

*Infrastructure Privatization Contracts and Their Effect on Governance*  
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On July 24, 2008, the *Denver Post* reported that Coloradans were shocked to learn that the private contractors that had leased the Northwest Parkway had objected to improvements on W. 160<sup>th</sup> Avenue. The contractors opposed improvements "because they might hurt the parkway financially."<sup>2</sup> Colorado State Representative Frank McNulty declared: "The purpose of toll roads is to augment state transportation infrastructure, not act as a roadblock to the construction of new transportation infrastructure in the northwest metro area."<sup>3</sup>

Not only was McNulty's objection wrong, but it came a year too late. Had he read the August 29, 2007 Northwest Parkway privatization contract<sup>4</sup> he would have known that for the next 99 years the contractors had every right to object to new or improved roads and mass transit systems.<sup>5</sup> He would also have known that building a "competing transportation facility" was a type of "Adverse Action" that the private contractors to compensation.

However, neither McNulty nor any member of the public could have raised objections to the contract, for the terms were not released until after the deal was signed. Barring scrutiny of decisions to privatize public infrastructure is not unique to the Northwest Parkway lease. For example, in 2008, Mayor Daley insisted that the Chicago City Council approve the seventy-five

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<sup>2</sup> Jeffrey Leib, *Toll Firm Objects to Work on W. 160th: The "Non-Compete" Clause for the Northwest Parkway Raises Legislative Concerns*, DENVER POST (July 24, 2008 ) [http://www.denverpost.com/news/ci\\_9976830](http://www.denverpost.com/news/ci_9976830)

<sup>3</sup> Jeffrey Leib, *Toll Firm Objects to Work on W. 160th: The "Non-Compete" Clause for the Northwest Parkway Raises Legislative Concerns*, DENVER POST (July 24, 2008 ) [http://www.denverpost.com/news/ci\\_9976830](http://www.denverpost.com/news/ci_9976830)

<sup>4</sup> The contract was between the Northwest Parkway Public Highway Authority, made up of local counties and cities (the City and County of Broomfield, City of Lafayette, and Weld County), and Brisas / CCR. *Brisa/CCR Selected as Preferred Concessionaire for NW Parkway Co*, TOLLROAD NEWS, Apr. 11, 2007. <http://www.tollroadsnews.com/node/64>; Greg Avery, *Company Set to Pay up for Parkway: Deal Would Lock in Rights to Roadway for 50 Years*, Broomfield Enterprise (March 23, 2007 )

<sup>5</sup> See Northwest Parkway Concession and Lease Agreement, Art. 14 (Aug.29, 2007). <http://www.northwestparkway.org/PDF/FinalCLA.pdf>. The noncompete provisions are also included in a Summary of Northwest Parkway Concession and Lease Agreement. <http://www.northwestparkway.org/PDF/SummaryCLA.pdf.pdf>

year lease of the city's parking meters within two days after they first saw the terms of the complex 279 page legal and financial document.<sup>6</sup>

As with Representative McNulty, most people assume that only privatization can provide money so cash-strapped governments can fix crumbling infrastructure. In its June 2009 testimony before the House Committee on Ways and Means, Subcommittees on Oversight and Select Revenue Measures, the Government Accountability Office reported:

The problem is simple: revenues from motor fuels taxes and truck-related taxes to support the HTF — the primary source of funds for highway and transit — are not keeping pace with authorized spending levels. This problem was made dramatically apparent last summer when the Highway Account within the trust fund was nearly depleted. Despite an \$8 billion infusion from the General Fund of the Treasury in September 2008 to replenish the account, we find ourselves in the same predicament a year later.<sup>7</sup>

Privatization proponents argue that, in addition to being a source of money, privatization shifts future financial risk to the private contractor,<sup>8</sup> as well as, of course, the financial rewards.<sup>9</sup>

The reality, though, is far different. Infrastructure privatization contracts actually make the public the insurer of private contractors' return on their investment. Indeed, were it not for the lengthy provisions that protect contractors from diminution of their expected returns, the contracts would not run on for so many pages. Put another way, infrastructure privatization contracts are a form of socialized welfare for the “entrepreneurs” and risk imposed on the public. They are a domestic form of “stabilization clause” –

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<sup>6</sup> Office of the Inspector General City of Chicago, Report of Inspector General's Findings and Recommendations: An Analysis of the Lease of the City's Parking Meters 1, 6 (June 2, 2009) <http://www.chicagoreader.com/features/blogs/pdf/IGO-CMPS-20090602.pdf>; The contract may be found here. [http://egov.cityofchicago.org/webportal/COCWebPortal/COC\\_EDITORIAL/Metered\\_Parking\\_System\\_Ordinance.pdf](http://egov.cityofchicago.org/webportal/COCWebPortal/COC_EDITORIAL/Metered_Parking_System_Ordinance.pdf). The contract contains a number of provisions also found in the Northwest Parkway privatization contract and the proposed Pennsylvania privatization contract, including Article numbering. Secrecy was also an issue in Texas. [http://www.slcatlanta.org/Publications/EconDev/2007\\_Idaho\\_speech.html](http://www.slcatlanta.org/Publications/EconDev/2007_Idaho_speech.html)

<sup>7</sup> Government Accountability Office, *Highway Trust Fund: Options for Improving Sustainability and Mechanisms to Manage Solvency* GAO-09-845T 1, 10 (June 25, 2009) <http://www.gao.gov/new.items/d09845t.pdf>

<sup>8</sup> See, e.g., Sean Slone, *Transportation and Infrastructure Finance: A CSG National Report 24-25* (n.d.) <http://www.csg.org/pubs/Documents/TransportationInfrastructureFinance.pdf>

<sup>9</sup> Kansas T-Link, *Using Tolls to Support Needed Transportation Projects: A Resource for Kansas Policymakers 3-32 to 3-33* (Nov. 2008) <http://www.kansastlink.com/downloads/VI%20Using%20Tolls%20to%20Support%20Needed%20Transportation%20Projects.pdf> (“By moving to private participation in toll roads, the public benefits from private assumption of risk as well as from the availability of private capital, and it is appropriate that investors be paid to produce those public benefits.”)

a risk-mitigation tool to protect foreign investments from such sovereign risks as nationalization, expropriation, or the obsolescence bargain, in which the host state can use changes in circumstances to impose new requirements on investors. These clauses also may be designed to insulate investors from environmental and social legislation, a matter of growing economic significance to investors. Lenders often view stabilization clauses as an essential element of the bankability of an investment project, particularly in emerging markets, and they may insist that at least the fiscal terms of an agreement be stabilized. Host states have viewed stabilization clauses as a way to foster a favorable investment climate.<sup>10</sup>

In other words, a tool used in developing countries is now standard for financing infrastructure construction, improvement, and maintenance in the United States. But far more important than the insult to our pride or our pocketbooks, these contracts elevate private contractors to a quasi-governmental status, giving them power over new laws, judicial decisions, propositions voted on by the public, and other government actions that a contractor claims will affect toll roads and revenues.

We are in uncomfortable territory here. The contractors want the perquisites of government but a private entity's freedom from the oversight and accountability obligations imposed by the Constitution and law on government. But such a hybrid may well violate the non-delegation doctrine that bars private entities from exercising power that is inherently governmental. These are serious matters. They deserve at least a public airing of the wisdom of giving private actors power over decisions that (1) affect the public interest, (2) that are normally made by public officials, and (3) that are subject to public oversight, disclosure, and accountability – oversight that does not apply to private contractors.<sup>11</sup> Instead, at best, the discussion on infrastructure privatization has focused narrowly on tolls; reflexive pro- or anti-private or public provision; assumptions that there are no alternatives; and how to spend or invest up-front payments.<sup>12</sup>

These issues certainly matter, but when even our elected representatives and their advisors do not understand key terms of the contracts they are agreeing to – or don't even know

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<sup>10</sup> *Stabilization Clauses and Human Rights: A Research Project Conducted for IFC and the United Nations Special Representative to the Secretary General on Business and Human Rights* vii (March 11, 2008) [http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p\\_StabilizationClausesandHumanRights/\\$FILE/Stabilization+Paper.pdf](http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/$FILE/Stabilization+Paper.pdf)

<sup>11</sup> See Ellen Dannin, *Red Tape or Accountability: Privatization, Public-ization, and Public Values*, 15 CORNELL J. L. & PUB. POL'Y 1111 (2006).

<sup>12</sup> See, e.g., Sean Slone, *Transportation and Infrastructure Finance: A CSG National Report* 25-27 (n.d.) <http://www.csg.org/pubs/Documents/TransportationInfrastructureFinance.pdf> This report includes a brief discussion of noncompete agreements. *Id* at 25.

they exist – something has gone terribly wrong.<sup>13</sup> The public deserves sufficient information to allow them to understand how these very long, multi-billion dollar contracts affect vital national infrastructure, how these contracts hand power over basic public policy decisions to private interests, and how they let private profit trump public welfare.

### **Reading Infrastructure Contracts<sup>14</sup>**

It is no surprise that infrastructure privatization contracts are not widely read. They are, after all, complex legal documents that tend to run over 100 pages and that concern a specialized area. It is also easy to assume that the only terms that matter concern the exchange up-front money for the right to collect tolls. The issues missing from public discussion and scrutiny are terms that make government the insurer of the private contractor's financial success and that cede power over public decisions to private entities. In other words, infrastructure contract terms control far more than just tolls or turnpikes, and their effects will be felt long after the contracts end. The goal of this paper is to provide basic information – identify and explain key terms of these contracts – so that we can, at last, engage in a public discussion that is long overdue.

The provisions I discuss here – and the problems they cause – are common to infrastructure contracts. This is the case, even though the contracts may involve different sorts of infrastructure and deals. For example, when I examined the order and wording of the table of contents for the Northwest Parkway and the Pennsylvania Turnpike contracts, they were at least 70% identical, and Article 14 in the contracts for the Colorado Northwest Parkway, Pennsylvania Turnpike, and Chicago Parking Meters all concern “Adverse Actions” that guarantee private contractors expected revenues. These similarities are more than coincidence or using form documents. They are provisions that private operators fight for in order to guarantee profits while minimizing risk.

In short, this paper examines three examples of provisions commonly found in infrastructure contracts: (1) compensation events; (2) noncompetition provisions such as that in the Northwest Parkway contract; and (3) the contractor's right to object to and receive compensation for legislative, administrative, and judicial decisions.

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<sup>13</sup> The Government Accountability Office has issued many reports on highways, including highway privatization, but without considering the contract provisions discussed here, nor their effects on state and local government. *See, e.g.*, Government Accountability Office, *Highway Trust Fund: Options for Improving Sustainability and Mechanisms to Manage Solvency* GAO-09-845T (June 25, 2009); <http://www.gao.gov/new.items/d09845t.pdf>; Government Accountability Office, *Surface Transportation: Restructured Federal Approach Needed for More Focused, Performance-Based, and Sustainable Programs* GAO-08-400 (March 2008). <http://www.gao.gov/new.items/d08400.pdf>

<sup>14</sup> Statutory sections discussed in the text are included in an appendix.

## Compensation Events

A private contractor is only interested in a deal if it concludes that it is likely to make more money on this investment than others available to it over the life of the contract. Toll road revenue projections are based on uncertain guesses as to how much the American public will be driving generations into the future and about interest rates; alternative investments; local, national, and world economies; and transportation modes. Traffic can decline due to gas shocks, higher unemployment, shifts to mass transit, changing housing patterns, and the economy in general. A shorter term would ameliorate many problems, but that would mean losing the benefit of federal tax provisions that allow accelerated depreciation only if the contract term exceeds the useful life of the infrastructure. Buying insurance is another option.

However, the popular infrastructure contractor solution to uncertainty is requiring the public to reimburse the contractor for the loss of anticipated revenues. For example, in September 2008, the State of Indiana reimbursed the private Indiana Toll Road operator \$447,000 for tolls waived for people being evacuated during severe flooding.<sup>15</sup> These reimbursement terms make government the contractor's insurer.<sup>16</sup> Making the public the insurer of the contractor's success puts a brake on governmental actions that might limit revenues or be claimed to limit revenues.

Before looking at the specific terms, it is important to consider the effect these terms are likely to have on behavior. First, the fact that such a large portion of infrastructure privatization contracts is taken up with just this sort of penalty structure is evidence of a problem. Compare them to simple bilateral contracts for a one-shot deal. The relevant terms are an exchange of money for a product at a specific time. However, these contracts concern more than the delivery of a physical product; they concern the operation of and care for vital and expensive infrastructure for very long periods. Second, remedies for breaches of contracts are simplest when they can be measured by objective standards and pricing. However, under these contracts the damages are claims that revenue long into the future will be lost. Both problems are the result of opting, not for a flexible method for dealing with uncertain future events, but for locking in the terms to govern relationships for decades. The value of the contract thus depends on accurately predicting and accounting for income, expenses, goals, quality of commitment to the relationship, others' needs and temptations, the economy, acts of nature, and how to deal with problems in any of these aspects. From the contractor's point of view, it also depends on assurance that the government party will pay and will do so with as little cost of getting that payment as possible.

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<sup>15</sup> US PIRG, *Private Roads Public Costs: The Facts About Toll Road Privatization and How to Protect the Public* 18-19 (March 31, 2009) <http://www.uspirg.org/uploads/rX/yT/rXyTdCxIacJTXJi3Cm-W1w/Private-Roads-Public-Costs-Updated.pdf>; *State to Pay Spanish - Australian Consortium for Waived Fees on Toll Road*, Associated Press, September 20, 2008.

<sup>16</sup> Judy MacInnes, *Cintra's August Traffic Falls on Main Concessions*, REUTERS (Sept 11, 2008). <http://uk.reuters.com/article/rbssIndustryMaterialsUtilitiesNews/idUKLB70560420080911>

A good example of the provisions that have been created to deal with these challenges is Section 3.7(a)(1) on “Rights of the [Pennsylvania] Commonwealth to Access and Perform Work on the Turnpike” in the proposed Pennsylvania Turnpike contract. The Commonwealth retains rights “to inspect the Turnpike or determine whether or not the Concessionaire is in compliance with its obligations under this Agreement or applicable Law pursuant to Section 8.3.”<sup>17</sup> Another provision allows the Commonwealth to enter the Turnpike if the private contractor has defaulted, so that the Commonwealth can “make any necessary repairs to the Turnpike, perform any work therein and take any reasonable actions in connection therewith, including remediation of Hazardous Substances, pursuant to Section 16.1 (b)(iii).”<sup>18</sup> Pennsylvania needed to retain rights to enter the highway after it was privatized in order to ensure that the private contractor keeps its side of the bargain.

However, the right to enter is full of limits and exceptions that can become a “Compensation Event” requiring paying “Concession Compensation” to the contractor. It is helpful to read some short excerpts in order to understand the impact these terms can have.

“Concession Compensation” means, with respect to a Compensation Event, compensation payable by the Commonwealth to the Concessionaire in order to restore the Concessionaire to the same after-Tax economic position that the Concessionaire would have been in if such Compensation Event had not occurred and calculated in accordance with Section 15.1(b).<sup>19</sup>

“Compensation Event” means (I) any applicable entry on the Turnpike by the Commonwealth pursuant to Section 3.7(a)(v) through Section 3.7(a)(ix); *provided* that the Concessionaire's use of the Turnpike as a highway is materially impaired resulting in Losses or reduced Turnpike Revenues, (ii) the Concessionaire's compliance with or the implementation of a Required Modification pursuant to Section 5.2, (iii) the Concessionaire's compliance with or the implementation of any modified or changed Operating Standard (as contemplated by Section 6.3(b)), (iv) the termination of an agreement with a Vendor as contemplated in Section 7.2(d), (v) the occurrence of an Adverse Action as contemplated in Article 14, (vi) the circumstances described in each of Section 2.5(I), Section 4.1(a), Section 4.2, Section 5.2 and Section 15.2(d), (vii) any breach of the covenant set forth in Section 3.10(b) or (viii) the occurrence of a Commonwealth Default as contemplated in Article 16.<sup>20</sup>

These clauses are not easy reading even for attorneys. They can only be interpreted by referring to many other parts of the contract, which, in turn, require referring to other sections.

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<sup>17</sup> Proposed Pennsylvania Turnpike Contract § 3.7(a) (i) 42 (2008).

<sup>18</sup> Proposed Pennsylvania Turnpike Contract § 3.7(a) (ii) 42 (2008).

<sup>19</sup> Proposed Pennsylvania Turnpike Contract Definition Section 6 (2008).

<sup>20</sup> Proposed Pennsylvania Turnpike Contract Definition Section 6 (2008).

Many of the terms have special meanings that require referring to the contract's definition section. Other difficulties arise from terms such as "material" and "breach". They are legal terms of art with long interpretational histories by courts. They are also highly subjective concepts. In short, contract terms that are included to provide certainty of revenues for the contractor is itself full of uncertainties.

It should also be noted that "Compensation Events" arise from what, before privatization, were simple acts whose sole purpose was to keep the public safe, such as inspecting the quality of the roadbed or responding to emergencies. Under the contract, however, they become complex acts in which compensation is owed if entry is not at a reasonable time or if the Commonwealth fails to give reasonable prior notice. Indeed, even though the contract says that the Commonwealth can enter the Turnpike in the case of emergencies, those rights are also hedged with conditions that can require compensation. For example, § 3.7(a)(iii) allows access by emergency crews, but only if the Commonwealth *reasonably* believes that conditions are emergencies – as defined in the contract – and only if the method of entry complies with other parts of the contract, including giving notice that is "practicable under the circumstances". In the worst case scenario of a national emergency, evacuation planners will have to add parsing the language of infrastructure contracts and negotiating with contractors for access to the road – even by people who have no transponder or money to pay the toll – along with issues of shelter and food for displaced people.

These are not exaggerated concerns. Experience has shown that the profit-maximizing logic of the private sector can clash with basic public safety concerns and leave people unprotected. For example, in 2006, the Indiana Toll Road contractor installed sand-filled barrels in the Toll Road turn-arounds to prevent drivers from using them to avoid tolls and cause accidents. Those turn-arounds were created to allow emergency crews get to accidents as quickly as possible. They were not consulted or even informed of the decision to block the turn-arounds, and it was months before the contractor agreed to remove the barrels. These problems could have been avoided had the contractor met its contractual obligation to prepare an emergency response plan for the Toll Road.<sup>21</sup> Privatizing the road left the public with less protection and powerless to do more than beg that safety be taken into consideration, while the contractor concentrated on installing barriers and tolling mechanisms.<sup>22</sup> In addition, concerns that inspecting the Turnpike to ensure compliance with safety requirements or the contract means compensation is owed will have the effect of shrinking the rights of government and its ability to protect the public. Rather than just doing their job, they must consider whether their budgets could meet a demand for Concession Compensation.

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<sup>21</sup> Joshua Stowe, *U-Turn Safety Barriers on Toll Road Finished; Emergency Crews Still Training on Median Bypass*, SOUTH BEND TRIBUNE (INDIANA), B-3, Nov. 11, 2006.

<sup>22</sup> Theodore Kim, *States Considering Privatizing Highways Can Study Indiana Toll Road Experience*, USA TODAY, 10A, Oct. 17, 2006.

Exceptions upon exceptions, complex language, and subjective standards create conditions that alter and limit the way government can act. Fear of litigation and of the cost of litigation increases when it is difficult to determine rights. The more uncertain and subjective is the contract, the greater that uncertainty will be. Thus, when faced with a claim for compensation for an unreasonable entry and the prospect of having to cover claimed lost revenues, concerns over the cost of litigating and losing are likely to push the government to settle. However, if settlements are reached without evidence that proves specific revenues have been lost – and lost as a result of the government’s actions – the government overpays.

Furthermore, emergencies, such as flooding that required using the Indiana Toll Road for evacuation, are predictable and not hidden costs. They are events whose cost should be factored into a contract as part of due diligence and for which people and institutions purchase insurance. It may even be that the contractor has done its due diligence and included these events in its assessment of costs and benefits. If so, the contractor is paid twice – in the contract price and through government reimbursement – and the public’s benefit from the contract is less.

But far more serious is the effect on public rights. Consider the effect on the right of fire, police, and medical crews to enter with no charge to deal with emergencies.<sup>23</sup> That right is lost unless the Commonwealth uses “its reasonable efforts to minimize (I) the duration and scope of any such declaration and (ii) the adverse impact that any such declaration may have on the Turnpike Operations.”<sup>24</sup> State, county, and city attorneys will have been briefed so they can, in turn, instruct police, emergency, and fire departments that, when there is an accident on the Turnpike, emergency responders must consider more than just getting to the scene as quickly as possible to render aid. Rather than consider whether each situation is an emergency, they will be instructed that they must, in every instance, make “reasonable efforts” to minimize the impact of their efforts on Turnpike tolls and to document their actions to minimize impact. The result will be hesitation and new obligations. Equally likely, of course, is that there will be no instruction, and eventually the public will learn that it costs more money to respond to emergencies and to provide for the public welfare.

### **Noncompetition Agreements**

Destroying competition would seem to undermine the basic argument for private operation. The theory is that consumer choice among competitors in the free market spurs better performance and drives down costs. Noncompete provisions forbid competition and consumer choice and eliminate these spurs to better performance and lower cost. Yet, standard

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<sup>23</sup> Proposed Pennsylvania Turnpike Contract § 3.18.50 (2008).

<sup>24</sup> Proposed Pennsylvania Turnpike Contract § 3.18.50 (2008).



infrastructure privatization agreements forbid building or improving competing infrastructure<sup>25</sup> in order to leave no alternative but using the privatized infrastructure and guaranteeing the contractor's revenues. Here is an example of the decision-making process by a Denver area driver in considering whether to use E-470, a public toll road that had a noncompete provision that required lowering speed limits on nearby Tower Road from 55 to 40 m.p.h. and that stop lights be installed on 96th, 104th and 112th Avenues:<sup>26</sup>

If I'm driving home at rush hour (Note: I'm a cheapskate!), sometimes I will take Tower Road south to I-70, then turn left and go east on I-70 to E470. This way, I avoid the \$2.00 toll plaza south of 56th Ave., but still use E470 to avoid the congestion on I-225 (almost always slow in the long unimproved section south of 6th Ave. and north of Parker. It's only \$3.75 one-way if take this route. I figure it takes about 5-7 minutes longer than getting on E470 at Peña, but, I save \$2.00 in tolls, and usually stop at the big, new King Soopers shopping center at 48th and Tower for a snack and/or some of the cheapest gasoline around.<sup>27</sup>

A private contractor must consider how to ensure that driver and other drivers see no alternative to the privatized road in order to protect its revenue stream. It must also be concerned that government actions will create conditions that decrease revenues. The Federal Highway Administration and others favor revenue reimbursements to private contractors in lieu of or with noncompetition agreements.<sup>28</sup> These revenue fixes, however, fail to appreciate that noncompete agreements and revenue subsidies for private contractors make it harder for government to protect the public interest. Governments actions may lower private revenues, but government does not take those action in order to harm private contractors' revenues. As a result, requiring

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<sup>25</sup> For examples, see U.S. PIRG Education Fund, *Private Roads, Public Costs: The Facts About Toll Road Privatization and How to Protect the Public* Appendix A (Spring 2009)  
<http://www.uspirg.org/uploads/H5/Q1/H5Q10NcoPVeVJwymw1URRw/Private-Roads-Public-Costs.pdf>

<sup>26</sup> *Colorado City Ruins Road to Boost Toll Revenue: Commerce City, Colorado Non-Compete Agreement Lowered the Speed Limit and Installed Unneeded Traffic Signals to Force People onto the E-470 Toll Road*, The Newspaper.Com – A Journal of the Politics of Driving (Aug. 15, 2005).  
<http://www.thenewspaper.com/news/05/599.asp>

<sup>27</sup> <http://www.usairportparking.com/e470.asp>. Experience with competition between a privatized tollroad (M5) and a public road in Hungary beginning in the mid-1990's is instructive. Avoidance of the tollroad eventually led the government to agree to make up the private company's lost revenues. Árpád G. Siposs, *Tolling on the Hungarian Motorway Network, Piarc Seminar on Road Pricing with Emphasis on Financing, Regulation and Equity*, Cancun, Mexico, 2005, (April 11-13, 2005),  
<http://www.piarc.org/library/aipcr/2/96F0i2jcGYbBqRNJ9VIA3630.pdf>;  
[http://www.worldbank.org/transport/roads/tr\\_docs/annex8.pdf](http://www.worldbank.org/transport/roads/tr_docs/annex8.pdf) (Traffic on the free roads around M5 increased 30% and led the Government to subsidize both local users and the private company).

<sup>28</sup> See, e.g., Federal Highway Administration, United States Department of Transportation, *Innovation Wave: An Update on the Burgeoning Private Sector Role in U.S. Highway and Transit Infrastructure* 31, 61 (July 18, 2008). [http://www.fhwa.dot.gov/reports/pppwave/ppp\\_innovation\\_wave.pdf](http://www.fhwa.dot.gov/reports/pppwave/ppp_innovation_wave.pdf)

government to insure the contractor's income complicates – and even eliminates – options for addressing important public issues for the life of the contract, such as reducing air pollution, environmental degradation, and urban and suburban congestion; promoting public health; and tackling other problems related to car-focused transportation. Recall that the Northwest Parkway contract penalized building or improving mass transit. The contracts for the Pocahontas Parkway and Chicago parking meters go farther. The Pocahontas Parkway requires the “exercise [of] all discretionary authority available to it under Laws, Regulations and Ordinances to prevent any other governmental or private entity from developing Competitive Transportation Facilities, including but not limited to connections to State Highways.”<sup>29</sup> The Chicago Parking Meter Contract states that “the City shall use its reasonable efforts to oppose and challenge Such action by any such other Governmental Authority; provided, however, that all reasonable out-of-pocket costs and expenses incurred by the City in connection with such opposition or challenge shall be borne by the Concessionaire.”<sup>30</sup> In short, the contract requires government to act as an agent or lobbyist for the private contractor – or pay for not making sufficient efforts

The Government Accountability Office's March 2009 review of surface transportation recognized government's struggle to accommodate many competing goals.<sup>31</sup> By freezing the status quo for generations, these contract terms could leave us with obsolete transportation systems or, at the least, supporting an expensive featherbedding system that unnecessarily delays modernizing transportation, as was the case with Hungary's M-5. It also imposes private and localized impediments to regional planning and integrated systems.

The use of noncompetition and reimbursement agreements alters governance in many ways. First, they create divided loyalties. Public officials enter these agreements in order to serve the public's need and desire for transportation, but, then, the contract terms compel officials to prevent or impede public access to alternative roads. These are acts that the public has seen as not in its interest and that have caused the public to feel betrayed by their public servants. That was the case when the existence of noncompete agreement have come to light in Colorado and California.<sup>32</sup>

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<sup>29</sup> Federal Highway Administration, Public Private Partnerships, *PPP Agreements (Pocahontas Parkway)* September 2005. [http://www.fhwa.dot.gov/PPP/agreements\\_pocahontas.htm](http://www.fhwa.dot.gov/PPP/agreements_pocahontas.htm)

<sup>30</sup> Authorization for Execution of Concession and Lease Agreement and Amendment of Titles 2, 3, 9 and 10 of Municipal Code of Chicago in Connection with Chicago Metered Parking System, Passed by the City Council of the City of Chicago in Special Meeting December 4, 2008[Chicago Parking Meter Contract] § 14.5.

<sup>31</sup> Government Accountability Office, *Surface Transportation: Restructured Federal Approach Needed for More Focused, Performance-Based, and Sustainable Programs* GAO-08-400 26-28 (March 2008). <http://www.gao.gov/new.items/d08400.pdf>

<sup>32</sup> Daniel Sorid, *Colorado Highway "Slowdown" Sparks Debate on Toll Roads*, REUTERS Aug 11, 2005. (available at [http://corridornews.blogspot.com/2005\\_08\\_01\\_archive.html](http://corridornews.blogspot.com/2005_08_01_archive.html))

Second, these agreements do more than just constrain options for dealing with problems; they do so for generations. Promoting mass transit or other alternatives to driving, closing or narrowing streets to provide more urban green space, and other actions, such as those set out in <sup>33</sup> PlaNYC's ambitious program and other initiatives under consideration across the country, certainly will affect revenues from privatized infrastructure, including highways, parking meters, and parking garages. Contracting with the government means having a party with the power to alter conditions that directly affect the value of the contract to the other party. Refusing to include a noncompetition agreement where the contractor wants one is not an option if there are to be private contractors willing to lease public infrastructure. Governments knowingly breach a contract is certainly not good practice. But government is not just any contractor. Its first duty is to the public.

It may be that this conflict can be resolved by accepting that government may need to be perpetually in breach of infrastructure privatization contract and need to buy its way out of its provisions throughout the life of the contract. The contract for the Chicago parking meters seems to contemplate exactly that situation in its provisions on Reserved Powers Adverse Actions.<sup>34</sup> However, rather than being a solution to the problem, this fundamental conflict among government, private contractors, and the people may signal the inadvisability of these contracts. Contract terms that hold back progress, impose extra costs on the public, and even force suboptimal decisions are a high price to pay for financing infrastructure. This is especially the case when there are other options for raising money that do not have these negative consequences. For example, in its June 2009 testimony before the House Committee on Ways and Means, Subcommittees on Oversight and Select Revenue Measures, the Government Accountability Office listed a number of financing alternatives.

A number of alternative financing mechanisms — such as enhanced private-sector participation, bonds, loans, and credit assistance — can be used to help state and local governments finance surface transportation. These financing mechanisms, where appropriate, could help meet growing and costly transportation demands. However, these potential financing sources are forms of debt that must ultimately be repaid.<sup>35</sup>

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<sup>33</sup> <http://www.nyc.gov/html/planyc2030/html/home/home.shtml>

<sup>34</sup> See §14.3. Reserved Powers Adverse Actions, Authorization for Execution of Concession and Lease Agreement and Amendment of Titles 2, 3, 9 and 10 of Municipal Code of Chicago in Connection with Chicago Metered Parking System, Passed by the City Council of the City of Chicago in Special Meeting December 4, 2008 [Chicago Parking Meter Contract].

<sup>35</sup> Government Accountability Office, Highway Trust Fund: Options for Improving Sustainability and Mechanisms to Manage Solvency GAO-09-845T 1, 10 (June 25, 2009) <http://www.gao.gov/new.items/d09845t.pdf>

### **Contract Provisions That Affect Government Rights to Legislate and Adjudicate**

Noncompetition provisions are a type of Adverse Action. As discussed, most noncompetition agreements have an indirect effect on governance, while some, such as the Pocahontas Parkway agreement requires that the government party to the contract take direct action to protect the contractor's interests if competing transportation is contemplated.<sup>36</sup> Another type of Adverse Action has a direct effect on basic governmental functions, such as legislating and adjudicating. For example, the proposed Pennsylvania Turnpike contract required paying compensation to the private contractor for "enacting any legislation or ordinance or promulgating any rule or regulation" that principally affects the private contractor or private toll road operators or is reasonably expected to have the effect of causing a "material adverse effect on the fair market value" of the infrastructure.<sup>37</sup> San Diego's South Bay Expressway (SR 125) contract gives the private contractor the right to compensation if the state legislature, CalTrans, any administrative body, or voters create a law in any form that leads to acquiring part of the road, negatively affects the private contractor's rights, or regulates or interferes with its right to collect tolls. It is also entitled to compensation if any of those results are caused by a court order, decree, or judgment.<sup>38</sup> The Chicago parking meter contract treats Chicago's enacting laws or taking actions that adversely affect revenues as to be expected when one deals with a government entity. The contract's Reserved Powers Adverse Actions provisions essentially regularizes those actions by setting out charges for them.<sup>39</sup>

Legislative, executive, and judicial bodies are bound to represent the public interest, faithfully execute the laws, and apply and interpret law to adjudicate disputes. However, as with the other contract provisions discussed, they will find their roles altered in important ways when they operate under a privatization agreement. As discussed above, it is not just the actual payment of compensation that will affect conduct. The mere fear that compensation could be owed or that there could be a legal battle can also affect actions. However, that effect more directly delegates core governmental powers to a private actor when contract provisions directly affect the fundamental government powers of the legislature, executive, and the judiciary. State and local bodies are being required to act with an eye to any effect their decisions will have – or can be argued to have – on the revenues of a specific private entity. By contract they must elevate

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<sup>36</sup> Federal Highway Administration, Public Private Partnerships, *PPP Agreements (Pocahontas Parkway)* September 2005. [http://www.fhwa.dot.gov/PPP/agreements\\_pocahontas.htm](http://www.fhwa.dot.gov/PPP/agreements_pocahontas.htm)

<sup>37</sup> Pennsylvania Turnpike Agreement § 14.1 89-90.

<sup>38</sup> Federal Highway Administration, Public Private Partnerships, *PPP Agreements (South Bay Expressway (SR 125) Agreement)* September 2005. [http://www.fhwa.dot.gov/PPP/agreements\\_sr125.htm](http://www.fhwa.dot.gov/PPP/agreements_sr125.htm)

<sup>39</sup> See § 14.3 Reserved Powers Adverse Actions, Authorization for Execution of Concession and Lease Agreement and Amendment of Titles 2, 3, 9 and 10 of Municipal Code of Chicago in Connection with Chicago Metered Parking System, Passed by the City Council of the City of Chicago in Special Meeting December 4, 2008 [Chicago Parking Meter Contract].

those private interests about others, public and private. The elevated status given the private contractor in the development of law will have long term effects. Had the Pennsylvania Turnpike lease been approved, legislation, administration, and enforcement of the law, and adjudication would have been altered for over three generations. By the time the contract would have expired decisions made and actions taken because the contract required them would permanently altered the state.

### **The Public Interest and the Infrastructure Privatization Revolving Door**

It is easy to understand that state and local governments that feel pinched financially might turn to privatization as a source for quick cash. They agree to them and even seek out these deals, because they see infrastructure privatization as the only way to provide basic services and infrastructure while not raising taxes.

For state and municipal governments strapped for cash to complete much-needed infrastructure construction and maintenance, public-private partnerships (P3s) – where authorities lease infrastructure assets to private parties, which then operate and design them – are becoming more attractive.<sup>40</sup>

However, it is far more difficult to see why they would agree to infrastructure privatization on terms that have such pernicious effects on the public, on governance, and on democracy. Was it impossible for them to have gotten a better deal?

Public officials may say there are no alternatives because of public resistance to taxes. As a result, they can appear not to have raised taxes if they can shift blame for making an unpopular decision to a private contractor.<sup>41</sup> In other words, fear of citizen resistance to and retaliation for raising taxes is an important factor driving privatization.<sup>42</sup>

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<sup>40</sup> Joshua Hamerman, *More Infrastructure Privatization Coming; Latest Chicago Deal Highlights the Growth of a Developed Market for Infrastructure Privatization in the US*, 74 INVESTMENT DEALERS' DIGEST 3 (Dec. 8, 2008).

<sup>41</sup> Kansas T-Link, *Using Tolls to Support Needed Transportation Projects: A Resource for Kansas Policymakers* 4-6 to 4-7 (November 2008).  
<http://www.kansastlink.com/downloads/VI%20Using%20Tolls%20to%20Support%20Needed%20Transportation%20Projects.pdf> On the other hand, The public is unlikely to support tolls to the extent that tolls are seen as taxes. Id. at 4-36. On the other hand, the Chicago Inspector General concludes that these claims are untrue. Office of the Inspector General City of Chicago, *Report of Inspector General's Findings and Recommendations: An Analysis of the Lease of the City's Parking Meters* 4-5 (June 2, 2009).  
<http://www.chicagoreader.com/features/blogs/pdf/IGO-CMPS-20090602.pdf>

<sup>42</sup> *Anyone for US PPP? Catherine McGuirk talks to US Secretary of Transportation Mary Peters*, PROJECT FINANCE (June 2008); Tom Barnes, *Turnpike Lease Looks Good on Paper: Rendell Advisers Present a Study Seeing Potential for Big Profits*, PITTSBURGH POST-GAZETTE (May 22, 2007).  
<http://www.post-gazette.com/pg/07142/788007-147.stm>; Leslie Wayne, *Politics and the Financial Crisis Slow the Drive to Privatize*, NY Times B-3 (June 5, 2009).  
[http://www.nytimes.com/2009/06/05/business/economy/05private.html?\\_r=1](http://www.nytimes.com/2009/06/05/business/economy/05private.html?_r=1)

Given that the option of raising taxes to fund an increasing number of transportation projects remains politically radioactive, policymakers continue to pursue a range of alternate funding mechanisms and P3s are a critical trend here.<sup>43</sup>

In other words, if the public understood the real cost of privatization, they might decide that their personal welfare and the public good are better promoted by paying infrastructure costs through taxes. However, as long as many people are convinced that their tax dollars are wasted, privatizing public infrastructure is more attractive than the alternatives. However, the public has also been indignant by what they see as officials who sell off governance and the ability to make important decisions.

While these forces help explain why privatization is attractive. It does not explain why the agreements provide such strong protection for the contractors compared to the public. It is not in the government's direct interest to agree to hamstring itself nor to guarantee that private contractors get the revenues they envision. But it is in the contractors' interest to make government the guarantor of its success. The best explanation seems to be the Infrastructure Contractor / Investor / Advisor revolving door.

Consider two advisors to the Commonwealth in the Pennsylvania Turnpike privatization process – the law firm of Mayer Brown and Morgan Stanley. Both are major players in this area and, in recent years, have served as international and domestic advisors to governments, private contractors, and infrastructure investment groups.

Morgan Stanley, which advertizes its international experience,<sup>44</sup> was an unsuccessful bidder on the Pennsylvania Turnpike. When it was not selected to make a formal bid, it became an advisor to Governor Rendell on the deal.<sup>45</sup> It makes sense to hire an advisor with experience and expertise in putting together the terms of complex infrastructure deals. Morgan Stanley, through its various components, has deep expertise related to infrastructure. For example, in October 2006, Morgan Stanley Infrastructure and French contractor LAZ were given the ninety-nine year lease for Chicago's downtown underground parking garages. Two years later, in 2008, Morgan Stanley was part of a consortium called Chicago Parking Meters, LLC, that leased Chicago's parking meters for 75 years.<sup>46</sup> There will be future deals, because at the time it was

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<sup>43</sup> Sujit M. CanagaRetna, Senior Fiscal Analyst, Southern Legislative Conference, Testimony before the Idaho Senate Task Force on Treasure Valley Transportation Issues (Dec. 4, 2007). [http://www.slcatlanta.org/Publications/EconDev/2007\\_Idaho\\_speech.html](http://www.slcatlanta.org/Publications/EconDev/2007_Idaho_speech.html)

<sup>44</sup> <http://www.morganstanley.com/index.html>

<sup>45</sup> Paul Nussbaum, *Pa. Turnpike Lease Plans 'Proprietary'; PennDOT Is Keeping 48 Firms' Plans for Running the Toll Road Secret from Legislators Even as the Governor Makes His Pitch*, PHILADELPHIA INQUIRER (March 20, 2007).

<sup>46</sup> Joshua Hamerman, *More Infrastructure Privatization Coming; Latest Chicago Deal Highlights the Growth of a Developed Market for Infrastructure Privatization in the US*, 74 *Investment Dealers' Digest* 3 (Dec. 8, 2008); Jerry Crimmins, *Privatization Deals May Be Tougher Now; But Are Not Dead; Lawyer Says*, CHICAGO

advising Pennsylvania, it was amassing over \$4 billion in the Morgan Stanley Infrastructure Partners investment fund.<sup>47</sup>

These and other roles have given Morgan Stanley at direct knowledge of with the various contract reimbursement terms discussed here. As discussed, many provisions in the proposed Pennsylvania Turnpike contract are found, often verbatim, in other privatization contracts. It may be that Morgan Stanley advised including them in the Pennsylvania contract because they have become standard contract language. However, Morgan Stanley's many roles – and especially its past and future experience as a contractor and future as an investor in privatization deals – may have disposed it to include contract terms that would benefit it as an investor, advisor, and contractor.

The only benefit to Pennsylvanians from including these terms seems to be that no private contractor would agree to a contract without those terms. While not the focus here, there is along history of hiring private contractors to perform discrete parts of highway design, construction, and repair. These roles, which are limited in time, task, and responsibility do not necessitate contract terms that are a reaction to the large uncertainties in today's infrastructure privatization contracts. The danger and concern is not just that Morgan Stanley's expertise might have narrowed its vision so that it failed to consider whether their inclusion was of value to the public.

Indeed, at the time the Turnpike deal was pending, people pointed out that Morgan Stanley's various involvements created incentives that undercut its independent judgment and ability to act on behalf of the Commonwealth of Pennsylvania. The potential of a conflict by Morgan Stanley was dismissed by the Rendell administration; however, they conceived of a conflict of interest in very narrow terms. Roy Kienitz, then deputy chief of staff for Governor Rendell, now Under Secretary of Transportation for Policy in the Obama Administration<sup>48</sup> said:

Morgan Stanley was not going to make any decisions.

"They (Morgan Stanley) don't have the power. People in this building, the general assembly and the governor, they will set the terms."

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DAILY LAW BULLETIN, 10001 (April 21, 2009);

<sup>47</sup> Joshua Hamerman, *More Infrastructure Privatization Coming; Latest Chicago Deal Highlights the Growth of a Developed Market for Infrastructure Privatization in the US*, 74 INVESTMENT DEALERS' DIGEST 3 (Dec. 8, 2008); Press Release: Morgan Stanley Closes \$4.0 Billion Global Infrastructure Fund (May 12 2008). <http://www.morganstanley.com/about/press/articles/193468f4-555c-11dd-adaf-ab43576ea42b.html>; Kelly Holman, *Infrastructure Investment Speeds up - Morgan Stanley and Global Infrastructure Partners Are Latest to Raise Investment Vehicles for the Space*, Investment Dealers Digest (May 12, 2008) <http://www.iddmagazine.com/news/181743-1.html>; Press Release: Morgan Stanley Closes \$4.0 Billion Global Infrastructure Fund (May 12 2008) <http://www.morganstanley.com/about/press/articles/6330.html>; see also Joshua Hamerman, *More Infrastructure Privatization Coming; Latest Chicago Deal Highlights the Growth of a Developed Market for Infrastructure Privatization in the US*, 74 Investment Dealers' Digest 3 (Dec. 8, 2008).

<sup>48</sup> <http://projects.washingtonpost.com/2009/federal-appointments/person/roy-kienitz/>

He said Morgan Stanley are strictly prohibited under the terms of their employment by the state from working for any bidder and from bidding. He said their compensation is proportional to the value of any deal consummated to give them an incentive to work to maximize benefits to the state. If they were paid a fixed fee they wouldn't have that incentive.<sup>49</sup>

Governor Rendell's press release announced more details of the pay arrangement:

Morgan Stanley will work on a success fee basis – that is, it will earn compensation only when the commonwealth receives funding for its transportation needs, a formula that is standard in these types of transactions.<sup>50</sup>

Rather than demonstrating that Pennsylvania's interest would control, the pay system actually created a conflict of interest. If the only way the advisors would be paid was consummating a contract, then they were likely to push for a contract, rather than the best solution to Pennsylvania's transportation challenges. The details of that arrangement included:

Morgan Stanley's payment is contingent upon the state selling or mortgaging the turnpike. But either deal promises a major payday. The firm's .0125 percent commission on a \$12 billion long-term lease would come out to \$15 million. Should the state opt to "mortgage" the road by issuing long-term debt on its value, a \$12 billion offering could bring the firm as much as \$18 million.<sup>51</sup>

Republicans representatives in the legislature objected to this form of payment:

Republicans said it's in Morgan Stanley's interest to push for leasing the turnpike regardless of whether it's the best plan, because the firm will get a big fee.

Republicans also claimed that Morgan Stanley could wind up as the investment banker for the project, working for the successful bidder and earning even more money.<sup>52</sup>

Governor Rendell, however, rejected any conflict of interest:

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<sup>49</sup> Longterm Lease of Turnpike Likely Best Value for Pennsylvania - Gov Rendell Seeking Law for a Concession, TollRoad News (May 21, 2007) <http://www.tollroadsnews.com/node/145>

<sup>50</sup> Governor Rendell Announces Selection of Financial Adviser for Transportation Funding Options Morgan Stanley & Co. To Analyze All Options, Including Turnpike's Proposal (Mar. 29, 2007) <http://www.state.pa.us/papower/cwp/view.asp?A=11&Q=461198>; Jerry Crimmins, *Privatization Deals May Be Tougher Now; But Are Not Dead; Lawyer Says*, CHICAGO DAILY LAW BULLETIN, 10001 (April 21, 2009).

<sup>51</sup> Debra Erdley, *Wall Street Mobilizes to Cash in on Privatizing Public Assets*, TRIBUNE-REVIEW (April 5, 2007) [http://www.pittsburghlive.com/x/pittsburghtrib/s\\_501218.html](http://www.pittsburghlive.com/x/pittsburghtrib/s_501218.html)

<sup>52</sup> Tom Barnes, *Turnpike Lease Looks Good on Paper: Rendell Advisers Present a Study Seeing Potential for Big Profits*, PITTSBURGH POST-GAZETTE (May 22, 2007). <http://www.post-gazette.com/pg/07142/788007-147.stm>



As Rendell sent his 42-page proposal to the legislature, Senate Republican leaders criticized what they said was a possible conflict of interest by financial adviser Morgan Stanley.

Since Morgan Stanley will be paid a fee based on the amount of any eventual lease value, the financial firm has an incentive to "recommend the largest transaction possible rather than a course of action which may be more balanced and more prudently serve the needs of the Commonwealth and its residents," said a letter from Sens. Scarnati, Majority Leader Dominic Pileggi (D., Chester), and transportation committee chairman Roger Madigan (R., Bradford).

Michael J. Masch, the governor's budget secretary, responded that the contract had been approved by the attorney general and that it "falls well within the bounds permitted" by the state's conflict-of-interest law.<sup>53</sup>

The law firm of Mayer Brown was also a consultant on both the Pennsylvania Turnpike deal<sup>54</sup> and, as its website shows, has been involved in the major infrastructure privatization deals of recent years as either an adviser to governments (Chicago Midway Airport, Chicago Skyway, Colorado Northwest Parkway, Indiana Toll Road, Pennsylvania Turnpike, Chicago Public Parking System)<sup>55</sup> and to infrastructure investors:

We advise on the structuring, formation, fundraising and closing of regional and global infrastructure funds on behalf of both sponsors and major investors and currently serve as counsel to the sponsor on several infrastructure fund formation projects for major global financial institutions including Macquarie, UBS Global Asset Management, and LS Power.<sup>56</sup>

Mayer Brown advertizes its international experience as expertise it can provide domestically:

Mayer Brown's Infrastructure practice brings together teams of lawyers in the Americas, Asia and Europe from such areas as finance and securitization, government regulatory, corporate and securities, real estate, tax, private equity and infrastructure funds to serve the range of client needs in this area. Our functionality and flexibility allows us to mobilize an experienced and integrated team wherever in the world it is needed.

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<sup>53</sup> Paul Nussbaum, *Turnpike Lease Plan Sent to Pa. Legislature: Gov. Rendell's Proposal to Raise Money for State Transportation Projects Faces Major Opposition*, *PILADELPHIA INQUIRER* May. 22, 2007 [http://www.philly.com/inquirer/home\\_top\\_stories/20070522\\_Turnpike\\_lease\\_plan\\_sent\\_to\\_Pa\\_\\_legislature.html](http://www.philly.com/inquirer/home_top_stories/20070522_Turnpike_lease_plan_sent_to_Pa__legislature.html)

<sup>54</sup> Jerry Crimmins, *Privatization Deals May Be Tougher Now; But Are Not Dead; Lawyer Says*, *CHICAGO DAILY LAW BULLETIN*, 10001 (April 21, 2009)

<sup>55</sup> <http://www.mayerbrown.com/infrastructure/index.asp?nid=11539>

<sup>56</sup> <http://www.mayerbrown.com/infrastructure/index.asp?nid=11440>.

Mayer Brown has worked on some of the largest and most important infrastructure projects in the world. These include the first US airport and first US toll road privatizations, the \$5.2 billion expansion of the Panama Canal and the award-winning Suzhou Industrial Park water project in China. A thorough understanding of the infrastructure market combined with our substantial track record representing clients in landmark deals makes Mayer Brown the first-choice law firm for the industry's most significant players.<sup>57</sup>

We are a leading law firm in the United States for the privatization of public assets. We regularly advise on drafting and negotiating concession agreements with detailed capital improvement requirements and operating standards. Clients benefit [sic] for the knowledge and experience that we have gained from advising on projects such as the Chicago Skyway, Indiana Toll Road, Chicago Midway Airport, Corredor Sur Toll Road, IIRSA Sur Toll Road and Jorge Chávez International Airport.<sup>58</sup>

According to Mayer Brown, the lease agreement it worked on in its role as co-counsel for the State of Indiana on the Indiana Toll Road “followed in many respects the form we developed for the Chicago Skyway transaction.”<sup>59</sup>

These revolving door relationships are not unique to the Turnpike. Investigative reporters revealed that, in the case of the Chicago parking meters, the city's financial advisers “were working on other multibillion-dollar deals with the company that emerged as the winning bidder, Morgan Stanley. The overlapping relationships are in violation of the city's own contracting rules.”<sup>60</sup> They also noted that paying advisors based on the percentages of the contract's value may have perverse incentives of encouraging decisions that put dollars over other aspects of the public interest.<sup>61</sup>

Finally, it should be noted that those who are most in a position to understand these contracts have not been candid in their public statements about the allocation of risk. For example,

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<sup>57</sup> <http://www.mayerbrown.com/infrastructure/>.

<sup>58</sup> Mayer Brown, Fact Sheet: Transportation Infrastructure: Ports, Port-Related Facilities and Intermodal Projects [http://www.mayerbrown.com/infrastructure/MB\\_Transportation\\_Infrastructure.pdf](http://www.mayerbrown.com/infrastructure/MB_Transportation_Infrastructure.pdf); see also Daniel Schulman, *Highway Privatization: A Dead End?* MOTHER JONES (May 22, 2009) <http://www.motherjones.com/mojo/2009/05/highway-privatization-dead-end>

<sup>59</sup> <http://www.mayerbrown.com/infrastructure/index.asp?nid=11539>

<sup>60</sup> Ben Joravsky & Mick Dumke, *The Parking Meter Fiasco: Part III The Insiders*, CHICAGO READER June 18, 2009 [http://www.chicagoreader.com/chicago\\_parking\\_meters\\_3/](http://www.chicagoreader.com/chicago_parking_meters_3/)

<sup>61</sup> Ben Joravsky & Mick Dumke, *The Parking Meter Fiasco: Part III The Insiders*, CHICAGO READER June 18, 2009 [http://www.chicagoreader.com/chicago\\_parking\\_meters\\_3/](http://www.chicagoreader.com/chicago_parking_meters_3/)

In addition to revenue, the low amount of risk is also advantageous, says Dana Levenson, head of the North American infrastructure finance and advisory business at Royal Bank of Scotland. "Ultimately, if people don't want to park in downtown Chicago, the risk doesn't accrue to the city, it accrues to the investors," he says. "The investors accrue most of the risk and pay the lessor an upfront payment to assume that risk."<sup>62</sup>

However, this claim fails to consider the risk taken on by the public, just as there is a failure to disclose the degree of conflict of interest involved in vetting these deals. While it is true that the private contractor may assume risk, the contracts shift a great deal of risk to the public. The question that has been ignored for too long is why the contracts are structured in this way. The contract terms and experience with advisors such as Morgan Stanley tell us that government needs to develop its own expertise if it is to avoid the revolving door problem of relying on advisors from industry.

## Discussion

Large parts of infrastructure privatization contracts – provisions that most people are unaware of – exist solely to make the transaction low risk and high return for the private contractor. A private contractor has every reason to try to protect itself from loss, as well as securing as large a return on its investments and efforts as possible. Reaching those goals is a challenge with contracts of many decades. Uncertainties abound. Toll road revenue projections are based on uncertain guesses about future transportation patterns, the cost of money, the economy, and incentives by others to take actions adverse to the private contractor's interests.<sup>63</sup>

Public officials who negotiate and are party to these contracts need to be equally zealous in promoting the public's interests. There is more to highway privatization contracts than just transportation and more to public interest than just economics. Sadly, the contract provisions discussed here embody an assumption that states are solely economic actors and that private capital is inevitably part of providing public infrastructure. These limited views are especially noteworthy in a time when we have seen private capital undermining the nation's welfare and government coming to the rescue of private financial institutions.

Infrastructure privatization contracts have also been problematic for denying the public information and the opportunity to be heard as to its own interests. The good news is that the recently released House Committee on Transportation and Infrastructure, *The Surface Transportation Authorization Act of 2009: A Blueprint for Investment and Reform* shows that private provision will continue be part of the discussion on infrastructure. The document,

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<sup>62</sup> Joshua Hamerman, *More Infrastructure Privatization Coming: Latest Chicago Deal Highlights the Growth of a Developed Market for Infrastructure Privatization in the US*, 74 INVESTMENT DEALERS' DIGEST 3 (Dec. 8, 2008)

<sup>63</sup> Judy MacInnes, *Cintra's August Traffic Falls on Main Concessions*, REUTERS (Sept. 11, 2008). <http://uk.reuters.com/article/rbssIndustryMaterialsUtilitiesNews/idUKLB70560420080911>

however, envisions a new emphasis on public protections within public-private partnerships and on disclosure and fair processes in the development of a PPP agreement.<sup>64</sup>

These declarations are a good start, but experience shows that more is needed. We are bedeviled as much by *unasked* questions as by unanswered questions. Indeed, our greatest challenge is to ask those fundamental questions about infrastructure and to have an intelligent, inclusive, respectful, and full discussion. It is tempting in a time of severe economic peril and crisis conditions with much of the country's infrastructure to get to the bottom line without delay. However, have the processes of shutting out the public until the real decisions are made been successful? Can we say that the process involved in making expensive, complex decisions with multi-generational effects with a commitment to democratic participation and engagement would be worse?

For all but those who have an ideological commitment to privatization, the issue driving privatization is how to fund public infrastructure. We cannot answer this question until we consider: Are states really so cash-strapped that their only option is to sell off their democratic institutions? This question too often leads no farther than a discussion limited to the problem of collecting taxes. For example, the federal gas tax is no longer adequate to meet our needs because more fuel efficient vehicles, whose use we need to encourage, mean that fewer miles are driven compared to gas consumed. The gas tax is attractive, because it costs little to collect and it fits with a user pays philosophy, that is, those who use roads should pay for the road. Tolls fit with the user-pays idea but are far more expensive to collect.

The user pays position has an implicit assumption that only those who drive on a road benefit from the road. We should recall President Eisenhower's insight that this nation needs not just roads, but a system of roads. That commitment reflected an understanding that we all benefit from the goods and people that travel our system of roads. We benefit from having a system of connected roads, some of which have tolls and some of which do not. We also benefit from people who never set tire on a road. Because of people who walk or use mass transit our roads are less crowded and damaged and our air is less polluted. That discussion should also consider whether a gas tax, as with a sales tax, is a fair allocation of financial burdens.<sup>65</sup>

In short, we are a people long overdue for an extended discussion about taxes and taxing and their effects. Taxes are not just about money but about the meaning of money. Even those who are part of the tax revolt are concerned about more than just money. They care about whether they get their money's worth from the way tax dollars are spent and about the decisions that government makes. The natural progression of such a discussion would be from whether gas

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<sup>64</sup> U.S. House of Representatives Committee on Transportation and Infrastructure, *The Surface Transportation Authorization Act of 2009: A Blueprint for Investment and Reform* 32-33 (June 18, 2009).

<sup>65</sup> Transportation Review Board, *Critical Issues in Transportation 2009 Update* 6 (June 17, 2009) <http://onlinepubs.trb.org/Onlinepubs/general/CriticalIssues09.pdf>

taxes are reasonable<sup>66</sup> to who benefits and who pays to whether taxes should be state or federal to the goals of an appropriate tax and the factors relevant to the answer. Such a discussion would be educational and would help us take stock of who we are and what we value. It would help us move from a limited way of thinking about just the costs to the benefits of the use of highways and whether they should be subsidized.

Closely related to that discussion is the unasked but basic question: Why do we toll a road? The obvious answer – to raise revenues – ignores that tolling can be used to create disincentives to drive and to promote the decisions that lead to less driving. Tolling and its purposes should raise questions about whether we assess costs fairly by placing them only on those who use the road and only use toll revenue directly for the road tolled. Can gasoline or vehicle taxes be used more generally or just for transportation?

The problem with privatizing infrastructure is that, although financial interests and issues are discussed, the public interest is far greater than dollars and driving.<sup>67</sup>

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<sup>66</sup> The Kansas T-Link process is a good example of that part of the discussion:

However, at the same time, what drivers may not see or understand is that even though higher fuel prices mean that they are paying a higher price for driving that does not mean that they contribute more towards the cost of roads. The Federal fuel tax of 18.4 cents per gallon remains unchanged since 1993; Kansas has only increased its state fuel tax from 20 cents in 2000 to 25 cents in 2008 (including a one cent environmental fee). So, as fuel taxes have been relatively flat at the same time that gas prices have been skyrocketing, the piece of the pie representing the fuel tax contribution to state and Federal funding has been shrinking.

<http://www.kansastlink.com/downloads/VI%20Using%20Tolls%20to%20Support%20Needed%20Transportation%20Projects.pdf> p.2-11

<sup>67</sup> The GAO has criticized infrastructure privatization processes that fail to include the public interest as a formal part of the evaluation. As a result the public interest is likely to be overlooked. Government Accountability Office, *Highway Public-Private Partnerships: More Rigorous Up-front Analysis could Better Secure Potential Benefits and Protect the Public Interest*, GAO-08-1149R 8 (Sept. 8, 2008); Office of the Inspector General City of Chicago, Report of Inspector General's Findings and Recommendations: An Analysis of the Lease of the City's Parking Meters 33 (June 2, 2009) <http://www.chicagoreader.com/features/blogs/pdf/IGO-CMPS-20090602.pdf>

Statutes referred to in  
*Infrastructure Privatization Contracts and Their Effect on Governance*

**Proposed Pennsylvania Turnpike Agreement**

**ARTICLE 1 DEFINITIONS AND INTERPRETATION**

**Section 1.1 Definitions.** Unless otherwise specified or the context otherwise requires, for the purposes of this Agreement the following terms have the following meanings:

"AA-Compensation" has the meaning ascribed thereto in Section 14.1(b).

"AA-Dispute Notice" has the meaning ascribed thereto in Section 14.1(c).

"AA-Notice" has the meaning ascribed thereto in Section 14.1(c).

"AA-Preliminary Notice" has the meaning ascribed thereto in Section 14.1(c).

"AA-Termination Damages" has the meaning ascribed thereto in Section 14.2(a).

"Adverse Action" has the meaning ascribed thereto in Section 14.1(a).

"Change of Law" means (a) the adoption of any Law after the Bid Date, or (b) any change in any Law or in the interpretation or application thereof by any Governmental Authority after the Bid Date.

"Compensation Event" means (I) any applicable entry on the Turnpike by the Commonwealth pursuant to Section 3.7(a)(v) through Section 3.7(a)(ix); *provided* that the Concessionaire's use of the Turnpike as a highway is materially impaired resulting in Losses or reduced Turnpike Revenues, (ii) the Concessionaire's compliance with or the implementation of a Required Modification pursuant to Section 5.2, (iii) the Concessionaire's compliance with or the implementation of any modified or changed Operating Standard (as contemplated by Section 6.3(b)), (iv) the termination of an agreement with a Vendor as contemplated in Section 7.2(d), (v) the occurrence of an Adverse Action as contemplated in Article 14, (vi) the circumstances described in each of Section 2.5(I), Section 4.1(a), Section 4.2, Section 5.2 and Section 15.2(d), (vii) any breach of the covenant set forth in Section 3.10(b) or (viii) the occurrence of a Commonwealth Default as contemplated in Article 16.

"Concession Compensation" means, with respect to a Compensation Event, compensation payable by the Commonwealth to the Concessionaire in order to restore the Concessionaire to the same after-Tax economic position that the Concessionaire would have been in if such Compensation Event had not occurred and calculated in accordance with Section 15.1(b).

"Material Adverse Effect" means a material adverse effect on the business, financial condition or results of operations of the Turnpike taken as a whole or the rights of the Concessionaire under this Agreement; *provided, however*, that no effect arising out of or in connection with or resulting from any of the following shall be deemed, either alone or in combination, to constitute or contribute to a Material Adverse Effect: (I) general economic conditions or changes therein; (ii) financial, banking, currency or

capital markets fluctuations or conditions (either in the United States or any international market and including changes in interest rates); (iii) conditions affecting any or all of the real estate, financial services, construction or toll road industries not geographically limited to the Commonwealth; (iv) any existing event, occurrence or circumstance of which the Concessionaire has actual knowledge as of the Bid Date; (v) any action, omission, change, effect, circumstance or condition contemplated by this Agreement or attributable to the execution, performance or announcement of this Agreement or the transactions contemplated hereby, with the exception of litigation related to the execution or delivery of this Agreement or related to the legislation referred to in Section 9.1(n); or (vi) any negligence, intentional misconduct or bad faith of the Concessionaire or its Representatives.

**Section 1.12 Laws.** Unless specified otherwise, a reference to a Law is considered to be a reference to (a) such Law as it may be amended, modified or supplemented from time to time, (b) all regulations and rules pertaining to or promulgated pursuant to such Law, (c) the successor to the Law resulting from recodification or similar reorganizing of Laws and (d) all future Laws pertaining to the same or similar subject matter. Nothing in this Agreement shall fetter or otherwise interfere with the right and authority of the Commonwealth to enact, administer, apply and enforce any Law. Except for Adverse Actions or if compensation or other relief is otherwise available or provided for pursuant to applicable Law or this Agreement, the Concessionaire shall not be entitled to claim or receive any compensation or other relief whatsoever as a result of the enactment, administration, application or enforcement of any Law by the Commonwealth.

### ARTICLE 3 TERMS OF THE LEASE

#### **Section 3.7 . Rights of the Commonwealth to Access and Perform Work on the Turnpike.**

(a) Reservation of Rights. The Commonwealth reserves (for itself and its Representatives, as well as grantees, tenants, mortgagees, licensees and others claiming by, through or under the Commonwealth) the right and shall, at all times during the Term, have the right to enter the Turnpike and each and every part thereof at all reasonable times and upon reasonable prior notice (except as provided in Section 3.7(a)(iii) and Section 3.7(a)(iv)), in the following circumstances:

- (I) to inspect the Turnpike or determine whether or not the Concessionaire is in compliance with its obligations under this Agreement or applicable Law pursuant to Section 8.3. -9
- (ii) if a Concessionaire Default then exists, to make any necessary repairs to the Turnpike, perform any work therein and take any reasonable actions in connection therewith, including remediation of Hazardous Substances, pursuant to Section 16.1 (b)(iii);
- (iii) in the event of an actual or reported emergency, danger, threat, circumstance or event that is reasonably believed by the Commonwealth or its designee (including relevant police, fire, emergency services, armed forces, and any other security or emergency personnel in accordance with Section 3.18) to have caused (or to present the imminent potential to cause) injury to individuals, damage to property, or threat to the Environment or to public safety, to take, at such times as the Commonwealth determines necessary in its discretion and with notice to the Concessionaire if practicable under the circumstances, such actions as the Commonwealth or such designee determines necessary to respond to or to rectify such emergency, danger, threat, circumstance or event;

## **ARTICLE 14 ADVERSE ACTIONS**

### **Section 14.1 Adverse Action.**

(a) An "Adverse Action" shall occur if the Commonwealth or any Governmental Authority established under the Laws of the Commonwealth, takes action at any time during the Term (including enacting any legislation or ordinance or promulgating any rule or regulation) and the effect of such action is reasonably expected (I) to be principally borne by the Concessionaire or principally borne by private operators of toll roads in the Commonwealth; and (ii) to have a material adverse effect on the fair market value of the Concessionaire Interest, except where such action (A) is in response to any act or omission on the part of the Concessionaire or its Representatives that (1) is illegal (other than an act or omission rendered illegal by virtue of the Adverse Action), or (2) constitutes nonperformance by the Concessionaire, (B) is otherwise permitted under this Agreement or (C) is mandated by action of the United States government (or any agency thereof); provided, however, that none of the following shall constitute an Adverse Action: (w) the exercise of police, subpoena or investigatory powers of the Commonwealth or any Governmental Authority where the Commonwealth or Governmental Authority has reasonable cause to exercise such powers or take other official action under existing Law; (x) an increase in Taxes not directed solely at the Concessionaire, the Turnpike, the users of the Turnpike or private operators of toll roads in the Commonwealth or their users; (y) Taxes for which the Concessionaire is not responsible pursuant to Section 3.10; and (2) the development, redevelopment, construction, maintenance, modification or change in the operation of any existing or new mode of transportation (including a road, street or highway) that results in the reduction of Toll Revenues or in the number of vehicles using the Turnpike.

(b) If an Adverse Action occurs, the Concessionaire shall have the right to (I) be paid by the Commonwealth the Concession Compensation with respect thereto (such Concession Compensation, the "AA-Compensation") or (ii) terminate this Agreement and be paid by the Commonwealth the Turnpike Concession Value, in either case by giving notice in the manner described in Section 14.1(c).

(c) Within 30 days following the date on which the Concessionaire first became aware of the Adverse Action, the Concessionaire shall give notice (the "AA-Preliminary Notice") to the Commonwealth stating that an Adverse Action has occurred. Within 180 days following the date of delivery of the AA-Preliminary Notice, the Concessionaire shall give the Commonwealth another notice (the "AA-Notice") setting forth (I) details of the effect of said occurrence that is principally borne by the Concessionaire generally or principally by private operators of toll roads in the Commonwealth and not by others, (ii) details of the material adverse effect of the said occurrence on the fair market value of the Concessionaire Interest, (iii) a statement as to which right referred to in Section 14.1(b) the Concessionaire elects to exercise, and (iv) if the Concessionaire elects to exercise the right to Concession Compensation under Section 14.1(b), the amount claimed as AA-Compensation and details of the calculation thereof. The Commonwealth shall, after receipt of the AA-Notice, be entitled by notice to require the Concessionaire to provide such further supporting particulars as the Commonwealth may reasonably consider necessary. If the Commonwealth wishes to dispute the occurrence of an Adverse Action or the amount of AA-Compensation, if any, claimed in the AA-Notice, the Commonwealth shall give notice of dispute (the "AA-Dispute Notice") to the Concessionaire within 30 days following the date of receipt of the AA-Notice stating in reasonable detail the grounds for such dispute. If neither the AA-Notice nor the AA-Dispute Notice has been withdrawn within 30 days following the date of receipt of the AA-Dispute Notice by the Concessionaire, the matter shall be submitted to the dispute resolution procedure in Article 19.



(d) If the Concessionaire has elected to exercise its right to AA-Compensation, the Commonwealth shall pay the amount of Concession Compensation claimed by the Concessionaire within 60 days following the date of receipt of the AA-Notice, or if a AA-Dispute Notice has been given, then not later than 60 days following the date of determination of the AA- Compensation (together with interest at the rate set forth in Section 20.9 from the date of receipt of the AA-Dispute Notice to the date on which payment is made); provided that, subject to the right of the Concessionaire to receive interest at the rate set forth in Section 20.9 on the payment owed by the Commonwealth from the date of receipt of the AA-Dispute Notice to the date on which payment is made, the Commonwealth may defer any such payment for an additional 120 days if the Commonwealth determines, in its discretion, that such additional period is necessary in order to obtain financing or otherwise to obtain the necessary funds to make such a payment.

**Reserved Powers Adverse Actions, Authorization for Execution of Concession and Lease Agreement and Amendment of Titles 2, 3, 9 and 10 of Municipal Code of Chicago in Connection with Chicago Metered Parking System, Passed by the City Council of the City of Chicago in Special Meeting December 4, 2008 [Chicago Parking Meter Contract].**

**Section 3.12. Competing Off-Street Parking.**

(a) Subject to Section 3.12(b) and Section 3.12(e), the City will not operate, and will not permit the operation of, a "Competing Public Parking Facility." A "Competing Public Parking Facility" means any off-street public parking lot or public parking garage that (I) is (A) owned or operated by the City or (B) operated by any Person and located on land owned by the City, or leased to the City, (ii) is within one mile of a Concession Metered Parking Space, (iii) is used primarily for general public parking; (iv) has a schedule of fees for parking motor vehicles that is less than three times the highest Metered Parking Fees then in effect for Concession Metered Parking Spaces in the same area; and (v) was not used for general public parking on the effective date of this Agreement.

(b) As used in Section 3.12(a), the term "Competing Public Parking Facility" does not include (I) any parking lot or parking garage located at, or providing parking for motor vehicles in connection with the regular operations of public buildings and facilities including, but not limited to, any airport, courthouse, correctional facility, police station, fire station, administrative building, public school, public library, public park or recreational facility, public hospital or similar government building; (ii) any parking facility located at, or within one-half mile of, any sports stadium or sports arena having a seating capacity in excess of 15,000; (iii) park and ride facilities that are used primarily by mass transit passengers; (iv) temporary parking facilities used for Special Events; and (v) any parking facility that is used primarily to provide parking for an affordable housing development or a public housing project.

(c) If the City undertakes or permits a Competing Public Parking Facility in violation of Section 3.12(a), such action shall constitute a Compensation Event requiring the payment of Concession Compensation. Such action shall not constitute a City Default, an Adverse Action or a Reserved Powers Adverse Action. No interest in real estate is conveyed by Section 3.12.

**§14.3. Reserved Powers Adverse Actions.**

(a) Use of Reserved Powers. The Parties acknowledge and agree that (i) it is anticipated that the City will exercise its Reserved Powers during the Term, (ii) the impact of certain of such actions may have a material adverse effect on the fair market value of the Concessionaire Interest; (iii) the provisions of Article , including the provisions thereof relating to the payment of Settlement Amounts by the City, are designed to compensate the Concessionaire for changes resulting from the exercise by the City of its Reserved Powers in a manner that will maintain the fair market value of the Concessionaire Interest over the Term and (iv) adverse changes may be mitigated by other Reserved Power actions of the City that will have a favorable impact on the fair market value of the Concessionaire Interest. The Parties also acknowledge and agree that there may be circumstances when the exercise by the City of its Reserved Powers may have a material adverse effect on the fair market value of the Concessionaire Interest that cannot be compensated fully under the provisions of Article 7 and that under such " circumstances the Concessionaire may seek compensation with respect thereto (the "Reserved Powers Adverse Action Compensation").

(b) Reserved Powers Adverse Action. A "Reserved Powers Adverse Action" shall occur if (i) the City takes any action or actions during the Term that would otherwise have constituted an Adverse Action under Section 14.1 except that such action or actions were taken by the City pursuant to its Reserved Powers, and (ii) such actions, individually or in the aggregate, are reasonably expected (A) to be borne principally by the Concessionaire or other operators of on-street metered parking systems and (B) to have a material adverse effect on the fair market value of the Concessionaire Interest after taking into account the provisions of Article 7. In addition, the events described in Section 7.10 relating to a reduction of Concession Metered Parking Spaces or to the average of the Monthly System in Service Percentage for certain Reporting Years being less than eighty percent (80%) are each a Reserved Powers Adverse Action.

#### **Pocahontas Parkway – Richmond, Virginia.**

"Competitive Transportation Facilities" are defined as any State highway crossing the James River within 3 miles of the project's bridge crossing. The Department agrees that it shall not, subject to certain exceptions, (i) initiate, authorize, franchise or finance private Competitive Transportation Facilities; (ii) open any Department owned or operated Competitive Transportation Facilities; and (iii) fail to exercise all discretionary authority available to it under Laws, Regulations and Ordinances to prevent any other governmental or private entity from developing Competitive Transportation Facilities, including but not limited to connections to State Highways. (Section 12.1).

Association's and the Trustee's sole and exclusive remedy for a violation of this covenant shall be to recoup an amount equal to the loss of Toll Revenues proximately caused by the Department's action as determined by the Toll Consultant (Section 17.9(b)).

#### **South Bay Expressway (SR 125) Agreement**

Federal Highway Administration, Public Private Partnerships, *PPP Agreements* (South Bay Expressway (SR 125) Agreement) September 2005. [http://www.fhwa.dot.gov/PPP/agreements\\_sr125.htm](http://www.fhwa.dot.gov/PPP/agreements_sr125.htm)

Developer has the right to seek compensation for "losses" in certain events and Caltrans agrees and understands that Developer is entitled to seek compensation for losses resulting from the occurrence of any of the following operative events:

(a) The State legislature, the California Transportation Commission, or any other administrative agency or authority of the State enacts, adopts, promulgates, modifies, repeals, or changes any State law, rule, initiative, referendum, constitutional provision, or regulation, all or any of which has the effect of

- (I) directing Caltrans to acquire the Transportation Facility or portion thereof,
- (ii) terminating, limiting, reducing, or abrogating the rights or benefits of Developer under this Agreement, or
- (iii) regulating or interfering with Developer's right to establish and collect tolls;

(b) The voters of the State, by initiative, referendum, or other ballot measure, enact, adopt, promulgate, modify, repeal, or change any State law, rule, initiative, referendum, constitutional provision, or regulation, all or any of which has the effect of

- (I) directing Caltrans to acquire the Transportation Facility or portion thereof,
- (ii) terminating, limiting, reducing, or abrogating the rights or benefits of Developer under this Agreement, or
- (iii) regulating or interfering with Developer's right to establish and collect tolls; or

(c) Any court issues any order, decree, or judgment which has the effect of

- (I) directing Caltrans to acquire the Transportation Facility or portion thereof,
- (ii) terminating, limiting, reducing, or abrogating, the rights or benefits of Developer under this Agreement,
- (iii) declaring illegal, void, or ultra vires any portion of this Agreement or voiding the rights of Developer under this Agreement, or
- (iv) regulating or interfering with Developer's right to establish and collect tolls.