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**STRATEGIC AND IMPLEMENTATION ISSUES
IN TEXAS' PUBLIC-PRIVATE
TRANSPORTATION PROJECTS**

by

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Research Report 1281-3F

*Research Project 0-1281
Highway Privatization in Texas*

conducted for the

TEXAS DEPARTMENT OF TRANSPORTATION

in cooperation with the

U.S. Department of Transportation
Federal Highway Administration

by the

CENTER FOR TRANSPORTATION RESEARCH

Bureau of Engineering Research
THE UNIVERSITY OF TEXAS AT AUSTIN

February 1994

IMPLEMENTATION STATEMENT

This project report is intended to provide TxDOT with additional information for exploring partnerships with the private sector. The various issues and policy questions to be addressed by TxDOT and the Texas Transportation Commission are presented. Importantly, the authors note that the process of privatization is complex. Public-private partnerships must be entered into deliberately. The over-arching goal is to provide transportation infrastructure that benefits the public interest. Recent experiences, as described in the 1281-1 report, demonstrate that there is an opportunity for greater private-sector involvement while maintaining the highest standards for public safety. It is our recommendation that formal policies be prepared to facilitate greater public-private participation. This document will assist decision-makers in this task.

Prepared in cooperation with the Texas Department of Transportation
and the U.S. Department of Transportation, Federal Highway Administration

DISCLAIMERS

The contents of this report reflect the views of the authors, who are responsible for the facts and the accuracy of the data presented within. The contents do not necessarily reflect the views or policies of the Federal Highway Administration or the Texas Department of Transportation. This report does not constitute a standard, specification, or regulation.

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**NOT INTENDED FOR CONSTRUCTION,
BIDDING, OR PERMIT PURPOSES**

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ABSTRACT

The Texas Department of Transportation (TxDOT), like most state transportation agencies, has limited resources for addressing growing transportation needs. Greater utilization of the private sector is heralded as an answer to this problem. While not a panacea, there are a range of privatization strategies that are consistent with the TxDOT mission and may assist in reducing the financial burden to the state. The advantages and disadvantages to various strategies are presented. There are a number of important issues to address in developing a privatization program, including: (1) design and construction standards, (2) disadvantaged business enterprise procurement, (3) liability and sovereign immunity, (4) government vehicle access and pricing, and (5) environmental reviews. These issues must be adequately addressed by policy-makers before proceeding with a program of privatization. Moreover, departmental policies must be developed for project selection.

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SUMMARY

The Texas Department of Transportation (TxDOT), like many other state departments of transportation, faces an unprecedented situation of limited resources and increased highway needs from a larger population, a maturing roadway system, and the mandate to preserve the existing infrastructure.

A number of other states have begun privatization and public-private partnership programs to address the gap between resources and needs. This report explores a range of issues involved in implementation of a public-private program in Texas, if this type of program is established during the biennium.

In crafting a public-private program, at least four key policy issues and one procedural issue will need to be addressed early. First, an investor-owned transportation facility may possess monopolistic characteristics, and therefore its finances and charges must be regulated. A decision needs to be made about which agency has responsibility for economic regulation and the type of economic regulation which will be used. Second, TxDOT will need to decide its approach to the use of eminent domain for public-private projects. Third, decisions will be required about the nature and extent, if any, of financial investments which TxDOT would make in approved projects. Fourth, TxDOT must decide if it will become actively involved in a public-private partnership program, like most other states, or whether the program will be conducted primarily through public-private partnerships established at the local level. And, fifth, the type of process by which projects will be submitted must be decided — either a formal request for proposals or a non-competitive process in which private firms submit their projects without a deadline per se. The advantages and disadvantages of various policy alternatives are suggested in the report.

Recommendations are then offered on a series of other policies and issues which would be a part of a Texas public-private partnership program. These include such matters as design and construction standards, environmental reviews, competing routes, and reimbursement by private entities for TxDOT services. Selection of projects is discussed in detail: who could submit projects, what types of projects would be eligible, and what criteria have been used for selection by officials in other states. Then the steps in a possible solicitation process are outlined. A final section enumerates a variety of organizational matters which would need to be addressed and sketches a timetable for implementation of a public-private partnership program by TxDOT.

If a partnership program is created in Texas, there cannot be unrealistic expectations about its potential for solving the widening gap between transportation needs and shrinking resources. Projects in other states have met with limited success to date, and nearly all public-private projects will depend greatly on current financial and development conditions. Nevertheless, there are few risks in undertaking cautiously a public-private partnership program in Texas. Over the longer term, this program may offer significant benefits to both TxDOT and Texas' drivers.

I. THE POTENTIAL BENEFITS OF PRIVATIZATION

Purpose and Scope of This Report

The Texas Department of Transportation (TxDOT) is faced with limited resources for addressing a growing number of highway needs. This — coupled with an increased population, a maturing roadway system, and a mandate to preserve the existing system — makes the quest for innovative ways to finance highway improvements more urgent. With encouragement from the U.S. Department of Transportation, a number of states have begun involving private-sector entities in building and rehabilitating their transportation infrastructure. Experiences of those states have been described in a companion report (1281-1).

This report explores a range of privatization strategies appropriate to TxDOT's mission and discusses key decisions involved in implementation of a privatization program, or, more precisely, a public-private program in Texas. Recommendations are offered in some instances, while the advantages and disadvantages of alternatives are suggested when the choices involve fundamental organizational policy or internal administrative issues which are beyond a research focus. After key implementation issues are enumerated, a description of possible steps in, and a timetable for, implementation by TxDOT are provided.

This report is limited to private and public-private transportation projects and does not discuss public toll roads. That is being analyzed in a companion research project, 1322, "An Evaluation of the Status, Effectiveness and Future of Toll Roads in Texas." Nor does this project deal with the actual or the potential privatization of functions of state transportation departments. TxDOT and other state DOTs have contracted out and privatized certain functions, such as highway maintenance, to varying degrees. Privatization of particular functions, however, was not included in the scope of this research.

Finally, it must be stressed that the public-private initiatives in other states are dynamic and constantly changing. In states such as Florida and Colorado, there are key statutory or rule changes which may be implemented in the next six months. So while every attempt was made to collect and present the most current information, there are likely to be changes in a number of states' situations by the fall of 1994.

Achieving Privatization's Potential

Private-sector resources have the potential to reconcile some of the increasing gap between growing infrastructure needs and less than adequate resources. Through a partnership with state and local transportation officials, private firms and institutions may be instrumental in bringing on-line additional transportation capacity sooner than if the facilities were financed solely by the public sector. Supplementing current and future public financing with private resources should allow state and local policy-makers to use public resources for other needed projects. (Other potential benefits may be leveraging of federal funds via the Intermodal Surface Transportation Efficiency Act [ISTEA], generation of new state transportation revenues either from toll surpluses or continuance of toll revenues after construction and operational costs are covered, and new tax revenues generated by private transportation facilities.)

Yet innovations are easily proposed and less easily executed. There is extensive experience with public highways and infrastructure, but almost no experience with private-sector involvement in the selection, design, and operation of transportation facilities in the United States. At a minimum, any public-private transportation project involving TxDOT must (1) provide significant transportation benefits for citizens; (2) be built and maintained to high standards for the safety and protection of citizens; and (3) be financially sound, for TxDOT and taxpayers, if not for the private interests. Ideally, projects also would be viewed as being fair and equitable in terms of user charges paid by citizens and as being selected and constructed without any impropriety. Ideally too, projects would be perceived by lawmakers and the public as being adequately monitored.

Although a legal analysis was not conducted as part of this research project, it may be possible that TxDOT could proceed with a program under any of the four broad models of new private or public-private transportation facilities.

- (1) A **perpetual franchise** is most like a utility in which the facility is privately owned, financed, and operated. While this arrangement is not common in transportation outside of the railroads and some ferries, a government's role usually is restricted to regulation of health and safety, and, if deemed a monopoly, to regulation of fares or rates of return.
- (2) Under a **Build-Operate-Transfer (BOT)** approach, the private firm or entity constructs and operates the facility during a franchise period (usually from 20-40 years), after which ownership is transferred to a governmental agency. The franchise period and fees are supposed to provide sufficient time to recover all costs, pay off debt, and generate an acceptable rate of return for the private party. **BOT** is thought to be the most common privatization model in transportation worldwide.
- (3) Under a **Build-Transfer-Operate (BTO)** model, the title is transferred to a governmental entity immediately after construction. A private entity then operates the facility under a franchise agreement, but has less liability than under **BOT**.
- (4) With a **lease-purchase** arrangement, a private entity finances and builds the facility, then leases it to a governmental entity that pays installments. The facility may be operated by either party, and there may or may not be a toll. This approach has been used for construction of local government waste treatment facilities and purchases of large equipment; it has not been common in transportation to date.

A fifth model, **Build-Own-Operate (BOO)**, would characterize the proposed Camino Columbia project. This model also would describe a public tollway, without participation by the private sector. In neither case would a BOO model be included in a public-private partnership program.

Key Initial Choices

In crafting a public-private program, at least four key policy issues and one procedural issue will need to be addressed early. First, an investor-owned transportation facility in some cases will possess monopolistic characteristics, and therefore its finances and charges must be regulated in some manner. A decision needs to be made about the agency with responsibility for

economic regulation and the type of economic regulation which will be used. Second, TxDOT will need to decide its approach to the use of eminent domain for public-private projects. Third, decisions will be required about the nature and extent, if any, of financial contributions which TxDOT would make to approved projects. Fourth, TxDOT must decide if it will become actively involved in a public-private partnership program, like most other states, or whether it will choose an approach such as that taken in Minnesota, where local road authorities will have the primary responsibility for establishing new infrastructure. And, fifth, the type of process by which projects will be submitted must be decided. So far, other states generally either have had a formal Request for Proposals (RFP) (or Request for Qualifications and then an RFP) competition or have chosen a non-competitive process in which private firms submit their projects without a deadline per se. (Each approach has its merits, as is pointed in the later section describing project solicitation.)

Economic regulation can be extraordinarily complex, as is apparent by the size of state regulatory agencies throughout the United States. Because economic regulation is so complex and would be a novel task for state departments of transportation, one alternative is to have that responsibility placed within an existing regulatory agency. Among the states in the forefront of public-private transportation, that alternative has been selected only once, in the Commonwealth of Virginia. There, the state's utility commission has authority to regulate toll rates based upon its analysis of applications submitted by private firms. Utility-type regulation has been criticized for being cumbersome, inefficient, stifling to novel pricing approaches, and more worrisome to potential investors. On the other hand, a traditional utility regulatory body has substantial expertise which can benefit oversight of a transportation facility, and there has been no shortage of investors in utilities for the past 50 years.

The predominant type of economic regulation being adopted is one which sets permissible rates of return for each project. The State of California initiated this approach, which has now been emulated by Arizona and Washington. Each agreement has some unique features, although generally each project franchisee is permitted to earn an acceptable rate of return based upon an assessment of the project's risks in obtaining financing, meeting revenue forecasts, and other factors. In the California projects, the ceilings on the rates of return ranged from a low of 17 percent to a high of 21.25 percent. (Incentives of up to an additional 6 percent were established if franchisees met certain transportation targets: increased auto occupancy, vanpooling, reduced accident and fatality rates.)

While the California type of regulation may be preferable to traditional utility regulation, it will require that outside financial advisors play an integral role during the agreement negotiation process. This type of regulation also is open to more criticism by the media and elected political officials, who are likely to focus on what appears to be a high rate of return rather than on an equitable toll rate. When rates on certificates of deposit are less than 5 percent, there is almost certain to be criticism of any rate of return ceiling above 10 percent, even if such a comparison is invalid. In recognition of the political environment in which public-private partnerships are likely to operate, perhaps TxDOT should consider seriously a blended type of regulatory approach. Under this approach, an agreement would specify a rate of return ceiling but also some ceiling on toll rates. This would be more similar to an incentive-based regulatory technique which allows operators to generate and garner a higher profit level, provided they maintain a low toll rate and are able to operate efficiently.

It must be pointed out, however, that rate of return regulation should not be presumed to be the best course of action. Unless there are state funds (or another type of state contribution) provided to a project, assuming a free competing route, the option of no economic regulation should be considered also. Except for guarding against potential safety problems and perhaps a default which would require TxDOT action, market forces may be a sufficient regulatory constraint in certain projects. Although each project should be judged in its entirety, TxDOT officials may wish to solicit a category of projects in which they expect to exert minimal economic regulation. A more traditional approach might be the preferred alternative in the first year or two, but in later years, this "minimal regulation" category of projects may deserve serious exploration.

A second key policy issue revolves around the use of eminent domain on behalf of public-private projects. No state has granted eminent domain power to a private operator. In most states (California, Florida, Arizona, Washington, Puerto Rico), the state DOT has the ability to use eminent domain on behalf of the project. None has yet done so. In Virginia, local governments may use eminent domain on behalf of a private transportation facility. On the one potentially viable facility in the state, one county government did use eminent domain to acquire several parcels at the end of the 15-mile (24-km) route. And in Minnesota, all public-private projects are being established through road authorities, and they may exercise condemnation for new or rehabilitated facilities.

It is too early to tell if the use of eminent domain in public-private projects will differ significantly from its use in solely public projects. While the situation has yet to arise, a public-private project may possess one advantage over public projects with respect to eminent domain. Whereas public agencies are limited to paying fair market value, private entities may pay what the market will bear. So in some cases, it may be easier for a private firm to pay above market if that would avoid delay or litigation. In such cases, if assembly of land by the private firm fails, the public agency could step in.

In Texas, leasing of assembled rights-of-way must be considered also. In the case of the Sam Houston Tollway, TxDOT apparently leased the right-of-way until debt retirement. While not strictly a public-private project, leasing of parcels to public-private projects would seem acceptable, provided that TxDOT's incurred costs would be repaid in future lease payments. Most other states have indicated they would provide right-of-way for public-private projects when it is required.

A third key policy issue involves the potential for government contributions to a private-public transportation partnership. Certainly TxDOT should not prohibit financial involvement by county and municipal governments in project proposals. In fact, that should be seen positively. If legally permitted under the state's Constitution and current statutes, TxDOT should consider the many ramifications of participating financially in one or more projects. While potential applicants may be forewarned that state financing is unlikely or would constitute no more than a small proportion of total costs (or would be provided for no more than one project in each RFP cycle), leaving the option open may elicit projects which would otherwise not be proposed.

There may be criticisms that financial participation is outside TxDOT's expertise and constitutes a precedent which offers opportunity for political shenanigans. Some may see it as a form of public enterprise. Any financial participation, from outright grants to loan guarantees, must be carefully weighed to determine if it is absolutely necessary to ensure the project's success

and if the state's interest is clearly protected. Beyond that, TxDOT should remind any critics that the primary purpose of a public-private partnership is to supplement existing resources and add further capacity. If leveraging, under very stringent conditions, can achieve that objective, then it deserves to be explored in particular projects and not be foreclosed at the beginning of the program. (It should be noted that while each state's transportation conditions are somewhat unique, Florida's privatization transportation staff believe that any new facility must have some public funds to be viable.)

Finally, TxDOT will need to decide its role in any public-private partnership program. Most, but not all, state DOTs have decided to be the principal public-sector organizational entity which establishes guidelines, selects projects, and negotiates agreements with private entities. In Minnesota, public-private partnerships will be developed primarily through local road authorities, with the state DOT role being more one of oversight. In Colorado, except for potential IVHS public-private projects, most other private-public projects are likely to be developed by consortia of local governments. In a current case, the Colorado Department of Transportation is negotiating terms of a \$20 million loan to a local consortium. If TxDOT decides that a program would be more beneficial if it were decentralized and operated at a county or metropolitan level, then different issues would need to be addressed, and more attention should be given to Minnesota's effort.

II. OTHER POLICY DECISIONS

Design and Construction

All projects considered under a public-private partnership program should meet existing TxDOT design and construction standards. Construction and maintenance inspections should be performed by TxDOT personnel at their discretion and in any frequency and manner deemed to safeguard the best interests of TxDOT.

It is likely that some private consortia will propose using the "design/build" technique which integrates the design and construction stages and may shorten total development time. TxDOT should consider seriously the advantages and disadvantages of design/build and other innovative construction management methods. Meeting performance-based specifications is the overriding goal, not whether a private entity has a different construction management approach.

At least one state (Georgia) is requiring that private entities or a private consortium certify that construction and maintenance contracts will be competitively bid, awarded, and administered in substantial conformance with the state transportation department's procedures. This requirement seems unnecessary for at least two reasons. First, the requirement interferes with the entity's internal procedures, and, second, the project has also been through a competition if a statewide RFP has been used. Meeting performance-based specifications should suffice.

Disadvantaged Business Enterprise Procurement

In the near future, TxDOT will be establishing guidelines for minority procurements on state-funded construction and maintenance projects as well as on goods and services obtained with state appropriations. Federal regulations govern TxDOT procurements obtained with federal funds. The appropriate federal or state guidelines should apply to all TxDOT's public-private projects. In all public-private projects approved by TxDOT, there will be a public purpose, and there are likely to be TxDOT funds expended in some manner.

If state guidelines for disadvantaged business enterprises cannot be required legally on public-private transportation facilities, TxDOT officials may wish to provide an incentive to consortia which meet specified targets of DBE involvement. The state of Arizona, for example, provides an incentive (5 points) beyond the maximum base of 100 points, if a bidder has both an affirmative action plan and DBE subcontractors who perform at least 10 percent of the total project value. The state of California allowed for an additional 10 points beyond the maximum base of 100 points to reward bidders who reached the state's contracting goals of 15 percent minority-owned and 5 percent women-owned business enterprises. The state of Washington, in a different approach, has established no formal target, but is using the DBE participation level as one of three criteria to allocate 10 points under the category, "State Benefits."

Liability and Sovereign Immunity

If there are any Build-Operate-Transfer projects, TxDOT should require that the operator maintain sufficient liability insurance to cover potential tort liability cases. In the franchise

agreement, and in new legislation if necessary, TxDOT should explicitly stipulate that there is no waiver of the state's sovereign immunity in its public-private transportation projects.

Concern on the part of private-sector participants about liability claims has been one key impetus for development of Build-Transfer-Operate (BTO) projects. Under the BTO model, the state's sovereign immunity is less likely to be challenged and the private operator's liability status is clarified. The sovereign immunity of counties and municipalities also will be affected in any situation in which a public-private facility connects with county roads or city streets.

Access By, and Pricing For, Government Vehicles

State and local law enforcement, along with fire and emergency medical service vehicles, should not be restricted in any manner from using a public-private facility. No tolls or other types of charges should be permitted.

Other governmental vehicles should have access, subject to payment of an agreed-upon fee. While a reduced toll for state, local, and federal governmental vehicles may be appropriate as part of the franchise agreement, that decision should be considered as one element in the larger set of decisions regarding rates of return and economic regulation more generally.

State and Local Traffic Laws

In general, state and local traffic laws should apply to persons driving motor vehicles on the public-private facility. If the facility is being built primarily for commercial traffic, then adjustments in weight or length limits may be appropriate, provided legal authority exists. Signs must conform to the *Manual on Uniform Traffic Control Devices* or other appropriate standards. The entity responsible for enforcement of traffic laws should be determined in conjunction with other relevant state and local agencies and be part of each franchise agreement.

Competing Routes

A private entity or consortium naturally will wish to minimize potential future competition which may diminish its facility's traffic volume, revenues, and profits. In both California and Puerto Rico, government officials have agreed to restrictions in competition. In California, each of the 35-year franchise agreements contains "no-compete" clauses within prescribed geographical areas and traffic corridors. The state will not construct new routes which would directly compete with the public-private facility, but Caltrans will continue to implement existing plans to expand parallel freeways. (While county governments are not bound by this no-compete provision, it is unlikely they would construct competing routes, and Caltrans has promised it would attempt to dissuade any county from doing so.) In Puerto Rico, a more unusual no-compete approach was adopted. Transportation officials have agreed to reduce maintenance and improvements on routes which would provide competition for the new facility.

The economic health of any public-private facility must be balanced, however, with the larger public interest of traffic movement by citizens and protection from a monopolistic franchise. One idea which may have merit is to replace an absolute pledge of "no competing routes" with one that is based on an agreed-upon level of traffic volume. If traffic volume in a defined traffic

corridor reached a certain threshold level, and/or if traffic on the public-private facility reached certain levels, then the no-compete provision would be eliminated from the franchise agreement. It should be noted that agreement would be needed among all relevant governmental bodies, as well as with the respective consortium, for this to be effective.

A different issue with respect to competing routes is part of the Arizona program. There, any new public-private transportation facility may be considered only after certification that a reasonable alternative route exists. The alternative route must be at least as direct as the proposed new public-private facility, and the existing alternative route must accommodate the same type of motor vehicles as the proposed new route. It is not clear how this would work in practice.

Environmental Reviews

As with the issue of competing routes, a private consortium will want to reduce the risk that environmental regulations will shelve its project. Alternatives for TxDOT range from the Puerto Rico approach, in which the Commonwealth's transportation department had total responsibility for obtaining all permits and the environmental impact statement (EIS), to the approach adopted by Minnesota ("Private operator must have environmental ... approvals") and most other states (California, Virginia, Arizona, and Florida), in which the state department of transportation plays a more passive role. In these states, the consortium has full responsibility for acquisition of, and compliance with, environmental permits and regulations.

Because of the state's interest in furthering transportation facilities, there may be alternatives besides the two positions just described. In some situations, TxDOT might offer expertise to a consortium on securing environmental compliance. Or, in exceptional situations, TxDOT might provide some type of loan to the consortium for completing an EIS. That alternative has been considered by the California Department of Transportation for projects in which there is a signed franchise agreement. If all environmental requirements are satisfied and the project moves forward, the idea is for the loan to be repaid out of the project revenues once tolls are being collected. This alternative needs further policy and legal review before being adopted by the state of Texas.

Taxes

A number of states have included provisions for refunds from taxes. This is guided by the concern of double taxation, in which vehicles, which are using a toll facility, continue to consume fuel that is taxed and allocated to projects off the toll facility. In Arizona, for instance, users may apply for a refund or credit from the state for motor vehicle fuel, license, or motor carrier taxes paid while operating the vehicle on the public-private facility. Implementation of the procedures for disbursing these refunds has yet to occur.

We would recommend that refund procedures not be used in Texas. The toll represents more than just an infrastructure charge. Moreover, fuel taxes are used for purposes other than transportation. A user's decision to select a toll route, given that it is a voluntary action, is based on time and purpose. The toll represents a premium for this decision, and as such is not a tax.

Another taxation issue may be more difficult, although it will not be a problem for TxDOT: valuations by central appraisal districts of a public-private transportation facility. Facilities owned by a private consortium will be subject to property taxes, but guidelines for appraisers will need to be developed. If there are public funds included in the transportation facility, some type of allocation will be required for proper tax payments. Because no public-private facility has yet been completed in the United States, there is little guidance available from other jurisdictions.

Bonding

TxDOT should review existing Departmental procedures with regard to completion and performance bonds to ensure that they are adequate to address the possibility of a default on a public-private facility. If the Department needs to revoke a certificate or if the franchise agreement is invalidated, TxDOT should receive the full proceeds of any payments due to claims against bonding companies or sureties for this purpose.

Reimbursement of TxDOT Services

Most state governments have adopted a general policy of requiring reimbursement from private consortia for state expenses incurred during the privatization process. Often this policy extends beyond the state transportation department to include other state agencies, local governments, and, in some cases, local utilities. Yet there are some differences among the states:

Arizona — Statute requires that a private entity reimburse the state department of transportation and any other state agency for costs incurred *after* the written agreement is finalized, including the costs of planning, environmental impact assessment, design, maintenance, police services, and any other services rendered.

Florida — All reasonable costs of the state and substantially affected governments and utilities are to be borne by the private entity except where an overriding state interest has been determined to exist.

California — Caltrans requires reimbursement for planning, design, and environmental review services. Should police or maintenance services be required on the demonstration projects once they are constructed, reimbursement would be required also. No payments are required for leases of rights-of-way or airspace in state highways or other easements granted to a consortium because the state will continue its ownership in all cases.

Virginia — State police will enforce traffic laws and be reimbursed for their expenses. The Virginia Department of Transportation would be reimbursed for its direct costs in supervising the project: review of project specifications, inspection of construction, and oversight of maintenance. The Department is to be reimbursed for performing environmental impact statements and other project development costs as specified.

Washington — All Washington State Department of Transportation (WSDOT) services will be negotiated as part of a franchise agreement. While all services must be reimbursed, there is a provision that reimbursements may be subject to deferral until user fee collection begins. In addition, the state of Washington requires a non-refundable proposal review fee of \$35,000 for each proposal submitted.

While reimbursement of costs is generally straightforward, in some cases a private consortium may wish to use existing TxDOT assets. These may include road designs or previously purchased rights-of-way. There are few precedents for these situations, although, as noted previously, existing right-of-way apparently was leased by TxDOT to the Sam Houston Tollway until bond retirement. The two general alternatives are (1) require reimbursement of services and assets up front; or (2) include these elements in the larger economic regulation component in the franchise negotiations.

Many TxDOT costs will be incurred by the group or office staff established to coordinate and lead the Department's public-private program. This group will be performing a variety of roles including outreach and promotion, reviews, perhaps negotiation, and facilitation. Because the office will have contradictory roles with regard to private entities, it is recommended that reimbursement of office costs be made from a source other than private entities. If reimbursement comes directly from private entities, employees implicitly will view the private entities as their sponsors.

III. SELECTION OF PROJECTS

A. Eligibility

Eligible Proposers

While the majority of proposers are likely to be individual for-profit entities, there may be proposals from a consortium of private and public organizations. Such proposals should be permitted. No limits should be placed on the number of submissions from any one entity. It is unlikely that there would be frivolous submissions, even in the absence of a proposal review fee as instituted by the state of Washington.

Major Types of Eligible Projects

To date, in the other states there has been an emphasis on projects which add new transportation capacity. Restricting the competition in this way will avoid the potential adverse consequences of tolling a previously untolled (and poorly maintained) facility. However, if maintenance and rehabilitation projects are excluded at the outset, TxDOT may be precluding an innovative project from being submitted. If new capacity is deemed preferable, that could be specified in prefatory language and/or in the selection criteria. Alternatively, the first cycle of projects might be restricted to projects which add new capacity, while subsequent cycles could be expanded to other types of projects, including those not requiring economic regulation.

It should be recognized, however, that limiting privatization projects to those which add new capacity may restrict opportunities in the state's major urban non-attainment areas: Dallas-Fort Worth, Houston, and El Paso. The Clean Air Act Amendments of 1990 severely restrict adding new capacity in non-attainment areas, because of the belief that it will increase average daily traffic. In a lawsuit filed by environmental groups in the San Francisco Bay Area, these groups demonstrated that latent demand would increase overall traffic and increase, rather than decrease, emissions. However, public-private toll roads using congestion pricing mechanisms should be viable, as both congestion and air quality concerns would be addressed.

Whenever all types of projects are eligible, there should be a two-step ranking procedure. First, similar types of projects should be grouped and ranked against one another — all bridge projects and all transit projects should be evaluated within their group before being ranked against one another. This grouping process will enable staff expertise to be applied more uniformly and may ward off criticisms that the comparisons were too different to be meaningful. Second, the projects should be evaluated using an investment methodology which estimates net present value. This second step will ensure that the better projects are selected, or, at least, that no project is selected which provides a negative rate of return.

Eligible Projects — Current Status

Transportation improvements and funding costs are the two principal criteria according to which transportation investments at the state level have been made. If these two criteria were still

the only important ones, then TxDOT could restrict the competition to high-priority projects which have been previously identified but not yet built. However, private investors have an additional important criterion (return on their investment) which has not been included systematically in developing current state transportation priorities. As a result, there may well be projects which private entities would be interested in building on which TxDOT has placed a lower priority, or even projects which have not been identified. Three of the four projects selected in California were not in the Caltrans seven-year transportation improvement program plan.

In short, while previously unidentified projects may be relatively uncommon, TxDOT should be open to any type of project which would enhance transportation. At least in the first cycle of projects, private entities should not be forced to choose from a short list prepared using a different set of criteria. In a second or later cycles, TxDOT officials might consider establishing a separate category of projects which could be "offered" to private entities, or some type of incentive might be provided if an applicant submitted a project which currently had relatively high priority.

Geography of Projects

As a political compromise to ensure passage of the legislation, the first California competition required that at least one project be selected from both the northern and southern sections of the state. Other states have not followed this policy. Texas should not formally adopt any type of geographical screen which is an absolute requirement. If there is an overriding need to balance projects, then a geographical criterion should be included among the numerous other criteria used for selection of projects.

B. Project Selection

Criteria for Project Selection

At a minimum, all projects must produce transportation benefits, be built and maintained to ensure high safety standards, be legal under current statutes and the Texas Constitution (three projects in Arizona's first competition exceeded existing legal authority and were disqualified), adhere to all environmental laws and regulations, and have a high probability of not being a financial liability to Texas taxpayers. Beyond such minimum conditions, officials in other states have adopted a diverse set of criteria for project selection.

They fall into roughly two groups, depending on whether a state uses a formal RFQ/RFP process or a process in which projects are assessed against a standard, rather than against other projects. When a state uses the RFQ/RFP process, the criteria tend to be much more specific than when a non-competitive process is used.

Caltrans, for example, used the following criteria and weighted them as follows for its first cycle of projects:

<u>California</u>	Maximum Points
Transportation services provided	20
Degree of local support	15
Ease of implementation	15
Experience and expertise of proposer	15
Encourages economic prosperity and makes overall good business sense	10
Environmental quality and energy conservation	10
Degree of technical innovation	10
Civil Rights objectives	10
Non-toll revenue support	5

The state of Washington is taking a rather different approach. Its selection criteria are:

<u>Washington</u>	
Qualifications and Importance	(30 points maximum)
Experience with similar projects	
Demonstration of ability to perform	
Leadership structure	
Project manager's experience	
Management approach	
Financial condition (of firm and project)	
Project Characteristics	(30 points maximum)
Well-defined project	
Plan for right-of-way	
Compatibility with existing transportation system	
Contribution to regional transportation goals	
Address unfunded project need	
Enhance community transportation facilities	
Conformance to state and federal regulations	
Consistency with local government comprehensive plans	
Consistency with state long-range multimodal plan	
Need for federal permits	
Need for state and local permits and plan to obtain them	
Proven or new technology and application to other projects	
Requirement for public resources	
Reasonableness of financial plan	

(continued on next page)

Community Acceptability	(30 points maximum)
Significance of transportation benefit for area	
Support or opposition to project	
Public involvement strategy	
State Benefits	(10 points maximum)
Consistency with state transportation goals	
Extent of economic impact on state	
Participation by Minority, Disadvantaged/ Women Business Enterprises	

In Arizona, the criteria are:

Arizona

1. Team composition — qualifications to perform project	15 points maximum
2. Capability and capacity to deliver and finance the proposed project	35
3. Conformance of project to Arizona's Privatization Program (one part pertains to highway construction, the second part to transportation facilities)	10
4. Commitment to meeting the proposed schedule	10
5. Contribution to meeting the state's transportation needs	30
6. Commitment to utilizing resources, contractors, and workers in the State of Arizona	Up to 5 Incentive points
7. Commitment to the Department's DBE program	Up to 5 Incentive points

While these were the formal criteria for the 1992 RFP, as the first set of projects were evaluated, the public's reaction to a project became the dominant criterion. In two of the three projects seriously considered, community opposition arose which effectively stalled the projects. The Arizona Department of Transportation has since developed with local political and community leaders a community acceptance policy for implementation.

In contrast to California, Washington, and Arizona, in Florida, the criteria were very general and contained in the state authorizing statute for private transportation facilities. A project must be in the public's interest, must be consistent with the state's transportation work plan, must not require state monies except where there is an overriding state interest, must contain adequate safeguards against service and cost disruptions to the public, and must comply with all local, state, and federal laws and plans. (In Florida, each project requires approval by the State Legislature.)

In Minnesota, all private-public partnerships will be implemented through local road authorities. For the most part, all selection decisions will be made by local authorities. The Commissioner of Transportation must approve the project, but there are few guidelines

enumerated. Unique features of the legislation include: (1) the potential for veto, by the governing body or municipality through which a facility would pass, within 30 days of approval by the Commissioner of Transportation; and (2) a legislative requirement that any project chosen for a private-public partnership from the Department of Transportation's six-year work program must be replaced by another project in the same metropolitan area.

In Virginia, as in Minnesota, there is no RFP competitive process per se. Therefore, applicants need only meet broad guidelines regarding design standards, acquisition of all necessary permits, toll regulation, interconnection with other roadways, and so forth. An applicant submits a project conceptually to the Transportation Board, which must respond within 60 days. A positive decision is made if the facility is in the public interest. Then a more detailed phase begins, including an agreement between the applicant and the Department of Transportation, and a process involving the Commonwealth's public utility oversight agency, which, as discussed earlier, has been given authority to determine key financial issues about the proposed project.

From experiences in other states, it is clear that most decisions regarding criteria pertain to the weighting or priority. TxDOT staff expertise should be utilized to determine which criteria would be used and what their relative importance would be. Regardless of which criteria are selected and how they are weighted, it is imperative that formal ranking criteria be used so as to avoid the appearance of favoritism.

C. Project Solicitation

Choice of Approaches

The key choice at the beginning will be that between a formal RFQ/RFP process (as undertaken by California, Arizona, and Washington) and a non-competitive process (as is being used in Virginia, Florida, and Minnesota). A blended approach is used in Puerto Rico and Colorado where there is competition on pre-defined projects. Both the RFP and non-competitive approaches have merit.

The non-competitive process is less intense and would probably be a less adventuresome step toward private-public partnerships. This approach would be less likely to attract unwarranted media coverage because of the open submission date and because there would be no clear winners or losers. A non-competitive approach probably would require less staff attention in the early stages. Such a process, however, may be viewed more suspiciously by the public and the media than an RFP process. Moreover, this process still requires that all key policies be developed and implementation stages be planned; therefore, there may be few savings in staff time or departmental resources. A final drawback may be that a non-competitive process does not convey the proper sense of urgency or importance to the need for private-public transportation partnerships in Texas.

In contrast, a competitive process is more visible, bolder, and more focused. It *does* convey urgency in its approach to meeting the transportation needs of Texans. A competitive process would be viewed by citizens and different publics as being fairer and more businesslike. In terms of TxDOT operational issues, a competition provides the Department with an opportunity to be proactive and create a structure which will ultimately bring more capacity on-line earlier than

if the Department waits for unsolicited projects to be brought forth. A competition will force resolution of most key policy issues prior to issuance of an RFQ/RFP and will provide a more certain time frame. Perhaps more importantly, market forces are likely to be galvanized more by a competition, and the likelihood of reaching successful agreements should be greater when a consortium is aware that there are other projects which could be considered by state officials.

Solicitation Steps

The competitive process, if that is the one selected, would be somewhat different from that used by TxDOT in its current bid structure. Washington's solicitation process appears adequate, although elements will need to be adapted to the Texas situation and to decision criteria eventually chosen. (For example, if economic impacts from a project are a criterion of some importance in the ultimate Texas selection criteria, then an outside economic impact analysis should be conducted.) It must be noted that Washington (as well as Arizona) views the initial submission as a **project concept**, which serves as a first hurdle only. The purpose is to ascertain whether the state wishes to pursue negotiation of a project agreement, and bidders are limited in the length of their proposal so that detailed design work is not performed and submitted. Basic stages of the Washington process include:

1. **Pre-proposal:** Potential bidders must request a packet of materials by a pre-determined date. In the packets, potential bidders receive information about the privatization program, its goals and purposes, and the competitive process, as well as supplemental materials such as the applicable statute, organizational structure of the department of transportation, names and backgrounds of department staff whom bidders may contact to ask questions or request information, and a demographic and economic profile of the state of Washington. Bidders may submit written questions by a certain date, and answers to these questions will be distributed at a pre-proposal meeting. Verbal questions asked at the pre-proposal meeting and written questions submitted up to two months before the proposal deadline will receive written responses from the department, and all answers will be distributed to all RFP holders. In addition to a privatization office and key departmental staff, bidders are given accessibility to documents in WSDOT's library.
2. **Proposal:** A project review fee of \$35,000 per project submission must accompany the proposal. (In Florida, new rules being developed are likely to require an application fee of at least \$50,000.) There is no limit to the number of proposals submitted by an entity. The document is limited to 40 pages, excluding appendices. (Arizona limits first-round proposals to 25 pages.) Proposals must specifically identify any elements which are deemed confidential and must provide justification. Proposals must address the following broad categories used for selection: the project team's qualifications and experience, the project's characteristics, the acceptability of the project to the community, and the project's statewide benefits.

3. **Proposal Evaluation:** After proposals are received, they are placed in categories such as new highways or bridges, transit projects, or marine system improvements. A group of three to five departmental experts is assigned to each category of projects. These individuals evaluate the technical aspects of proposed projects in that category. The technical evaluation team may request information from a proposer, who will provide a written response. In addition, financial advisors will be retained by WSDOT to provide an assessment of the financial condition of the proposer, a risk assessment of the project, and the feasibility of the preliminary financing plan.

The State of Washington then utilizes a Project Review Board, comprised of members with relevant experience and knowledge, to determine which projects most closely meet the state's goals, program requirements, and RFP objectives. (An alternative to the Review Board for TxDOT could be a group of senior TxDOT employees and perhaps one or more individuals from outside the Department and/or outside the state of Texas.) The Review Board considers each project proposal and its accompanying technical review and financial review. Then all proposers are provided an opportunity to present their project. Based on the original proposal, the reviews, the presentation, and any supplemental written comments, the Review Board ranks the proposals within each category. The Review Board then may recommend up to six projects, as specified in the statute, to the Secretary of Transportation (Executive Director in Texas). The Review Board must recommend the highest-ranked projects within each category but is not obligated to recommend any projects from a specific category. (In both Arizona and California, the maximum number of projects which can be selected is four.)

4. **Project Selection:** Recommended projects are submitted to the Secretary, who selects those which are to be forwarded to the Transportation Commission for their approval. If the Commission determines the projects are consistent with state transportation policy, they are approved. The Department then begins the detailed negotiation phase, which is designed to result in an agreement to proceed.

There is no pre-established deadline for achieving a detailed agreement. (In Arizona, there was a 60-day deadline, which proved too short. In California, negotiations dragged on, reportedly for at least three months.) If an agreement cannot be achieved in a reasonable period of time, the Secretary has the authority to submit to the Transportation Commission a project or projects which are the next-highest-ranked proposal or proposals in a specific category.

5. **Project Denials:** Those projects which are not selected initially are held in a back-up status for approximately one year. Departmental personnel will provide a debriefing about proposals to firms upon request.

Texas, like Washington and other states, should reserve the right to reject any and all proposals, to discontinue agreement negotiations with any party at any time, to choose fewer than the maximum number of projects if an upper limit is identified, and to assume no costs or liability incurred by firms in proposal preparation.

D. The Franchise

General Provisions

Because the primary purpose of a public-private transportation partnership program is to add more transportation capacity, all franchise agreements should specify that the project be started within a reasonable time period, perhaps no later than 18 months after the effective date of the franchise agreement. Once signed, transfer of the franchise from one private entity to another should be allowed only in unusual circumstances, and then only with the approval of TxDOT.

Most of the agreements signed in other states have allowed an operational phase of 30-35 years, a period which seems reasonable. It is not known whether any of the franchise agreements permit the transfer of ownership from one private entity to another after the facility becomes operational. This possibility should be explored in more detail with potential bidders prior to project solicitation. TxDOT may wish to leave flexibility for the entities, yet restrict any transfers to situations involving fiscal distress or other conditions which would affect the maintenance or operation of the facility.

TxDOT needs to include in the franchise agreement a full array of oversight and monitoring procedures. In addition to those involving all engineering aspects, TxDOT should require a yearly independent financial audit of the facility as well as annual independently audited financial statements from all major private entities prior to construction and operation of the facility. Appropriate financial oversight mechanisms should be in place during the facility's operation to provide information on its financial condition and to pinpoint flows of funds to all participating entities.

Non-performance by franchisees will require a specific process of establishing standards and penalties for each stage of the franchise agreement. Penalties during the pre-construction phase should emphasize revocation of the franchise. During the operational phase, economic penalties might be emphasized to a greater extent.

All contingencies regarding the transfer or acquisition of a facility by TxDOT should be planned for. Other states have included provisions which give the state department of transportation flexibility to maintain, dispose of, or close the facility. A number have taken steps to safeguard the state's full faith and credit rating by legislatively stipulating that only toll revenues will provide for bond retirement.

Particular attention must be given to exploring contingencies during the construction phase. If a private entity stops work during construction, there is likely to be intense political pressure on TxDOT to complete the facility even if there is no legal requirement to do so.

Finally, because some of the transportation projects may be feasible only because of development revenues, TxDOT should be prepared for dealing with unexpected issues such as the use of airspace and, as in California, the use of a viaduct facility over a river channel. To aid with planning, TxDOT may wish to secure expertise from the development community before the first set of projects is solicited.

IV. ORGANIZATIONAL CONSIDERATIONS

Legal Review

Prior to creating a public-private program staff within TxDOT, or as one of their first tasks, there is a need to perform a comprehensive legal review of potential statutory and constitutional impediments to public-private transportation facilities. In several other states, new state enabling legislation has been needed to establish conformity with provisions of ISTEA or to address issues which had not arisen in projects financed entirely by the public sector. Such issues might include the transfer of right-of-way for private uses, state financing of environmental studies, methods of selling existing transportation assets, transfer of existing transportation assets for incorporation into an enlarged and improved facility, the adequacy of default provisions, and clarification of the state's full faith and credit rating in the event of a foreclosure. A variety of other possible legal questions are listed in Appendix II.

Staffing and Budgetary Requirements

It appears that several other states underestimated the magnitude of starting a public-private transportation program. Arizona needed to increase significantly its annual budget, and California has devoted considerable staff resources to its pilot project process. Staff should be drawn from within the Department whenever possible. Because public-private transportation facilities may entail financial issues (rate of return, cash flows, taxable debt and different types of debt, etc.) not commonly encountered on state and federally funded projects, supplemental expertise should be added, initially using outside personnel. Additional expertise which may be needed would include general regulatory guidance and media and communications, as described below.

Ethics Guidelines

TxDOT privatization staff must be perceived as meeting the highest ethical standards. In all probability, the public-private facilities program will receive considerable publicity and attention from the media as well as scrutiny from the Legislature. For these reasons and because the staff will be functioning in a quasi-regulatory role, consideration should be given to adopting strong provisions for (1) staff acceptance of gifts, gratuities, etc., and (2) employment with private entities with whom the staff have worked in context of the program. While the current TxDOT and state ethical standards may appear sufficient, stronger guidelines may be in order.

Communications

Departmental staff will be faced with significant communication challenges. Texas' residents, particularly those in the major urban areas and along the border, will need to be informed about this program and the reason why toll roads may be necessary. In addition, because of the importance of community acceptance in public-private transportation projects, serious consideration should be given to contracting with an outside communications/media firm for this

communication task. Planning for this effort should be one of the staff's early priorities, even if the actual campaign is not begun for 12-15 months.

State legislators, urban county elected officials, and appointed and elected municipal officials will need briefings periodically. Coordination with these groups should be ongoing. Communication with contractors should be straightforward, although it is likely that some private entities will have had infrequent contact with TxDOT in the past. Most private applicants will be consortia involving developers and international construction companies who do not normally bid on state construction contracts.

As the process moves into 1995 (see below), TxDOT staff should consider a series of informational briefings for financial institutions. While the major burden for arranging financial backing must be the responsibility of the lead party in each consortium, the state does have an interest in seeing substantial participation by financial institutions. Outside expertise should be secured to assist TxDOT staff in preparing the content of these briefings as well as their format.

Timetable

If the public-private program is to succeed, a Department-wide approach will be required. In the first three to six months, two specific actions should be undertaken. First, office personnel should canvass key central and district office personnel about privatization — their concerns, ideas, and suggestions will be vital to the long-term success of the initiative. Second, a one- or two-day meeting should be held in Austin which focuses on the experiences of other states. TxDOT should bring in senior officials from other state departments of transportation to review what has worked, what unforeseen problems arose, what to be on guard for, and what officials would do differently in retrospect.

If a decision is made to establish a public-private unit within TxDOT by July 1, 1994, the following target dates may be feasible:

No later than October 1, 1994 — (1) Begin initial outreach campaign to prospective private entities to alert them to TxDOT's general thinking about public-private transportation projects and to solicit their concerns and priorities; and (2) determine whether additional legislative authority is needed.

No later than February 15, 1995 — Issue proposed program rules and regulations, including guidelines on such issues as the allowable rate of return and how that would be calculated, whether state financial participation can be included and what the maximum percentage or dollar amounts would be, general franchising parameters such as guarantees against competing roadways, and so forth. In the first cycle of projects, it is recommended that TxDOT allow only new highway construction projects proposed by private entities.

No later than June 15, 1995 — Issue final rules.

No later than June 30, 1995 — Release of RFP.

August 15 – November 30, 1995 — Following the State of Washington's proposal solicitation process, conduct the pre-proposal meeting, respond to questions from potential applicants, provide TxDOT program plans, etc. Submissions due on December 1, 1995.

Early January 1996 — Presentations by applicants and final evaluation by TxDOT team. Provisional selection of projects forwarded to TxDOT Executive Director by third week of January 1996.

No later than April 15, 1996 — End of negotiations with first group of applicants and beginning of second cycle of negotiations if agreements could not be reached with all parties in the first cycle.

October 1996 — Release of second RFP and beginning of second cycle. In this cycle, it is recommended that TxDOT allow both new highway projects and several other categories of projects: (1) state-designated projects in which financial participation is desired; (2) projects which will require no economic regulation; and (3) projects involving rehabilitation of existing highways.

Realistic Expectations

Today, and looking forward, public resources appear insufficient to meet infrastructure needs. Public-private transportation partnerships may be part of the solution to the problem of the widening gap between transportation needs and shrinking resources, and, for that reason, deserve very serious consideration by TxDOT.

A public-private program cannot be viewed unrealistically, however. To date, most projects in other states are stalled because of inadequate financing or lack of community support. Some researchers believe that most projects which would have proved feasible as tolled facilities have already been constructed as public facilities; hence there will be few viable public-private projects.

Nevertheless, there are few risks in undertaking cautiously a public-private Texas transportation partnership. Given current and projected economic, demographic, and transportation trends in Texas, the number of potential projects may be far greater than in other states. As growth and development continue without the excesses of the past, there will be an increasing number of parties interested in exploring public-private projects.

Texas is in an advantageous position administratively as well. Several other states have moved ahead with such programs and have dealt with some of the more difficult policies. While each state has somewhat unique needs and conditions, Texas officials should take comfort in knowing that most other states have not had major problems with their privatization effort. Where problems have been encountered, they should serve as warnings and possible hazards to be anticipated.

Over the longer term, a public-private program may offer significant benefits. With development of appropriate policies and controls, thorough legal and financial analyses, and adequate program resources during the first two years of the plan, a public-private transportation partnership would have an opportunity to succeed in Texas. A partnership with private entities for meeting the transportation needs of Texas citizens deserves serious consideration.

APPENDICES

I — Questions Legislators May Ask About A Texas

Public-Private Partnership

II — Potential Legal Issues Regarding Public-Private Partnerships

APPENDIX I

Questions Legislators May Ask About A Texas Public-Private Transportation Partnership

Q: How would these public-private projects differ from those privatization projects like Camino Columbia and Camino Falcon?

A: They could be very similar or very different, depending on how the partnership program was established. Either way, projects could be proposed by applicants other than those grandfathered under the 1991 statute.

Q: Would the applicants grandfathered under the 1913 Act be eligible to submit their projects under a newly established public-private partnership program?

A: A thorough legal analysis must be completed to determine whether there are any Constitutional or statutory impediments to creation of a partnership program at this time. Ultimately, the status of the 1913 applicants would be decided by the Commission or by the Legislature.

Q: Why should a partnership program be established now?

A: Existing and projected transportation needs are not projected to be met by current revenue sources. The primary reason for teaming with private-sector applicants is to bring on-line additional transportation capacity (and meet ever-increasing maintenance and road reconstruction costs) sooner than would otherwise occur.

Q: What types of projects would be eligible for a partnership program?

A: New highway construction should be included from the outset. Rehabilitation might be included from the beginning, although that type of project and several other types might be deferred until we have more experience. Some states have considered disposition of existing highways, but, to our knowledge, none has attempted to sell an asset. The sale of an existing Texas highway would not be considered at this time.

Q: How many projects would be submitted, and from which parts of the state would they come?

A: Based on experiences in other states, most proposed projects would be in densely populated areas. It is conceivable that projects may be from smaller communities also, if there are unique development opportunities. Border projects could be expected as well.

Q: Which other states have privatization or public-private programs, and what have been their experiences?

A: California, Virginia, and Puerto Rico generally are cited as the pioneers. More recently, Florida, Arizona, and Washington have begun programs. Legislation has passed in Minnesota. Experiences have been mixed. One California project is moving ahead as planned, and progress is reported on the other three projects. At last report, financing was still problematical for the proposed Northern Virginia tollway. Puerto Rico's privately financed bridge is scheduled for completion in 1994, and a franchise for a congestion-relief highway in the suburbs of San Juan has been awarded. Projects in Arizona have been stymied by community and political opposition. In Washington, the first request-for-proposal (RFP) cycle is being conducted in 1994. In Florida, one project is in very preliminary review.

Q: How are these public-private partnership projects actually structured?

A: The most common form in the United States probably will be a Build-Transfer-Operate (BTO) model. Typically, a private firm will build the facility and, upon completion, will transfer title to a governmental entity. This is intended to insulate the private entity from liability claims. In turn, the government and private party agree to a long-term franchise (20-40 years on average) for operation of the facility. At the end of the franchise, the facility is free of debt. At that time, a government entity can decide whether it wants to continue with tolls and who would operate the facility. Another form of partnership, which is much more common outside the United States, is a Build-Operate-Transfer (BOT) model. In nearly all respects it is similar to the BTO model, except that the private entity retains title to the facility during the operational phase. At the end of the franchise, title is transferred to a governmental agency.

Q: How are projects proposed?

A: In most states, projects are proposed by private applicants. They normally are given access to state and local transportation plans and may choose to propose a project which has yet to be constructed. Frequently, completely new projects are proposed. In other states, the public transportation agency identifies a project and seeks private-sector participation. For instance, in Puerto Rico, government transportation officials were responsible for the traffic forecasts,

development of preliminary plans, purchase of right-of-way, preparation of the environmental impact statement, and obtaining the required permits. The private entity committed equity as part of the financing package and built the bridge.

Q: What criteria would be used to select projects?

A: All projects would need to comply with existing TxDOT regulations regarding construction standards, traffic safety laws, environmental and local permits, maintenance and repair standards, and so forth. Beyond these criteria, TxDOT would need to develop a scoring system for assessing each project's characteristics. States have attached different priorities to project characteristics, and Texas would need to develop a project selection methodology which would identify projects meeting the state's current and future transportation needs. The Commission would make decisions at the following stages: (1) upon recommendation by the executive director, one or more projects would be selected provisionally, and staff would attempt to negotiate an agreement with an applicant, or applicants; (2) if an agreement can be negotiated, the Commission would decide whether it is in the state's and public's interest to proceed; and (3) amendments to the agreement, if any, would require Commission action.

Q: Would these projects be completely privately funded or would they require some financial contribution by TxDOT?

A: Unless directed by the Legislature, the Commission would need to decide this question. Given the high risks involved in building and operating a transportation facility without subsidies, it may be that state funding of some type may be both necessary and worthwhile. While extreme caution would need to be exercised before committing to any project partnership, there may be cases in which state funding would be required before projects could be implemented.

Q: What would TxDOT need to do to ensure that the Department and Texas' taxpayers are not hurt by a project's default?

A: Current default provision on construction contracts may prove adequate. In the event that additional protection is deemed necessary, there are numerous legal provisions in most other states' statutes which could be examined for applicability to Texas. In addition to a legal default and termination, the Department would need to adopt provisions which would guard against the possibility that public and political pressure would force TxDOT to complete an unfinished transportation project because of default.

Q: What would prevent a project from being built which is not wanted by citizens or local elected officials?

A: The Commission would need to determine the priority to be placed on community acceptance and support. Both Arizona and Minnesota effectively allow local communities to veto any public-private project being proposed. Those policies could be incorporated within a Texas program, or a more statewide orientation of benefits and costs could be used.

Q: Would private transportation facilities generate tax revenues?

A: Yes. For facilities operated by private entities but owned by a public entity, there would be state franchise taxes and possibly sales taxes. For facilities owned and operated by private firms, there would be local property taxes also. No estimates have been developed concerning the amount of potential tax revenue which may be generated.

Q: Does TxDOT become a regulating agency if a public-private program is initiated?

A: In all likelihood, yes. Virginia is the only state in which the appropriate transportation agency does not have responsibility for economic regulation of public-private projects. Most state departments of transportation have utilized outside financial expertise during the project selection and project negotiation phases. This is because most projects have been considered partial monopolies and, therefore, subject to financial limits. The outside financial expertise is used to analyze the feasibility of the project financing and to recommend ceilings on the maximum rate of return in the franchise agreements for the applicant.

Q: What can be done to help the franchise agreement be successful and not meet the same fate as the Texas High Speed Rail project?

A: The scale of the highway projects will be smaller and require small amounts of financing. More importantly, appropriate staff will examine the franchise agreement in detail and compare it with the agreements in other states, even before consideration of projects from applicants. With the high-speed rail situation as a learning experience, and with agreements from other states as possible guides, we are confident that agreements can be structured which will prove satisfactory.

Appendix II

Potential Legal Issues

1. What type of state enabling legislation, if any, will be required to make use of certain provisions in ISTEA regarding federal funds in tollway projects?
2. Is TxDOT legally permitted to donate ROW to potential franchisees for a new transportation project?
 - A. Would ownership remain with TxDOT?
 - B. If ROW cannot be donated, can it be loaned for an extended period of time for use in a new tolled facility involving a private entity?
3. Is TxDOT legally permitted to provide funding for environmental studies pertaining to possible roadways to be financed primarily, or exclusively, with private financing?
4. In the two previous questions, what are the differences, if any, between what is permissible on facilities which have had, or have, federal funds, and those financed exclusively with state funds?
5. While ISTEA waives the previous requirement that federal funds would have to be repaid if a highway or bridge is privatized, does ISTEA permit an outright sale of an existing federally financed highway or bridge to a private party without any provision the facility eventually reverting to state ownership?
6. Under current state statutes and the Texas Constitution, could an existing state highway be sold to a private firm? Under current state statutes, could an existing state highway be transferred to a political subdivision or to a non-profit entity?

