

US P3 PROCUREMENT GETS IT JUST RIGHT

THE PROCUREMENT PROCESS FOR THE EAST END CROSSING SCHEME IN SOUTHERN INDIANA GOT IT JUST RIGHT, ACCORDING TO BARNEY ALLISON, A PARTNER IN THE INFRASTRUCTURE PRACTICE GROUP AT NOSSAMAN LLP'S LOS ANGELES OFFICE. THE DEAL HAD STRONG POLITICAL SUPPORT AND A WELL-STRUCTURED ALLOCATION OF PROJECT RISKS.

We all know the story of Goldilocks and the Three Bears. Young girl gets lost in the woods, stumbles upon a house and discovers the occupants aren't present. Goldilocks' adventure in the woods has made her very hungry; she finds three tempting bowls of porridge on the dining room table. She tries the first bowl – it's too hot; she tries the second bowl – it's too cold; she tries the third bowl and it's just right.

By all accounts, the procurement process for the East End Crossing bridge project in southern Indiana by the Indiana Finance Authority using an availability payment approach got it just right – construction costs 23% below estimates, a procurement schedule that from shortlisting to commercial close took less than eight months, and a fierce competition among highly qualified teams, including several new players to the US P3 market.

So what was the recipe for the success of this project? As I will discuss, the primary ingredients included strong political support, an unparalleled commitment of time and resources by the public sponsor to the process, a wealth of available information regarding the project, and an allocation of project risks designed to produce the most value for money for the state.

A tale of two bridges

The East End Crossing project is a cross-river transportation scheme intended to meet the current and future transportation needs of the Louisville, Kentucky/Southern Indiana region, and is a component part of the larger Ohio River Bridges project. The Ohio River Bridges project will provide two new bridges across the Ohio River (the East End Bridge and the Downtown Bridge) and connecting roadways, as well as the modernisation of the existing Kennedy Bridge.

Because the Ohio River Bridges project links Indiana and Kentucky, it requires the co-operation and partnership of both states. In March 2012, Governor Mitch Daniels of Indiana and Governor Steve Beshear of Kentucky signed a memorandum of understanding outlining the responsibilities of the two states with regard to the development and financing of the two projects. To document the terms of the MoU, the Indiana Department of Transportation (INDOT),

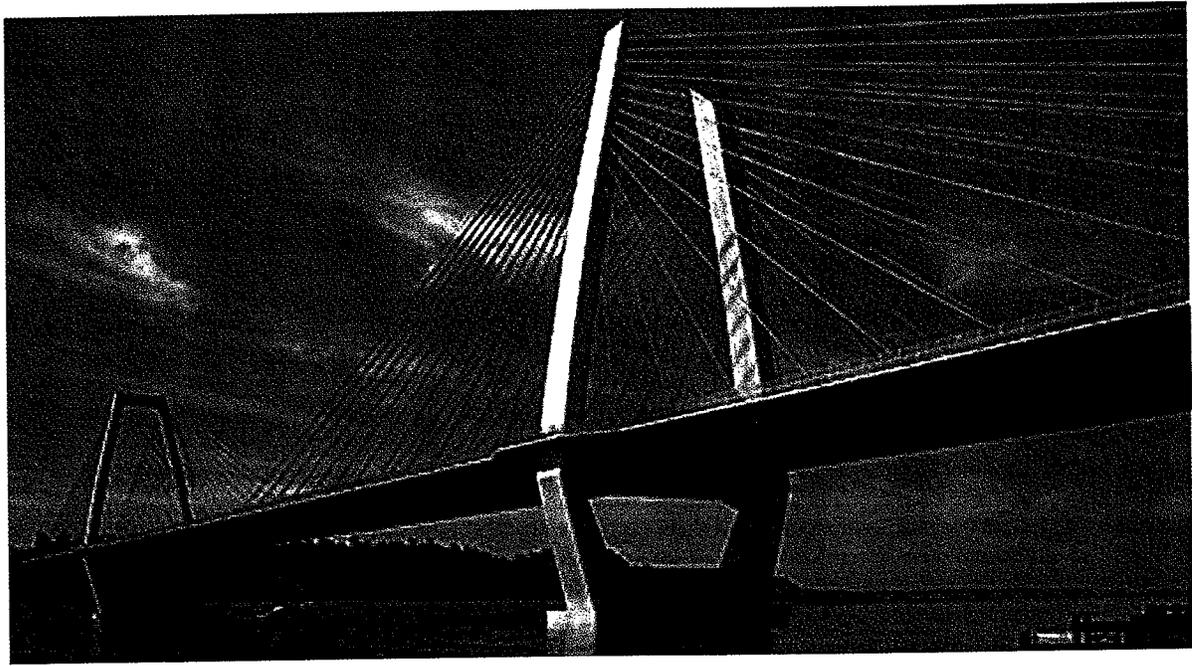
the Kentucky Transportation Cabinet (KYTC), the Indiana Finance Authority (IFA), and the Kentucky Public Transportation Infrastructure Authority (KPTIA) entered into a Bi-State Development Agreement that addresses the relationship of the parties to the Ohio River Bridges project. Pursuant to the Bi-State Development Agreement, KYTC is the procuring agency for the Downtown Crossing, while IFA is the procuring agency for the East End Crossing. The specific components of the East End Project consist of the design, construction and financing of three integrated, but different, types of surface transportation improvements: (a) the approximately 3.3-mile Gene Snyder Freeway (KY 841) approach to the East End Bridge (defined below) in Eastern Jefferson County, Kentucky, including an approximately 1,700ft long tunnel; (b) the approximately 2,500ft four-lane (two lanes each, opposing, with median) new East End Bridge, which can accommodate six lanes (three lanes each, opposing, with median), and will be located approximately eight miles east of downtown Louisville; and (c) the approximately 4.1-mile Lee Hamilton Highway (SR 265) approach to the East End Bridge in Indiana.

Unwavering political support

The East End Crossing is the latest example of the State of Indiana using innovative delivery approaches to leverage private capital to deliver needed transportation infrastructure sooner than expected and at the lowest possible cost to taxpayers. Governor Mitch Daniels' Major Moves highway programme leased the 157-mile Indiana Toll Road in 2006 for US\$3.8bn, which is being reinvested in economic development and long-term transportation infrastructure. An innovative bidding technique prompted a private design-build team to replace the Milton-Madison Bridge upstream from the East End Crossing with



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significantly less disruption to motorists and at 20% less cost.

Building on the success of these projects, the state conducted an extensive review of the value for money in pursuing various alternate delivery approaches relying on preliminary cost estimates for design, construction and operation and maintenance costs. Assumptions were made regarding available funding from state and federal sources, as well as potential toll revenue from tolling the new bridge.

Following the execution of the MoU between the two states assigning development and financing responsibility for the East End and the Downtown Crossing, Governor Daniels mandated the use of an availability payment structure to provide for the design, construction, financing and long-term operation and maintenance of the East End Crossing and directed state officials to achieve commercial close by the end of 2012, when the Governor's term expired. Furthermore, the state committed US\$392m of state and federal highway funds over a five-six year period to fund construction milestone payments.

Meet every procurement milestone

Kicking off the procurement shortly after the Governor signed the bi-state MoU, IFA released an RFQ and announced four shortlisted teams in late April 2012. The teams included many of the major international developers and equity providers that have shown interest in other US P3 transportation projects and some new players, including SNC Lavalin and Vinci. The responses to the RFQ also demonstrated a growing interest by several of the large US contractors to participate on the equity as well as the design/build side of these transactions, including Keiwi and Walsh Construction. Also, there had been keen interest by the private side in the project given its size, construction challenges and advanced environmental planning.

The procurement schedule released to the shortlisted bidders offered a five-month industry review/preparation of bid period. This required preparation of the draft RFP, including the public-private agreement and the technical provisions, essentially from the ground up. The recent successes of the Presidio Parkway project in California, as well as the two transportation projects brought to financial close in Florida as availability payment concessions, offered a starting point. Also, the state had some experience with alternate project delivery methods for transportation facilities that assisted in drafting the East End RFP. To support the effort, IFA hired a team of highly qualified legal, financial and technical advisers to help produce RFP documents, manage the industry review process and evaluate the final proposals, and achieve commercial and financial close.

Starting with the release of the draft RFP in early May 2012, immediately after the bidder shortlist was established, until commercial close was reached on December 27 2012, IFA met every procurement milestone, responding in a timely and consistent way to input from all four teams that were actively involved in the procurement process. As a testament to the public sponsor's commitment to the procurement, all four shortlisted teams submitted conforming bids, a first for a US P3 project (and perhaps in the world!) maintaining a highly competitive procurement and producing the attractive winning bid.

Allocate the risks, share the rewards

The mantra in the P3 world for allocation of risk is to allocate the risk to the party best in the position to manage and price the risk. Assigning 100% of the risk to either the public agency or the private developer is really only possible for a discrete set of those risks. In general, public

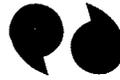
agencies are in the best position to deal with ROW acquisition and environmental risk, while the private developers are in the best position to handle many of the cost and scheduling risks. That leaves a number of risks that require some form of risk-sharing due to their problematic nature or uncertain costs.

Because the states had spent a fair amount of time studying the project and planning for its construction, and INDOT had allocated a fair amount of its budget for the project over the next five years, IFA was willing to take on a good amount of the risk relating to utilities, permitting and environmental compliance. Furthermore, as the tunnel was not going to be part of the operation and maintenance responsibility of the P3 developer but would be turned over to KYTC at substantial completion, the risks associated with long-term operation and maintenance of the tunnel, which can be significant for this kind of transportation asset, did not factor into the availability payment bid.

For the East End Crossing, subsurface conditions relating to the excavation of the tunnel on the Kentucky-side posed the most significant risk of project construction. INDOT had performed a fair amount of site investigation for this portion of the project and decided to take risk of differences in subsurface conditions from those identified in a baseline geotechnical report prepared for the state, provided the developer stayed within a prescribed construction envelope. Furthermore, since IFA and KYTC had a track record of working with a number of utilities in the area, IFA agreed to negotiate several of the utility relocation agreements, leaving to the developer the obligation to finalise agreements, particularly those where the developer's final design would influence the scope and location of the necessary relocations.

Another of the most significant risks for the project, particularly the ability to achieve financial close, was posed by an existing lawsuit under the federal National Environmental Protection Act (NEPA). Additionally, the need to supplement the existing environmental approval raised the spectre of additional lawsuits under NEPA.

IFA agreed to take the risk of any new environmental litigation, as well as the issuance of any actions by the court under the existing environmental litigation, by excusing the developer from achieving financial close if lenders weren't able to get comfortable with any increased risks relating to actions by the court necessitating a termination, and paying termination compensation to recompense design costs as well as costs related to obtaining financing commitments. Furthermore, after financial close, if such court actions resulted in work stoppages or necessitated scope changes, IFA agreed to compensate the costs of such actions as relief events that would also entitle the developer to schedule relief if the actions affected critical path items.



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IFA recognised early on that the developer needed to be shielded as much as possible from its state partner to the south; having to deal with not one but two public masters would add time and contingency to the bids. The bi-state agreement discussed above gave KYTC the right to review and approve the technical provisions for the tunnel and to work in tandem with INDOT regarding review of design and construction by the private developer, with IFA taking risk of any delays in design and plan approvals. However, the decision on the substantial completion and final acceptance even as to the tunnel portion of the project was IFA's alone.

A unique feature of the public-private agreement was to establish a relief events allowance account equal to US\$45m funded by appropriations from INDOT over and above the milestone payments as the first source of payment of compensation for a large basket of relief events that could occur during the construction period. At substantial completion, any amounts left in the account were shared 50/50 between IFA and the private developer, thus providing an incentive to reduce claims and minimise the cost of such claims.

Certain project improvements were taken out of the scope of the developer's responsibility under the public-private agreement. In addition to removing the tunnel portion of the project from the O&M limits, INDOT entered into several early construction contracts to reduce certain seasonality risks.

Conclusion

The private sector often complains about the time it takes for public owners to complete the procurement process, as well as the risk that the owner will abandon the procurement altogether after the private bidders have expended millions of dollars participating in the process and preparing their bids. Another common complaint is the unrealistic expectations on the part of the public owner as to the appetite for the private sector to take on most, if not all, of the risks associated with construction and operations and maintenance. Based on the successful procurement by the State of Indiana of a private development team to design, construct, finance, operate and maintain the East End Crossing for the 35-year contract period, IFA got this one just right in establishing itself as an attractive place for the private P3 industry to do business, as evidenced by the robust response to a recent RFI for a potential new highway project in the state. ■