

# PUBLIC INTEREST CONCERNS OF PUBLIC-PRIVATE PARTNERSHIPS

## OVERVIEW

The United States national transportation system is designed to provide trade corridors for the movement of goods from coast to coast, fort-to-port connections for military personnel and materiel, long-distance recreational travel, local delivery (becoming more prominent due to rapidly rising e-commerce), and local and regional personal mobility.

During the second half of the 20<sup>th</sup> Century, the system has successfully met the diverse transportation needs of the national economy and the American people. Cornerstones of the national transportation system are strong federal leadership and a robust federal-state partnership. But the system is facing very serious challenges that stem from explosive traffic growth, increased international trade, changing demographics, evolving travel patterns, and insufficient funding.

Under the right circumstances and conditions, public-private partnerships (“PPPs”) can lead to more efficient and effective construction, management, operation, and maintenance of transportation facilities. Where private financing is involved, PPPs can *supplement—but not provide a substitute for*—public investments in transportation improvements.

When a government agency considers contracting with a private company to renovate, construct, operate, maintain, manage, or finance a facility or system, there are many issues that must be examined.

*Paramount among these responsibilities must be preserving the integrity of our integrated national surface transportation system and protecting the public interest.*

## SUMMARY OF RECOMMENDATIONS

### ADVANCING PUBLIC OBJECTIVES

- States should regulate PPP toll facilities to provide private operators with a reasonable return on their investments while protecting the public from potential monopolistic price gouging, and ensuring that all needed maintenance will be provided throughout the life of the concession agreement.
- Revenues and proceeds generated from PPPs should be used only for projects to enhance transportation safety, capacity, and mobility, preferably within the corridors from which they are generated.
- States should not include “non-compete” clauses in PPP concession agreements that limit state and local governments’ ability to meet the current and future mobility and safety needs of the traveling public.
- To ensure the flexibility needed by future governments to meet changing conditions, PPP agreements should not extend beyond the design life of the facilities; they should be structured to be as short as possible.
- State transportation agencies, to the maximum practical extent, should develop and maintain independent, competent, in-house capabilities to negotiate with private-sector firms, to get the best value for the public in PPPs.
- States should ensure that PPP agreements do not result in environmental degradation, deny access to transportation by segments of our society, or otherwise undermine broadly supported social and public policy goals. Low-income drivers should be provided relief from high tolls charged for congestion pricing. The toll proceeds should be used to fund public transit and other highway alternatives for low-income individuals, in addition to maintenance of the facility and retirement of debt.

### MAINTAINING THE INTEGRITY OF THE TRANSPORTATION PLANNING PROCESS

- States should enact enabling legislation that promotes timely distribution of relevant information to the public concerning proposed PPP projects and encourage open and full public participation throughout the review of the projects.
- States should enact enabling legislation that does not allow unsolicited PPP proposals, which do not go through the established planning process or open, competitive procurement. Private firms wishing to carry out projects under PPP arrangements should work with public authorities to develop projects consistent with the transportation improvement programs (TIPs, STIPs) and long-range plans.

### PRESERVING AN INTEGRATED NATIONAL SURFACE TRANSPORTATION SYSTEM

- PPPs should be pursued with vigorous federal oversight and coordination to produce a robust regional and national transportation system.

## PUBLIC INTEREST CONCERNS

### I. ADVANCING PUBLIC OBJECTIVES

#### A. Public-Private Partnerships Should Protect the Public from Monopolistic Pricing

*Recommendation: PPP toll facilities should be regulated to provide private operators with a reasonable return on their investments while protecting the public from unreasonably high toll rates or excessive profits.*

*Background:*

Toll facilities under public-private partnerships, like water and electric utilities, are government-sanctioned monopolies. They should be regulated as such to protect the public against abuses of monopoly power resulting in excessive tolls. Tolls should be set at a level which limits the operator to a reasonable return on investment.

Concession agreements that provide automatic toll escalation may result in tolls much higher than needed to produce a reasonable return on investment.

States should consider establishing a pre-determined return on the investment as part of PPP concession agreements. This would allow early conclusion of the agreements and control of the facility to be returned to the state ahead of schedule after the set total return on investment is attained.

#### B. Public-Private Partnerships Should Enhance Transportation Safety, System Capacity, and Mobility

*Recommendations: Revenues and proceeds generated from PPPs should be used only for projects to enhance transportation safety, capacity, and mobility, preferably within the corridors from which they are generated.*

*Non-compete clauses, broadly defined, which limit state and local governments' ability to meet the mobility and safety needs of the traveling public, should not be included in PPP concession agreements.*

*Background:*

Enhancement of safety, capacity, and mobility should be the primary objectives of a government's transportation policy, and hence of the public-private partnerships. Revenues and proceeds derived from PPPs should be used by the states for transportation improvement projects only, preferably within the same corridors from which the revenues are generated.

“Non-compete” clauses in concession agreements limit the ability of the state to improve roads and meet economic development objectives.

The most recent versions of the “non-compete” clause allow the state to go forward with projects that are included in the 20-year plan when the concession agreement is signed, but require reimbursement of the toll road operator if the state undertakes projects not in the plan that impair toll revenues. States implementing needed transportation improvements in the vicinity of toll facilities under such concession agreements therefore could find themselves facing severe financial strains to reimburse the private operators for their lost revenues.

States should be cautious in agreeing to these arrangements as they may significantly limit a state’s ability to respond to changing needs by revising its transportation plans.

### **C. Public-Private Partnerships Should Preserve Flexibility in Future Decision-making**

*Recommendation: Terms of PPP agreements should not extend beyond the design life of the facilities; they should be structured to be as short as possible.*

#### *Background:*

Whether used to build new capacity (greenfield projects) or to turn existing public toll facilities into private operation (brownfield projects), public-private partnerships most often involve long-term concessions.

Recent leases of existing toll facilities in Illinois, Indiana, and Virginia involve concession agreements that run from 75 to 99 years. Recent concessions for new toll roads in California and Texas are for 45 and 50 years, respectively. Public control over these facilities with regard to operation, maintenance, and improvement has been ceded to the private firms for up to four generations.

Highways are important economic development tools for state and local governments. Extremely long leases of toll roads not only transfer control of the affected facilities to the private sector, they also limit, for generations to come, the ability of state and local governments to develop the wider regions through which the toll roads run. European experience shows that political leverage by public agencies over their private-sector partners in PPPs dissipates very rapidly, and is virtually exhausted about 10 years into a concession agreement.

Long-term concessions may provide substantial savings in public spending or upfront cash infusion, but this mortgaging scheme shifts the burden of paying for the facilities to future generations. Moreover, long term concessions severely limit the ability of future

governments of states and localities to make rational decisions to adapt to changing circumstances.

**D. Public-Private Partnerships Should Promote an Equitable Sharing of Risks and Rewards**

*Recommendation: State transportation agencies, to the maximum practical extent, should develop and maintain independent, competent, in-house capabilities to negotiate with private-sector firms in order to get the best value for the public in public-private partnerships.*

*Background:*

When private firms participate in transportation investments, varying degrees of risks are shifted to those firms in exchange for an opportunity to earn financial rewards.

To ensure that the risks are shifted to the partner that can best handle them, and that the rewards earned are commensurate with the risks assumed, states need to develop independent, in-house capabilities to negotiate with, and oversee the operations of, private-sector firms.

Many project sponsors rely on outside advisors to provide assistance in their analysis and negotiations of proposed public-private partnerships. This may be a problem because of serious potential conflicts of interest. Wall Street analysts have posited the hypothetical example of a firm that is providing financial advice to a state involved in PPP negotiations while simultaneously engaging in investment banking for the same deal. With rapidly growing interest in PPPs in the United States among investment banking firms that also provide financial advice to the states, this hypothetical situation is quite real. In such a situation, there must be strong firewalls separating the financial advice from investment banking to prevent conflicts of interest.

Even firewalls may be inadequate, since the high financial stakes involved will create strong incentives to breach the firewalls.

Moreover, even advisors with no other line of business or no private-sector client may still fail to adequately represent a state in PPP negotiations. The advisor may not want to alienate private-sector firms, which may want to use the advisor in future PPP deals.

If outside advisors must be used, states should impose and enforce a code of ethics requiring the advisors to provide full disclosure of formal and informal business relationships with any potential bidders, enter into confidentiality agreements with the public agencies, and agree to a ban of meaningful duration from representing private-sector bidders.

**E. Public-Private Partnerships Should Protect Workers, the Environment, Small Businesses, and Low-Income Drivers**

*Recommendation: In developing the terms of PPPs, state transportation agencies should ensure that the agreements do not result in environmental degradation, denial of opportunities or access to segments of our society, or otherwise undermine broadly supported social and public policy goals. Low-income drivers should be provided relief from high tolls charged for congestion pricing. The toll proceeds should be used to fund public transit and highway alternatives for low-income individuals.*

*Background:*

Federal assistance for highway development is provided under the Federal-aid Highway Program that imposes requirements regarding prevailing wages (Davis-Bacon), assistance for small and minority-owned businesses (disadvantaged business enterprises), environmental review (NEPA), air quality improvement (clean air conformity), environmental mitigation (wetlands), resource conservation (4(f), endangered species), domestic job and industrial base protection (Buy America), and accommodation for the disabled (ADA). These requirements are intended to help achieve specific social and public policy goals that are widely accepted. States should not attempt to avoid these requirements by segmenting projects and funding selected portions with only non-federal funds.

Tolls charged for the use of a transportation facility under a public-private partnership arrangement are regressive; the higher the tolls—such as the high tolls that would be charged in congestion pricing—the greater the negative impact on low-income drivers. These impacts should be mitigated. Electronic toll collection makes it feasible to reduce or eliminate the tolls paid by low-income drivers.

Some low-income drivers may wish to switch to public transportation services because congestion pricing tolls are too high to be affordable. To accommodate these needs, states should use some portion of the toll proceeds to fund the public transit and highway alternatives for low-income individuals.

## II. MAINTAINING THE INTEGRITY OF THE TRANSPORTATION PLANNING PROCESS

### A. Public-Private Partnerships Should Preserve the Planning Process and Public Participation in Project Review

*Recommendation: States should enact enabling legislation that promotes timely distribution of relevant information concerning proposed PPP projects to the public and encourages open and full public participation throughout the review of the projects.*

*Background:*

Federal environmental and transportation law requires detailed transportation planning by the states and metropolitan planning organizations. The plan must be developed through a transparent public process that promotes full participation by all stakeholders. The final planning documents—the transportation improvement program (“TIP”), state transportation improvement program (“STIP”), and long-range transportation plan—are designed to reflect the collective views and vision of the community. Individual projects included in these documents must also undergo vigorous review.

Some states have enacted laws authorizing public-private partnerships that also limit the timely dissemination of information about the projects. Allowing PPP projects to avoid the full public review process will undercut the transparency and opportunity for public participation in the transportation planning and project review processes.

### B. Public-Private Partnerships Should Reflect and Follow State and Local Transportation Priorities

*Recommendation: States should enact enabling legislation that does not permit unsolicited PPP proposals which may undercut or circumvent the planning process or distort open, competitive procurement. Private firms wishing to carry out projects under PPP arrangements should work with public authorities to develop projects consistent with the transportation improvement programs (TIPs, STIPs) and long-range plans.*

*Background:*

Some states have enacted, or are considering, laws to permit the submission of unsolicited proposals by private firms for transportation projects. These laws would require public transportation agencies to review the proposals within specified timeframes, and to go forward if the proposed projects are determined to be feasible.

The transportation planning process is designed to establish local and state transportation priorities, without regard to whether individual projects are financially profitable or not. Allowing unsolicited private proposals to bypass the transportation planning process seriously impairs the process. The result could be that the fiscally constrained projects that are included in the TIPs, STIPs, and long-range plans will have to be pushed back to make room at the front of the queue for the financially profitable privately proposed projects. This rearrangement of publicly-determined priorities undermines the established transportation planning process and, consequently, substantial taxpayer investment in transportation planning is squandered.

States must ensure that public-private partnerships do not undermine the planning process, which ensures that priority will be given to the public interest, not the desire of profits.

### III. PRESERVING AN INTEGRATED NATIONAL SURFACE TRANSPORTATION SYSTEM

#### A. Public-Private Partnerships Should Help Advance the Goals of and Improve our National Transportation Program

*Recommendation: PPPs should be pursued with vigorous federal oversight and coordination in the context of a robust regional and national transportation program.*

*Background:*

Our national transportation system is under tremendous stress, and needs to be improved. A fragmented national system cannot deal effectively with the challenges it faces. Performance of the overall system will deteriorate over time. If left uncorrected, it could lead to system failure. Public-private partnerships can play a role in meeting the needs to enhance our transportation system. However, they must be implemented in a manner that does not reinforce and exacerbate the fragmentation of the national transportation system.

Many of the needed improvements include facilities in more than one state, and the development of projects which are located only in one area but benefit large regions or even the entire nation.

If states with very diverse social, economic, and other requirements act in complete independence of one another, they will produce an uncoordinated and inefficient transportation system that will not even serve each state's individual needs, because of contradictory or inconsistent actions taken by neighboring states.

These tendencies will be accentuated by PPPs if there is not strong oversight to ensure that these projects are developed as part of an overall plan for a national transportation system which also meets the needs of each state. Unless appropriate planning and public interest protections are incorporated into the procedures of implementing PPPs, these transactions could stimulate and accelerate the devolution of the federal program to the states.