

Public-Private-Partnership (P3): The Practical Basics

As Project Delivery System Grows, Contractors Should Take Care to Ensure They Take Necessary Safeguards Upfront

By Gregory Dukellis

The **Public-Private Partnership (P3)** has become an attractive project delivery system for cash strapped governmental entities looking to construct needed facilities without the immediate outlay of the costs that would otherwise be incurred under traditional procurement means.

Under a typical P3 arrangement, a public owner awards a franchise to a private sector partner to design, build, finance, operate and maintain (DBFOM) a project for a pre-determined concession period. The private sector partner has the right to collect all revenue generated by the project during the franchise period, whether an office building, school, highway facility, power plant, etc. Generally, the private sector partner bears the revenue risk that the funds generated will be sufficient to pay for the underlying project capital expense, including loan commitments, operating expenses, and provide a reasonable return on the investment. As concession periods often extend for periods of 25 to 30 years or longer, this type of project delivery method results in complex contract documents that must foresee issues arising over the course of the long-term relationship, and must allocate risk to the party in the best position to manage the risk.

P3 procurement begins with a public owner that contracts with the private concessionaire. The private concessionaire often is a single purpose entity (SPE) created solely for the purpose of designing, building and operating the facility. The SPE separately contracts with a design-build contractor or joint venture, or otherwise will act as the general contractor. The SPE generally finances the project through equity contributions, bank loans, federal loans and through creative arrangements with adjacent developers or governmental entities that provide for the donation of right of way, easements and infrastructure.

Often, an SPE has no assets other than its franchise rights, equity contributions and any right to recover insurance



Gregory Dukellis

proceeds. However, even these assets are typically pledged to the lenders in the event that a default occurs. Accordingly, for a design-build contractor who contracts with a P3 private franchisee, it is imperative that security be obtained to guarantee the payment of the contract price and any claims.

P3 contractual documents typically are weighted heavily to protect the lenders. Lenders, in turn, are principally concerned with assuring that the cost of the project does not increase, thereby destroying the economic model for success, and also in completing the project on schedule. The earlier the completion, the sooner revenue is generated.

For the design-build contractor employed by a SPE, it is critical that key remedy granting provisions, including a parent company guarantee or letter of credit, be negotiated up-front. Having a fair process to resolve project disputes and a meaningful remedy if claims arise against the SPE should be a prerequisite for anyone contracting with a SPE. Similarly, having safe-guards in place to prevent a SPE from unilaterally declaring a default and making a demand on a letter of credit or parent company guarantee is important.

While a full discussion of the contract issues of P3 projects is beyond the scope of this article, there are some key issues worthy of mention. First, most concessionaires will demand that design-build partners or joint ventures provide a parent company guarantee or letter of credit guaranteeing the performance of the design-build contract. This requirement often is imposed by the lenders. While this is not an unreasonable requirement, there should be limitations imposed on the enforcement of the guarantee or letter of

credit. For example, the SPE should be required to provide notice of a claimed default to the design-build joint venture and parent company; the design-build joint venture should have the right to contest and cure the default; the parent company should have the right to cure the default; and the guarantee should not be enforceable unless the design-build joint venture or principal does not have the ability to pay for or perform the underlying guaranteed obligation. In other words, the parent company (and letter of credit) is not obligated until the design-build joint venture is unable to satisfy the underlying obligation.

The P3 project delivery system did not originate in the United States and has only recently gained popularity here. Many of these concessions, in fact, are being pursued in this country by entities based in Europe and Australia. Therefore, while it may be nice to have a parent guarantee or contract remedy against the concessionaire, enforcement in a foreign country may be burdensome and expensive. Therefore, letters of credit from a U.S. bank and disputes procedures that allow for the prosecution of a claim in the United States are important provisions for any contractor to insist upon when dealing with a SPE owned by a foreign entity.

P3 projects are dependent upon an economic model that must be preserved. Accordingly, they work best when there is absolute cooperation between the public entity, the private concessionaire and the design build contractor(s). When the parties cease to work towards a common goal of timely and cost effective project delivery, the consequences can be enormous.

As in all things legal, this general advice is not a replacement for specific analysis of a particular P3 project and its contract terms. 🐾

Gregory Dukellis, Esq. is a partner in the Irvine office of the national law firm of Watt, Tieder, Hoffar & Fitzgerald, L.L.P. and primarily represents contractors on a wide-range of projects, with an emphasize in engineering, heavy and underground public works infrastructure projects. Gdukelli@wthf.com (949)852-6706.