders, management company, guarantors, a government/state entity, hard and soft facility management contractors and other subcontractors and service providers), communication becomes even more important. However, communication often breaks down, due to a high turnover of staff in longer running P3 projects combined with a lack of "corporate memory." When coupled with mismatched project expectations and goals, the need for a structured channel for all participants to share both knowledge about what works well and also concerns about what does not, becomes paramount. As such, a best practice is to designate team leaders, with a succession plan in the event of turnover, and hold periodic meetings to ensure the communication of all issues in a consistent way to all team members. Additionally, cross-entity "management teams" and "leadership teams," which often include independent consultants, promote the collaborative nature of the P3 model and facilitate a consistent message across all project participants. This leads us to our next lesson, which goes hand-in-hand with clear communication between project participants.

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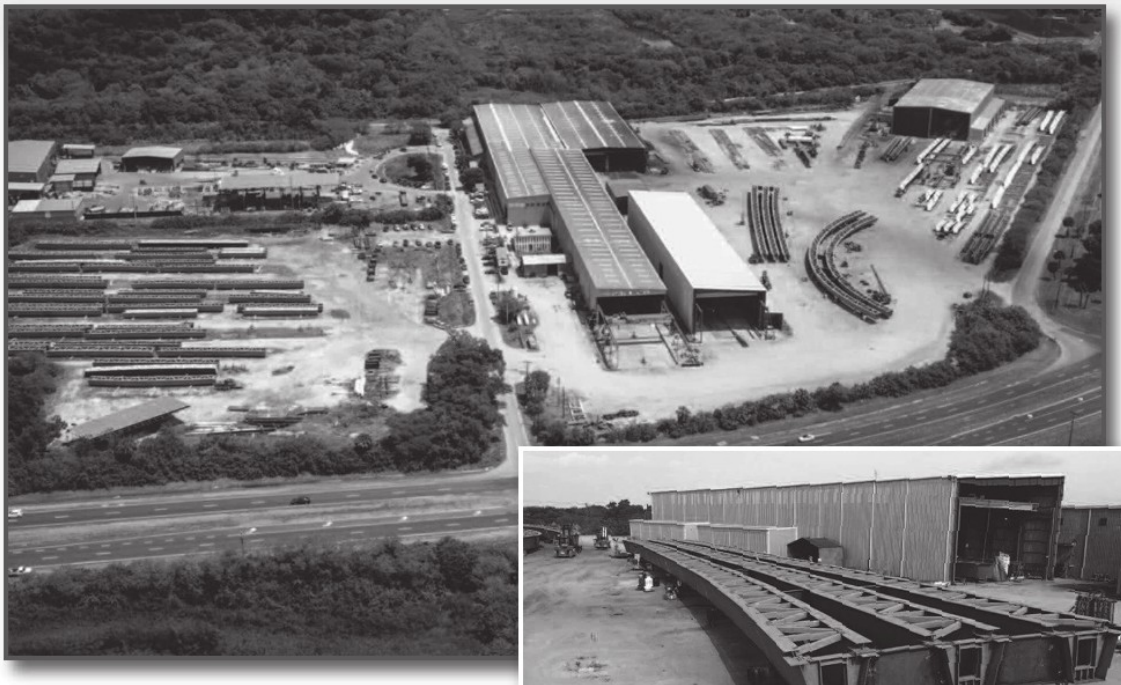

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John M. Clark - Vice President, Tampa Steel Erecting Co.

Jeff Ames, Robert J. Clark, Olivia Butler - Miss Tampa 2017, and John M. Clark in front of laydown on Bridge 230, unit No. 5.

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4 Clear Communication Between Project Participants and End-User/Owner and Management of Expectations

Poor communication between the project team and the end-user/owner can significantly impact the success of a P3. This is particularly true when payments from the end-user/owner are issued subject to deductions if the asset is not maintained or operated to agreed standards. Mismatched understandings between the end-user/owner and service providers can lead to extreme levels of payment deductions for quite minor infringements of performance standards, which will ultimately lead to unnecessary disputes. It is therefore imperative to ensure that any payment and performance standards are fully understood and agreed to (and optimally based upon objective, measureable standards). Best practice is to include a "cure period" to allow the time for correction, before a deduction can be levied. However, if a deduction is assessed, open communication becomes even more important and should continue to ensure the avoidance of future deductions. In other words, a long-term view of the partnership (rather than a focus on short-term financial gains for applying such deductions) can assist in building and maintaining relationships.

5 Flexibility In The Event Of A Change

With the P3 model, "projects" are now lasting decades, not just months or years. Longer contractual durations carry unique risks, including the risk of unexpected change. This can 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 legally addressed during the 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 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, 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 still been the cause of much debate, especially with regard to the continuing time and cost related to agreeing and implementing such changes.

6 Accurate And Thorough Documentation

Unfortunately, the lack of detailed, accurate records is all too common, and most times it is based upon a decision grounded on perceived commercial reasons: "we did not want to start a fight over this issue," "we did not want to negatively affect a performance rating," or "we were trying to show good faith by working with the other party." These reasons, while rational and understandable, greatly hinder the ability to support a claim. It has been said:

A party to a dispute, particularly if there is arbitration, will learn three lessons (often too late): the importance of records, the importance of records and the importance of records. It is impossible to exaggerate the extent to which lawyers can find unexpected grounds, often quite real, on which to cast doubt on evidence if it is not backed by meticulously established records.[19]

Even more, the decision to not report or document an issue is more often than not made before the commercial ramifications can be fully appreciated.

Accurate and thorough documentation is important in any project, but this importance is magnified greatly in the multi-party P3 market where contractual relationships for some of the parties last decades, not just a couple years. Whether it is the difficulty of assimilating complex legal drafting, the sheer volume of project documents, or the challenge of maintaining and storing proper records (especially as ongoing schemes are subject to multiple variations), documentation comes up time and time again as a major issue, especially in the operational and maintenance stages. As such, it is important to foster a culture of accurate and thorough documentation through training that explains the contractual need for documentation and monthly status meetings to ensure training has been put into practice. Additionally, document management software often assists in the retention of records and the ability to efficiently search for relevant documents in the event of a claim.

Conclusion

According to the American Society of Civil Engineers, infrastructure in the United States has barely maintained a below-standard grade of "D+" over the last four years. In its "Infrastructure Report Card" issued every four years, the engineering group forecast that it would cost about $4.6 trillion over the next decade to bring the country's roads, bridges, public schools and ports up to a safe, functioning level, about $2.064 trillion more than what governments and the private sector are ready to spend.[20] This, coupled with the White House's May 2017 statement identifying P3s as a "key principle" to advance its infrastructure initiative, 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 the United States can learn from the more mature international P3 market is that it will ultimately fall or rise with the diligence, foresight and savviness of the project participants.

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9 The United States: The World's Largest Emerging P3 Market Rebuilding America's Infrastructure, Dan McNichol, April 2013; US could become 'world's largest P3 market,' September 2014, http://www.p3bulletin.com/news/view/82163; U.S. P3 Market is Ripe for Growth, Albert E. Dotson, Jr. and Anthony De Yurre, April 2016.

10 Moody's Predicts Bright Future for U.S. P3 Market, March 2016, http://www.ncppp.org/moodys-predictsbright-future-for-u-s-p3-market/.

11 P3 Digest: May 23, 2017, http://www.ncppp.org/p3-digest-may-23-2017/; Should the U.S. spend $1 trillion on new infrastructure?, Yonah Freemark, November 2016.

12 The World's Most Successful P3 Market, December 2014, https://www.swg.com/worlds-successful-p3-market/.

13 The Canadian P3 Model: Will It Work in the United States?, Sarah Jo Peterson, April 2014.

14 The "value for money" standard was also implemented by Australia and is a "must" in any P3 or "alliance." And it seems that the P3 laws and regulations enacted and implemented in the United States have almost universally followed suit by including a "value for money" analysis, defined as the optimum combination of life-cycle costs and quality (or fitness for purpose) of a good or service to meet the end-user's requirement.

15 The Canadian P3 Project Database, http://projects.pppcouncil.ca/ccppp/src/public/searchproject/market-snapshot?pageid=3d067bedfe2f4677470dd6ccf64d05ed.

16 U.S. DOT, Federal Highway Administration, https://www.fhwa.dot.gov/ipd/p3/legislation/.

17 Build-Finance, Design-Build-Finance, Operation & Maintenance, Design-Build-Finance-Maintain (DBFM), and Design-Build-Finance-Maintain-Operate (DBFMO). 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).

18 Public-private partnerships and the global infrastructure challenge, 2015, http://www.ey.com/Publication/vwLUAssets/EY-

19 Max W Abrahamson – Engineering Law and the I.C.E Contracts.

20 U.S. Infrastructure Gets 'D+' Grade From Civil Engineers, Wall Street Journal, Cameron McWhirter, March 2017, https://www.wsj.com articles/u-s-infrastructure-gets-d-grade-from-civil-engineers-1489069827.

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