Private Sector Perspective on DBO and BOT – ("PPP's")

Dr. John B. Miller

With Input From

Michael Simmons and Tony Kushnir

Patton Boggs, LLP

Executive Summary

- Great Results with EUL
  - Deal Flow is still “Anecdotal”
  - Cost of Participation is High
- Attracting Private Sector Interest in PPP’s
  - Proper Positioning of Opportunities by Federal Owners
  - Solves Numerous Problems on Both Sides
  - If Projects are Strongly Positioned, Financing follows easily
- Procurement Must Be Dramatically Simplified
  - To Give More Authority to Buying Entities
  - To Lower Transaction Costs
  - To Increase Early Transparency
    - Allow Competitors to Match Capabilities/Teams to Projects
  - Key Variables to Private Sector
    - Expected Cash Flow
    - Suitability of Chosen Project Delivery Method
- 2007 ABA Model Code for Public Infrastructure Procurement

Fort Detrick

- Conditioned Power Project
  - US Army – Interagency Services Agreement for multiple federal entities to buy power through Army
  - 50 Year E U Lease
  - 10 Year “GSA FAR type” Purchase Back of Energy by Army
  - Unused Capacity Can Be Sold to Grid
  - Special Purpose Entity to Receive Non-Recourse Financing
    - $120+ Million financing through capital markets
    - “Essentiality” of the Function Allowed financing
  - Chevron won the procurement competition
    - Contractor and operator
  - Second Phase (in Future) will likely add cogeneration capacity

Argonne National Labs

- Research and Development Facility
  - DOE is Ground Lessor
  - Special Purpose Entity is Lessee
    - Obtains Financing from the Capital Markets
      - Illinois Finance Authority issues taxable, revenue bonds
      - Essentiality of the facility and the function critical to financing in capital markets
    - Contracts for Development and Management accomplished on competitive basis
    - Leases space in to-be-developed Facility to M&O Contractor
      - M&O Contractor rent is a reimbursable from DOE under DOE M&O Contract
  - "EUL Like" transaction Under Separate Legislative Authority for DOE

Jesse Brown VA Medical Center

- Cogeneration Facility through EUL
  - 200+ bed acute care center, with 4 outpatient clinics
  - 3.4 Megawatt Cogeneration Plant in Chicago
    - Replaces Steam purchased from U of Illinois and Electricity purchased from Com Ed
  - Special purpose trust raised financing for the $13 million project through capital markets
  - Unused warehouse space leased by VA to energy contractor
    - Energy Contractor builds, maintains and operates the plant
    - Trust bills VA for steam and electricity
    - Trust pays principal and interest on its loans, and pays the contractor for O&M services
    - Trust pays into contingency reserve fund to cover major repairs and enhancements
  - $31 million in savings over first ten years. VA Option to extend or reposition after 10 years.

Common Public and Private Sector Interests

- Best Practices in Facility Management Apply
- Projects That Make Sense
  - Function
    - Durable or Essential Needs
  - Program – Clear Scope of Work
    - Design – Construction – Ops & Maint
    - Approvals in Place or Readily Obtained
  - From Cost Perspective
    - Initial Cost
    - Long Term Operations, Maintenance, & Repair
    - Replacement/Rehabilitation/Decommissioning
  - Revenues that Match
    - Lease Payments; 3rd Party Revenue Opportunities

An Example of How Private Sector Teams Think about PPP Opportunities

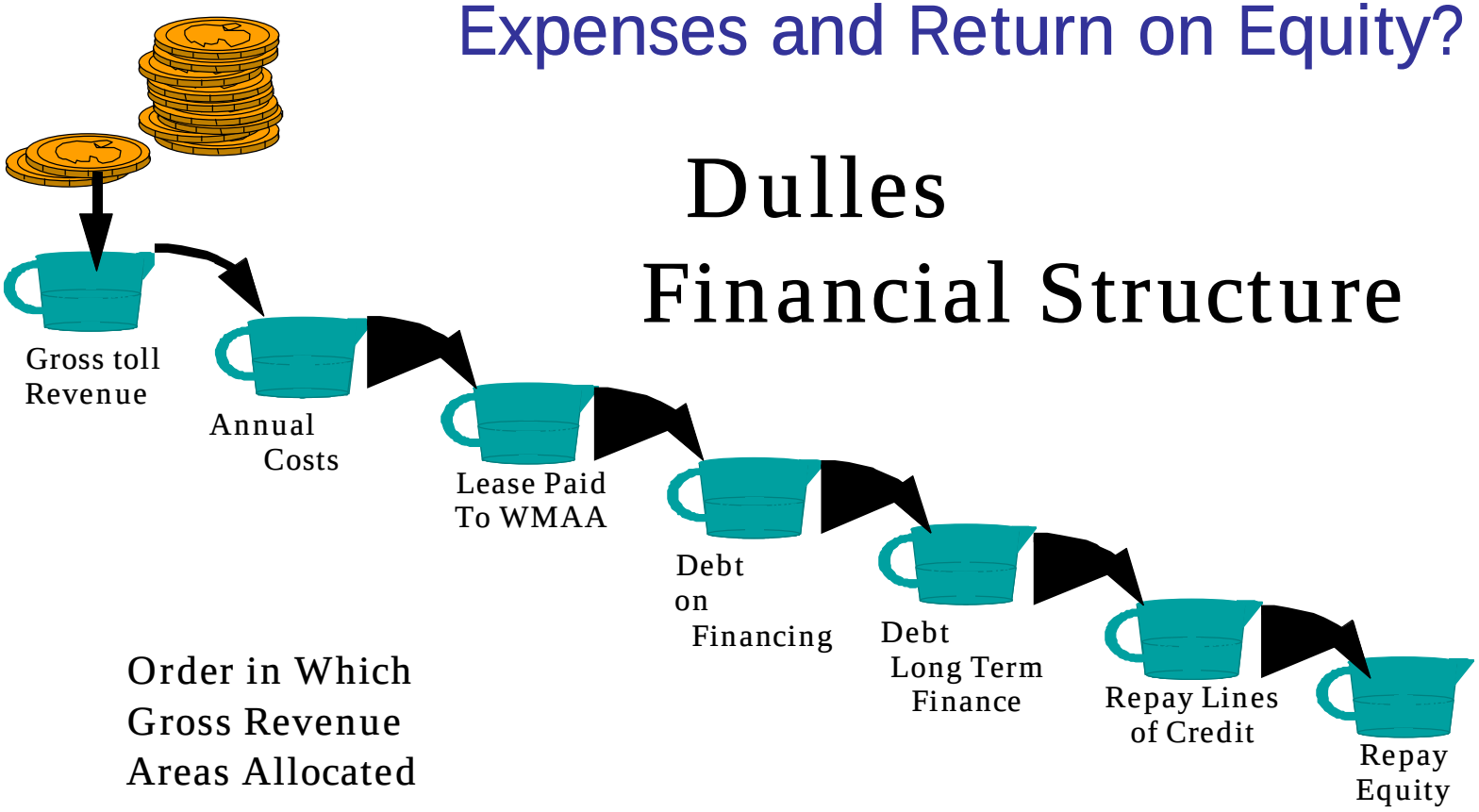
from Transportation Sector

Dulles Greenway

Round 1

Private Sector Discipline Helps Address Life Cycle Cost Issues !

Will Revenues Be Sufficient to Pay Expenses and Return on Equity?

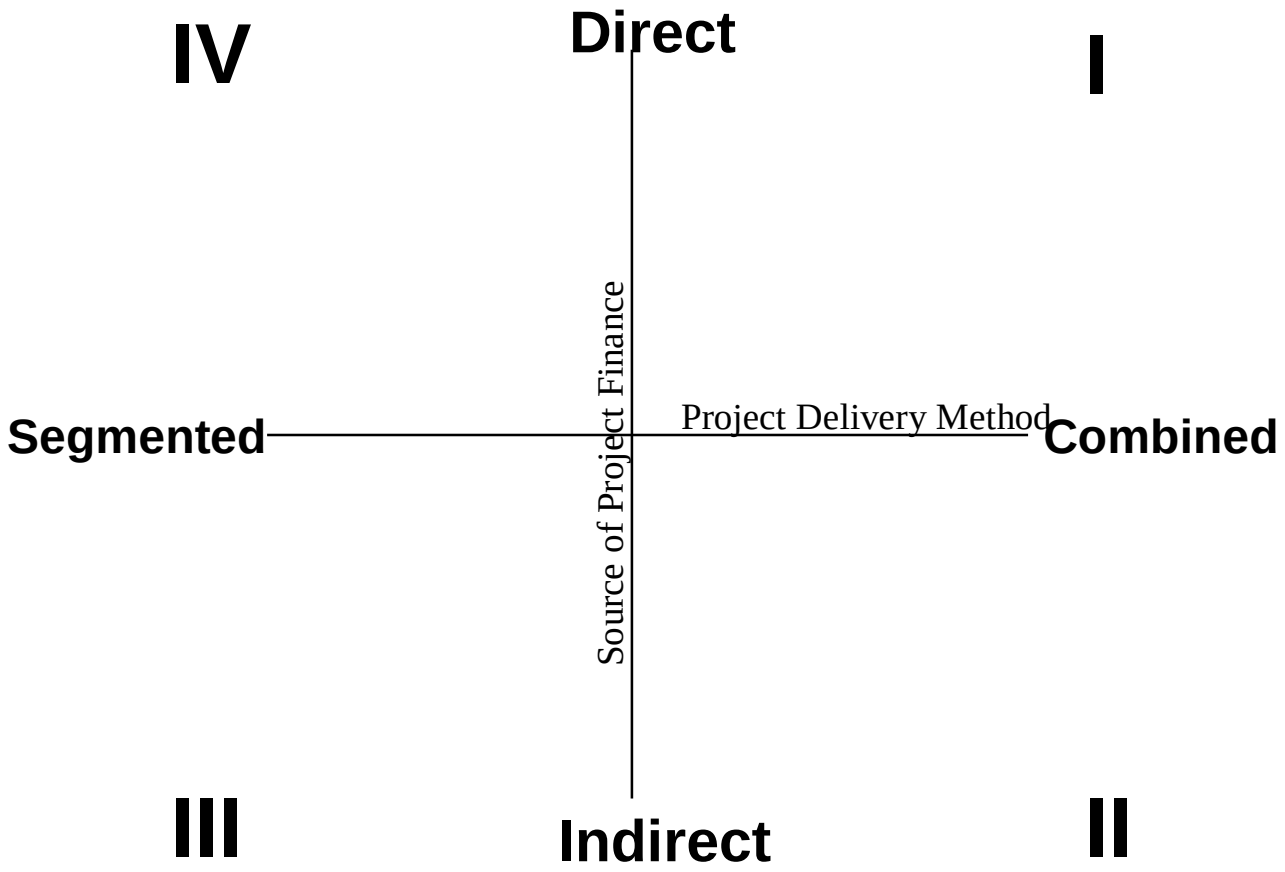


Configuring Projects That Are Mutually Attractive to the Public and Private Sectors

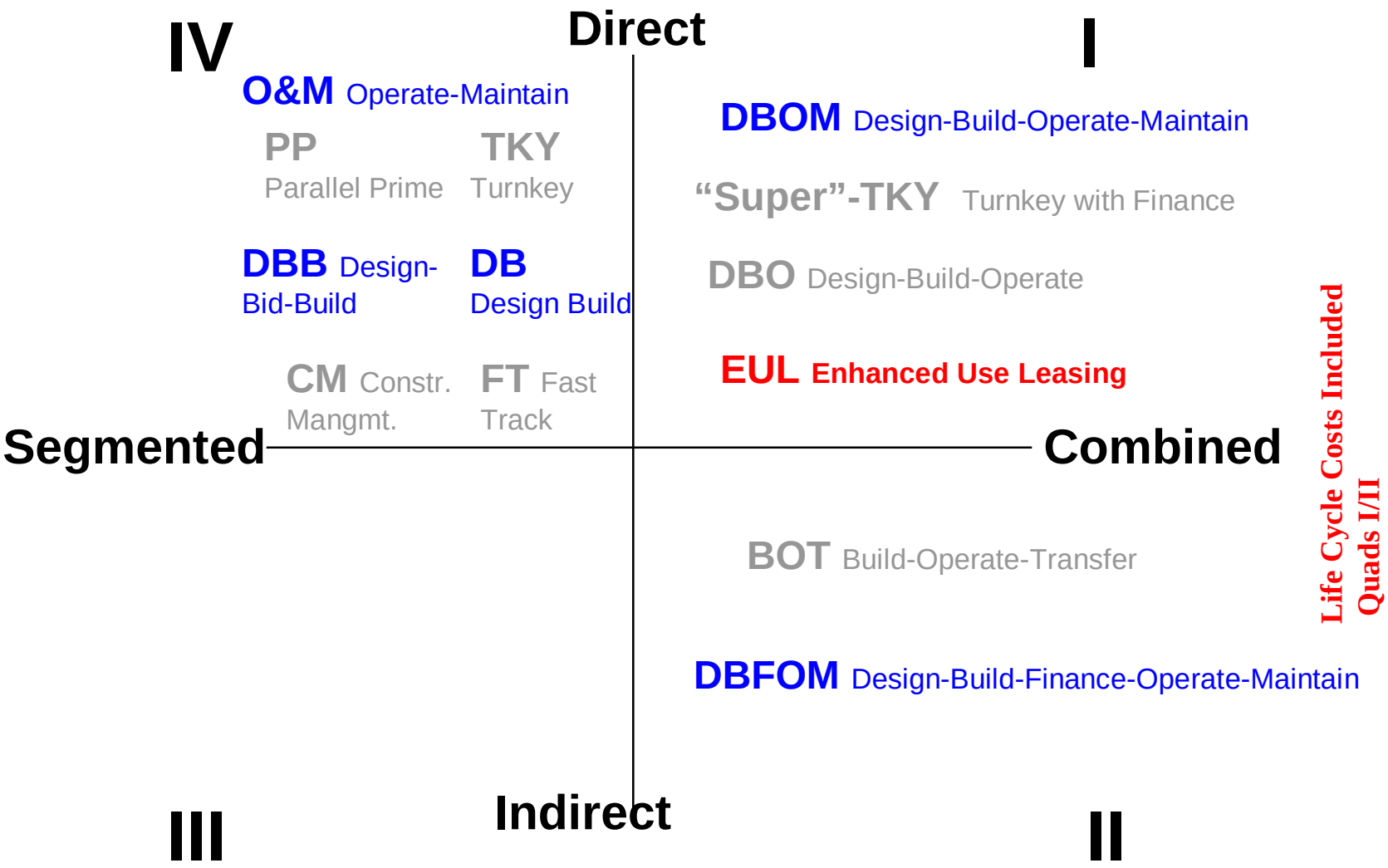
Clear Statement of

Expected Cash Flow
Expected Delivery Processes and Scope

The Quadrant Framework

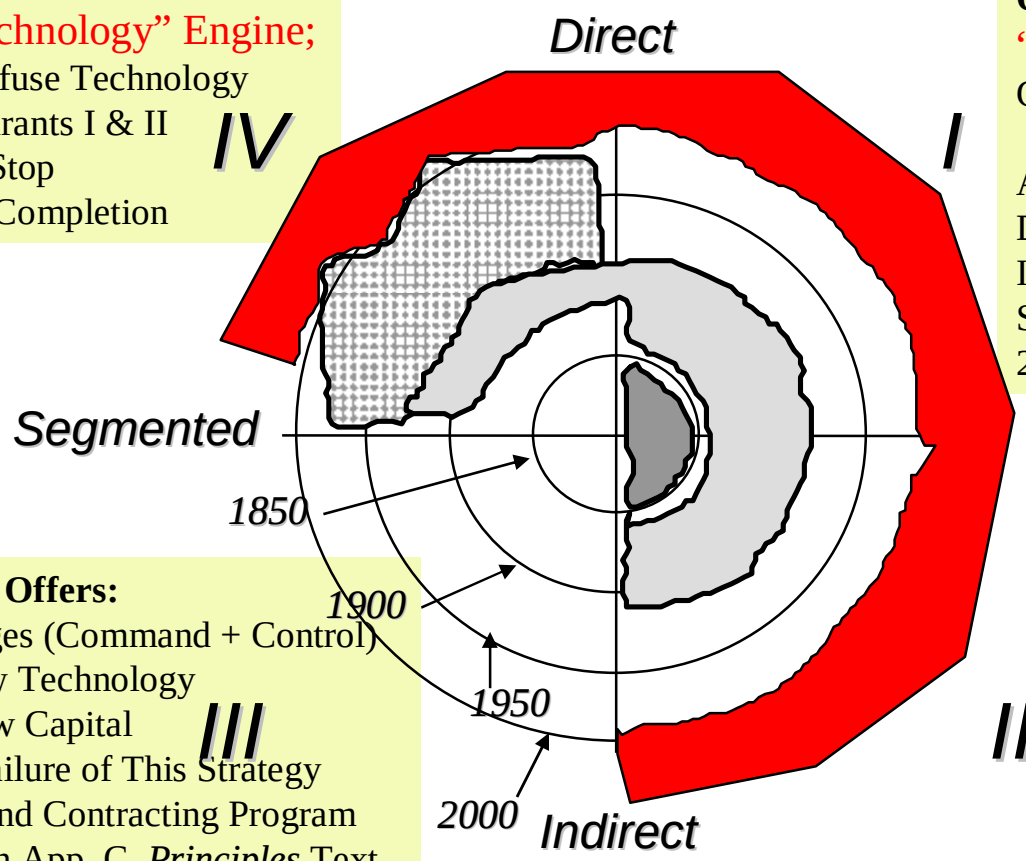


Delivery Methods Fit the Quadrants



The Quadrants Behave Differently

Quadrant IV Offers:
"Isolated Technology" Engine;
A Place to Diffuse Technology
From Quadrants I & II
Flexibility to Stop
At Design Completion



Quadrant I Offers:
"Efficient Technology" Engine;
Combined Delivery with Owner's Money
Associated Capital Investment
Different Players
Incrementally Better Solutions
Sustainable Opportunities
20-40% Savings in Life Cycle $$

Quadrant III Offers:
Few Advantages (Command + Control)
Averse to New Technology
and To New Capital
Example of Failure of This Strategy
US Superfund Contracting Program
Described in App. C, *Principles* Text

Quadrant II Offers:
"New Technology" Engine;
Combined Delivery with Private Sector's Money
New Capital Investment
New Players
Different Solutions New Services
Sustainable Opportunities
30-40% Savings in Life Cycle $$

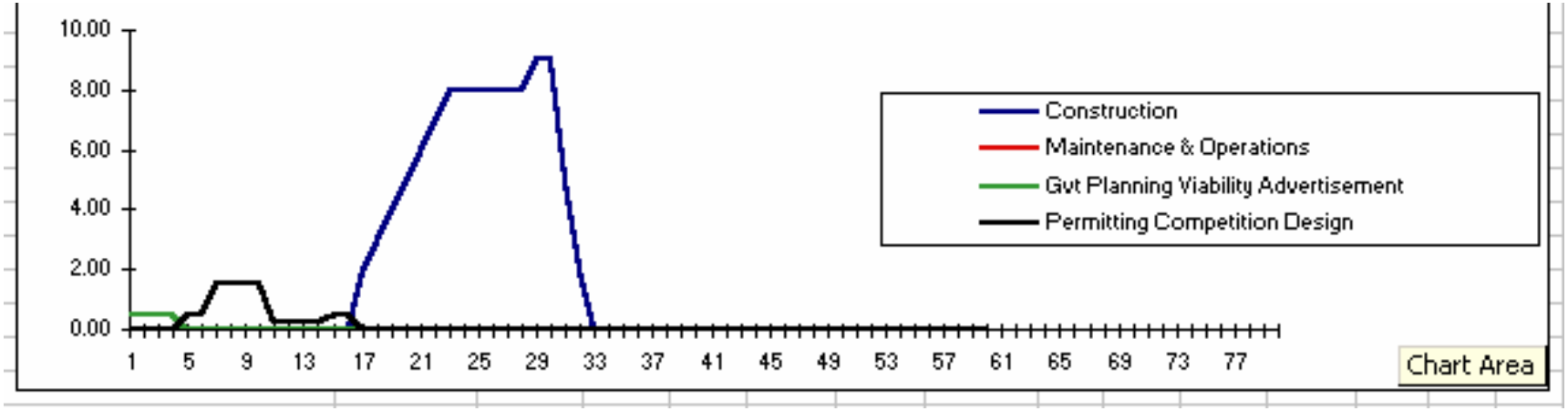
The Quadrants Have Remarkably Different Cash Flows

Design Bid Build
and
Design Build

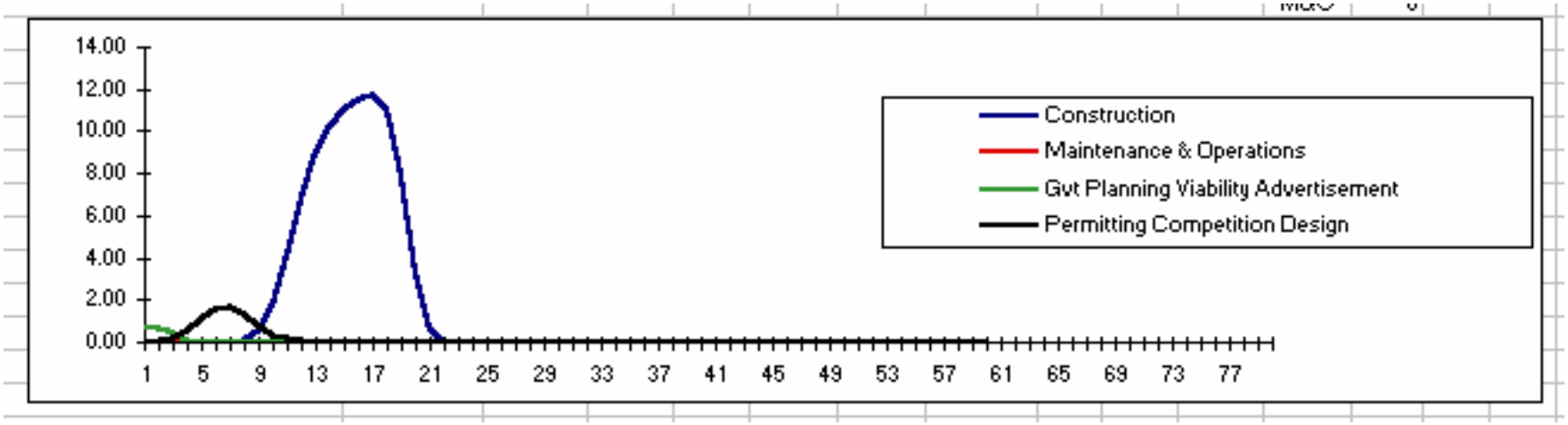
Very Little Opportunity to Play
with Overall Cash Flow

Life Cycle Costs are Not Considered

- Design Bid Build = Cash Flow A + Uncertainty



- Design Build = Cash Flow B + Uncertainty

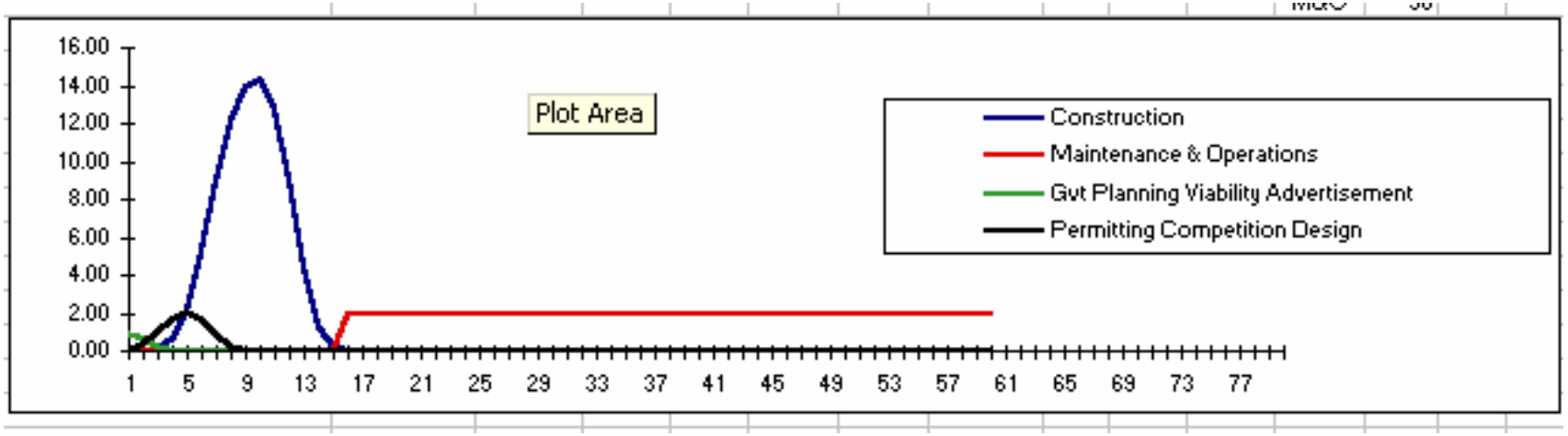


Design Build Operate (Maintain)

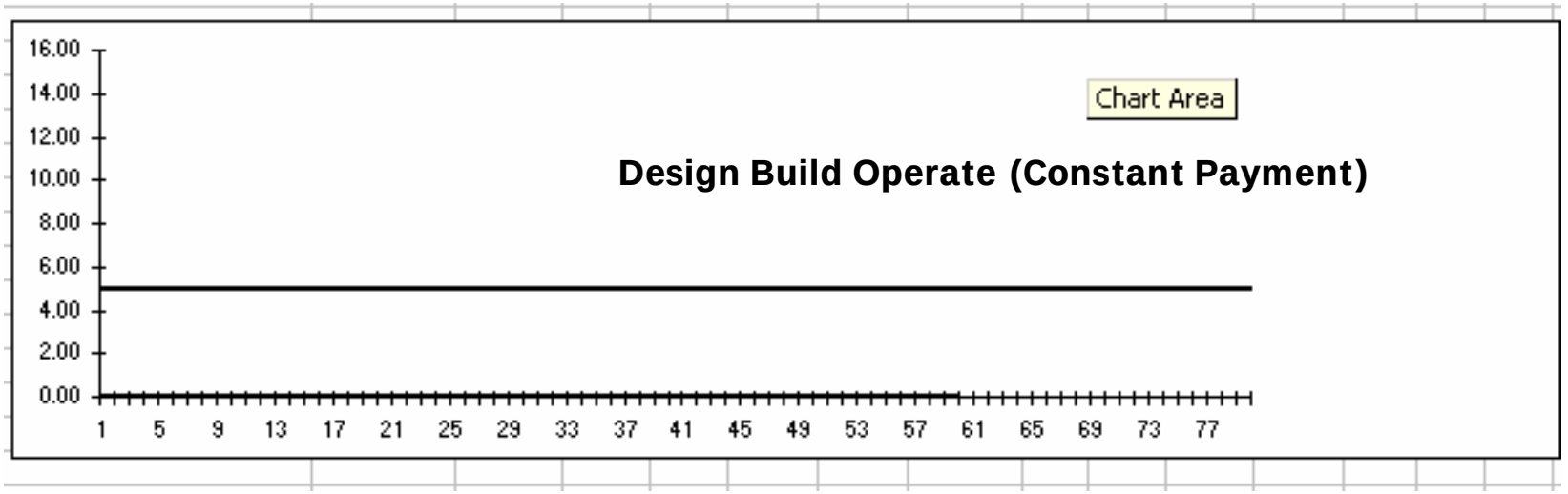
- or Enhanced Used Leasing

- Flexible Tool to Manage Overall Cash Flow Across an Infrastructure Network
- The “Weapon of Choice” for Long Term Stability:
  - Managing Rates, Fees, and Tolls
  - Preventing Rate Shock
  - Funding Capital Improvements Now through Future Lease Payments
- Getting Out of the Annual Appropriation Business (and Fights about Deferred O&M&R)
- An Efficiency Engine If Used Competitively

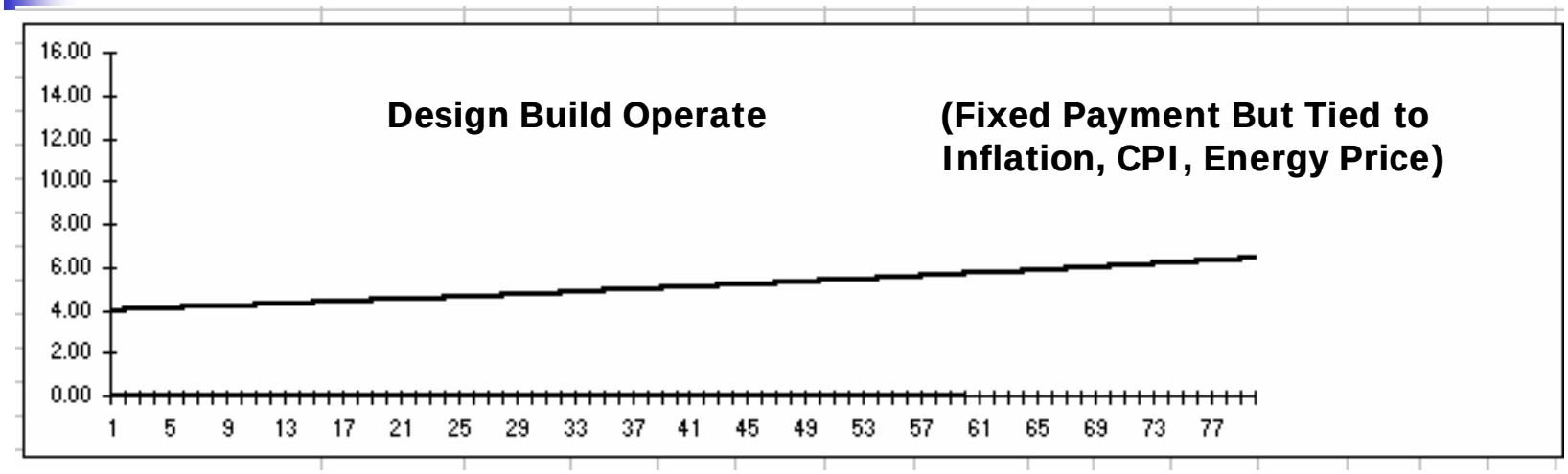
- Design Build Operate = Cash Flow C + Budget Predictability



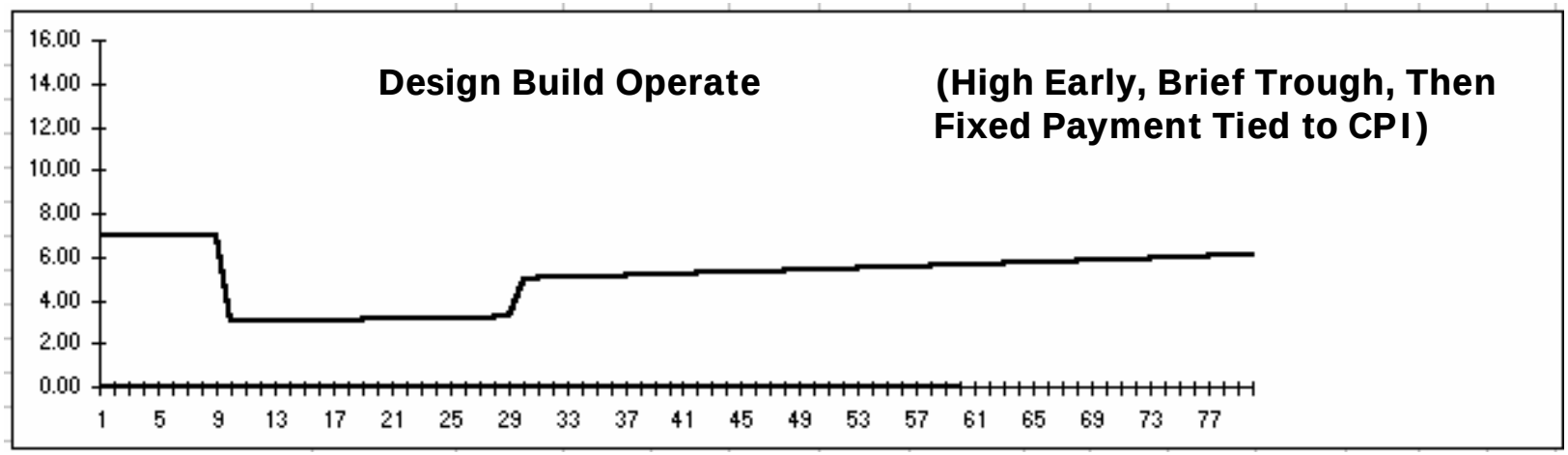
- Design Build Operate = Cash Flow D (Budget Stability)



- Design Build Operate = Cash Flow E (Moderate Stability)



- Design Build Operate = Cash Flow F (Tailored Stability)

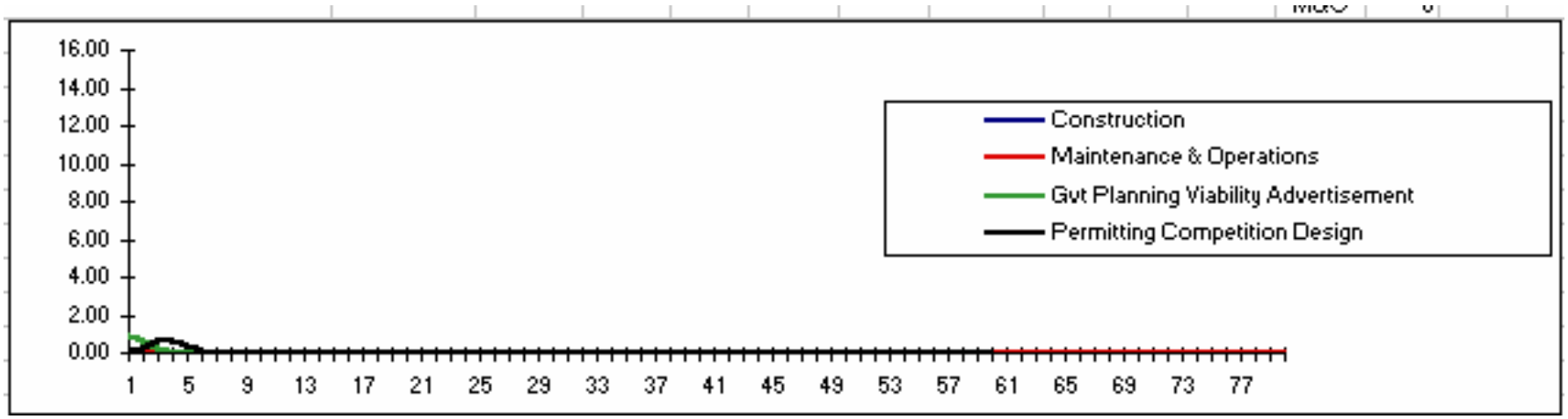


Design Build Finance Operate

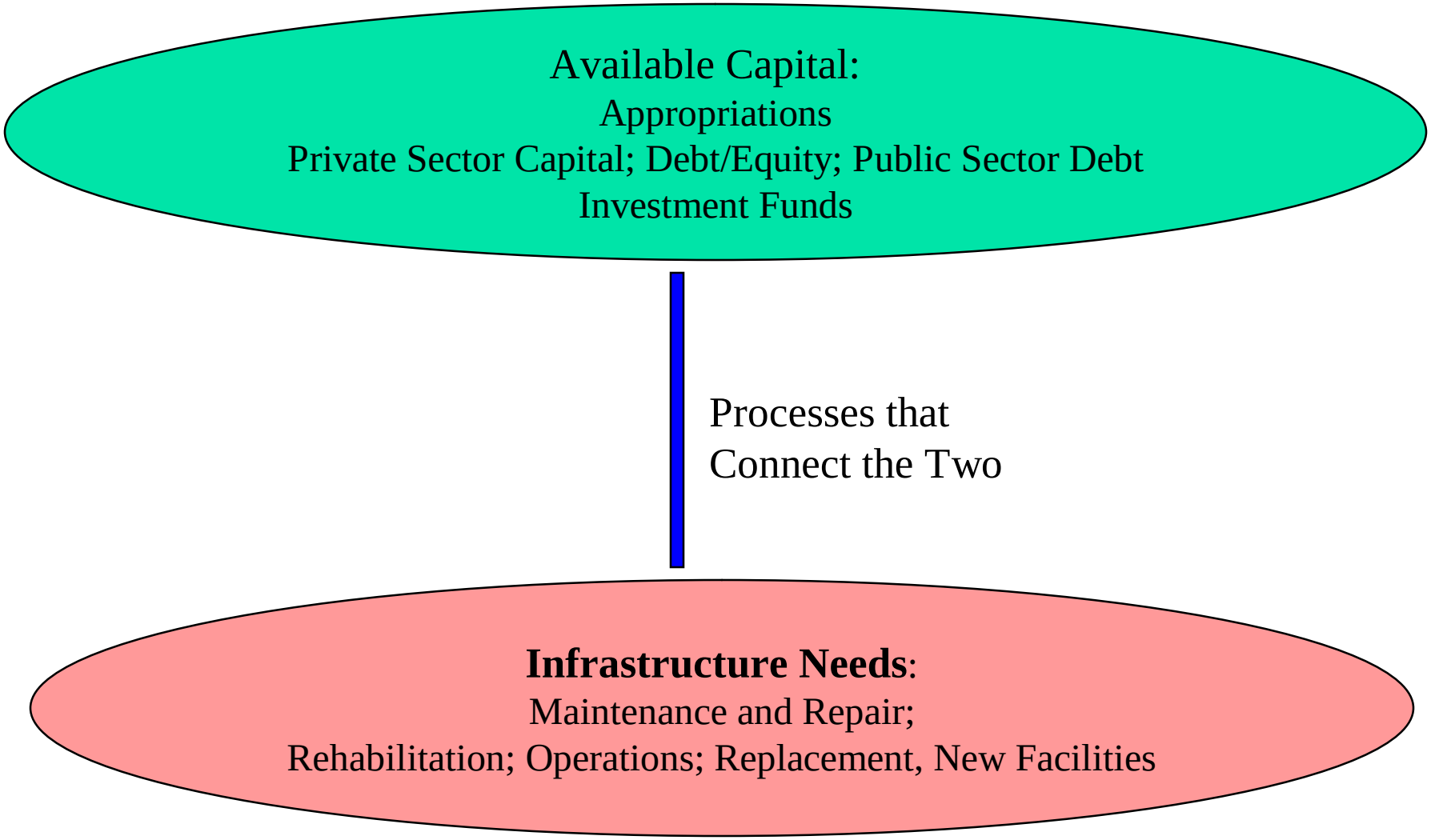
- The “High Risk High Reward” Scenario for Private Sector
  - Drivers for this Method
    - New Technology
    - New Methods – design, construction, operations
    - High Early Investment – with uncertain early revenue
    - Conservation of Scarce Public Funds -- If financed on the Public side, High Risk High Reward Projects Can Consume All the Public Sector’s Available Capital
  - DBFO is Primarily a Technology Engine – Overcomes Public Sector Reluctance to Experiment with New Technology by Placing Risk/Reward Squarely on the Private Sector
  - DBFO is a Technology Spreader – Once proven, new methods and technologies are available to be used in DBB, DB, and DBO

Design-Build-Finance-Operate

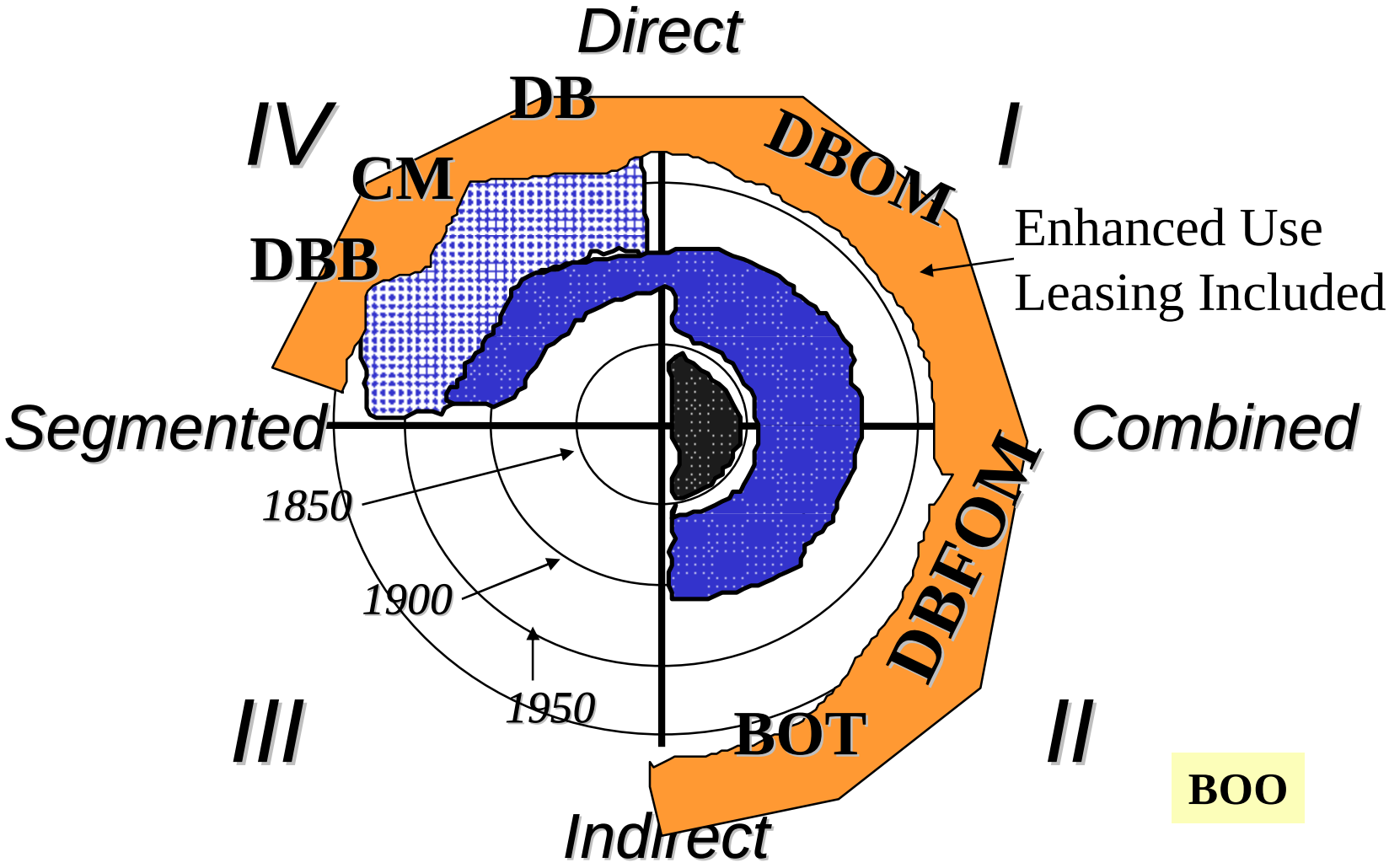
- A Unique Animal
  - NO DIRECT PUBLIC CASH (as defined in the ABA 2000 MPC) after contract award
- Design Build Finance Operate = Cash Flow G (Revenue and Expense Balanced, but at Contractor's Risk)



The Irony of US Infrastructure



US Infrastructure Procurement – The Past and A Prediction for the Future



Building a Coalition to Widen These Processes

Goal is to establish durable procurement mechanisms that allow proven project delivery and finance methods to be used simultaneously at federal, state, and local levels.

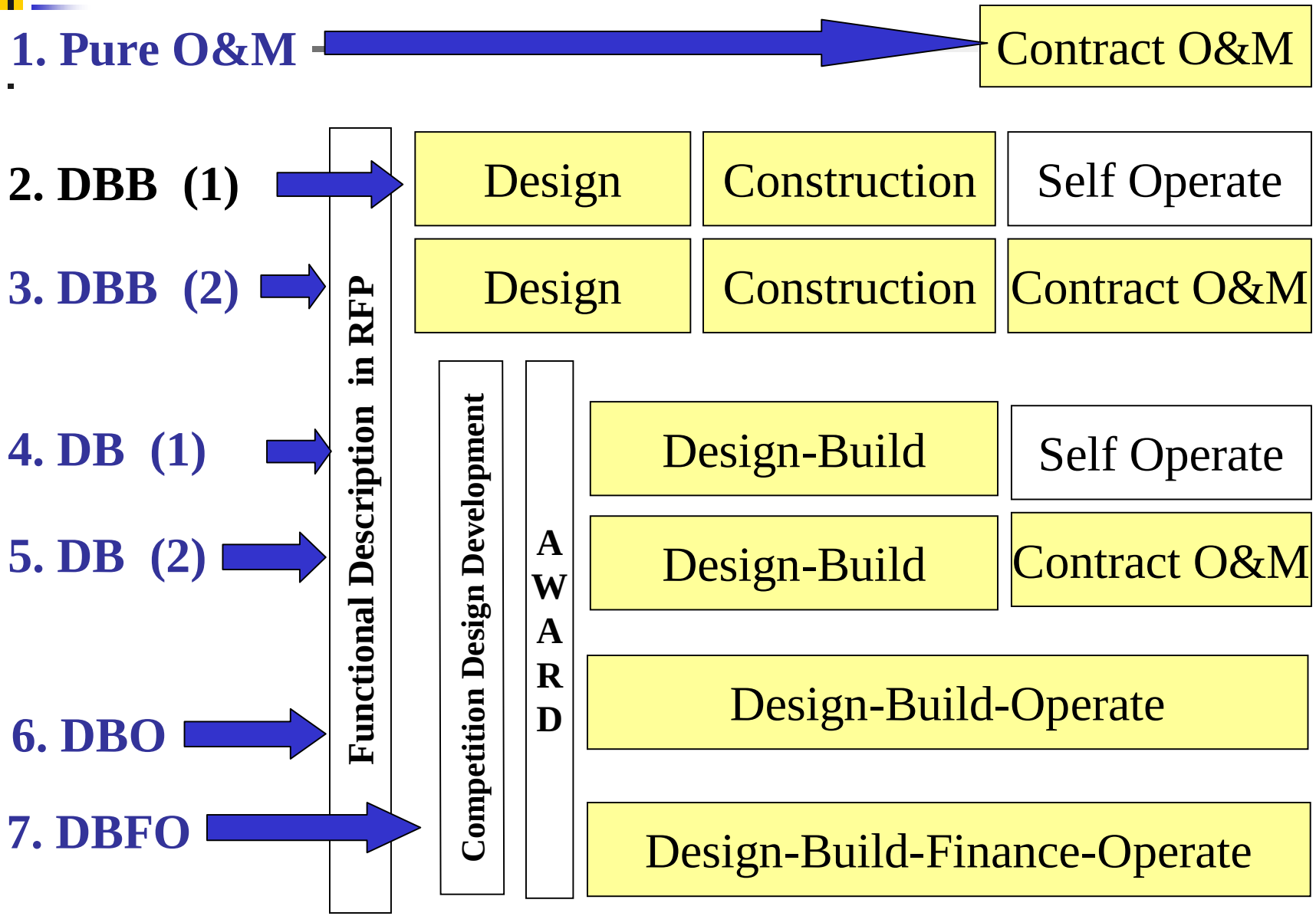
The 2007 ABA Model Code for Public Infrastructure Procurement

- We believe the 2007 Model Code Provides a Base to Meet Mutual Interests of the Private and Public Sector in Moving Infrastructure Project Forward
  - Transparent processes
  - Competitive processes
  - Reductions in Transaction Costs
  - Promotes:
    - Good Planning
    - Fair Treatment of Potential and Actual Competitors
- Consistent with Current Procurement Policies for Acquisition

The Model Provides Authority to Use Five Project Delivery and Finance Methods Simultaneously

- Design-Bid-Build
  - No Change from 1979 Statute
  - Straight Brooks Act + Fixed Price Construction
- Pure Maintenance & Operations
  - IFB Process
  - Lump Sum Fixed Price
- Design Build, Design Build Operate (EUL), and Design Build Finance Operate
  - **Uses Competitive Proposal Process (Art. 3) With Several Adjustments**
  - **Two Hard Competition Points**
    - **Design Requirements**
      RFP Release After Owner Establishes Requirements
      - Stated Evaluation Factors, Including Weights (if any) on Factors and Subfactors
    - **Proposal Development Documents**
      Response to RFP Submitted When Design is Sufficiently Complete to Establish Price (typically 30% +/- Design)
  - **Independent Peer Reviewer** (Design Peer Review Function)

The ABA 2007 Model Code for Public Infrastructure Procurement



Questions?

Contact Information

Dr. John B. Miller
Patton Boggs
Cell: 339-221-0401
DC direct: 202-457-6500
Email: jbmiller@pattonboggs.com
Web: www.pattonboggs.com/jmiller

Dr. John B. Miller

- Education
  - MIT: SB Civil Eng, SM Soil Mechanics (1974), PhD Infrastructure Systems (1995)
  - Boston University: JD (1977), LLM Taxation (1981)
- Background
  - Fellow, American College of Construction Lawyers
  - Section of Public Contract Law
    - Chair from 1994-95
    - Reporter for ABA 2000 Model Procurement Code Revision Project (1998 – 2002)
    - Reporter for ABA 2007 Model Code for Public Infrastructure Procurement
  - Gadsby & Hannah, Boston and Washington (1981 – 1995)
    - Founding Member of Construction Practice
  - MIT
    - Assoc. Professor, Construction Management 1995 – 2003
    - NSF CAREERS Grant – 1997 to 2001 to develop procurement models integrating DB, DBO and DBFO into US project delivery methods