

PPP and US Highway Infrastructure

If you are unfamiliar with the acronym PPP, look down the next time you're on a toll road: you may be driving on it. PPP stands for Private-Public Partnership, and it refers to a facility and infrastructure construction finance and procurement model that is beginning to catch on in the US and Canada. The model has developed in response to the increasingly limited pool of public funds for large-scale projects. Given the need for public agencies to better manage project risk, and given the unusual nature of these arrangements for the private participants, PPPs demand creative risk management and transfer solutions for everyone involved. Contractors and design firms considering PPP opportunities should be aware of what may lie ahead.

The Problem

Maintaining the pavement, ramps and bridges that make up the public highways of the US is an expensive undertaking. To make sure the system can accommodate predicted growth in traffic levels, necessary spending at all levels of government is estimated at \$235 billion in 2006, increasing each year to \$472 billion in 2030. If spending falls below this level, road conditions can be expected to deteriorate. Projections for the revenue streams that currently fund the federal government's contribution to the system – primarily from the Highway Trust Fund – show a cumulative budget shortfall through 2015 of half a trillion dollars. The cash balance in the fund is currently expected to reach zero some time in 2008. Given the price of gas, Congress is unlikely to authorize an increase in the gas tax – the source of income for the Trust Fund.

Estimates of the cost required to improve – not just maintain – the system add more than a trillion dollars to the shortfall.

Searching for Solutions

The federal Department of Transportation recognizes the problem and is doing what it can to promote alternative funding options at the state and local levels. These include:

- Expanded use of tolling
- Non-traditional procurement arrangements utilizing public-private partnerships, also called private financing initiatives (PFI)
 - Design-build, procurement or project delivery by a single entity (a contractor with subconsultants, or team of contractors and engineers, often with subconsultants) is entrusted with both design and construction of a project. This contrasts with traditional procurement where one contract is bid for the design phase and then a second contract is bid for the construction phase of the project.
 - Build-operate-transfer (BOT), a public-private partnership arrangement involving private construction, private operation for a given period of time, and eventual



Professional Liability Newsletter for the Design and Construction Industry

. . . people whose work revolves around construction management should be aware of the variable range of exposures they could face.

transfer to public ownership. The public sector sponsor is responsible for raising the finances.

- Non-traditional financing structures
 - Build-own-operate (BOO), a public-private partnership arrangement involving private financing, design and construction of a project in its entirety and at the sole risk of the private sector entity. The public sector entity may provide some form of payment guarantee via long-term contracts, but any residual value of the project accrues to the private sector entity.
 - Build-lease-transfer (BLT), which is similar to a BOT project except that a lease of the facility, project site, buildings and equipment is granted to the private sector entity during the term of the lease.

PPPs and PFIs have a longer history outside the US than inside. The Channel Tunnel, the tunnel under the English Channel, is probably the most famous PPP product. Australia has many privately operated toll roads; some have struggled, while most are counted as successes. The US is catching up, however. Texas has several PPP roads, and a major PPP tunnel is in the works in Miami.

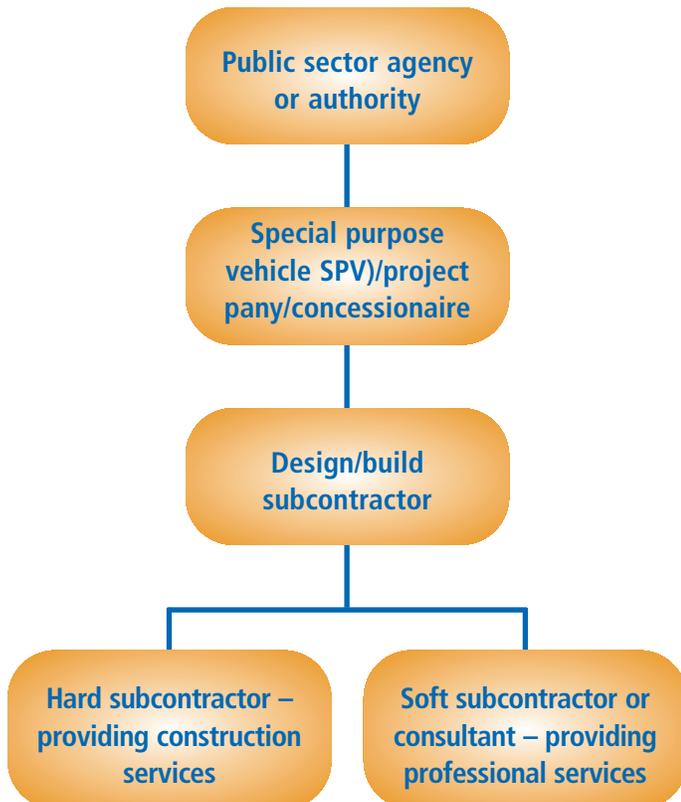
Dealings in the State Capitol

PPP may be the wave of the future, but it faces obstacles. Legal barriers to non-traditional arrangements exist in many states. Many states prohibit design-build contracts; some restrict outsourcing of certain functions, some prohibit tolling and some do not permit commingling of public and private funds.

In many states, the authority to develop toll roads is allocated to special public authorities. Special legislation may be required to expand or transfer these powers. Even in states where non-traditional arrangements are not expressly prohibited, legislation allowing them is being sought to help minimize the risk of litigation and delay. Such processes are slow, but 34 states have laws allowing design-build contracts, and 28 of those allow them in highway projects. Legislation allowing private sector participation in transportation projects has passed in 19 states.

Contract and Insurance Issues for Design and Construction Professionals

Given that the PPP model revolves around a novel sharing of responsibilities, it is no surprise that unusual liability and other risk management questions would arise. Typically, government agencies seek to transfer as much risk as possible to the concessionaire. In this process, design risk is typically passed down from the public sector entity to the project company and then, often, in turn to a design-build contractor and its design consultants.



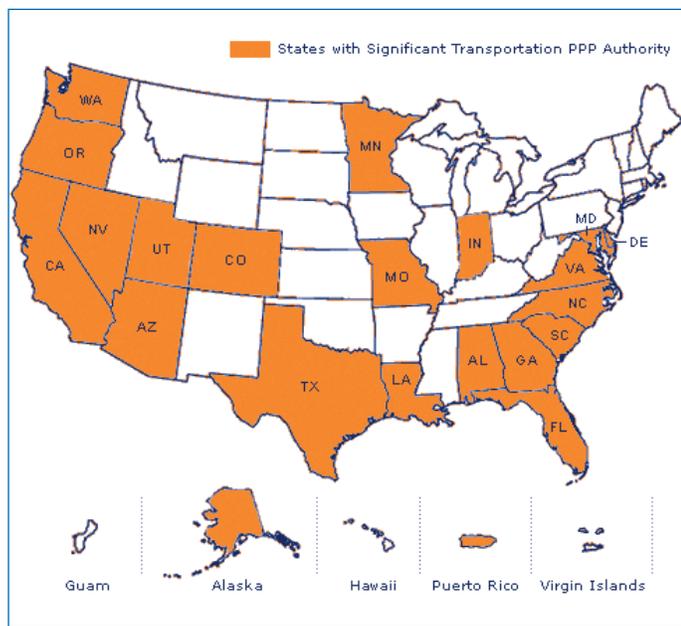
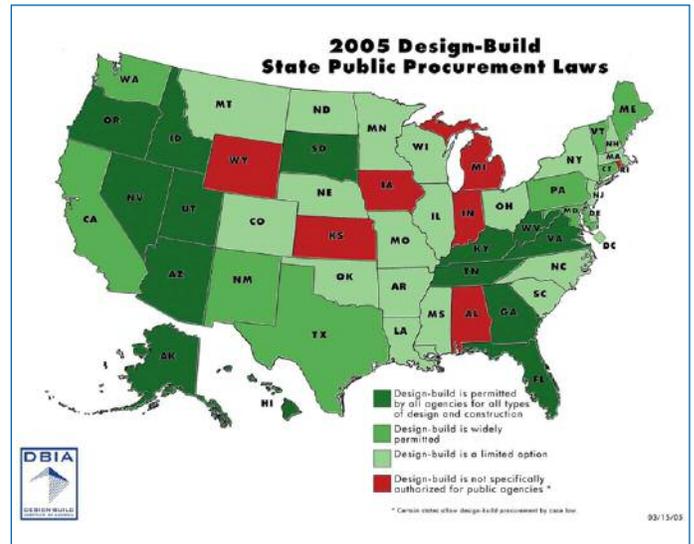
These arrangements are established by the high-level agreements that frame the PPP projects. The requirements in these agreements are often passed on via “linkage” to the design and construction entities as they negotiate their lower-level agreements.

It is imperative that design and construction professionals be familiar with the terms and conditions of the higher-level agreements so they have an idea what they are in for. Linkage may result in design and construction companies assuming liabilities more akin to those of a full joint-venture or special purpose vehicle partner – without participation in the profits.

Special purpose vehicles (SPV) often function as the entity that raises the money and takes on the main responsibility for delivery of a PPP project. The SPV will generally farm out the work through a series of contracts and appointments, which could be to companies with whom they are financially associated. The SPV might also be a joint venture between one or more of the contractors or consultants involved on the project. The challenge here is how to insure the exposures of the SPV – whether through the arrangement of specialist or project-

specific insurance, or by means of piggy-backing the SPV under the terms of the cover for the contractor or consultant.

The franchise period for a PPP project will generally run for an extended period of time. If the operator is or is related to the contractor responsible for building the facility there can be challenging issues with respect to Professional Liability claims arising from design defects. The situation could arise where a contractor would want to bring a claim against a related entity (or itself!). Equity interest wordings need to be very carefully crafted. Accommodation of claims arising post-handover needs to be addressed. Certain operations and maintenance activities may be considered professional responsibilities and the contractor's or SPV's Professional Liability insurers may be prepared to extend the policy to cover such areas after discussion between the parties.



Contractors and designers should be especially wary of the warranty and guarantee requirements that are often characteristic of the higher level agreements. PPP projects are frequently subject to output- or performance-based specifications in order for the public sector entity to ensure that design risk stays with the project company and to foster innovation and creativity in design, engineering and construction technology.

The scope of professional services to be provided should be carefully defined. Responsibilities should be confined to only those professional services outlined and to the design and construction phase of the project – they should not inadvertently flow to the post-availability date phase and subsequent operations and maintenance exposures. Consultants should also pay attention to duty and standard of care provisions. They should be sure that “reasonable skill and care” (or similar wording) is the standard for the provision of professional services.

The pass-through of design-risk that is typical of PPP agreements must always be carefully checked against applicable Professional Liability policies. The potential damages resulting from a design error – particularly in an environment that encourages innovation – will potentially far exceed the likely level of Professional Liability cover provided by the design team. This situation is particularly problematic as a result of the significant reduction in capacity for project-specific insurance coverage.



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